

**INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH "I-2": NEW DELHI  
BEFORE SHRI RAJPAL YADAV, JUDICIAL MEMBER  
AND  
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER**

ITA No.6212/Del/2013  
(Assessment Year: 2009-10)

Lumax Industries Ltd.,  
B-85/86, Mayapuri Industrial Area,  
Phase-1, New Delhi  
PAN:AADCR6902J  
**(Appellant)**

Vs.

DCIT,  
Circle-4(1),  
New Delhi

**(Respondent)**

Assessee by :

Sh. Pradeep Dinodia, Adv  
Sh. R.K. Kapoor, CA

Respondent by:

Sh. Manu Chaurasia, Sr. DR

Date of Hearing

18/02/2016

Date of pronouncement

22/04/2016

**ORDER**

**PER PRASHANT MAHARISHI, A. M.**

1. This is an appeal filed by the assessee against the order u/s 143(3) read with Section 144C of the Income tax Act ( In Short 'the Act') passed by the DCIT, New Delhi in accordance with direction u/s 144C(5) dated 16.08.2013 by the DRP-1, New Delhi for the Assessment Year 2009-10.
2. The brief facts of the case are that assessee is a manufacturing concern specializing in automobile lighting business. It deals in various high quality automotive lighting equipment such as headlamps, tail lamps, sundry lamps and accessories for two wheelers and four wheelers. During the year it has entered into several international transactions including payment of royalty of Rs.6,69,57,682/- to its associated concern M/s. Stanley Japan who by virtue of having appointed an executive director on the board of Assessee is an associated enterprise of the assessee.
3. Assessee filed its return of income on 30.09.2009 at a loss of Rs.18,96,07,791/- which was revised subsequently to Rs.19,27,69,767/-. A reference was made to TPO to determine Arm's length price with respect to international transactions of the Assessee with its AE. Ld. TPO vide order dated 29.01.2013

passed an order u/s 92CA(3) who determined Arm's length price of royalty transactions applying CUP method at Rs.NIL and therefore proposed an adjustment of payment of royalty of Rs.6,69,57,682/-. The main reasons for adopting NIL amount as ALP for royalty transaction are as under :-

- i. *The taxpayer did not produce any evidence/ documentation on how the royalty rate fixed. At an arm's length, party receiving technology would like to see the profitability from future revenue streams before fixing a royalty rate.*
  - ii. *The taxpayer did not produce any cost benefit analysis at the time of entering into the agreement with its AE showing that the royalty rate is not fixed based on expected benefit.*
  - iii. *There is no proof that the other group concerns or third parties are also charged identical royalty.*
  - iv. *The taxpayer has also not been able to show that it derived any economic benefit from the alleged know how received the AE.*
  - v. *The profitability is below the arithmetical mean margin of the comparable companies considered by the TPO.*
  - vi. *The profit that accrues to the licensee may not raise solely through the engine of the technology. There are returns from the mix of assets it employs such as fixed and working capital and the returns from intangible assets such as distribution systems, trained workforce, etc. Allowances need to be made for them. In the absence of any data provided by the taxpayer, it is impossible to know what percentage of profits the licensee would like to share at an arm's length after removing the returns from assets employed and other economic factors which may not arise solely through the engine of the technology.*
4. Other international transactions remain undisputed and are held to be at Arm's length.
  5. Based on this order Id. AO passed draft assessment order which was served on the Assessee on 06.02.2013 wherein further disallowance u/s 14A of Rs.16,59,069/- and leave encashment of Rs.1,31,92,275/- u/s 43B was made. Assessee preferred application before DRP who upheld the action of the Assessing Officer with respect to ALP determination of royalty and disallowance u/s 14A and leave encashment u/s 43B of the act. Pursuant to this Id. Assessing Officer passed final order on 09.10.2013 which is under challenge before us.
  6. The assessee has raised the following grounds:-
    - “1) *That the learned Assessing Officer has erred in law and on facts in making an addition of Rs.8,18,09,026/- on wholly illegal, erroneous and untenable grounds.*
    - 2) *The order of assessment is bad in law.*
    - 3) *That the learned AO has erred in law. on facts and in the circumstances of the case in making addition on account of arms”*

