

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : 'C', NEW DELHI

BEFORE SHRI BHAVNESH SAINI, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA.No.3584/Del/2015
Assessment Year 2011-12

Indica Industries Pvt. Ltd., A-4, Greater Kailash-I, New Delhi-110048. PAN No.-AAACI0233Q	Vs.	Addl. Commissioner of Income Tax, Range-11, New Delhi.
(Appellant)		(Respondent)

For Assessee :	Shri Hari Mittal, C.A.
For Revenue :	Shri A.K. Yadav, Sr. D.R.

Date of Hearing :	16.08.2018
Date of Pronouncement :	04.09.2018

ORDER

PER: BHAVNESH SAINI, JM

This appeal by Assessee has been directed against the Order of the Ld. CIT(A)-4, New Delhi, dated 31.03.2015, for the A.Y. 2011-2012.

2. We have heard the Learned Representatives of both the parties and perused the material available on record.

3. On Ground No.1, assessee challenged the order of the Ld. CIT(A) in confirming the action of the A.O. in excluding duty drawback of Rs.57,771/- from eligible income under section 80IC in respect of Kotdwar Unit-III. The A.O. following the decision of the Hon'ble Supreme Court in the case of Liberty India 317 ITR 218 excluded the above amount from computation of deduction under section 80IC of the I.T. Act. Learned Counsel for the Assessee in view of the above decision of the Hon'ble Supreme Court in the case of Liberty India (supra), did not press Ground No.1 of the appeal of the assessee. Ground No.1 is, therefore, dismissed as not pressed.

4. On Ground No.2, assessee challenged the order of the Ld. CIT(A) in restricting and retaining the apportionment allocation of 10B unit of Rs.10,54,371/- (Rs.12,78,120/- (-) Rs.2,23,748/-) on account of Head Office, common expenses and allocation of Rs.1,05,305/- to Kotdwar Unit-III under

section 80IC of the I.T. Act. It is also stated in this ground that Ld. CIT(A) has erred in not totaling deleting the allocation of above expenses to Unit 10B and Kotdwar Unit-III as similar claim have been accepted in earlier years. Learned Counsel for the Assessee referred to Para 5.10.7 of the impugned appellate order in which this issue have been decided by the Ld. CIT(A). The Ld. CIT(A) noted that this issue relates to allocation of common expenses towards profits of units eligible under section 10B and units eligible under section 80IC respectively. The Counsel for Assessee pleaded before Ld. CIT(A) that in making the disallowance, the A.O. wrongly assumed the expenses appearing in Schedule-20, 21 and 22 pertain only to Central Office/Head Office. It was informed that the assessee had stated in the letters addressed to A.O. that these expenses represented the sum total of the expenses incurred at seven non-exempt units and the Head Office. In view of this, it was pleaded that total expenses incurred at Central Office/Head Office amounted to Rs.78,00,184/- while the remaining expenses of Rs.46,64,806/- pertain to seven non-exempt

units. It was pleaded that the figure of Rs.78,00,184/- incurred at Head Office are exclusive of Rs.2,23,747.89ps and Rs.1,42,969.89ps already allotted to EOU unit and to Kotdwar Unit-III respectively, which represented the salary of General Manager (Finance) and Accountant Mr. Anil K. Mittal. In view of this, it was submitted that since such expenses were considered as partly attributable to EOU Unit and Kotdwar Unit-III, as in the earlier years, the same have been already allocated to these Units and no further allocation of such expenses required to be made. The assessee apart from the above submission also submitted that even ignoring all the submissions of the assessee, it would be only an amount of Rs.81,66,901/- that could be allocated to various units on turnover basis though the amounts so allocable to 10B Unit and Kotdwar Unit shall be reduced by Rs.2,23,747.89ps and Rs.1,42,969.89ps respectively. On this basis, it was submitted that expenditure allowable to EOU would amount to Rs.12,78,120/- (15.65%) and to Kotdwar Unit-III Rs.2,48,274/- (3.04%) as reduced by Rs.2,23,747.89ps and

Rs.1,42,967.89ps respectively. In view of this, assessee has worked-out for further allocation of common expenses of Rs.4,57,235/- and depreciation of Rs.85,726/-.

4.1. The Ld. CIT(A) considering the facts of the case in the light of revised working filed by the assessee found the claim of assessee based on reasonable basis. The A.O. was accordingly directed to recomputed the disallowance in view of the submissions made above. This ground was partly allowed.

