

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**R/TAX APPEAL NO. 1065 of 2018****With****R/TAX APPEAL NO. 1066 of 2018****With****R/TAX APPEAL NO. 1067 of 2018****With****R/TAX APPEAL NO. 1068 of 2018****=====**
PRINCIPAL COMMISSIONER OF INCOME TAX 2, VADODARA**Versus****SHRENO LTD**
=====**Appearance:****MR.VARUN K.PATEL(3802) for the PETITIONER(s) No. 1****MR B S SOPARKAR(6851) for the RESPONDENT(s) No. 1**
=====**CORAM: HONOURABLE MR.JUSTICE AKIL KURESHI****and****HONOURABLE MR.JUSTICE B.N. KARIA****Date : 27/08/2018****ORAL ORDER****(PER : HONOURABLE MR.JUSTICE AKIL KURESHI)**

1. These appeals filed by the Revenue involve the same assessee. Facts are similar. We may record them from Tax Appeal No.1065 of 2018.

2. This appeal is filed by the Revenue to challenge the judgment of the Income-tax Appellate Tribunal dated 17.11.2017. Following questions are presented for our consideration :

"(a) Whether on the facts and in circumstances of the case, the learned ITAT has erred in law and on facts in not upholding the disallowance u/s.14A of the

Income Tax Act made by the Assessing Officer ?

(b) Whether on the facts and in the circumstances of the case, the learned ITAT has erred in law and on facts in not upholding the disallowance u/s.14A of the Income Tax Act made by the Assessing Officer and in deleting the disallowance even under Rule 8D(2)(iii) without considering that in any case, this disallowance was not dependent on whether investments were made out of interest free funds ?

3. The issue pertains to assessment year 2010-11. Respondent assessee is a registered company and is engaged in the business of manufacturing glass ware items, machinery and equipments for chemical glass and other industries and also in real estate development. During the assessment proceedings the Assessing Officer noticed that the assessee had earned dividend income of Rs.1.24 crores (rounded off) which was claimed as exempt income under Section 10(34) of the Income Act, 1961 (for short 'the Act'). The assessee had on its own added back an amount of Rs.1 lac as disallowance under Section 14A of the Act towards administrative expenses incurred for earning such exempt income.

4. The Assessing Officer was not satisfied

with this working out presented by the assessee. He therefore issued a notice why disallowance should not be made under Section 14A read with Rule 8D of the Income Tax Rules, 1961 ('the Rules' for short). The assessee replied to such notice contending that it had sufficient interest free funds for making the investments from which dividend was earned. The investment was thus made out of its own funds. The principal borrowing of the assessee comprised of cash credit, corporate loans and term loans from banks. Such loans were opted through hypothecation of assets, investments in securities was not permissible from such borrowed funds. The assessee supplied details of its own interest free funds available contending that its reserves and surplus are sufficient to cover the investments made in shares.

5. The Assessing Officer rejected such a contention of the assessee observing that the assessee has not adduced any evidence in support of such a contention except for providing aggregate figures of share capital and reserves as on 31.3.2010. He observed that the business funds and investment funds of the assessee are mixed up and it cannot be

assumed that the funds deployed for earning tax free income were entirely out of interest free funds and resultantly the entire interest cost is to be loaded on to activities leading to taxable income. Merely because the assessee has positive net worth, it does not mean that the entire tax free income yielding activities were carried out by deploying own or surplus funds. He further observed that "the tax free income earning activities and taxable income earning activities are both carried out using the common kitty of funds, it would be reasonable to apportion the interest burden between the two activities".

6. The assessee carried the matter in appeal. The CIT (Appeals) gave partial relief to the assessee. To the extent co-relation of interest free funds being used for investments yielding tax free income could be established, he spared the assessee the disallowance. For the rest, he approved the view of the Assessing Officer.

7. The assessee carried the matter in further appeal. The Tribunal by the impugned judgment deleted the entire disallowance. The Tribunal referred to the earlier judgment in case of

the assessee itself and borrowed the discussion in such judgment, in which it was observed that, it is a settled position that Assessing Officer has to record a specific satisfaction before resorting to disallowance under Section 14A read with Rule 8D to the effect that disallowance offered by the assessee is inadequate to cover the expenses incurred in earning tax exempt income. Resorting to the method prescribed under Rule 8D is not automatic.