- length price under section 92CA(3) of the Income-tax Act amounting to Rs. 6.69.57.682/- on wholly illegal, erroneous and untenable grounds.
- 4) The learned AO's order based on the findings of the learned Transfer Pricing Officer and the directions of the learned Dispute Resolution Panel u/s.144C(5) of the Income-tax, is erroneous, untenable in law and on facts for the various reasons and not limited to the following: -
- a) The TPO as well as the DRP and consequently the AO has erred in law and on facts and in the circumstances of the case in erroneously determining the ALP of the transaction on account of payment of royalty to the AE of the appellant as NIL.
  - b) The TPO as well as the DRP and consequently the AO has erred in law and on facts and in the circumstances of the case in erroneously holding that the appellant has not been able to show that it derived economic benefit from the know how licensed from the AE.
  - c) The TPO and DRP and consequently the AO failed to appreciate that royalty was one of the two elements of cost and sales and could have been evaluated under same overall method as had been correctly done by the assessee under TNMM method and royalty payment is not independent to sales and could not be examined on standalone basis.
  - d) The TPO as well as the DRP and consequently the AO has erred in law and on facts and in the circumstances of the case in erroneously exceeding their jurisdiction by judging the Royalty payments made by the assessee through a "benefit test", which is not based on any of the methods prescribed as per section 92C of the IT Act,
  - e) The DRP and consequently the AO has erred in law and on facts and in the circumstances of the case in drawing the conclusion that the assessee is largely applying some home-grown technology and no technology was required from Authorized Representative
  - f) The Hon'ble DRP and consequently the AO has erred in law and on facts and in the circumstances of the case in not considering the judgment of Hon'ble Delhi ITAT in assessee's own case in earlier years where the issue of payment of royalty has been decided in favor of the assessee on identical facts.
- 5) The DRP as well as AO has erred in law and facts and circumstances of the case and made additions, amounting to Rs.1,31.92,275/- on account of disallowance of provisions for leave encashment u/s 43B of the IT Act.
- 6) That the disallowance u/s 14A of the Act is bad in law.
- 7) The DRP and consequently AO has erred, in law and facts and circumstances of the case and made additions amounting to Rs.16,59,0697- on account of disallowance u/s 14A of the IT Act r.w. Rule 8D of I Tax Rules.
8. That each ground is independent of and without prejudice to the other grounds raised herein.”

7. Ld. AR submitted that ground Nos. 1, 2 and 8 are general in nature and therefore are not pressed. Hence, these grounds are dismissed.
8. Ground Nos.3 and 4 are pertaining to the determination of ALP of royalty transactions at NIL against transaction value of Rs.6,69,57,682/-. Ld. AR submitted that ld. TPO has determined the ALP holding that the taxpayer did not produce any cost benefit analysis at the time of entering into the agreement with its AE showing that the royalty rate is not fixed based on expected benefit. He submitted that there exists a technical assistance agreement between the Assessee and its AE since 1984 before the parties became associated enterprises. He further stated that benefit arising out of royalty expenses is embedded in sales price of goods sold therefore the benefit itself is existing and derived by the Assessee . He submitted that the cost of royalty is included in the cost of goods sold. He further submitted that royalty is paid to AE @4% on sales which is way below the specified rate by Reserve Bank of India and The Foreign Exchange Management Act which is 5% and 8% for technology transfer, therefore it is paid at the rate which has been approved by technical collaboration agreement by Govt. of India. He further submitted that the issue is now squarely covered in favor of Assessee in its own case by Hon'ble Delhi High Court by order dated 28 October 2015 where in the appeal of the revenue against the order of ITAT decided in favour of the assessee has not been admitted. Therefore he contended that now the issue is required to be decided in favour of the Assessee. He also placed on record the order of ld. TPO in AY 2012-13 wherein following the decision of Hon'ble Delhi High Court has held that international transaction of royalty is at ALP.
9. Ld. DR relied on the orders of lower authorities and submitted that as Assessee could not show the benefit accruing out of payment of royalty the ld. TPO, DRP and Assessing Officer are correct in determining its ALP at Rs. NIL. he relied up on the decision of Honourable Punjab and Harayana High court in case of 2015-TII-51-HC-P&H-TP COMMISSIONER OF INCOME TAX, FARIDABAD Vs M/s KNORR-BREMSE INDIA PVT LTD.
10. We have carefully considered the rival contentions. The Assessee has entered into technical assistance agreement with Stanley Electric Company

