

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**R/TAX APPEAL NO. 900 of 2018****With****R/TAX APPEAL NO. 901 of 2018****With****R/TAX APPEAL NO. 902 of 2018****PRINCIPAL COMMISSIONER OF INCOME TAX VADODARA 1****Versus****GUJARAT STATE FERTILIZERS AND CHEMICALS LTD****Appearance:****MR.VARUN K.PATEL(3802) for the PETITIONER(s) No. 1****MR MANISH J SHAH(1320) for the RESPONDENT(s) No. 1****CORAM: HONOURABLE MR.JUSTICE M.R. SHAH****Sd/-****and****HONOURABLE MR.JUSTICE A.Y. KOGJE****Sd/-****Date : 31/07/2018****COMMON ORAL ORDER****(PER : HONOURABLE MR.JUSTICE M.R. SHAH)**

1. Feeling aggrieved and dissatisfied with the impugned order passed by the learned Income Tax Appellate Tribunal, "A" Bench, Ahmedabad dated 29.11.2017 passed in ITA No.339/AHD/2012 for the Assessment Year : 2008-2009, the order passed in ITA No.178/Ahd./2013 for the Assessment Year : 2009-2010, and ITA No.38/Ahd./2013 (Revenue's Appeal) for the Assessment Year : 2009-2010, the Revenue has preferred the present Tax Appeals No.900/2018, 901/2018 and 902/2018.

2. In Tax Appeal No.900/2018, arising out of the impugned order passed in ITA No.339/Ahd/2012 for the Assessment Year : 2008-2009, the Revenue has proposed the following question of law :-

“(a) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in restricting the disallowance made u/s. 14A of the Income Tax Act to Rs.10 lacs (on ad-hoc basis) from Rs.187.25 lacs, without appreciating that the assessee was maintaining mix funds and failed to establish that it has its own surplus funds for investment in dividends?

(b) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in allowing the assessee's claim for deduction u/s. 80IA of the Income Tax Act, 1961 for generating power for captive consumption, when the assessee had adopted rate on which the GEB supplied power to its consumers ignoring the rate on which power generating company supplied its power to GEB?

(c) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in allowing set off of loss incurred on sale of fertilizer bonds at Rs.91,45,000/- treating as business loss and ignoring the fact that the fertilizer bonds subscribed by the assessee falls within the bracket of section 2(14) of the Income Tax Act and thus sale of fertilizer bonds is not allowable as business loss and is to be instead treated as capital gains loss?”

3. In Tax Appeal No.901/2018, arising out of the impugned order dated 29.11.2017 passed in ITA No.178/Ahd./2013, for the Assessment Year : 2009-2010 (Assessee's Appeal), the Revenue has proposed the following questions of

law:-

“(a) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in restricting the disallowance made u/s. 14A of the Income Tax Act to Rs.15 lacs from Rs.892.57 lacs, without appreciating that the assessee was maintaining mix funds and failed to establish that it has its own surplus funds for investment in dividends?

(b) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in allowing the assessee’s claim for deduction u/s. 80IA of the Income Tax Act, 1961 for generating power for captive consumption, when the assessee had adopted rate on which the GEB supplied power to its consumers ignoring the rate on which power generating company supplied its power to GEB?”

4. In Tax Appeal No.902/2018, arising out of the impugned order dated 29.11.2017 passed in ITA No.38/Ahd./2013 for the Assessment Year : 2009-2010, the Revenue has proposed the following question of law :-

“(a) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in allowing the assessee’s claim for deduction u/s. 80IA of the Income Tax Act, 1961 for generating power for captive consumption, when the assessee had adopted rate on which the GEB supplied power to its consumers ignoring the rate on which power generating company supplied its power to GEB?

5. From the aforesaid, it appears that the proposed question 2.(b) in the respective Tax Appeals are common.

6. Considering the fact that the identical question / issue is at large before this Court in Tax Appeal No.935/2018, in the case of Alembic Limited, all these Tax Appeals are **ADMITTED** to consider the following question of law :-

“(b) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in allowing the assessee’s claim for deduction u/s. 80IA of the Income Tax Act, 1961 for generating power for captive consumption, when the assessee had adopted rate on which the GEB supplied power to its consumers ignoring the rate on which power generating company supplied its power to GEB?”