4.2. Learned Counsel for the Assessee in the written submissions submitted the details and submitted that disallowance of Rs.11,35,150/- may also be deleted. Learned Counsel for the Assessee has however, not been able to satisfy as to from where this figure is appearing-up because it is not arising out of the grounds of appeals as well as findings of the Ld. CIT(A).

5. Ld. D.R. submitted that since the claim of assessee has been accepted by the Ld. CIT(A), therefore, this ground has become infructuous and perhaps the appeal effect order

would have given the present figure which is mentioned in the written submissions of the assessee.

6. Learned Counsel for the Assessee in view of the submissions of the Ld. D.R. also stated that whatever claim of assessee was made before Ld. CIT(A) have since been accepted, therefore, this ground have become infructuous.

7. Considering the facts of the case in the light of submission of the parties above, we are of the view that no interference is required in the matter. The Ld. CIT(A) accepted revised working of the assessee which was based on reasonable basis. A.O. was accordingly directed to re-compute the disallowance as per statement made by assessee. It, therefore, appears that the contention of the assessee now raised for deleting the addition of Rs.11,35,150/- may be coming out of the appeal effect order passed by the A.O. which cannot be challenged in the present proceedings. Since the Ld. CIT(A) has already allowed relief to the assessee, therefore, no further interference is called for in the matter. Ground No.2 of

the appeal of the assessee has, therefore, become infructuous and is accordingly dismissed.

8. On ground No.3, assessee challenged the order of the Ld. CIT(A) in confirming the disallowance of Rs.26,48,712/- as expenditure incurred in relation to exempt income by applying Section 14A read with Rule 8D as against Rs.4,01,209/- claimed by the assessee.

9. Briefly, the facts of the case are that the A.O. observed that assessee had earned dividend income of Rs.2,23,05,114/-, long term capital gains of Rs.62,85,629/- and short term capital gains of Rs.10,43,490/- However, no disallowance of expenses incurred for earning the same was made under section 14A. When confronted, assessee filed letter dated 21.08.2013 and submitted that a sum of Rs.2,01,209/- being the remuneration paid for the services rendered by the portfolio management services may be considered for disallowance under section 14A and other expenses, if at all, at nominal level may be considered. The

A.O. was not satisfied with the explanation of assessee and applied the provisions of Rule 8D and thereby, made disallowance of Rs.26,48,712/- which includes disallowance of Rs.2,01,209/- taken under Rule 8D(2)(i). Accordingly, addition of Rs.26,48,712/- was made to the total income of assessee.

10. The assessee challenged the addition before Ld. CIT(A). Written submissions of the assessee is reproduced in the appellate order in which the assessee briefly explained that the job of portfolio management handling and advisor services were entrusted to well-known portfolio managers, namely, ICICI Prudential Assessment Management Company Ltd., which independently handled the entire working and furnish the account statement to the assessee. The Managing Director had done the only work by saying Yes or No to the major portfolio reshuffling, if any. The assessee itself had disallowed portfolio management fees aggregating to Rs.2,01,209/- and for abundant precaution had further disallowed Rs.2 lakhs. Even if A.O. was not satisfied with the explanation of assessee,

he should have worked-out the quantum of disallowance within the parameters of Section 14A(2) without straightaway proceeding to apply Rule 8D. The assessee has no active role to play except that sometimes whenever they feel like they talked/informed the Managing Director over telephone or e-mail. No other Executive is concerned with the matter nor they are qualified on the subject. The assessee-company did not have any Senior qualified Administrative Staff apart from Engineers or technical persons. No expenditure having proximate connection with dividend income is incurred except the above expenditure. The dividend income is directly remitted by mutual fund and companies to the Bank account of the assessee. The assessee-company had not taken any loan or borrowed funds for investments placed with portfolio managers. The assessee had huge interest free general reserve and credit funds aggregating to Rs.101 crores. The A.O. ignored the specialized nature and range of services rendered by portfolio managers not only for the assessee but to their other clients also. The A.O. failed to take into account the

modern technology in the form of computerization and online transactions, De-mat Accounts, Direct online access of the portfolio managers with all mutual funds managements and stock exchanges, all mutual funds administrations and there was little other expenditure to be incurred. The A.O. has not brought anything on record, if expenses were incurred for earning exempt income. No services were rendered by administrative staff. No rent was paid and no conveyance expenses were incurred. No notional expenses can be considered. A.O. must record that he was not satisfied with the correctness of the claim of assessee in respect of such expenditure. The A.O. shall have to give reasons for the same and A.O. should examine the accounts and facts before arriving at the satisfaction. The A.O. has completely ignored the same. The assessee relied upon several decisions of different Benches of the Tribunal and also relied upon decision in the case of CIT vs. Hero Cycle Limited 223 ITR 518 in which it was held that *“there cannot be any disallowance of any expenditure in relation to income which does not form part of*

total income where there is no nexus between the expenditure incurred and income generated.” There should not be any adhoc disallowance. Thus, the only expenditure of Rs.4,01,209/- incurred by the assessee in relation to exempt income may be accepted.

