IN THE INCOME TAX APPELLATE TRIBUNAL "J" BENCH, MUMBAI

BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER AND
SHRI NARENDRA KUMAR BILLAIYA, ACCOUNTANT MEMBER

ITA NO. 4521/Mum/2012
Assessment Year.2009-10

M/s JM Financial Limited 7th Floor, Cnergy, Appasaheb Marathe Marg Prabhadevi, Mumbai – 400 025.	Vs.	Additional Commissioner of Income Tax -4(3) Mumbai.
PAN: AAACJ 2590B		
Appellant		Respondent

Assessee by	Shri K. Shivaram and Shri Sanjay R. Parikh
Revenue by	Shri S.D. Srivastava

Date of hearing	13.3.2014
Date of pronouncement	26.3.2014

ORDER

Per Vijay Pal Rao, JM

This appeal by the assessee is directed against the order dated 11.04.2012 of CIT(A) for A.Y. 2009-10. The assessee has raised following grounds in this appeal:-

2. During the year under consideration the assessee earned dividend income of Rs. 14,14,000/- which is exempt u/s 10 (34). The assessee has disallowed a sum of Rs. 1,40,000/- u/s 14A. However the AO did not

accept the disallowance made by the assessee and proceeded to make the disallowance u/s 14A by applying Rule 8D. Accordingly, the AO made the disallowance of Rs. 7,61,37,727/- as per Rule 8D of Income Tax Rules.

3. Assessee challenged the action of AO before CIT(A) and contended that Rule 8D cannot be applied without recording the satisfaction that the claim of the assessee was not proper. It was further contended that the investment made by the assessee was strategic investment and in the subsidiary companies. Accordingly no expenditure was required to be incurred for maintaining the portfolio. CIT(A) did not accept the contention of the assessee and confirmed the disallowance made by AO.

4. Before us, the Ld. AR of the assessee has pointed out that though an identical issue was considered by the Tribunal for the A.Y. 2008-09 and it was held that Rule 8D is applicable for disallowance u/s 14A in respect of exempt income, however for the A.Y. 2008-09, the assessee was asked to furnish the computation of expenditure disallowed by him which was not explained and, therefore, the disallowance made by AO was confirmed. The Ld. AR has submitted that the AO was required to record the satisfaction that the claim of the assessee is not correct having regard to the accounts of the assessee and only if the AO is not satisfied with the explanation offered by the assessee with regard to the accounts, he could apply Rule 8D. In support of his contention he has relied upon the decisions of Hon'ble Jurisdictional High Court in the case of Godrej & Boyce Manufacturing Co. Ltd. Vs. DCIT (328 ITR 81) and submitted that the major investment of the assessee company i.e. Rs. 1490.86 crores out of

Rs. 1524.08 crores which comes to 97.82% is strategic investment in unlisted subsidiary companies and joint venture companies and are long term investments. No expenses are incurred for maintaining the portfolio of these investments or for holding the same. Hence, no disallowance u/s 14A can be made with respect to these investments. The Ld. AR has relied upon the decision of this Tribunal in the case of Garware Wall Ropes Limited Vs. Addl. CIT, dated 15/01/2014 In ITA No. 5408/Mum/2012. He has also relied upon the decision dated 02/12/2011 of Delhi Bench of this Tribunal in the case of Oriental Structural Engineers (P) Ltd., Vs. ACIT, as well as the decision of Pune Bench of This Tribunal in the case of Kalyani Steels Ltd. Vs. ACIT dated 30.01.2014 and submitted that the Tribunal has dealt with an identical issue in these decisions and held that when the assessee has brought on record the fact to show that no expenditure has been incurred on the investment made in the subsidiary companies then the AO has to record its satisfaction for not accepting the claim of the assessee and also give the finding that expenditure has been incurred by the assessee for earning the exempt income. The Ld. AR has also relied upon the decision of Hon'ble Delhi High Court, dated 15.01.2013 in the case of CIT Vs. Oriental Structural Engineers Pvt. Ltd, whereby the decision of Delhi Bench of this Tribunal has been confirmed by the Hon'ble High Court.