7. Now so far as proposed question No.2(a) in Tax Appeals No.900/2018 and 901/2018 are concerned, they are with respect to the disallowance made by the Assessing Officer under Section 14A of the Income Tax Act, 1961 which was disallowed, considering Rule 8(d) of the Rules.

8. For the sake of convenience, the facts in Tax Appeal No.900/2018 are narrated as the facts in Tax Appeal No.901/2018 for the Assessment Year : 2009-2010, as such are common.

9. That during the year under consideration, the assessee an exempt income of Rs.14,76,74,453/= as dividend and

Rs.29,82,636/= interest on tax free ITI Bonds. During the financial year under consideration, the assessee has shown to have received exempt income in the form of dividend. The assessee made an expenditure of Rs.40,281/= against this exempt income. The Assessing Officer issued a Notice upon the assessee and called upon the assessee to showcause considering the provisions of Section 14A of the Act and to furnish the details of sources of investment and to explain why expenditure incurred in relation to income not includible in total income should not be disallowed. The assessee replied to the same and submitted that the Assessee was already having surplus tax free funds available and therefore, requested not to make disallowance under Section 14A of the Act and Rule 8(d) of the Rules. However, the Assessing Officer disagreed with same and made a disallowance under Section 14A of the Act read with Rule 8(d) of the Rules and added the expenditure of Rs.1,86,84,719/= to the total income. At this stage, it is required to be noted that while making the aforesaid disallowance under Section 14A(2) of the Act read with Rule 8(d) of the Rules, the learned Assessing Officer made a disallowance by observing solely as under :-

“I have considered the submission of the assessee. Since the interest bearing borrowed funds has been used in acquiring shares and since such borrowed funds continue to be blocked in the investment in equity shares, contention raised by the assessee that no interest expenditure could be attributed to earning of dividend income is not sustainable. The assessee has not given any details of interest expenditure or other expenditure incurred in relation to dividend income.”

10. The learned CIT (Appeals) confirmed the disallowance made by the Assessing Officer under Section 14A(2) of the Act read with Rule 8(d) of the Rules. However, on a Appeal, the learned Tribunal deleted the said disallowance made under Section 14A(2) of the Act read with Rule 8(d) of the Rules. Considering the fact that incase of the very assessee but in respect of the earlier assessment years, the High Court has quashed and set aside such disallowance made under Section 14A of the Act on the ground that the assessee was already having surplus interest free funds and therefore, the Assessing Officer was not justified in making the disallowance under Section 14A of the Act. The learned ITAT observed in the present order also similar is the situation and the assessee in the year under consideration is also having surplus interest free fund. Consequently, the learned ITAT deleted the disallowance made by the Assessing Officer made under

Section 14A(2) of the Act read with Rule 8(d) of the Rules.

11. Feeling aggrieved and dissatisfied with the impugned order passed by the learned ITAT in deleting the disallowance made by the Assessing Officer under Section 14A(2) of the Act read with Rule 8(d) of the Rules, the Revenue has preferred the present Appeal with the following proposed question of law :-

(a) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in restricting the disallowance made u/s. 14A of the Income Tax Act to Rs.10 lacs (on ad-hoc basis) from Rs.187.25 lacs, without appreciating that the assessee was maintaining mix funds and failed to establish that it has its own surplus funds for investment in dividends?

12. Learned Counsel Mr. Varun K. Patel appearing on behalf of the appellant has submitted that in the present case, the assessee was maintaining mix fund and thereafter, failed to show as to whether the investment was made out of borrowed fund and/or interest free fund available with the assessee. It is therefore submitted that as such the Assessing Officer was justified in making calculation considering Section 14A of the Act read with Rule 8(d) of the Rules, while making the

disallowance. It is submitted that therefore, the learned Tribunal has materially erred in deleting the entire disallowance made by the assessing officer under Section 14A of the Act.