8. Before us, counsel for the Revenue contended that the view adopted by the Tribunal is incorrect. Present was the case where the assessee had mixed funds i.e. interest bearing as well as interest free funds. The assessee could not establish the co-relation between the funds received from such sources and the investment thereof. Under the circumstances, the Assessing Officer was perfectly justified in applying the formula contained in Rule 8D which is made precisely for such purpose. While agreeing that in case of assessee itself in earlier year, this Court had ruled against the Revenue, counsel submitted that since then the judgment of the Hon'ble Supreme Court in case of **Maxopp Investment Ltd., vs.**

Commissioner of Income Tax, reported in (2018) 402 ITR 640 has been rendered altering the situation materially. Our attention was drawn to para 42 of the said judgment.

9. On the other hand, learned counsel Shri Soparkar for the Revenue opposed the appeal contending that application of Rule 8D is not automatic. Unless and until the Assessing Officer records his satisfaction that accounts of the assessee of previous year do not reflect correctly the claim of expenditure made by the assessee in relation to income not forming part of the total income, formula provided in sub-rule of Rule 8D cannot be applied. In the present case the assessee had established through reliable evidence that the assessee had sufficient interest free funds which were utilized for making investment yielding tax free income. He submitted that the decision of Supreme Court in case of **Maxopp Investment Ltd., (Supra)** does not alter the basic requirements of applicability of Rule 8D, understood and explained, by various decisions of the High Courts.

10. As is well known, Section 14A of the Act relates to expenditure incurred in relation

to income not includable in total income. Sub-section (1) of Section 14A provides that for the purposes of computing total income under Chapter-IV no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act. As per sub-section (2) of Section 14A the Assessing Officer would determine the amount of expenditure incurred in relation to such income which does not form part of the total income in accordance with the method as may be prescribed, if having regard to the accounts of the assessee he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. The method for such purpose has been prescribed under Rule 8D of the Rules. Sub-rule (1) of Rule 8D substantially reiterates what sub-section (2) of Section 14A provides. Essentially under sub-rule (1), the Assessing Officer would be authorized to determine the expenditure to be disallowed in relation to earning tax free income in terms of sub-rule (2) where having regard to the accounts of the assessee of the previous year he is not satisfied with the correctness of the claim of expenditure made by the assessee or the claim made by the assessee is that no

expenditure has been incurred in relation to income which does not form part of total income.

11. In case of **S. A. Builders Ltd., vs. Commissioner of Income-Tax (Appeals), reported in (2007) 288 ITR page-1 (SC)** the Supreme Court considered an issue where the Revenue desired to disallow an assessee's claim of expenditure of interest on borrowed capital which was lent to its sister concern without charging interest. The Supreme Court interpreted the term "for the purpose of the business" used in Section 36(1)(iii) of the Act in such context. The Supreme Court approved the decision of the Delhi High Court in case of **CIT vs. Dalmia Cement (B) Ltd., reported in (2002) 254 ITR 377** and observed that once it is established that there was nexus between the expenditure and the purpose of business which need not necessarily be the business of the assessee itself, the Revenue cannot justifiably claim to put itself in the armchair of the businessman or in the position of the Board of Directors and assume the rule to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize his profit. The

transfer of borrowed funds to a sister concern has to be seen from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.

12. The exposition of law made by the Supreme Court in case of **S. A. Builders** and observation made therein have been applied by this court on various occasions, particularly in connection with the disallowance to be made under Section 14A of the Act. It has been held that if the assessee can demonstrate availability of surplus interest free funds for making investment generating tax free income, disallowance under Section 14A of the Act would not be justified.

13. In case of this very assessee such an issue came up for consideration for the assessment year 2008-09. In such case the Tribunal had held that Section 14A read with Rule 8D could be applied only after the Assessing Officer is not satisfied with the claim of the assessee regarding the expenditure. The Revenue had approached the High Court against the judgment of the Tribunal. The Court dismissed the appeal by judgment dated 6.9.2017 making following

observations:-

"5. Learned counsel for the Revenue was unable to point out that these observations on facts by the Tribunal to the effect that the assessee had interest free funds far in excess yield tax exempt income was wrong. That being the position as held by this Court in number of occasions including judgments in case of **Deputy Commissioner of Income Tax Vs. Vasco Sales & Marketing Corpn.** reported in 66 **taxmann.com 366** relying upon the judgment of the Supreme Court in case of **S A Builders Limited Vs. Commissioner of Income Tax (Appeals), Chandigarh** reported in 288 **ITR 1**, disallowance under section 14A would not be permissible. We do not find that the Tribunal has committed any error."

