

**IN THE INCOME TAX APPELLATE TRIBUNAL
“J(SMC)” BENCH MUMBAI**

**BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER &
SHRI MAKARAND VASANT MAHADEOKAR, ACCOUNTANT MEMBER**

**ITA No. 8360/Mum/2025
(Assessment Year: 2017-18)**

Kuntal Hasmukhlal Shah 104, 1 st floor, Plot No. 53, Panchsheel, P. M. Shukla Marg, C-Road, Churchgate, Mumbai-400 020	Vs.	ACIT-4(1)(1) Aayakar Bhawan, Churchgate, Mumbai-400 020
PAN/GIR No. AAGPS5867F		
(Applicant)		(Respondent)

Assessee by	Shri Ashok Shah, Ld. AR
Revenue by	Shri Aditya Rai, Ld. DR

Date of Hearing	08.01.2026
Date of Pronouncement	12.01.2026

आदेश / ORDER

PER MAKARAND VASANT MAHADEOKAR, AM:

This appeal by the assessee is directed against the order passed by the learned Addl./JCIT (A)-2 from the office of Commissioner of Income Tax (Appeals), Lucknow [hereinafter referred to as “CIT(A)”), dated 09.10.2025, passed under section 250 of the Income-tax Act, 1961[hereinafter referred to as “the

Act"], for Assessment Year 2017-18, arising out of the assessment order dated 14.12.2019 passed by the Assessing Officer under section 143(3) of the Act.

2. The brief facts of the case are that the assessee, an individual, for the assessment year under consideration filed his return of income electronically on 29.07.2017, declaring a total income of Rs. 21,70,080/-. The return was processed under section 143(1) of the Act. Subsequently, the case was selected for limited scrutiny under CASS, with the specific reason to examine the allowability of expenses incurred in relation to earning of exempt income. Statutory notice under section 143(2) dated 09.08.2018 was issued and duly served upon the assessee. Further notice under section 142(1) dated 13.08.2019 was also issued. During the year under consideration, the assessee earned exempt income comprising dividend income of Rs. 11,60,930/-, and long-term capital gains (STT paid) of Rs. 2,49,99,481/-, exempt under section 10(38) of the Act. No disallowance under section 14A was made by the assessee in the return of income.

3. During the course of assessment proceedings, the Assessing Officer observed that the assessee had earned substantial exempt income but had not made any disallowance under section 14A of the Act. The assessee was accordingly called upon to explain as to why disallowance under section 14A read with Rule 8D of the Income-tax Rules, 1962 should not be made. In response, the assessee submitted that the expenses relating to earning of exempt income were not debited to the Profit and Loss Account,

but were directly debited to the capital account, and therefore were not claimed as deduction in the computation of income. Since no expenditure was claimed in relation to exempt income, the provisions of section 14A were not applicable.

4. The Assessing Officer did not accept the explanation of the assessee. He held that the provisions of section 14A were applicable and, being dissatisfied with the correctness of the assessee's claim, proceeded to compute disallowance in accordance with Rule 8D, as amended with effect from 02.06.2016. Applying Rule 8D(2), the Assessing Officer computed the disallowance at Rs. 81,59,223/-, being 1 percent of the annual average of the monthly averages of the value of investments yielding exempt income. However, in view of the proviso to Rule 8D, which restricts the disallowance to the total expenditure claimed by the assessee, the Assessing Officer restricted the disallowance to Rs. 13,76,621/-, being the total expenses debited by the assessee during the year. The said amount of Rs. 13,76,621/- was added to the total income of the assessee, and the assessment was completed under section 143(3) of the Act at a total income of Rs. 35,46,700/-, after allowing deduction under Chapter VIA. Interest under sections 234A, 234B, 234C and 234D was also charged accordingly.

5. Aggrieved by the assessment order, the assessee carried the matter in appeal before the learned CIT(A). During the appellate proceedings, the assessee reiterated that:

- No expenditure relating to exempt income was claimed in the return of income.
- Expenses of Rs. 7,92,077/- were directly debited to the capital account and were never claimed as deductible expenditure.
- The Assessing Officer mechanically applied Rule 8D without recording proper dissatisfaction and without establishing any nexus between the expenditure claimed and the earning of exempt income.