11. The Ld. CIT(A) considering the explanation of assessee and material on record, rejected this ground of appeal of assessee. His findings in paras 5.8.3 to 5.8.5.2 of the appellate order is reproduced as under :

“5.8.3. With regard Ground number 5 of the appeal, relating to disallowance under section 14A, I find that the appellant had made disallowance of an amount of Rs.4,01,209/- in the return of income towards expenses incurred for earning the dividend income of Rs.2.23 crores during the year. The learned AO examined the claim of the appellant and based on which, she observed that the appellant's claim was not correct, having regard the accounts of the appellant, based on which she invoked the

provisions of Rule 8D by using power nested upon her u/sec. 14A(2).

The learned counsel of the appellant pleaded before me that the disallowance of Rs.4,01,209/- made by the appellant in the return of income comprised of an amount of Rs.2,01,209/- towards the fees paid to two portfolio managers, who are managing appellant's portfolio. Further, an estimated amount of Rs. 2 Lacs was also disallowed by the appellant towards any other admissible expenditure, with a view to avoid any litigation on the issue.

5.8.3.2. *The provisions of section 14A (2) provide that before invoking the provisions of rule 8D, the AO has to hold that the claim of the appellant with regard the expenses incurred for earning the exempt income was incorrect, which in the light of the decision of Hon'ble Delhi High Court in the case of CIT Vs Maxopp Investments 64 DTR 122, should be on cogent grounds. I find that the*

appellant had pleaded before the AO that it had significant own funds of Rs. 101 crores, whereas against that it had made investments of Rs. 57 crores as on the year-end on 31.03.2011. The AO was not satisfied with this explanation, since the appellant company also had borrowed funds. In view of this, the AO was of the view that the claim of the appellant with regard the expenses incurred for earning dividend income was incorrect. Under the circumstances, the only course of action left with the AO was to apply the provisions of rule 8D of the Income Tax Rules, which is the only prescribed method for computing disallowance under section 14-A under such circumstances. In view of this, I find that the action of the AO was duly mandated by law in this regard.

5.8.3.3. Moreover, the explanation given by the appellant before the AO that the claim of Rs.4,01,209/- includes an estimated amount of Rs.2 lakh towards administrative expenses incurred for earning income, is

itself based on a presumptive estimation of administrative expenses made in an ad hoc basis manner. No scientific formula or a reasonable basis for arriving at this figure of Rs.2 lakh was given by the appellant to the AO. The underlying purpose of notifying Rule 8D was to minimize litigation due to subjectivity in such computation. Therefore, in the absence of any prudent basis, it is evident that the lack of satisfaction of the AO with the unfounded claim of the appellant was justified.

5.8.4. *Further, I find that the appellant had claimed that other than the portfolio charges of Rs. 2,01,209/- paid to the two portfolio managers, there were no other direct or indirect expenditure, incurred for earning the exempt income. In its view, further, disallowance of Rs. 2 Lacs over and above that would have sufficed any other administrative of expenditure, to avoid litigation, though in the opinion of the appellant, no other expenses other than the payment made to the two portfolio managers were*

incurred for earning the exempt income. Before me, the appellant filed the following brief on the nature of expenses incurred by the appellant for earning the dividend income, which reads as under:

"The Appellant has appointed two eminent Investment Portfolio Managers, namely, ICICI Prudential Asset Management Company Ltd., Bombay, and HSBC Asset Management (India) Pvt. Ltd., Bombay, who are authorized to purchase, acquire, obtain, take, hold, sell, transfer, substitute or change all or any of the investment of the Assessee. They are also provided with funds by the Appellant and are also authorized to operate the Bank Accounts of the appellant Company opened for the purpose. All the investments are held by them in Demat Account which is also operated by them. They maintain regular Accounts of the Investment portfolio and periodically render the audited Statements of Account showing the expenses incurred on the Investments and

their portfolio management fees. The Appellant has no active role to play except that sometimes whenever they feel like they talk to / inform the Managing Director over telephone or email. No other executive is concerned with the matter nor are they qualified on the subject. The Appellant Company doesn't have any senior qualified administrative staff apart from engineers or technical persons. Even the Head of the Accounts Department is neither a Chartered Accountant nor a MBA. No expenditure having any proximate connection with dividend Income is incurred except, as submitted earlier, occasional interaction between the Managing Director and the Portfolio Managers. Dividend income is directly remitted by Mutual Funds and Companies to the Bank accounts of the appellant. The Appellant Company had not admittedly taken any loans or borrowed funds for investments placed with the Portfolio Managers. It had its own huge interest free General Reserve funds and credit