14. As pointed out by the counsel for the assessee Punjab & Haryana High Court in case of **M/s. Max India Ltd.**, in a judgment dated 8.3.2017 considered a similar issue as under :

"6. With regard to the second issue regarding expenditure related to exempt income, the same is covered by the decision of this Court in the case of the assessee in **Commissioner of Income Tax, Jalandhar I, Jalandhar vs. M/s Max India Limited**, **ITA No.186 of 2013**, decided on 6.9.2016, wherein after considering the relevant case law on the point, the issue was decided in favour of the assessee and it was recorded thus:-

"9. This presumption is unfounded. Merely because the interest free funds with the assessee have decreased during any period, it does not follow that the funds borrowed on interest were utilized for the

purpose of investing in assets yielding exempt income. If even after the decrease the assessee has interest free funds sufficient to make the investment in assets yielding the exempt income, the presumption that it was such funds that were utilized for the said investment remains. There is no reason for it not to. The basis of the presumption as we will elaborate later is that an assessee would invest its funds to its advantage. It gains nothing by investing interest free funds towards other assets merely on account of the interest free funds having decreased. In that event so long as even after the decrease thereof there are sufficient interest free funds the presumption that they would be first used to invest in assets yielding exempt income applies with equal force."

Learned counsel for the appellant-revenue has not been able to distinguish the aforesaid decision taken by this Court."

15. Division Bench of this Court in case of **Gujarat State Fertilizer and Chemicals Ltd.**, in a judgment dated 31.7.2018 followed the earlier judgment in case of the assessee and observed as under :-

"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."

16. The primary question which the Supreme Court considered in case of **Maxopp Investment Ltd., (Supra)** was whether disallowance of expenditure under Section 14A of the Act would be applicable in a case where shares or stocks of a company were purchased for the purpose of gaining control over the said company and incidentally tax free dividend income was generated. The assessee had contended that the dominant intention for purchasing the shares was not for earning the dividend but to gain control over the business in the company in which the shares were purchased. The Supreme Court held that the purpose for which the shares were purchased was inconsequential. As long as such investment generated tax free income, disallowance of expenditure for making such investment would be justified. This issue does not arise in the present case. However, it is true that while disposing of bunch of appeals by the said judgment the Supreme Court also considered the correctness of the view of the Punjab & Haryana High Court in case of **Avon Cycles Ltd.** It was the case in which the Assessing Officer had invoked Section 14A read with Rule 8D and apportion

the expenditure between investments made for earning tax free income and the rest. The CIT (Appeals) had deleted the entire disallowance upon which in the appeal filed by the Revenue the Tribunal restored portion of the disallowance observing that the funds utilized by the assessee being mixed funds, the disallowance is confirmed in view of the provisions under Rule 8D(2) of the Rules. This decision of the Tribunal was challenged before the High Court. The Court held that the funds utilized by the assessee were mixed funds and the interest paid by the assessee is also an interest on the investments made, was the finding of fact and therefore, no substantial question of law arises. This judgment was carried in appeal by the assessee. The Supreme Court dismissed the appeal confirming the decision of the High Court.

17. We do not find that this portion of the judgment of the Supreme Court in case of **Maxopp Investment Ltd.**, can be seen as fundamentally changing the understanding and interpretation of Section 14A and Rule 8D of the Rules adopted by this Court and various Courts, noted above. This judgment does not lay down a proposition that the requirement

of sub-rule (1) of Rule 8D of the satisfaction to be arrived by the Assessing Officer before applying the formula given in sub-rule (2) of Rule 8D is done away with. In other words, the judgment in case of **Maxopp Investment Ltd.**, does not lay down a proposition that the moment it is demonstrated that the assessee had availed of mixed funds i.e. interest free as well as interest bearing funds and utilized them for making investments into securities earning tax free income and the rest applicability of the Section 14A read with Rule 8D would be automatic. We are conscious that neither in **M/s. Max India Ltd., Punjab & Haryana** nor in **Gujarat State Fertilizer and Chemicals** case, this High Court had noticed the judgment of the Supreme Court in case of **Maxopp Investment Ltd.** Nevertheless in view of the discussion above, in our opinion the situation would not change on account of the said judgment of the Supreme Court.

18. All tax appeals are dismissed.

(AKIL KURESHI, J)

(B.N. KARIA, J)

K.K. SAIYED