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### ***KARNATAKA STATE BEVERAGE CORPORATION LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX***

*IN THE ITAT BANGALORE BENCH 'B'*

*N. V. VASUDEVAN, VP & CHANDRA POOJARI, AM.*

*ITA Nos. 971/Bang/2018, 972/Bang/2018, 1925/Bang/2017*

*Jul 29, 2021*

*(2021) 62 CCH 0370 BangTrib*

#### Legislation Referred to

*Section 143(3)*

#### Case pertains to

*Asst. Year 2009-10, 2010-11*

#### Cases Referred to

*Bharat Earth Movers Vs. CIT 245 ITR 428 (SC)*

*Decision of Apex Court in CIT Vs. Walfort Share & Stock Brockers P Ltd 326ITR 0001*

*CIT Vs. SG Investment and Industries Limited [2004] 89 ITD 44*

*Kalpatharu Construction Overseas (P) Limited Vs. CIT [2007] 13 SOT 194 (Mum)*

#### Counsel appeared:

*S. V. Ravishankar, Advocate for the Assessee.: Priyadarshi Mishra for the Revenue*

#### **N. V. VASUDEVAN, VP.**

1. ITA Nos.971 and 972 are appeals by the assessee's against two orders dated 30.11.2017 of CIT(A)-4, Bengaluru, relating to Assessment Years 2009-10 and 2010-11 while ITA No.1925/Bang/2017 is an appeal by the assessee against the order dated 17.07.2017 of CIT(A)-2, Bengaluru, relating to Assessment Year 2010-11. This appeal arises out of an order passed under section 143(3) r.w.s. 147 of the Act for Assessment Year 2010-11.

2. First we shall take up for consideration ITA Nos.971 and 972/Bang/2018. As far as these two appeals are concerned, for Assessment Year 2009-10, an Order of Assessment was passed by the AO under section 143(3) of the Act dated 30.12.2011. The Order of Assessment was subject matter of

appeal before the Hon'ble ITAT and the Hon'ble ITAT remanded certain issues for consideration by the AO. The AO passed an order dated 19.03.2015 under section 143(3) r.w.s. 254 of the Act on remand by the ITAT. Similarly, for Assessment Year 2010-11, an order under section 143(3) dated 27.02.2013 was passed by the AO.

3. The assessee filed writ petition before the Hon'ble High Court of Karnataka in WP No.12872/2013 in which the assessee challenged the order dated 19.03.2015 passed in Assessment Year 2009-10 and the order dated 27.02.2013 in Assessment Year 2010-11. The Hon'ble Karnataka High Court in its judgment dated 18.02.2016 gave directions with regard to taxability of privilege fees paid by the assessee and set aside the orders of assessment for Assessment Years 2009-10 and 2010-11 referred to above. The Hon'ble Karnataka High Court also directed that in so far as other disallowances are concerned, the matter is remanded to the AO to re-examine the same after affording assessee opportunity of being heard.

4. It is pursuant to the aforesaid judgment of the Hon'ble Karnataka High Court that the AO passed orders for Assessment Years 2009-10 and 2010-11. Both the orders are dated 31.01.2017. We shall first take up the issue with regard to disallowance of provision for payment of ex-gratia of a sum of Rs.18,90,000/- in Assessment Year 2009-10. In the original Order of Assessment passed under section 143(3) of the Act for Assessment Year 2009-10 dated 30.10.2011, no disallowance of provision for ex-gratia payment was made by the AO in the Order of Assessment. However, in the order dated 19.03.2015 passed under section 143(3) r.w.s. 254 of the Act, after remand by the Tribunal, this issue was considered by the AO. The assessee had included a sum of Rs.18.90 lakhs towards liability for ex-gratia payment. This was part of the administrative and general expenses claimed by the assessee in the profit and loss account. The liability for payment of ex-gratia was only in the nature of provision. According to the AO, it was an unascertained liability and cannot be allowed as a deduction. It was the case of the assessee that the liability for payment of ex-gratia was an ascertaining liability and had to be allowed as a deduction. Alternatiely, the assessee prayed that in the Assessment Year 2010-11 it made an actual payment of Rs.18,66,328/- towards ex-gratia payment and if the sum of Rs.18,90,000/- is not allowed in Assessment Year 2009-10, atleast the sum of Rs.18,66,328/- paid in Assessment Year 2010-11 should be allowed as a deduction in Assessment Year 2010-11. The AO however did not accept the plea of the assessee. He held that the liability in question was an unascertained and contingent liability and cannot be allowed as a deduction. The CIT(A) concurred with the view of the AO. The CIT(A) observed that ex-gratia payment was a liability which becomes ascertained only on approval by the Government and since no such approval was given in the previous year relating to Assessment Year 2009-10, the liability was an unascertained liability and contingent and therefore cannot be allowed as a deduction. The CIT(A) however directed that the amount should be allowed in the Assessment Year in which the payment is made so that the assessee does not suffer double taxation.

