

**IN THE INCOME TAX APPELLATE TRIBUNAL  
BENCH 'C' AHMEDABAD**

**ITA No.3179/Ahd/2009  
Assessment Year: 2006-2007**

**SAGAR DRUGS & PHARMACEUTICALS (P) LTD  
'SAGAR', OPP KAMDHENU COMPLEX  
NR SAHAJANAND COL LEGE  
AMBAWADI, AHMEDABAD**

**Vs**

**ADDL COMMISSIONER OF INCOME TAX  
RANGE-8, AHMEDABAD**

**M K Shrawat, JM and D C Agrawal, AM**

**Dated: June 03, 2011**

**Appellant Rep by:** Smt Urvashi Shodhan, AR  
**Respondent Rep by:** Shri B L Yadav, Sr.DR

**ORDER**

**Per: D C Agrawal:**

This is an appeal filed by the assessee raising following grounds :-

(1) The Id. CIT(A) failed to understand the facts and circumstances of the case.

(2) The Id. CIT(A) erred in applying Rule 8D of the Income-tax Rules though the conditions for application of Rule 8D are not satisfied on the facts of the case.

(3) The Id. CIT(A) erred in confirming the disallowance of Rs.7,75,201/- u/s 14A, considering the same as expenditure incurred for the purpose of earning tax-free dividend income, out of salary, wages, bonus & PF expenses.

(4) The Id. CIT(A) erred in enhancement of the disallowance to Rs.9,17,154/- from Rs.7,75,201/- u/s 14A by applying Rule 8D of Income-tax Rules.

2. The only issue involved in this appeal is about disallowance of part of administrative expenses u/s 14A by invoking Rule 8D of the IT Rules as according to the AO part of the administrative expenses related to earning of exempted income. In this regard the AO worked out the disallowance as under :-

*"The assessee has shown dividend income of Rs.66,82,739/- and long term capital gain u/s 10(36) and 10(38) of the Income-tax Act, 1961 of Rs.1,35,37,801/-. The aforesaid incomes are exempted from tax. The assessee was asked to explain as to why expenses attributable to earning of dividend income and long term capital gain*

should not be disallowed in accordance with section 14A of the Income-tax Act, 1961. The assessee's explanation in this regard has been duly considered. The assessee has disallowed direct expenses which are attributable to earning of dividend income. However, expenses attributable to earning dividend income and long term capital gain out of payment to employees in respect of salary, bonus and PF have not been disallowed. The assessee has debited payment to employees (salary, wages, bonus & PF expenses) to the tune of Rs.58,81,000/-. This expenditure incurred on employees is multiplied by the ratio of dividend income and capital gain (Rs.2,02,20,540/-) to the total turn over (Rs.15,34,26,146/-) which works out to Rs.7,75,201/-. The working of disallowance u/s 14A of the Income tax Act, 1961 is as under :-

	Rs.	Rs.
Salary, Wages, Bonus & PF Exp.		58,81,946/-
Exempted income		
Dividend income	66,82,730/-	
Long term capital gain u/s 10(36) & 10(38)	1,35,37,801/-	2,02,20,540/-
Total turnover		15,34,26,146/-
= <u>Rs.58,81,946/- x Rs.2,02,20,540/-</u> Rs. 15,34,26,146/-	= Rs. 7,75,201/-	
Disallowance i/s 14A of the I.T. Act of Rs.7,75,201/-		

3. The Id. CIT(A) was not satisfied and he enhanced the disallowance to Rs.9,17,154/- as per the calculation made in the appellate order.

4. The Id. AR submitted that disallowance of administrative expenses cannot be done prior to Asst. Year 2007-08 because Rule 8D has not been accepted as having retrospective effect and, therefore, only those expenses which have direct nexus with the exempted income can only be disallowed. She referred to following judgment in support of her argument:

*CIT vs. Catholic Syrian Bank Ltd. & Ors. (2011) 237 CTR (Ker) 164* in which Hon. Kerala High Court observed as under :-

*"So far as the disallowance of administrative expenditure is concerned, considering the fact that there is no precise formula for proportionate disallowance, no disallowance is called for, the proportionate administrative cost attributable to earning of tax free income until r.8D came into force. Therefore, all the assessments are remanded back to the AO for reworking disallowance under s.14A in the case of each assessee for each assessment year. The proportionate disallowance under s.14A should be limited to only interest liability and not overheads or administrative expenditure, which should be considered for disallowance under r.8D from 2007-08 onwards."*