5. On the other hand, the Ld. CIT(DR) has vehemently contended that it is immaterial whether the investment is in subsidiary companies or in unrelated companies. The disallowance of expenditure u/s 14A has to be computed as per Rule 8D of the Income Tax Rules. The AO has calculated

the amount of disallowance as per Rule 8D and, therefore, there is no question of accepting the disallowance made by the assessee which is not in accordance with the formula given in Rule 8D. The Ld. DR has submitted that for the purpose of disallowance under Rule 8D, the entire investment as well as the entire expenditure which is booked to the profit & loss account has to be taken into account. He has referred para 51 of the decision of Hon'ble Jurisdictional High Court in the case of Godrej & Boyce Manufacturing Co. Ltd (supra) and submitted that once the proximate relationship between the expenditure and the exempt income is established the disallowance has to be made as per Rule 8D. He has relied upon the orders of authorities below.

6. In rebuttal, the Ld. AR has submitted that Hon'ble High Court in para 32 and 33 has clearly laid down the principles for disallowance u/s 14A and held that sub section 2 does not *ifso facto* enable the AO to apply the method prescribed by the Rule straightaway without considering whether the claim made by the assessee in respect of expenditure incurred in relation to income which does not form part of the total income is correct. Thus the Hon'ble High Court has held that where the accounts of the assessee furnish an objective basis for the AO to arrive at a satisfaction in regard to correctness of the claim of the assessee of the expenditure, there would be no warrant for taking recourse to the method prescribed by the Rules.

7. Having considered the rival submissions as well as relevant material on record, we note that so far as applicability of Rule 8D is concerned,

there is no quarrel on this point that for the A.Y. under consideration Rule 8D is applicable. Further for the A.Y. 2008-09, the Tribunal held in para 15 as under:-

> *"We have considered the rival arguments made by both the sides, perused the orders of the AO and CIT(A) and the paper book filed on behalf of the assessee. We have also considered the various decisions cited before us. In the instant case, the only dispute is regarding determination of disallowance of expenditure for earning tax free dividend income of Rs. 18,17,68,458/- the assessee disallowed on its own Rs. 16.50 lakhs u/s 14A. Despite being asked by the AO to furnish the disallowance under rule 8D, the assessee did not furnish the details. The provisions of rule 8D inserted by the IT (Fifth Amendment) Rules 2008 with effect from 24.3.2008 are applicable for A.Y. 2008-09 and onwards. Therefore, the revenue authorities are bound to follow the mandatory provisions for calculation of disallowance u/s 14A. Therefore, we do not find any infirmity in the order of the CIT(A) upholding the action of the AO for disallowing the deduction u/s 14A read with rule 8D. The contention of the assessee that the AO without satisfaction being reached invoked the provisions of Rule 8D, in our opinion, does not hold good especially in absence of non-furnishing of details for the purposes of calculation of disallowance at Rs. 16.50 lakhs by the assessee on its own. In this view of the matter and in absence of any distinguishable feature brought to our notice by the learned Counsel for the assessee against the order of the CIT(A), we do not find any infirmity in the same. Accordingly the same is upheld and the ground raised by the assessee is dismissed."*

8. As it is clear from the finding of Tribunal that the assessee failed to furnish the details of disallowance under section 14A and, therefore, the disallowance made by the AO was found by the Tribunal without any infirmity. For the year under consideration the assessee has specifically raised a point before the AO that 97.82% of the investment is in the subsidiary companies and joint venture companies and, therefore, no expenditure was incurred for maintaining the portfolio on these investments or for holding the same. The assessee has also pointed out that these investments are long term investment and no decision is required in making the investment or disinvestment on regular basis

because these investments are strategic in nature in the subsidiary companies on long term basis and, therefore, no direct or indirect expenditure is incurred. We find that the department has not disputed this fact that out of the total investment about 98% of the investment are in subsidiary companies of the assessee and, therefore, the purpose of investment is not for earning the dividend income but having control and business purpose and consideration. Therefore, *prima facie* the assessee has made out a case to show that no expenditure has been incurred for maintaining these long term investment in subsidiary companies. The AO has not brought out any contrary fact or material to show that the assessee has incurred any expenditure for maintaining these investments or portfolio of these investments. In the case of Godrej & Boyce Mfg. Co. Ltd. (supra) Hon'ble Jurisdictional High Court while dealing with the issue of disallowance u/s 14A and application of Rule 8D has recorded the principles as laid down by the Hon'ble Supreme Court in the case of Walfort Share and Stock Brokers P. Ltd. [2010] (*326 ITR 1*,) in para 31 as under:-

> *(a) "The mandate of section 14A is to prevent claims for deduction of expenditure in relation to income which does not form part of the total income.*
> *(b) Section 14A(1) is enacted to ensure that only expenses incurred in respect of earning taxable income are allowed;*
> *(c) The principle of apportionment of expenses is widened by section 14A to include even the apportionment of expenditure between taxable and non-taxable income of an indivisible business;*
> *(d) The basic principle of taxation is to tax net income. This principle applies even for the purpose of section 14A and expenses towards non-taxable income must be excluded;*
> *(e) Once a proximate cause for disallowance is established – which is the relationship of the expenditure with income which does not form part of the total income – a disallowance has to be effected. All expenditure under the provisions of the Act has to be disallowed under section 14A*

Income which does not form part of the total income is broadly adverted to as exempt income as an abbreviated appellation."