5. Aggrieved by the order of the CIT(A), the assessee has raised grounds 2 to 4 before the Tribunal. The primary contention of the learned Counsel for the assessee before the Tribunal was that the liability in question was not a contingent liability and in this regard, placed reliance on the decision of the Hon'ble Supreme Court in the case of Bharat Earth Movers Vs. CIT 245 ITR 428 (SC). In the aforesaid decision, the question for consideration was whether provision for liability on account of leave encashment of employees could be disallowed as being a contingent liability. The Hon'ble Supreme Court laid down that if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What is important is the incurring of the liability and ascertainment of the quantum of liability with reasonable certainty. If the above requirements are satisfied, the Court held that the liability is not a contingent one. The learned Counsel drew our attention to page 233 to 251 of the Paper Book wherein the assessee has given the basis of the quantification of the liability of Rs.18,58,958/-. A specific query was raised by the Bench as to what is the basis on which ex-gratia payment was sanctioned by the Government. The learned Counsel for the assessee submitted that the quantification as given in pages 233 to 251 is based on the Rules / Policy of the Government regarding payment of

ex-gratia. It was submitted by him that the actual payment was made by the assessee on 06.04.2010 and therefore the quantification as done by the assessee cannot be faulted. From pages 233 to 251 of the Paper Book what we have notice is that the payment is in reference to the Financial Year 2008-09 relevant to Assessment Year 2009-10. The order of Managing Director approving payment is stated to be dated 31.03.2010. Prima facie it appears that the quantification of the liability at Rs. 18,90,000/- by the assessee to be true to the extent of Rs. 18,66,328/- which is the actual payment made towards ex-gratia and approved by the Government. We are, however, of the view that the assessee has to furnish the evidence on the basis of which he quantified the liability at Rs.18.90 lakhs and what is the Rules / Policy under which ex-gratia payments are made and how the quantification made by the assessee is in accordance with the Rules / Policy of the Government in this regard. We therefore deem it fit and appropriate to remit the issue to the AO for fresh consideration with the direction to the assessee to establish conditions necessary for considering the liability in question as ascertained liability on the basis of the principles laid down by the Hon'ble Supreme Court in the case of Bharat Earth Movers (supra). The AO will afford opportunity of being heard to the assessee before deciding the issue. Thus the relevant grounds of appeal of the assessee are treated as allowed for statistical purposes.

6. The next disallowance which is challenged in the appeal for Assessment Year 2009-10 with regard to the disallowance made under section 14A of the Act by the AO. The grievance of the assessee on this disallowance is projected in ground Nos.5 to 10 of the grounds of appeal. As far as the disallowance of expenses under section 14A of the Act is concerned, in the order dated 19.03.2015 passed under section 143(3) r.w.s. 254 of the Act, the AO has observed that the assessee has earned dividend income of Rs.7,70,76,402/- which is claimed as exempt income under provisions of the Act. The AO also noticed that the assessee had incurred interest expenditure of Rs.2,50,93,000/-. The AO proposed to disallow proportionate interest expenditure by applying Rule 8D(2)(ii) of the Act. The assessee did not offer explanation with regard to the source of funds out of which investments were made. The AO therefore concluded as follows:

*"6.9 The investments have flown from a common pool of funds, -the current accounts. The business receipts and payments as well investments are made from these accounts. The company has not maintained separate records in report of its income not forming part of total income. Therefore, it cannot be assumed with any degree of certainty that the investments were made exclusively out of surplus funds. Considering the commonality of the expenses, having regard to the accounts, not being satisfied that the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of total income. I am satisfied the assessee's claim that no expenditure is incurred, is not correct and therefore, the provisions of section 14A are hereby invoked and applied. Considering the fact that such indirect expenses cannot be allocated to any specific head of income and also that the assessee does not maintain the accounts in such manner as to enable to identify the expenditure relating to exempted income, the provisions of section 14A are attracted and accordingly are applied."*

7. The AO also was of the view that in the absence of any explanation regarding disallowance of other expenses in terms of Rule 8D(2)(iii) of the Act, he had to apply the provisions of the Rules and make a disallowance. Accordingly, the AO made a disallowance under section 14A of the Act read with Rule 8D(2)(ii) and (iii) as follows:

*"6.18 Assessee company has submitted vide letter dated 18.03.2015 that for the purpose of Rule 8D the amount of total assets on the first day of the ..:7revious year is at Rs. 517,27,23,000 and the last day of the previous year is at Rs. 438,48,47,000. Assessee's contention is not acceptable, since as per the provisions of Rule 8D the total assets as appearing in the Balance Sheet are to be taken into account. According to the financials submitted by the assessee,*

Balance sheet figures are Rs. 517,27,23,000/- and Rs. 359,69,71,000/- as at 31.03.2008 and 31.03.2009 respectively. Hence, while computing under Rule 8D, the total of assets as appearing in the Balance Sheet are considered.

6.19 Therefore the disallowance attracted u/s 14A read with Rule 8D is as follows:

A	Total amount of Direct Interest / other expenses pertaining to tax exempt investments u/r 8D(i)	Nil		
B	Total amount of indirect interest expenditure	Rs. 2,50,93,000		
		AY 08-09	AY 09-10	Average
C	Average amount of tax exempt investments	20,00,00,000	57,00,00,000	38,50,00,000
D	Average amount of total assets	359,69,71,000	517,27,23,000	438,48,47,000
E	Proportionate indirect interest to be disallowed	$B \times C / D$	Rs. 22,03,225	
F	0.5% of average amount of tax exempt investments			Rs. 19,25,000
G	Total disallowance Attracted U/s 14A read with Rule 8D	$A + E + F$	Rs. 41,28,225	

8. In the order passed by the AO under section 143(3) of the Act dated 31.01.2017 giving effect to the directions of the Hon'ble High Court, the AO observed as follows and confirmed the original disallowance made in the order dated 19.03.2015:

*"In so far as the source of investment relating to the exempt income is concerned, the assessee has not provided any clarity or distinction in the source of use of funds, whether from borrowed or from temporary surplus funds, as the investment has flown from a common pool of funds viz. the current account. In such a scenario such expenditure is to be disallowed. In all other cases where a direct nexus cannot be established between the expenditure and the exempt income the provisions of section 14a read with rule 8D are applied. This is the essence of this section. The*

*business receipts and payments as well as investments are made from these accounts. The company has not maintained separate records in report of its income not forming part. of total income. Therefore, it cannot be. assumed with any decree of certainly that the investments were made exclusively out of surplus funds. Considering the commonality of the expenses, having regard to the accounts of the assessee, regarding the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of total income, the undersigned is satisfied that the assessee's claim that no expenditure is incurred, is not correct and therefore, the provisions of section 14a are hereby invoked and applied. Considering the fact that such indirect expense cannot be allocated to any specific head of income and also that the assessee does not maintain the accounts in such manner as to enable to identity the expenditure relating to exempted income, the provisions of section 14A are attracted and accordingly applied.*