Balance in the Profit Account which aggregated to over Rs.101 crores. Notwithstanding the fact that apart from Portfolio management fees and other expenses incurred by them no other expenses had direct and proximate connection with the exempt Income. With a view however to avoid any controversy, a further sum of Rs. 2 lacs was additionally allocated by the Appellant to exempt Income."

5.8.5. *On careful consideration of the above submission of the appellant, it is seen that the plea of the appellant has been twofold is namely (i) the appellant had significant funds of its own and hence no interest expenses were incurred for making investments for earning exempt income, and (ii) the two portfolio managers were singularly responsible for making investment, monitoring investments, reporting on the income received, and the dividend income was automatically received in the bank accounts of the appellant. The plea of the appellant*

has been that no other employee or director of the appellant company had any role in making, monitoring and exiting from the investments or on earning of the exempt income except that the Managing Director had interactions with the two portfolio managers in this regard.

5.8.5.2. On careful consideration, I find that the appellant's claim is not satisfactory, since, it does not capture all relevant expenses that are incurred for earning the exempt income. The appellant had itself conceded that there were occasional interactions of the Managing Director of the appellant company with the two portfolio managers. The appellant company owns several manufacturing undertaking and is significantly involved in export sales. Therefore, to hold that only the Managing Director was singularly responsible for dealing with the portfolio managers without the role of any other officials from the finance department looks unreasonable. In any case, the Managing Director and the Head of the Finance

Department both are heavily compensated by the company. Therefore, even if disallowance was to be made in respect of the compensation paid to Managing Director and the Head of the Finance Department only with regard their salary and other emoluments, the ad hoc amount of Rs.2 Lacs could not have reasonably covered the administrative efforts that these two high-ranking officials would have made in this regard. Moreover it cannot be conceived that in making a significant investment of Rs.57 crores, that too, since the appellant is primarily a manufacturing concern and hence any diversion of funds away from core activity, would have required to be properly assessed, no consultation within the Board of Directors of the company was made. The value of such high-level executive time for investment activity is also required to be properly captured. Evidently, in the era of computerization, with the advent of demat accounts and the online banking, the manual efforts have reduced however, the cost of computerization, including hardware

and software cost, manpower cost, AMC, electricity cost, etc, have added different nature of costs to be apportioned to the investment activity. It is also seen that there are certain common expenses in the business of the appellant, which the appellant had attributed towards various business undertakings of the appellant. On the same reasoning, such common expenses were also to be apportioned towards the exempt income as well, which the appellant has failed to do. Under the circumstances, I uphold the action of the AO of made disallowance in the Section 14A (2), which was made by the AO by invoking the prescribed method under Rule 8D. In view of this, Ground number 5 of the appeal is dismissed.”

12. We have heard the Ld. Representatives of both the parties and perused the material on record. The Ld. Counsel for assessee reiterated the submissions made before the authorities below and also submitted that investments are completely made and handled by portfolio managers. The

authorities below completely ignored these facts. Similar issue is considered by ITAT, Delhi Bench in the case of the assessee for A.Y. 2012-2013 in ITA.No.1764/Del/2016 in which vide order dated 28.02.2018, the departmental appeal has been dismissed. Ld. Counsel for the assessee submitted that Rule 8D is subject to condition that the AO only after having regard to accounts of the assessee is not satisfied over the correctness of the claim of the assessee. However, AO has not recorded any satisfaction or the cogent reasons for making disallowance.

13. On the other hand, Ld. DR relied upon the orders of the authorities below.

14. After considering the rival submissions, we are of the view that addition made by the authorities below is wholly unjustified. The assessee pleaded before the authorities below that the assessee has appointed the eminent Investment Portfolio Manager as referred to above, who are authorized to purchase, acquire, obtain, take, hold, sell, transfer, substitute

or change all or any of the investments of assessee. It was also pleaded that assessee has no active role to deal with investment. It was also pleaded that assessee had not taken any loans, advances or borrowed funds for investments placed with the Portfolio Managers. The assessee has its own interest free reserves funds which aggregating to over Rs.101 crores. The authorities below did not deal with the above explanation of the assessee in the impugned order. The AO merely observed that there are incidental expenses in relation to earning of the exempt income which are incurred by the assessee. It was also observed that since entire dividend income has been claimed exempt, therefore, Section 14A is attracted in this case and any expenditure relatable to earning of the dividend income shall have to be disallowed. Similar matter was considered by Hon'ble ITAT, Delhi Bench in the case of the same assessee for the A.Y. 2012-2013 in which the departmental appeal has been dismissed vide order dated 28.02.2018 (supra). The findings of the Tribunal in paras 6 to 10 of the aforesaid order are reproduced as under:-