Japan on 01.04.2007 for grant of nonexclusive and nontransferable license without a right to sub-license, to manufacture and sale license product in India using the technical information of Stanley Electric Company. Since 1990 the royalty is being paid by the Assessee to Stanley @3% of sales. During the period from 1990 to 1994 the two parties were unrelated party hence the royalty contract was made under uncontrolled conditions and the payment of royalty by the Assessee to AE can be considered as comparable uncontrolled price for the purpose of bench marking the royalty payment for the year. Accordingly, Assessee in its TP Study report has said that the payment of royalty is at Arm's length price as the agreement is in accordance with industrial policy of the Govt. Further in its TP study report assessee applying the TNMM method and submitted that the above transaction is also conducted at an ALP. On the identical facts and circumstances in the case of the assessee in ITA No.102/2014 dated 28.10.2015 has not admitted the appeal of the revenue with respect to the determination of ALP of royalty relying on the decision of CIT Vs. EKL Appliances Ltd. 345 ITR 241 and CIT Vs. Sony Ericson Mobile Communication 374 ITR 118. The coordinate bench for AY 2008-09 in ITA No.4456/Del/2012 in assessee's own case has held as under:-

*"19. In this regard, it is seen that during the year, royalty was paid by the Assessee to its AE on sales made using the trade mark of 'Stanley'; that the assessee is a widely held listed company, a market leader. The payment of royalty was for trade mark, patent and technology. The contract, i.e., the Technical Collaboration Agreement, between the assessee and its AE stood approved by the Government since 1984. Ever since, the assessee had been carrying out the manufacture of some of its products under the brand name of 'Stanley.' For this, the assessee had been paying royalty. Approval in this regard had been pre-obtained from SIA, as required. The RBI had also granted its approval, which was being renewed yearly. Initially, the royalty had been paid @ 4% on the sale of some of the products produced under the brand name 'Stanley.' Later, it was reduced to 3%. In F.Y. 2003-04, Stanley Electric Company of Japan acquired the status of the AE of the assessee. Thus, it was right from 1984, that technical assistance got started being given by Stanley Electric Company, Japan to the assessee, with regard to the manufacture of automotive lighting equipment. As available from para 1.4 of the agreement in the year under consideration (copy at APB-I, 340-359, relevant portion at page 342), a non-exclusive license had been granted by Stanley, Japan to the assessee, only for India. As per the conditions thereof, the assessee*

was to pay royalty on its net sales, after deduction from the net sale price of the licensed products sold by Lumax in India. The basis of calculation of payment of royalty, as agreed to, is contained in Article 4 of the Agreement (APB-I, page 345). Such payment was to be @ 4% on the net sales. However, during the year, royalty was paid @ 2.43% on the sale of licensed products, amounting to ₹ 218.08 crores, as available at APB-I, page 385. This was so, since the cost of standard imported components, standard local components and certain other deductions had been deducted from the net sales of ₹ 218.08 crores.

20. The Ld. DR has contended that just because the assessee and its AE are publicly listed companies, this is no reason for the requirements of ALP to be flouted. However, the assessee's contention regarding both the entities being listed companies, it is seen, is not at all to support any violation of the ALP provisions. This argument, in fact, has been taken to bolster the assertion regarding benefits of the transactions and the genuineness thereof.

21. The next contention of the Department has been that the RBI approval sought to be relied on by the assessee is only for the purposes of FEMA/FERA and it does not stop the transaction from being looked into by the Income-tax Authorities for the purpose of the Income-tax Act. Here again, it is seen that this argument has been taken by the Assessee only to stress that the agreement between the assessee and Stanley was not merely a paper transaction, rather it was approved by the RBI as well, besides other governmental authorities. It has not been shown by the Department to be otherwise.