*The above points are supported by the following case laws:*

*i) Indian Sugar Exim Corpn. Ltd. Vs. DCIT in ITA No. 1042(Del)/2005, dated 05/12/2008*

*ii) Decision of Apex Court in CIT Vs. Walfort Share & Stock Brockers P Ltd 326ITR 0001.*

*iii) Judgement of the Honible High Court of Bambay in the case of Godrej & Boyce Mfg. Co Ltd dated 12/08/2010*

*iv) ACIT Vs. Citicorp Finance (India)Ltd 108 ITD 457 ITA Nos.971, 972/Bang/2018 and 1925/Bang/2017*

*v) CIT Vs. SG Investment and Industries Limited [2004] 89 ITD 44*

*vi) Kalpatharu Construction Overseas (P) Limited Vs. CIT [2007] 13 SOT 194 (Mum)*

*A detailed discussion on the aforementioned issued are already discussed in the Assessment order dated. 19.03.2015. with regard to the computation submitted by the assessee, the same is not acceptable as they are contrary to the records available and hence the computation as carried out in the Assessment Order holds good. "*

9. On appeal by the assessee, the CIT(A) confirmed the order of the AO. The following are the relevant observations of the CIT(A):

*" 6 5 - In the present case it is seen that the AO has placed reliance on the elaborate findings contained in the original assessment order u/s 143(3) r.w.s. 147 r.w.s. 254 dated 19/03/2015. The assessee has failed to furnish (during the impugned assessment proceedings) as well as the present appeal proceedings, any specific fund-flow break-up or justification to counter or negate the AO's findings in the said original order. This leads to the conclusion that. a substantial amount of fund applied towards the earning of exempt income, came from borrowed funds. It is therefore held that the nexus between the source of funds and its application towards exempt income was quite evident, in the given facts & circumstances and as also brought out in the original assessment order dated 19/03/2015.*

*In background of the above discussion, facts & circumstances of the case and the legal position on the issue, the disallowance to the extent of Rs. 18,87,663/-made on account of proportionate interest, is to be upheld.*

*6.6. The AO made a disallowance of Rs. 19,25,000/- (under rule 8D(iii)) on account of the sum being 0.5% of average amount of tax- exempt investments. There is no dispute in the fact that,*

*whenever exempt income is earned, certain Indirect / common expenditures would always be attributable to such receipts. In this view of the matter, the application of Rule 8D(iii) r.w.s 14A, has to be upheld in principle. It is also apparent in the present case that, statedly there is exempt income earned during the year to the extent of Rs. 7,70,76,407/-. The jurisdictional courts have held there can be application of section 14A r.w.s. 8D(iii) in a particular case, only to the of exempt income which has been earned during the year. In the present case, the AO has recorded that the appellant earned dividend income of Rs. 770,76,407/-, during the current year, which was claimed as exempt. In respect of clause (iii) of 8D of I.T. Rules, one-half percent of average value of tax-free investments is suggested for any other indirect expenditure. The indirect expenditure is normally estimated even under the standard accounting principles as per the requirements of section 14A. The rule suggests a prescribed percentage in this regard. Rule 8D(i) and (ii) may require examination of accounts and various details by the AO for making the disallowances whereas on the other hand, no such exercise is required in respect of Rule 8D(iii), as the percentage of disallowance is fixed with reference to average tax exempt investments.*

*In background of the discussion in the preceding paras, the disallowance made by the AO in terms of section 14A r.w.r.8D(iii) is upheld at the figure of Rs. 19,25,000/- being less than Rs. 7,70,76,407/- ,the extent of Exempt Income earned by the appellant, during the year. "*

10. Learned Counsel for the assessee submitted before us by drawing our attention to page 182 of the assessee's Paper Book which contained the profit and loss account for the year ended 31.03.2009 that the turnover realizations were Rs.8,22,841.26 lakhs and this was a sufficient source of funds for investments that yielded tax free income. No other material was placed before us nor any explanation except the same explanation as put forth before CIT(A) was made before us. With regard to disallowance under Rule 8D(2)(iii) of the Act, no submissions were made.