She then referred to judgment in the case of *Impulse (India) (P) Ltd. (2008) 22 SOT 368 (Delhi)* for the similar proposition that expenditure having no nexus with the earning of exempted income cannot be disallowed. Finally she referred to a judgment

of this Tribunal in the case of *ACIT vs. G M M Pfaulder Ltd. in ITA No.1241/Ahd/2006 Asst. Year 2002-03* and others wherein following findings were given:-

*"14. We have considered the rival submissions and perused the material on record. In our considered view, the matter would go to the file of AO as per the decision of Hon. Bombay High Court in the case of Godrej Boyce Mfg. Co. Ltd. (supra) only when it is held that some amount is required to be disallowed as there is a nexus between the exempted income and investment, i.e. if Revenue is able to show that interest bearing capital has been invested in shares but where no such nexus is established the question of determining any disallowance does not arise and, therefore, matter need not be sent to the file of AO as no determination of any disallowance would be necessary. In the present case we notice that loan funds have decreased this year as compared to earlier years. Even though investments have increased from Rs. 940.32 lacs to Rs. 1008.51 lacs but such increase in investment cannot be linked to any borrowed funds this year as assessee has in fact not borrowed any additional fund this year. Prior to the decision of Hon. Supreme Court in the case of Hon'ble Supreme Court in *S.A. Builders vs. CIT 288 ITR 1(SC)* onus was considered on the assessee to show the nexus between the interest free funds and investment on which no income is earned. After *S.A. Builders*' case (supra) onus is considered shifted to the Revenue and AO has to show that interest bearing capital alone were invested in investment on which no income was earned. Hon. Supreme Court in the case of *Munjal Sales Corporation vs. CIT (2008) 298 ITR 298 (SC)* held where assessee had sufficient profits in the current year then interest free advances can be considered to be flowing from such profits. Hon'ble Bombay High Court in *CIT vs. Reliance Utilities & Power Ltd. (2009) 313 ITR 340 (Bom)* held that if there are funds available both interest free and interest bearing, then a presumption arises that investment was out of interest free funds generated or available with the assessee. If the interest free funds were sufficient to meet the investment no disallowance of interest paid on borrowed funds would be necessary. Once such presumption is established claim of interest was allowable.*

*15. There is another aspect of the matter. If the assessee has made investment in subsidiaries out of mixed funds and for commercial expediency then no interest out of payment made on borrowed funds can be disallowed as held in *S. A. Builders Ltd. vs. CIT (2007) 288 ITR 1 (SC)*. Hon'ble Punjab & Haryana High Court in *CIT vs. Hero Cycles Ltd. (2010) 323 ITR 518 (P & H)* held that no disallowance out of interest payment is permissible if AO does not establish nexus between the expenditure incurred and income generated.*

*16. Since assessee had sufficient profits generated this year and it had mixed funds and no nexus is established by the AO as to whether investment was made out of interest bearing funds, disallowance of interest cannot be made. Similarly no disallowance out of administrative expenditure can be made as there is no direct nexus. As a result, this ground is allowed."*

She submitted, following above decisions, no disallowance on administrative expenses should be made.

5. The Id. DR on the other hand, supported the orders of authorities below and submitted that disallowance on estimate basis can also be done and such estimate can also be applied to administrative expenses.

6. We have heard the rival parties. In our considered view the position of law in relation to disallowance of administrative expenses is now clear. Such disallowance cannot be made prior to Asst. Year 2007-08 unless there is a direct nexus established by the AO. It has been held that rule 8D is not retrospective and would be applicable for and from Asst. Year 2007-08 and, therefore, it cannot be applied in Asst. Year 2006-07 which is before us and, therefore, calculation as per rule 8D cannot be done for disallowance of administrative expenses, unless of course a direct nexus is established which has not been done in the present case. Accordingly, the addition made by the AO and enhanced by the Id. CIT(A) is deleted and the appeal filed by the assessee is allowed.

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

(Order was pronounced in open Court on 3.6.2011.)