“6. The only other ground in the appeal of the Revenue is against deletion of disallowance of Rs.31,16,268/- u/s 14A of the Act.

7. The facts apropos this ground are that the assessee earned exempt dividend income of Rs.1,79,68,892/- and a sum of Rs.2,42,047/- was offered for disallowance u/s 14A towards management fees, custody fees, audit fees and portfolio management fees. The Assessing Officer invoked the provisions of section 14A and computed disallowance in terms of Rule 8D at Rs. 31,66,268/-. The Id. CIT(A) observed that apart from offering disallowance of Rs.2,66,688/- (noted by the AO as Rs.2,42,047), the assessee had also offered additional disallowance of Rs.3,79,432/- which escaped the Assessing Officer’s attention. Thus, it was found that the assessee offered disallowance for total sum of Rs.6,42,120/- and not Rs.2,66,688/-.

Considering the fact that the investment portfolio of the assessee was handled and managed by portfolio managers and the portfolio of the assessee managers' fees was voluntarily disallowed by the assessee along with other direct expenses, the ld. CIT(A) held that disallowance to the extent of Rs.6.46 lac was in order. He, therefore, deleted the remaining disallowance. The Department is aggrieved against the deletion of such disallowance.

8. *We have heard both the sides and perused the relevant material on record. It is found as an admitted position that the assessee's investments were handled by portfolio managers to whom only a particular sum was paid as fees, which along with other direct expenses, comes to Rs.2,42,047/-, being the amount voluntarily disallowed by the assessee.*

9. Sub-section (2) of section 14A clearly stipulates that the Assessing Officer shall determine the amount of expenditure incurred in relation to exempt income as per Rule 8D if he, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim made by the assessee. The crucial question which looms large before us is whether the Assessing Officer recorded proper satisfaction before venturing to make disallowance as per Rule 8D. It can be seen from the assessment order itself that the Assessing Officer has nowhere recorded any satisfaction about the incorrect claim having been lodged by the assessee with reference to its accounts. There is no discussion whatsoever about the examination of the assessee's claim about the actual incurring of expenses in relation to the exempt income. It can be seen from the impugned order that the Assessing Officer even did not

consider the correct amount offered by the assessee for disallowance at Rs.6.46 lac. In view of the fact that no proper satisfaction was recorded, in our considered opinion, the Assessing Officer did not acquire any valid jurisdiction for computing disallowance u/s 14A. Since the ld. CIT(A) has sustained the amount disallowable u/s 14A at Rs.6,42,120/-, being the amount voluntarily offered by the assessee, we uphold the impugned order to pro tanto.

10. In the result, both the appeals are dismissed.”

15. Considering the facts of the case in the light of the above decision of the Tribunal, it is clear that in the Assessment Order, AO has nowhere recorded any satisfaction about the incorrect claim having been lodged by the assessee with reference to its accounts. There is no discussion whatsoever about the examination of the assessee's claim

about actual incurring of expenses in relation to the exempt income. It can be seen from the impugned order that the AO even did not consider the correct amount offered by the assessee for disallowance at Rs.4,01,209 (Rs.2,01,209 + Rs.2,00,000). The authorities below have not rejected the claim of the assessee that it has not borrowed any funds for investment and that it was having sufficient own funds to make investment through Portfolio Managers. This issue is, therefore, covered in favour of the assessee by order of ITAT Delhi Bench dated 28.02.2018 (supra). Following the same reasons for decision, we set aside the orders of the authorities below and restrict the addition to Rs.4,01,209/- already offered by assessee for disallowance in return and delete the additions. In the result, this ground of appeal of the assessee is allowed.

16. In the result, appeal of the assessee is partly allowed as indicated above.

Order pronounced in the open court.

Sd/-
(PRASHANT MAHARISHI)
ACCOUNTANT MEMBER

Sd/-
(BHAVNESH SAINI)
JUDICIAL MEMBER

Dated 04th September, 2018

VBP/-
&
Pooja.

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT 'C' Bench
6. Guard File

//By Order//

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