13. Learned Counsel Mr. Manish J. Shah appearing on behalf of the Assessee has supported the impugned order passed by the learned ITAT and relying upon the decision rendered by the Division Bench of this Court in the case of the very assessee and in respect of the earlier Assessment year, in the case of **Commissioner of Income Tax v. Gujarat State Fertilizers and Chemicals Ltd.** reported in **[2013] 358 ITR 323 (Guj)** for the Assessment Year : 2004-2005, whereby the Division Bench of this Court has set aside the similar disallowance made by the Assessing Officer under Section 14A of the Act. It is submitted that in the earlier years also, right from 2004-2005 to 2007-2008, similar disallowances are set aside. It is submitted that in this case also, the assessee was having a similar mixed fund, considering the fact that the assessee was already having surplus interest free fund, the Assessing Officer was not justified in making disallowance under Section

14A of the Act. Therefore, it is requested to dismiss the present Appeal qua the proposed question No.2(a) is concerned.

14. Heard learned Counsels appearing on behalf of the respective parties.

15. So far as question No.2(a) is concerned, while deleting the disallowance made under Section 14A of the Act, the learned ITAT has observed in Paragraph 6 to 11 as under :-

“6. We have heard rival contentions and perused the records placed before us. Common issue raised by the assessee in ground no.2 of the respective appeals for A.Y. 2008-09 & 2009-10 relates to disallowance for interest and administrative expenditure confirmed by Ld. CIT (A) which were made by the A.O. invoking the provisions u/s.14A of the Act and thereby applying rule 8D to calculate interest disallowance at Rs.1.21 crores and Rs.6.86 crores and disallowance of administrative expenses at Rs.0.66 crores and 2.07 crores for A.Y. 2008-09 & 2009-10 respectively.

7. We find that there is no dispute to the following facts for A.Y. 2008-09 & 2009-10 respectively.

-Dividend income earned at Rs.14.77 crores and Rs.19.70 crores.

-Average investment at Rs.132.43 crores & 413.71 crores.

-Interest expenditure at Rs.44.68 crores & Rs.39.17 crores.

-Surplus Interest free funds (share capital + reserve & surplus) at Rs.1473.33 crores & Rs.1931.47 crores.

8. We find that Ld. A.O. merely on looking to the figure of dividend income, interest expenditure and investment fetching tax free income invoked the provisions u/s.14A and applied the method provided in rule 8D of Income Tax rules and calculated the respective disallowance for both the years. Even though assessee had surplus interest free funds at its disposal still Ld. A.O. has not recorded any satisfaction of the specific instances showing borrowed funds having been applied to the investment giving tax free income.

9. We further observe that the very same set of facts including dividend-income, interest expenditure, tax free investment and surplus interest free funds in the form Share Capital and Reserve & Surplus were there before the Tribunal in assessee's own case for A.Y. 2004-05, 2005-06, 2006-07 & 2007-08 and it has been consistently held that no interest disallowance is called for u/s.14A of the Act. In holding so Co-ordinate Bench held as follows :

For A.Y. 2004-05

31. We have considered the rival submissions, perused the material on record and gone through the orders of authorities below. We find that disallowance was made by Assessing Officer mainly on this basis that assessee could not establish that the investment was made out of own fund '7 nd no borrowed funds have been utilized for making such treatments. The Assessing Officer has categorically stated in para-7 of his assessment order that it is held that assessee has utilized interest bearing borrowed funds tonon-business purpose, i.e. for making the investments. He also observed that disallowance is to be made for administrative expenses also. He made disallowance to the extent 10% of dividend income. So far : interest expenditure is concerned for earning dividend income, we are of the considered opinion that the own fund is much higher than investment and therefore, it cannot be said that interest bearing borrowed funds were used for making investments in share and therefore, no disallowance u/s. 14A is required in respect of interest expenditure. For other expenses, Ld. DR of the Revenue has requested to restore the matter back

to the file of Assessing Officer whereas it has submitted by Ld. AR of the assessee that disallowance of Rs.5 lakh may be made here itself. Considering the facts of present case and volume and quantum of investment, we feel that it disallowance of Rs.5 lakh is made, it will meet both ends of justice. We confirm the disallowance of Rs.5 lakh in respect of administrative expenses. This ground of Revenue's appeal is partly allowed.