11. We have considered the submissions of the learned Counsel for the assessee and are of the view that the explanation given by the assessee before us is not sufficient to avoid the disallowance in terms of Rule 8D(2)(ii) of the Rules. The assessee has to establish by necessary fund flow statements that burrowed funds on which interest paid was not utilized for the purpose of making investments with yielded tax free income. In these circumstances, we are of the view that the disallowance made by the Revenue authorities by invoking the provisions of section 14A of the Act read with Rule 8D(2)(ii) and 8D(2)(iii) of the Rules deserves to be upheld and the same is upheld. The grounds of appeal are accordingly dismissed.

12. In the result, ITA No.971/Bang/2018 is treated as partly allowed for statistical purposes.

13. ITA No.972/Bang/2018

In this appeal, the grounds 2 to 4 raised by the assessee is with regard to disallowance of a sum of Rs.38,90,000/- towards ex-gratia payments. This issue is not the subject matter of the Order of Assessment dated 31.01.2016 passed pursuant to the directions of the Hon'ble Karnataka High Court. In fact, no grounds of appeal has been raised by the assessee in this regard before the CIT(A). Consequently, these grounds are dismissed as not arising out of the order of the CIT(A). We however observe that this issue arises out of an order passed under section 143(3) r.w.s. 147 of the Act, dated 20.03.2015 for Assessment Year 2010-11 and the appeal in ITA No.1925/Bang/2017 deals with the aforesaid ground. The issue will be adjudicated while deciding the said appeal.

14. The second issue raised by the assessee in this appeal is the disallowance under section 14A of the Act. The grievance in this regard is projected by the assessee in grounds 5 to 11 of the grounds of appeal. The facts are identical to the facts as it prevailed in Assessment Year 2009-10. As far as Assessment Year 2010-11 is concerned, the AO recorded identical reasons for making disallowance

under section 14A of the Act and this emanates from the Order of Assessment dated 27.02.2013 in which the AO has given the following findings:

4.5 The assessee has submitted that the daily collection amount has been invested in mutual funds in order to avoid the funds remaining idle in current accounts, that too after fulfilling all requirements such as advances, weekly payments and revenue and capital expenditures of the Corporation. But it is seen that the Corporation has also been making use of loan funds/overdraft facility for giving advance to distillers/suppliers etc. This has resulted in financial expenses to the extent of Rs. 55,58,000/- being paid in the year, thus reducing the profit of the assessee to that extent.

4.6 By making investment in mutual funds, the assessee has also earned Rs. 7,16,78,000/- of tax exempt income. Therefore, it can be seen that the assessee is trying to earn tax exempt income, while at the same time borrowing money from banks for its working capital requirements. It would have been prudent on the part of the assessee to reduce the working capital loan and payment of interest by utilizing the excess funds available with it.

4.7 Therefore, Sec.14A read with rule 8D is applicable in this case. Whenever, a direct nexus can be proved between the amount borrowed and amount invested in tax exempt investments, the interest paid on such loans can be disallowed. But in all other cases, where direct nexus cannot be established between the amount borrowed and amount invested in tax exempt investment, the Sec.14A read with Rule 8D helps in quantifying the indirect expenses incurred in earning tax exempt income. This is the main reason of constitutionality of Sec.14A read with rule 8D.