6. The learned CIT(A), however, did not accept the contentions of the assessee. Relying upon the decisions of the Hon'ble Supreme Court in Maxopp Investment Ltd. v. CIT (402 ITR 640) and Godrej & Boyce Mfg. Co. Ltd. v. DCIT (394 ITR 449), as well as the decision of the Hon'ble Delhi High Court in CIT v. Taikisha Engineering India Ltd. (370 ITR 338), the learned CIT(A) held that section 14A applies even where the assessee claims that no expenditure has been incurred in relation to exempt income. Accordingly, the learned CIT(A) confirmed the disallowance of Rs. 13,76,621/- made under section 14A read with Rule 8D and dismissed the appeal of the assessee.

7. Aggrieved by the order of the learned CIT(A), the assessee is in appeal before us raising following grounds of appeal:

- 1) *The Assessing Officer erred in assessing total income of the Appellant at Rs. 35,46,700 as against Rs. 21,70,080 being income declared in his return of income.*
- 2) *The Assessing Officer has erred in making disallowance of Rs. 13,76,621 under section 14A of the Act r.w. Rule 8D of the Income Tax Rules, 1962 (the Rules).*

Your Appellant submits that he has not claimed any expenditure incurred in relation to earning of exempt income and hence no disallowance under Section 14A of the Act is required to be made for the year under consideration.

- 3) *Without prejudice to the above grounds, the Assessing Officer erred in disallowing expenses of Rs 792,077 contrary to Rule 8D of the IT Rules and ignoring the fact that such expenses were never claimed as deductible expenditure by the Appellant.*

Your Appellant submits that these expenses of Rs 792,077 were not claimed in tax return as such expenses were directly debited to capital account of Appellant.

- 4) *Without prejudice to the above grounds, the Assessing Officer erred in making a disallowance which is very excessive and unreasonable.*
- 5) *Your appellant crave your leave to add, alter and delete any of the Grounds of Appeal.*

8. The learned Authorised Representative, reiterating the facts placed on record, submitted that during the course of assessment proceedings, the assessee furnished complete details of expenses amounting to Rs. 5,84,544/-, which were claimed against taxable consultancy income of Rs. 8,00,000/-, resulting in net consultancy income of Rs. 2,15,456/-. These expenses were wholly and exclusively incurred for earning taxable consultancy income. The AR further submitted that all direct expenses relatable to exempt income were never claimed in the Profit and Loss Account. Such expenses, aggregating to Rs. 7,92,077/-, were directly debited to the capital account of the assessee. The AR pointed out that the Assessing Officer, however, mechanically disallowed the total sum of Rs. 13,76,621/-, comprising Rs. 5,84,544/- claimed against taxable consultancy income, and Rs.

7,92,077/- which were never claimed as expenses in the return of income. It was submitted that only expenditure actually claimed as deduction can be subject matter of disallowance. Expenditure not claimed in the computation of income cannot be disallowed under section 14A.

9. The AR vehemently contended that the Assessing Officer failed to record objective dissatisfaction with the assessee's claim as required under section 14A(2) and establish any direct and proximate nexus between the expenditure claimed and the earning of exempt income. It was argued that the Assessing Officer merely applied Rule 8D mechanically, without pinpointing any specific expenditure incurred for earning exempt income.

10. The AR also submitted that the learned CIT(A) confirmed the disallowance of Rs. 13,76,621/- relying upon judicial precedents without appreciating the fact that no expenditure to earn exempt income is debited to profit and loss account.

11. The AR placed reliance on the following decisions:

- *CIT v. Hero Cycles Ltd.* (2015) 379 ITR 347 (SC), wherein it was held that disallowance under section 14A cannot be made in the absence of nexus between expenditure and exempt income.
- *ACIT v. Vireet Investment Pvt. Ltd.* (2017) 165 ITD 27 (Delhi ITAT, Special Bench), holding that Rule 8D cannot be applied mechanically and requires clear evidence of expenditure incurred for earning exempt income.

12. The Departmental Representative relied on the orders of lower authorities.

13. We have carefully considered the rival submissions, perused the orders of the authorities below, and examined the material placed on record. The short controversy before us relates to the disallowance of Rs. 13,76,621/- made under section 14A read with Rule 8D.