9. After considering these principles as emerged from the decision of Hon'ble Supreme Court in the case of Walfort Share and Stock Brokers P. Ltd. (supra), Hon'ble Jurisdictional High Court has held in para 32 and 33 as under:-

"32. Sub-ssection (2) and (3) to section 14A were inserted by an amendment brought about by the Finance Act of 2006 with effect from April 1, 2007. Sub Sections (2) and (3) Provide as follows.

"14A.(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.
(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act :

Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154 for any assessment year beginning on or before the 1st day of April, 2001."
(The proviso was inserted earlier by the Finance Act of 2002 with retrospective effect from May 11, 2001)

33. Under sub-section (2), the Assessing Officer is required to determine the amount of expenditure incurred by an assessee in relation to such income which does not form part of the total income under the Act in accordance with such method as may be prescribed. The method, having regard to the meaning of the expression "prescribed" in section 2(33), must be prescribed by rules made under the Act. What merits emphasis is that the jurisdiction of the Assessing Officer to determine the expenditure incurred in relation to such income which does not form part of the total income, in accordance with the prescribed method, arises if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of

the expenditure which the assessee claims to have incurred in relation to income which does not part of the total income. Moreover, the satisfaction of the Assessing Officer has to be arrived at, having regard to the accounts of the assessee. Hence, sub-section (2) does not ipso facto enable the Assessing Officer to apply the method prescribed by the rules straightaway without considering whether the claim made by the assessee in respect of the expenditure incurred in relation to income which does not form part of the total income is correct. The Assessing Officer must, in the first instance, determine whether the claim of the assessee in that regard is correct and the determination must be made having regard to the accounts of the assessee. The satisfaction of the Assessing Officer must-be arrived at on an objective basis. It is only when the Assessing Officer is not satisfied with the claim of the assessee, that the Legislature directs him to follow the method that may be prescribed. In a situation where the accounts of the • assessee furnish an objective basis for the Assessing Officer to arrive at a satisfaction in regard to the correctness of the claim of the assessee of the expenditure which has been incurred in relation to income which does not form part of the total income, there would be no warrant for taking recourse to the method prescribed by the rules. For, it is only in the event of the Assessing Officer not being so satisfied that recourse to the prescribed method is mandated by law. Sub-section (3) of section 14A provides for the application of sub-section (2) also to a situation where the assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under the Act. Under the proviso, it has been stipulated that nothing in the section will empower the Assessing Officer, for an assessment year beginning on or before April 1,2001, either to reassess under section 147 or pass an order enhancing the assessment or reducing the refund already made or otherwise increasing the liability of the assessee under section 154."

10. It has been made clear by the Hon'ble High Court that sub-section (2) does not *ifso facto* empower the AO to apply the method prescribed by Rules straightaway without considering whether the claim made by the assessee is correct.

11. The assessee has relied upon various decisions of this Tribunal wherein an identical issue has been considered. In the case of Garware Wall Ropes Limited Vs. Addl. CIT (supra), the Tribunal while deciding an identical issue has held in para 2.4 as under:-