4.8 Therefore the disallowance attracted u/s14A read with Rule 8D is as follows:

A] Total amount of Direct Interest/other expenses NA pertaining to tax exempt investment

B] Total amount of Indirect interest pertaining to Rs.55,58,000 tax exempt investment

	AY 2009-10	AY 2010-11	Average
C] Average amount of tax exempt investment	10,00,00,000	57,00,00,000	33,50,00,000
D] Average amount of total assets	125,95,05,000	62,33,27,000	94,14,16,000

E] Proportionate indirect interest to be disallowed =  $BXC = Rs.19,77,797$

F] 0.5% of average amount of tax exempt investment =  $Rs.16,75,000$

G] Total disallowance u/s14A read with Rule 8D =  $A-4-E+F = Rs.36,52,797$

15. The AO in the Order of Assessment dated 31.01.2015 has followed the findings of the AO in the

order dated 27.02.2013. On appeal by the assessee, the CIT(A) confirmed the order of the AO. In the findings of the CIT(A) in this regard are identical to findings of Assessment Year 2009-10. Submissions made by the learned Counsel for the assessee are identical to the submissions made in Assessment Year 2009-10. We have already rejected similar contention raised on behalf of the assessee. The conclusions arrived at in this regard in Assessment Year 2009-10 will hold good for Assessment Year 2010-11 also. Accordingly, relevant grounds of appeal raised by the assessee are dismissed.

16. The other issues raised by the assessee is with regard to computation of tax liability under section 115JB of the Act and the grounds of appeal in this regard raised by the assessee reads as follows:

*"12. The learned Commissioner of Income-tax (Appeals) failed to adjudicate the ground of the appellant that the learned Assessing Officer is not justified in law in computing the tax under section 115,JB of the Act on the facts and circumstances of the case.*

*13. The learned Commissioner of Income-tax (Appeals) failed to adjudicate the ground of the appellant that the learned Assessing Officer computed the tax liability under section 115,JB of the Act without giving a show cause notice to the appellant and consequently the computation made is in violation of principles of natural justice and requires to be deleted on the facts and circumstances of the case.*

17. We are of the view that the computation of income under section 115JB of the Act is automatic and the conditions laid down in section 115JB of the Act are satisfied. It is not the case of the assessee that in computing the income under section 115JB of the Act, there has been violation of the provisions of those sections. In such circumstances, we are of the view that there is no merit in ground Nos.12 and 13 raised by the assessee and accordingly the same is dismissed.

18. In the result, ITA No.972/Bang/2018 is dismissed.

19. **ITA No.1925/Bang/2017**

This appeal relates to Assessment Year 2010-11. The AO passed an order dated 20.03.2015 under section 143(3) r.w.s. 147 of the Act and in this order, he disallowed a sum of Rs.38.90 lakhs being ex-gratia payment. The contention of the assessee was that provision for ex-gratia payment was an ascertained liability and not contingent. The stand of the assessee and AO in this regard are identical to the similar issue decided in Assessment Year 2009-10. The CIT(A) confirmed the order of the AO. The directions given in Assessment Year 2009-10 remanding this issue to the AO for consideration afresh will hold good for Assessment Year 2010-11 also. Accordingly, the AO is directed to examine this issue as per the directions given in Assessment Year 2009-10. The order of CIT(A) is set aside to this limited extent.

20. The assessee has also raised an issue with regard to validity of proceedings under section 148 of the Act. It is the case of the assessee that notice under section 154 of the Act was issued on the issue of making addition on account of provision for ex-gratia payment and after receipt of reply from the assessee, proceedings order under section 154 of the Act were not continued but a notice under section 148 of the Act was issued. It is the plea of the assessee that having initiated proceedings under section 154 of the Act, the AO cannot issue notice under section 148 of the Act on the ground of belief regarding escapement of income. We are of the view that the provisions under section 154 and 148 of the Act are for different purposes and so long as conditions for initiating proceedings under section 148 of the Act are satisfied, the initiation of proceedings cannot be held to be invalid. We therefore concur with the view of the CIT(A) on this issue.

21. In the result, appeal by the assessee is treated as partly allowed for statistical purposes.

22. In the result, ITA Nos.971/Bang/2018 and 1925/Bang/2017 are partly allowed for statistical purposes and ITA No.972/Bang/2018 is dismissed.

Pronounced in the open court on the date mentioned on the caption page.

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**Customized Notes**

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