For A.Y. 2005-06

79. We have considered the rival submissions and gone through the orders of authorities below. In A.Y. 2004-05, we have held that no disallowance u/s. 14A of the Act is called for in respect of interest expenditure because the own funds of the assessee is much higher than the investment in share etc., Regarding other administrative expenses, we have confirmed a disallowance of Rs.5 lakh in A.Y. 2004-05 and hence, in the present year also, we confirm the disallowance of Rs.5 lakh regarding other administrative expenses and delete the balance disallowance. This ground of Revenue's appeal is partly allowed.

For A.Y. 2007-08

8. We have considered rival submissions and perused the material available on record and gone through the order of authorities below and the Tribunal decision cited by Ld. A.R. of the assessee. Regarding disallowance out of interest expenditure, we are of considered opinion that no such disallowance is called for when the own interest free funds is far in excess of investment in tax free securities and the A.O. could not prove any nexus between interest bearing borrowed funds and such investment in tax free securities and therefore, the same is deleted. In respect of disallowance u/s 14(A) out of other expenses, a disallowance of Rs.5 lacs was confirmed by the Tribunal in assessee's own case in A.Y. 2004-05 and also in A.Y. 2005-06 and accordingly, in the present year also, we confirm disallowance of Rs.5 lacs u/s. 14(A) in respect of other expenses and delete the balance disallowance made by the A.O. in respect of interest expenditure and other expenses. This ground is partly allowed.

10. Hon'ble Jurisdictional High Court vide tax appeal No. 126 of 2013 dated 25.06.2013 in assessee own case for A.Y. 2004-05 has upheld the finding of the Tribunal by holding that "where it transpires from the record that the assessee's own funds are higher than the investment made by it and with nothing to indicate that borrowed funds utilized for making investments are earning dividend income, interest disallowance u/s. 14A is not justified."

11. We therefore respectfully following the judgment of jurisdictional High Court and decision of Co-ordinate Bench in assessee's own case for preceding years and in view of and similarity of facts, clearly showing that

. assessee's own interest free fund in the shape of share capital and Reserve and surplus being much more than the investments made for earning tax free and the Revenue being unable to indicate that the borrowed funds were utilized for making investment to earn dividend/ exempt income, we find no justification in the order of both the lower authorities confirming interest disallowance u/s.14A of the Act. We delete the same for both the A.Yrs. i.e. A.Y. 2008-09 & 2009-10.

12. As regards the disallowance of administrative expenses u/s. 14A of the Act at Rs.0.66 Crores & 2.07 Crores for both the assessment years calculated by the A.O. @ 0.5% of the average investments after giving benefit of suo moto disallowance of Rs.40,281/- & Rs.50,281/- for A.Y. 2008-09 & 2009-10 respectively we find that Co-ordinate Bench Ahmedabad as well as Hon'ble Jurisdictional High Court has dealt with this issue also.

13. Co-ordinate Bench in ITA No.729/Ahd/2010 in the case of assessee A.Y. 2007-08 while dealing with this issue of administrative disallowance sustained the addition to lumpsum amount of Rs.5 lakh which was previously sustained by the Tribunal in A.Y. 2004-05 & A.Y. 2005-06. Disallowance of administrative expenses sustained by Tribunal at Rs.5 lakh for A.Y. 2004-05 stands confirmed by Hon'ble High Court of Gujarat in Tax Appeal No.126/2013 dated 25.06.2013. The above judgment and decision were for the assessment year preceding assessment year 2008-09. From A.Y. 2008-

09 onwards amendment was brought in rule 8D thereby prescribing a method for calculation of disallowance u/s. 14A of the Act. However the condition precedent to applying Rule 8D of Income Tax Rule is that the A.O. has to make a proper satisfaction from the records of the assessee that such expenses have been incurred towards making the investment and earning the exempt income. In the instant appeal no such satisfaction has been recorded by the learned Assessing Officer pointing out any error in the calculation of the administrative expenses rather he has mechanically applied the method provided under Rule 8D of Income Tax Rule.