"We have considered the rival submission and carefully perused the relevant records. So far as the issue regarding disallowance u/s 14A in the case where no dividend has been received, the same is covered against the assessee by the order of Tribunal in assessee's own case for the assessment year 2008-09, wherein the Tribunal has followed the decision of special bench of Tribunal while deciding the issue. Therefore, we do agree with the finding of the Tribunal on this point. Further since the assessee has raised the new plea in the year under consideration that no expenditure had been incurred by the assessee for earning the exempt income or for the investment in question. We find merit and substance in the contention of the assessee on this point because the investment has been made by the assessee in the group concern and not in the shares of any un-related party. Therefore, the primary object of investment is holding controlling stake in the group concern and not earning any income out of investment. Further the investment were made long back and not in the year under consideration. Therefore, in view of the fact that the investment are in the group concern we do not find any reason to believe that the assessee would have incurred any administrative expenses in holding these investments. The AO has not brought on record any material to show that the assessee has incurred any expenditure in relation to the income which does not form part of the total income. Section 14A has within it implicit the notion of apportionment in the cases where the expenditure is incurred for composite/indivisible activities in which taxable and non taxable income is received but when no expenditure has been incurred in relation to the exempt income then principle of apportionment embedded in section 14A has no application. The object of section 14A is not allowing to reduce tax payable on the non exempt income by deducting the expenditure incurred to earn the exempt income. In the case in hand it is not the case of the revenue that the assessee has incurred any direct expenditure or any interest expenditure for earning the exempt income or keeping the investment in question. If there is expenditure directly or indirectly incurred in relation to exempt income the same cannot be claimed against the income which is taxable. For attracting the provisions of section 14A- "there should be proximate cause for disallowance which has relationship with the tax exempt income as held by the Hon'ble Supreme Court in case of CIT Vs. Walfort Share and Stock Brokers P. Ltd. (*326 ITR 1). Therefore, there should be a proximate relationship between the expenditure and the income which does not form part of the total income. In the case in hand the assessee has claimed that no expenditure has been incurred for earning the exempt income, therefore, it was incumbent on the AO to find out as to whether the assessee has incurred any expenditure in relation to income which does not form part of the total income and if so to quantify the expenditure of disallowance. The AO has not brought on record any fact or material to show that any expenditure has been incurred on the activity which has resulted into both taxable and non taxable income. Therefore, in our view when the assessee has prima facie brought out a case that no expenditure*

has been incurred for earning the income which does not form part of the total income then in the absence of any finding that expenditure has been incurred for earning the exempt income the provisions of section 14A cannot be applied. Accordingly we delete the addition/disallowance made by AO u/s 14A r.w. Rule 8D."

12. A similar view was taken by the Delhi Bench of this Tribunal in the case of M/s Oriental Structural Engineers (P) Ltd (supra) which has been confirmed by the Hon'ble Delhi High Court vide decision dated 15.01.2013 in para 6.3 as under:-

"'6.3 We have carefully considered the submissions and perused the records. We find that Ld. Commissioner of Income Tax (Appeals) has given a finding that only interest of Rs 2,96,731/- was paid on funds utilized for making investments on which exempted income was receivable. Further, Ld. Commissioner of Income Tax (Appeals) has observed that in respect of investment of Rs 6,07,775,000/- made in subsidiary companies as per documents produced before him, they are attributable to commercial expediency, because as per submission made by the assessee, it had to form Special Purpose Vehicles (SPY) in order to obtain contracts from the NHAI and the SPVs so formed engaged the assessee company as contract to execute the works awarded to them (i.e. SPVs) by the NHAI. ***In*** *its profit and loss account for the year, the assessee has shown the turnover from execution of these contracts and therefore no expense and interest attributable to the investments made by the appellant in the PSVs can be disallowed u/s 14A LW. Rule 8D because it cannot be termed as expense/ interest incurred for earning exempted income. Under the circumstances, Ld. Commissioner of Income Tax (Appeals) is correct in holding that disallowance of a further sum Rs 40,556/- calculated@2%ofthedividend earned is sufficient. Under the circumstances, we do not find any infirmity in the order of the Ld. Commissioner of Income Tax (Appeals), hence we uphold the same."*

13. In view of the above discussion and facts and circumstances of the case we agree with the view taken by this Tribunal in the above stated cases and accordingly hold that the assessee has brought out a case to show that no expenditure has been incurred for maintaining the 98% of the investment made in the subsidiary companies, therefore, in the absence of any finding that any expenditure has been incurred for earning the exempt income, the disallowance made by the AO is not justified, accordingly the same is deleted.

14. In the result appeal of the assessee is allowed.

Order pronounced in the open Court on 26 /03/2014

Sd/-	Sd/-
(N.K. Billaiya)	**(Vijay Pal Rao)**
Accountant Member	**Judicial Member**

Mumbai dated 26 /03/2014
SKS Sr. P.S

Copy to:
The Appellant
The Respondent
The concerned CIT(A)
The concerned CIT
The DR, "J" Bench, ITAT, Mumbai

By Order

Assistant Registrar
Income Tax Appellate Tribunal,
Mumbai Benches, MUMBAI