22. The Ld. DR then contended that the royalty in question was not benchmarked by the assessee, as held by the TPO and that it has not been shown that the payment of royalty was an arm's length transaction. Since the average PLI of the comparables taken by him resulting in 7.05% - OP/sales was within the (+)/(-) 5% range of the assessee's PLI worked out by him at 4.09%, the range between 2.05% to 12.05%, as per the proviso to Section 92C (2) (2A) of the Act.

23. The Ld. DR has further contended that the assessee did not apply the CUP method properly, since such method has been supported by the assessee, based on the approval by the RBI. In this regard, we find that as noted above, the argument regarding the RBI approval was raised by the assessee to buttress the claim of genuineness of its transaction. In the TPO's order, there is not even as much as a mention about RBI. So far as regards the DR's objection that the plea of earlier payment to the same party, when it was not the assessee's AE, has not been allowed, is not maintainable, it is to be reiterated here, as above, that the assessee did benchmark its transaction by two methods, i.e., CUP and TNMM and this was taken note of by the TPO himself. Apropos the reliance by the Department on 'CGM Global' (supra), it is correct that therein, the internal CUP was held to be not applicable, since the transaction was with an AE having related party transactions and it was held that there was no external

CUP for making any comparison in the relevant year, as the earlier Agency Agreement with the third party had expired and rates applicable in the earlier years could not be made applicable during

therelevant year. However, this decision does not have any adverseeffect on the case of the assessee. The facts herein are entirely atvariance with those of 'CGM Global'. Herein, as opposed to the facts in'CGM Global', the same Royalty Agreement and the same license hasbeen in continuance from 1984 till the year under consideration, thelicense being renewed from year to year, albeit on the same terms andconditions. Moreover, the following decisions are instances of theexternal CUP having been employed and this has not been disputed bythe Department:-

1. 'Sona Okegawa Precision Forgings Ltd. vs. ACIT' (ITANo.4781/Del/2010)

2. 'ACIT vs. Sona Okegawa Precision Forgings Ltd.' (ITANo.260/Del/2010.

3. 'CIT vs. Federal Mogul TPR India Ltd.' (ITA No.398/2012)

4. 'Climate Systems India Ltd. vs. CIT' (2009) 319 ITR 113(Delhi)

5. 'CIT vs. Eicher Motors Ltd.' (2007) 293 ITR 464 (MP)

6. 'Praga Tools Ltd. vs. CIT' (1980) 123 ITR 773 (A&P)

7. 'Ekl Appliances (2012-TII-01-HC-DEL-TP)

8. 'Ericsson India Pvt. Ltd. vs. DCIT' (2012-TII-48-ITAT-Del-TP) 16 ITA No.4456/Del/2012

24. In "Sona Okegawa Precision Forgings Ltd.' (supra), it has beenheld that since the royalty paid by the Indian company was 3% of netsales and it falls within the range of @ 8% on export sales and 5% on domestic sales as per directions of the RBI, therefore, the paymentstands justified under the CUP method.

25. This view was accepted by the Tribunal in 'Sona Okegawa's casefor Assessment Year 2004-05 also, as well as in 'Climate Systems'(supra), 'Swaraj Engines Ltd.' (supra) and 'Eicher Motors' (supra).

26. In 'Federal Mogul' (supra), payment of royalty @3% on the saleprice, on transfer of technical knowledge and information, wasaccepted.

27. In 'Climate Systems India Ltd.' (supra), again, payment of royalty@ 3% on the sale price on transfer of technical knowledge andinformation was accepted.

28. All the above companies, like the assessee, were in the autoancillary industry.

29. In 'Praga Tools Ltd.' (supra), which was also in an auto ancillaryindustry, payment of royalty @ 5% on the sale price, on transfer oftechnical knowhow and assistance was accepted.

30. The royalty payment by the above companies is directlycomparable with that made by the assessee company. The assessee,as observed, is also an auto ancillary, manufacturing automotive partsfor OEMs. In all these cases, as in that of the assessee, the payment ofroyalty was related to transfer of technical assistance and know-how in the automotive industry. That being so, the CUP method is availableapropos the issue of arm's length price qua the payment of royalty.

31. So far as regards other case laws relied on by the Department,the same are also distinguishable on facts, being on generalpropositions of law relevant to the specific facts present in those cases.In the present

case, an ALP analysis had been done by the assessee, as above. The assessee applied the CUP method and the TNMM. The TPO, however, despite being legally bound to do so, did not apply any method.