14. We also observe that Hon'ble Jurisdictional High Court in the case of Pr. CIT vs. India Gelatin and Chemical Limited (2015) 376 ITR 553 (Gujarat) adjudicating similar issue of administrative disallowance u/s. 14A of the Act for A.Y. 2009-10 thereby confirming the order of the Tribunal limiting the disallowance suo moto made by the assessee thereby disregarding the administrative disallowance computed by the A.O. applying method provided under rule 8D of the Income tax rules.

15. Similar view was also taken by Co-ordinate Bench Ahmedabad in ITA No.2398/Ahd/2012 dated 19.11.2015 in the Gujarat & Alkalies & Chemicals Ltd. wherein the Tribunal sustained a lumpsum disallowance as against the disallowance made by the A.O. applying rule 8D of Income tax rule r.w.s. 14A of the Act as the assessee provided audited financial statement and no specific disallowance u/s. 14A of the Act was appearing in the Auditors report and nothing erroneous was brought on record by the A.O.

16. We therefore in the given facts and circumstances of the case as well as in light of the judgment and decisions referred above, find that in the instant appeals Ld. A.O. has mechanically applied 0.5% of the average investments to compute administrative expenses disallowance as per the rule 8D of Income tax rules without recording any satisfaction on his part which as per the provisions of section 14A of the Act is precedent before applying rule 8D of IT Rules. However we find that assessee has made a minor

disallowance suomoto at Rs.40,281/- & Rs.50,281/- for A.Y. 2008-09 & 2009-10 even though the exempted income is at Rs.14.77 crores and 19.70 crores and the fact that there has been regular movement of funds under the head investment, an ad-hoc disallowance of Rs.10 lacs and 15 lacs for A.Y. 2008-09 and for 2009-10 respectively would meet the end of justice. We accordingly do so, giving partial relief to the assessee.

17. In the result interest disallowance u/s.14A of the Act stands deleted for A.Y. 2008-09 & 2009-10 and the administrative disallowance u/s. 14A of the Act is sustained at Rs.10 lacs & Rs.15 lacs for A.Y. 2008-09 and 2009-10 respectively. Accordingly ground No.2 of ITA No.339/Ah.d/2012 for A.Y. 2008-09 and ground No. of ITA No.178/Ahd/2013 is partly allowed."

16. Considering the aforesaid findings and decision of the Division Bench of this Court of the very assessee for the Assessment Year : 2004-2005, the Division Bench of this Court in the case of the very assessee has set aside / deleted the similar disallowance made by the Assessing Officer under Section 14A of the Act, the same has been subsequently followed in the case of the very assessee that in the proceeding years, i.e. 2005-2006 to 2007-2008. The Division Bench of this Court in the aforesaid decision has specifically observed that in a case where the assessee was having sufficient funds available with it, more than amount invested for earning the dividend, the disallowance in respect of interest expenditure under Section 14A of the Act read with Rule

8(d) of the Rules is not permissible. The decision of the Division Bench of this Court in the case of the very assessee for the Assessment Year : 2004-2005 has attained finality. In the present case, it is required to be noted that in the earlier years also more particularly, even in the Assessment Year : 2004-2005, the assessee was also having mixed funds and still considering the fact that the assessee was already having sufficient surplus interest free funds, the Division Bench of this Court has held that the disallowance under Section 14A of the Act is not permissible. At the cost of repetition, it is observed that the said decision has attained finality between the parties. Not only that, but the Department has followed the same in the subsequent assessment years also. Considering the aforesaid facts and circumstances, it cannot be said that the Tribunal has committed any error in deleting the disallowance made by the Assessing Officer under Section 14A of the Act. Therefore, the two Tax Appeals No.900/2018 and 901/2018 stands dismissed so far as the proposed question No.2 (a) is concerned.

