

1. Satisfaction of the AO to make disallowance u/s 14A must be based on clear and cogent material that interest bearing funds have been used to earn tax free income.

CIT vs. Abhishek Industries Ltd, ITA No. 320, Date of order: January 27, 2015, High Court of Punjab & Haryana, [2015] 56 taxmann.com 391

As per the provisions of section 14A, the AO has to record satisfaction that interest bearing funds have been used to earn tax free income and the satisfaction to be recorded must be based upon credible and relevant evidence.

The onus, to prove that interest bearing funds were used, lies squarely on the shoulders of the revenue. Thus, if the AO is able to refer to relevant material while recording satisfaction that borrowed funds were used to earn interest free income as opposed to the assessee's own funds, the AO may legitimately disallow such a claim. The AO, however, cannot, by recording general observations, particularly where the assessee has denied using interest bearing funds, proceed to infer that interest bearing income must have been used to earn exempted income. Section 14A of the Act, being in the nature of an exception, has to be construed strictly and only where the AO records satisfaction, on the basis of clear and cogent material, shall an order be passed u/s 14A of the Act, disallowing such a claim.

As in this case there is no tangible material on record that could have enabled the Assessing Officer to record satisfaction in terms of Section 14A of the Act, findings recorded by the CIT(A) and the ITAT that the Assessing Officer has failed to discharge this onus are neither perverse nor arbitrary and, therefore, do not call for interference.

A relevant extract from the order passed by the High court reads as follows:—

Even otherwise, the controversy, in our considered opinion, is squarely covered in favor of the assessee by the judgment in *Winsome Textile Industries Ltd. (supra)*. We, therefore, find no reason to interfere with findings recorded by the Income Tax Appellate Tribunal, answer the questions of law against the revenue and dismiss the appeal accordingly.

2. Whether Commerciality challenges the genuineness of charitable nature of education activities of a trust or institution under the amended provision of section 2(15)

Meritta Welfare Trust v. CIT, IT Appeal No. 5481/Delhi/2013, Date of Order: 27 February, 2015, [56 taxmann.com 363 [2015] (ITAT- Delhi)]

In brief, the assessee was a public charitable trust with primary motive of promoting educational activities. The assessee filed an application for registration u/s 12AA but the commissioner rejected the same on the grounds that the school would be purely for commercial purpose because the assessee had entered into a franchisee agreement and agreed the terms that school would be conducted and run on the terms of the franchisor.

The provisions of Section 2(15) of the Act include education as a charitable purpose and impose no restriction on the manner and mode of providing Education. Moreover, the proviso to section 2(15) provides that the aspect of commerciality does not apply on any limb except the 'advancement of any other object of general public utility' and also, Circular No. 11 of 2008 dated 19-12-2008 made the argument stronger where it provided that the insertion of proviso to section 2(15) by Finance Act, 2010, will not apply to the first three limbs, i.e., relief of the poor, education or medical relief even if it independently involves carrying on commercial activity.

Hence, it was held that the decision of the commissioner was incorrect as an application u/s 12AA for registration cannot be rejected on the assumption that the income of the trust will not be utilized for charitable purpose. Thus, in the case, the terms of the franchiser for running the school cannot be assumed to non application of income for charitable purpose.