32. Apropos the decision of the Delhi Bench of the Tribunal in the case of 'Interra Information Technology (I) Pvt. Ltd. vs. DCIT', 2012-TIOL-142-ITAT-DEL-TP (supra), it is seen that here also, the facts are a complete variance with those of the assessee's case, where in payment of royalty for supply of technology and knowhow to manufacture licensed products was held to be for the benefit of the assessee and the same rate of royalty payment was allowed as allowed in the years when the parties were not in an AE relationship, but were having identical transactions as those in the year under consideration before the Tribunal. It was held that the royalty payment was a revenue expenditure incurred wholly and exclusively for the benefit of the assessee. The part of the payment disallowed as capital expenditure was held by the Hon'ble Delhi High Court to be revenue expenditure. It is as such that the invocation of the rule of consistency has been sought on behalf of the assessee and, in our considered opinion correctly so, contending that since the circumstances before and after the coming into existence of the AE relationship between the assessee and Stanley are identical inter se, it cannot at all be said that though in the earlier years, the royalty payment was for the benefit of the assessee, since the inception of the AE relationship, it ceased to be so, due to which, the application of the benefit test by the TPO is entirely uncalled for. Payment of royalty was being claimed and allowed right from 1984 to Assessment Year 2003-04, as business expenditure of the assessee and no new circumstance has been pointed out by either of the authorities below to hold that in the year thereafter, the benefit accrued to the assessee by the payment of such royalty has dried up. Therefore, we find that the reliance by the Department on 'Interra' (supra), to support the contention that the rule of consistency should not be applied, is wholly misplaced. It cannot be gainsaid that a judgment has to be, in its entirety, considered in the backdrop of and with reference to the peculiar facts and circumstances doing the rounds therein. In 'Interra' (supra), the assessee raised an argument that transfer pricing adjustment at best cannot exceed the amount of the margin retained by the assessee as well as the AE. This argument did not find favour with the Tribunal. It was also contended that the TPO had not made any adjustment in the earlier years and as such, no adjustment was called for in the year before the Tribunal as well, on the principle of consistency. The Tribunal observed that the assessee had not been able to demonstrate as to which particular conclusion of the previous TPO or Assessing Officer had been reviewed in an opposite manner by the current TPO and that it was a case of non-application of mind by the previous TPO on some issues. It was therefore, that the Tribunal rejected this argument raised by the assessee. This is the background for the Tribunal not having allowed the principle of consistency to be invoked in that case. In the present case, however, it is patent on record that the facts remain identical pre-AE relationship and thereafter, as also that the related payment has been consistently allowed by the department

itself in the numerous earlier years, where the arguments were at an exactly similar, nay identical footing.

33. The TPO has made the disallowance in question mainly on the basis of the benefit test. In this regard, it is seen that the payment of royalty cannot be examined divorced from the production and sales. Royalty is inextricably linked with these activities. In the absence of production and sale of products, there would be no question arising regarding payment of any royalty. Rule 10A(d) of the ITAT Rules defines 'transaction' as a number of closely linked transactions. Royalty, then, is a transaction closely linked with production and sales. It cannot be segregated from these activities of an enterprise, being embedded therein. That being so, royalty cannot be considered and examined in isolation on a standalone basis. Royalty is to be calculated on a specified agreed basis, on determining the net sales which, in the present case, are required to be determined after excluding the amounts of standard bought out components, etc., since such net sales do not stand recorded by the assessee in its books of account. Therefore, it is our considered opinion that the assessee was correct in employing an overall TNMM for examining the royalty. The TPO worked out the difference in the PLI of the outside party (the assessee) at 4.09% and the comparables at 7.05%. This has not been shown to fall outside the permissible range.

34. The decision of the Tribunal in 'Ekla Appliances', 2012-TII-01-HCDel-TP,

has been sought to be distinguished by the TPO, observing that the facts in that case are not in pari materia with those of the assessee's case. However, therein also, the benefit test had been applied by the TPO, as in the present case. The matter was carried in appeal before the Hon'ble High Court. The Hon'ble Delhi High Court has held that the so-called benefit test cannot be applied to determine the ALP of royalty payment at nil and that the TPO could apply only one of the methods prescribed under the law. A similar view has been taken in 'Sona Okegawa Precision Forgings Ltd.' (supra) and in 'KHS Machinery Pvt. Ltd. vs. ITO', 53 SOT 100 (Ahm) (URO).