17. Now so far as the proposed question No.2(c) in Tax Appeal No.900/2018, arising out of the impugned order

passed in ITA No.339/Ahd/2012 for the Assessment Year : 2008-2009 is concerned, which is with respect to the disallowance of loss of sale of fertilizer bond at Rs.91,45,000/= treating as business loss, while holding so, the learned Tribunal in Paragraph 31, 32 and 33 has observed and held as under :-

“31. We have heard the rival contentions and perused the record placed before us. Assessee grievance is against the order of Ld. CIT (A) confirming the disallowance of loss of sale of fertilizer bonds at Rs.91,45,000/- treating it as capital loss as against business loss claimed by assessee. We find that the appellant company is engaged in manufacturing of fertilizer. Incentive is provided by the Government of India (GOI) which is based on the quantum of DAP & Urea based fertilizer dispatched. The sale price of fertilizers are fixed by the Government of India and many a times, such price is even lower to the cost of production. Therefore to compensate the manufacturer for the difference between the retention price of individual unit and sale price, subsidy is given by the Government. There is no dispute to the fact on the part of the Revenue authority that the assessee accounts for such subsidy receivable on accrual basis which is credited to the sales account and offered as income. This subsidy account is a running account and the amount receivable at the end of the year is shown as subsidy receivable on the asset side of the balance sheet. It transpires from the records that due to cash crunch Government of India at a certain point of time discharged its dues of paying the subsidy by replacing cash/cheque with the fertilizer bonds. These bonds are saleable in the open market and the prices of such bonds are varying.

32. We further find that against the subsidy income duly credited in the profit and loss account, assessee received fertilizer bonds. When these bonds were sold in the open market it fetched less value than the value at which they were given to the assessee. This gave

rise to a loss which has been claimed as business loss.

33. It is true that these bonds were shown as investment in the Balance Sheet. Before moving further we would like to go to the judgment of Hon'ble Apex Court in the case of Patnaik and Co. Ltd. wherein a company subscribed for a Government loan on a promise by the Government that assessee will receive preferential treatment in placing the order for motor vehicles which in turn would be supplied to Government departments. Assessee claimed a certain amount of loss sustained by it on disposing of its subscription and claimed it as business loss. Revenue disallowed treating it as capital loss. Tribunal held it as business loss but Hon'ble High Court took different view confirming the action of the A.O. However, Hon'ble Apex Court held it to be a Revenue loss by observing that there was nothing to show that there is any reason for the assessee to hold on the investment in the loan indefinitely. There was no enduring advantage. Thus the investment does not bring in an asset of a capital nature and the loss suffered by the assessee was a Revenue loss."

18. Thus, from the facts and circumstances of the case and considering the material on record, it appears that the fertilizer bonds were issued by the Central Government in lieu of the subsidy. It is not disputed that the subsidy income cannot be said to be a business income. If that is so, in that case, the fertilizer bonds which were given by the Central Government in lieu of the subsidy when the same was sold at a lower price and the assessee suffered loss, the same was required to be allowed as business loss incurred and it cannot be treated as capital.

19. We are in complete agreement with the view taken by the learned Tribunal while considering the loss incurred on sale of fertilizer bond as purely business loss. No substantial question of law arises. Under the circumstances, Tax Appeal No.900/2018 stands dismissed so far as question No.2(c) is concerned.

20. As observed hereinabove, the present Appeals are admitted to consider the aforesaid question of law :-

“Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in allowing the assessee’s claim for deduction u/s. 80IA of the Income Tax Act, 1961 for generating power for captive consumption, when the assessee had adopted rate on which the GEB supplied power to its consumers ignoring the rate on which power generating company supplied its power to GEB?”

21. Learned Counsel Mr. Manish J. Shah waives service of notice of admission on behalf of the respondent – assessee in each of the Appeals.

Sd/-
(M.R. SHAH, J)

Sd/-
(A.Y. KOGJE, J)

CAROLINE