14. The undisputed facts emerging from the record are that the assessee earned exempt income in the form of dividend income of Rs. 11,60,930/- and long-term capital gains exempt under section 10(38) amounting to Rs. 2,49,99,481/-. It is also an admitted position that the assessee did not make any suo motu disallowance under section 14A in the return of income. It is further not in dispute that the assessee incurred total expenditure of Rs. 13,76,621/- during the year, out of which expenses of Rs. 5,84,544/- were claimed against taxable consultancy income and expenses amounting to Rs. 7,92,077/-, stated to be relatable to exempt income, were not debited to the Profit and Loss Account, but were directly debited to the capital account and were not claimed as deduction in the computation of income.

15. The primary contention of the assessee before us is that expenditure of Rs. 7,92,077/-, which was never claimed as a deduction in the return of income, could not have been brought within the ambit of disallowance under section 14A, and that the

Assessing Officer mechanically invoked Rule 8D without recording the requisite satisfaction or establishing a direct nexus between the expenditure claimed and the earning of exempt income.

16. At this stage, it would be apposite to note that section 14A contemplates disallowance only of such expenditure which is claimed as deduction and which is incurred in relation to income not forming part of the total income. Expenditure which is not claimed in the computation of income cannot be disallowed, as there is no deduction granted in the first place which can be withdrawn by way of disallowance. The Hon'ble Supreme Court in CIT v. Hero Cycles Ltd. (2015) 379 ITR 347 (SC) has held that disallowance under section 14A of the Act requires a finding of incurring of expenditure; where it is found that for earning exempt income no expenditure has been incurred, disallowance under section 14A cannot be made. Further, the Special Bench of the Tribunal in ACIT v. Vireet Investment Pvt. Ltd. (2017) 165 ITD 27 (Delhi – SB) has categorically held that Rule 8D cannot be invoked mechanically. The Assessing Officer must demonstrate, with reference to the accounts of the assessee, that expenditure has in fact been incurred in relation to exempt income.

17. In the present case, we find that neither the Assessing Officer nor the learned CIT(A) has recorded any specific finding to show that the expenditure of Rs. 7,92,077/-, which stood debited to the capital account (details of the same are placed in the paper book page No.31), was claimed as deduction or had any direct

nexus with the earning of exempt income so as to warrant disallowance under section 14A. The reliance placed by the learned CIT(A) on the decisions of the Hon'ble Supreme Court in Maxopp Investment Ltd. and Godrej & Boyce Mfg. Co. Ltd. does not advance the case of the Revenue in the facts of the present case. Even in those decisions, the Hon'ble Supreme Court has emphasized that Rule 8D cannot be applied automatically, and the Assessing Officer must record dissatisfaction with reference to the accounts of the assessee.

18. In the present case, the satisfaction recorded by the Assessing Officer is merely general in nature and does not deal with the assessee's specific explanation that expenditure of Rs. 7,92,077/- was never claimed as a deduction. The disallowance, to that extent, is therefore not sustainable in law.

19. As regards the expenditure of Rs. 5,84,544/- claimed against taxable consultancy income, we find that the Assessing Officer has not brought on record any cogent material to establish that these expenses were incurred in relation to earning of exempt income. In the absence of such a finding, disallowance of the said expenditure under section 14A is also not justified.

20. In view of the foregoing discussion and respectfully following the binding judicial precedents, we hold that the disallowance of Rs. 13,76,621/- made under section 14A read with Rule 8D is unsustainable on facts and in law. Accordingly, the disallowance of Rs. 13,76,621/- is deleted.

21. In the result, the appeal filed by the assessee is allowed.

Order pronounced in the open court on 12.01.2026.

Sd/-

(AMIT SHUKLA)
JUDICIAL MEMBER

Sd/-

(MAKARAND VASANT MAHADEOKAR)
ACCOUNTANT MEMBER

Mumbai, Dated 12/01/2026
Dhananjay, Sr.PS

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / The CIT(A)
4. आयकर आयुक्त (अपील) / Concerned CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुम्बई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

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1.

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आयकर अपीलीय अधिकरण, मुम्बई/ ITAT, Mumbai