35. It is, thus, seen that the royalty payment @ 3% by the assessee is at arm's length. The Technical Collaboration Agreement stands approved by the Government of India. The royalty payment has been accepted by the department as having been made by the assessee wholly and exclusively for its business purposes. For Assessment Years 2004-05 and 2005-06, such payment of royalty has been allowed by the CIT (A). As per the FEMA Regulations, royalty can be paid on net sales @ 5% on domestic sales and @ 8% on export sales. The royalty payment by the assessee falls within these limits. It also falls within the limits of payment of royalty in the automobile sector, as per the market trend. This payment of royalty is at the same percentage as that paid by other auto ancillaries in the automotive industry. Then, in 'Ekla Appliances' (supra) and in 'Ericsson India Pvt. Ltd. vs. DCIT',

2012-TII-48-ITAT-Del-TP, it has been held that royalty payment cannot be disallowed on the basis of the so-called benefit test and the domain of the TPO is only to examine as to whether the payment based

*on the agreement adheres to the arm's length principle or not. That being so, the action of the TPO in the present case, to make the disallowance mainly on the ground of the benefit test, is unsustainable in law.*

*36. Keeping in view all the above factors, the disallowance made on account of royalty is found to be totally uncalled for and it is deleted as such. Accordingly, ground Nos. 3 and 4 raised by the assessee are accepted."*

11. In view of the of Honorable Jurisdictional high court in assessee's own case we incline to follow that decision over the decision cited by the Id. DR in case of COMMISSIONER OF INCOME TAX, FARIDABAD Vs M/s KNORR-BREMSE INDIA PVT LTD. However we would like to quote para no 29 of the decision where in honourable court has held as under :-  
 "29. We hasten to add that in the case before us the assessee has, in fact, contended that it has benefited from the international transactions entered into by it with its AEs. However, even assuming that this has not been established, it would make no difference."
12. In view of the above facts and respectfully following the decision of Hon'ble Delhi High Court in case of assessee for earlier years wherein the decision coordinate bench of ITAT in assessee's own case is upheld we direct the Id. TPO/AO to delete the adjustment of Rs.66957682/- made on account of ALP of royalty payments.
13. In the result ground Nos. 3 and 4 of the appeal of the assessee are allowed.
14. Ground No.5 of the appeal of the assessee is against the addition of Rs.13192275/- on account of disallowance of provision for leave encashment u/s 43B of the Income Tax Act. Id. AR submitted before us that this ground is not pressed and hence it is dismissed.
15. The next Ground No.6 and 7 are against disallowance amounting to Rs.1659069/- u/s 14A of the Act.
16. Assessee has disallowed a sum of Rs.1266605/- suo motto u/s 14A of the Act. During the course of assessment proceedings vide order sheet entry dated 29.11.2012 assessee was asked to explain that why disallowance u/s 14A read with Rule 8D should not be made with respect to exempt income. The assessee has made total investment of Rs.36689144/- as at 31.03.2009 out of this an amount of Rs.35474204/- was made in SL Lumax Ltd. and

Rs.603000/- in Inapex Ltd. Further Rs.611940/- is invested in PNB Gilts Ltd. Assessee has made fresh investment of Rs.3974204/- in SL Lumax Ltd. during the year whereas all other investments are carried forward from previous year. Applying the provision of Rule 8D ld.AO , as assessee has already made disallowance of Rs 1266605/- made further disallowance of Rs. 1659069/-. Against this assessee is in appeal.

17. Ld. AR submitted before us as under:-
- a. AO has straightway applied Rule 8D without recording the reasons for non-satisfaction to the disallowance offered by the assessee.
  - b. There is no direct nexus established by the Assessing Officer that borrowed funds are used for investments and therefore there cannot be any disallowance of interest
  - c. Interest received and interest paid should be netted off with interest income and only net interest should be considered for disallowance.
  - d. Strategic investment made by the assesseees which are driven by business strategies should not be considered for disallowance and therefore investment made in SL Lumax Ltd. should be excluded for working out disallowance.

Ld. AR relied upon several decisions of various courts for advancing the above argument.

18. Ld. DR on the other hand submitted that regarding satisfaction of the AO same can be verified now by the Tribunal and for this he relied on decision of Hon'ble Delhi High Court in case of CIT Vs. Jan Samparak Advertising and Marketing Pvt. Ltd., and decision of Hon'ble Supreme Court in case M/s Deepak Agro Foods Vs. State of Rajasthan. On the other issues he submitted that the assessee has only disallowed the half percent average investment amounting to Rs.1266605/- and omitted any disallowance on account of interest expenditure. He further submitted that strategic investment have already been included by the assessee while working out disallowance of expenditure then the argument to exclude it for the purpose of interest is contradictory. He further stated that the moment AO issued show cause notice vide order sheet entry it amounts to satisfaction of the Assessing Officer. Therefore he contended that the disallowance u/s 14A by invoking Rule 8D has rightly been made by the AO.

19. We have carefully considered the rival contentions. Assessee has voluntarily offered disallowance of Rs.1266605/- which is out of expenses, however, no disallowance has been made on account of interest expenditure. Ld. Assessing Officer without examining the correctness the claim of the assessee about disallowance of Rs.1266605/- has asked assessee vide sheet entry dated 29.11.2012 straightway to explain that why disallowance u/s 14A read with Rule 8D should not be made in respect of tax free income. On reading of the assessment order we do not find any finding about the verification of correctness of the claim of the assessee that it has incurred an amount of Rs.1266605/- only towards expense which can be disallowed.
20. Hon'ble Delhi High Court Held In the case of I.P. Support Services India (P) Ltd vs CIT [TS-573-HC-2015-DEL] that AO cannot invoke Section 14A read with Rule 8D (2) without recording his satisfaction and noted that the recording of satisfaction as to why "the voluntary disallowance made by the assessee was unreasonable and unsatisfactory" is a mandatory requirement of the law. Ld AR also placed reliance on decision of Hon'ble Delhi high court in Maxopp Investment (P) Ltd. /TS-668-HC-2011-DEL] & CIT' v. Taikisha Engineering India Ltd.[2015J 229Taxman 143 (Delhi)] where same view has been expressed that recording of satisfaction on the correctness of claim of the assessee on disallowance u/s 14A before invoking rule 8 D of the Income tax rules 1962 is mandatory. The language of section 14A provides that AO must record a satisfaction if he was unsatisfied with any incorrect claim of the assessee. If he failed to record such a finding then it cannot be said that he rightly invoked provision of section 14A of the act for application of rule 8D.
21. Further noticed that as against the opening investment of about Rs.46.99Cr on 31.03.2008 there was own capital, free reserves and surplus of Rs. 143.35 Cr. as against closing investment of about Rs.3.67 Cr. Therefore it is apparent that assessee had own funds far in excess of the amount invested in investments earning tax free income. In such a case presumption is that own funds have been used to finance the investment activities. Hon'ble Bombay High Court in case of CIT Vs. Reliance Utilities and Power Ltd. has held that when interest free funds are available then the presumption would be that such interest free funds are invested or advanced as interest free

loan. If the presumption is applied to the facts of this case then there cannot be any disallowance on account of interest expenditure. Therefore on two counts i.e. non-recording of satisfaction and interest free fund far in excess of investments, we do not incline to uphold disallowance made the ld. Assessing Officer of Rs.1659069/- over and above disallowance already offered by the assessee of Rs.1266605/- u/s 14A of the Act. Therefore Grounds No.6 and 7 of the appeal of the assessee are allowed and we direct AO to delete the further disallowance of Rs.1659069/- u/s 14A of the Act.

22. In the result appeal of the assessee is partly allowed.

**Order pronounced in the open court on 22/04/2016.**

-Sd/-

**(RAJPAL YADAV)  
JUDICIAL MEMBER**

-Sd/-

**(PRASHANT MAHARISHI)  
ACCOUNTANT MEMBER**

Dated:22/04/2016  
*A K Keot*

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR  
ITAT, New Delhi