

IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

Income Tax Appeal No.458 of 2015 (O&M)

DATE OF DECISION: 3rd February, 2017

Punjab Tractors Ltd. SAS, Nagar, Mohali.

....Appellant

versus

Commissioner of Income Tax, Patiala and another

.....Respondents

**CORAM:- HON'BLE MR.JUSTICE S.J. VAZIFDAR, CHIEF JUSTICE
HON'BLE MR. JUSTICE DEEPAK SIBAL, JUDGE.**

Present: Mrs.Radhika Suri, Senior Advocate with
Ms. Rinku Dahiya, Advocate, and
Mr. Manpreet Singh, Advocate, for the appellant.

Mr. Zora Singh Klar, Advocate,
for the respondents.

..

S.J. VAZIFDAR, CHIEF JUSTICE:

This is an appeal against the order of the Income Tax Appellate Tribunal confirming the order of the Commissioner of Income Tax (Appeals). The matter pertains to the assessment year 2008-09.

2. The appeal is admitted on the following substantial questions of law framed by us:-

- i) Whether the Assessing Officer had recorded satisfaction that the appellant-assessee's claim was incorrect?
- ii) Whether the Income Tax Appellate Tribunal had erred in upholding the application of Rule 8-D of the Income Tax Rules, 1962?
- iii) Whether the Tribunal erred in applying the provisions of Rule 8D(2)(ii) to the interest paid

as opposed to the net interest earned by the appellant?

The appellant also raised the following question of law which it did not press:-

- iv) Whether in facts and circumstances of the case, the Income Tax Appellate Tribunal had fallen in error in not excluding the value of investment in subsidiaries from the computation under Rule 8D?

3. The appellant filed its return of income declaring a business income of ₹ 1,05,52,20,790/-. The case was taken under scrutiny. The assessee derives income from the manufacturing and sale of tractors, harvester combines, forklifts and components/spares. During the assessment year 2008-09 it declared a profit of about ₹ 97.10 crores on a turnover of about ₹ 988 crores.

4. The Assessing Officer sought details of the bifurcation of the expenses incurred on exempt income and taxable income and called upon the assessee to show-cause why the expenses attributable to exempt income should not be disallowed on pro-rata basis and added to the returned income. The Assessing Officer rejected the assessee's contention that no expenditure was incurred for earning the dividend income as it received the dividend by ECS credit. He held that the assessee had invested ₹ 6 crores in different securities which being volatile in nature required the assessee to keep constant vigil on the movements of prices as well as the financial group viability of the company. This he observed would require the company to incur expenses, including the salaries of persons entrusted with the job of

keeping a 'constant vigil' on the movements of prices. He further held that separate records, including correspondence with the portfolio managers, stock exchange, would be required to be kept and statutory guidelines such as maintenance of statutory records would have to be maintained and board meetings held. The reference to ₹ 6 crores appears to be an error for admittedly the assessee invested an amount of about ₹ 150 crores in different securities. In other words, the Assessing Officer held that the administrative expenses to manage such a large portfolio would obviously have been incurred. The Assessing Officer also rejected the assessee's contention that it had made the investments "way back" observing that if the funds were not blocked in these securities they would have been available to the assessee which would have obviated its need to borrow funds carrying interest from banks. Lastly, the Assessing Officer observed that the assessee had for long been paying heavy interest on the borrowed funds and that there was a direct nexus between the investments and borrowed funds. While summing up the Assessing Officer held that the assessee had deployed sufficient staff and officers to handle its investment portfolio incurring substantial amount of expenditure for various operations and that the assessee did not provide separate details of the expenses relating to dividend income. On this issue, the assessee concluded as follows:-

"I have, therefore, to treat income earned as criteria to estimate expenses incurred to earn exempted income, accordingly, the expenses are apportioned as under:-

Exempted income : 225.72 lacs

Trading income : 96958.58-69089.21-1692.29 = 26177.08 lacs

Operating expenses + Finance charges =

18162.04 - 1457.74 = 16704.30 lacs.

Expenditure attributable to exempted income

<u>16704.30 x 225.72</u>	= 144.03 lacs.
<u>26177.08</u>	

Accordingly, addition of ₹ 144.03 lacs is made to the returned income of the assessee. Penalty proceedings u/s 271(1)(c) of I.T. Act for concealment/furnishing inaccurate particulars have been initiated separately."

5. Before the CIT (Appeals) the assessee relied upon the fact that for the assessment year 2004-05 the issue had been settled in its favour by the Tribunal and that an appeal against that order had been dismissed by this Court in ITA No. 453 of 2010. The CIT (Appeals), however, noted that the appellant ultimately admitted that the facts in that year and the facts in the assessment year in this appeal were not the same as in the assessment year 2004-05 the addition made under section 14A was deleted mainly on the ground that the investments in the shares of the Indian Companies had been made in the past years and the dividend income from those investments was claimed as exempt in the year 2004-05 and that no part of the interest expenditure was attributable to those investments. On the other hand in the assessment year 2008-09 which falls for consideration, fresh investments yielding tax free income had been made. Moreover the facts of the assessment year 2009-10 were similar to the assessment year in question and the assessee had itself disallowed certain expenses under section 14A which indicated that the assessee was of the opinion that the tax free income calls for disallowance of expenditure.

The assessee expressly contended that the operating and finance expenses incurred by it had no nexus

with the earning of dividend income and that all the investments were made by it out of its profits and not out of borrowed funds. This submission was sought to be supported on the basis of the assessee's audit accounts. A fund flow statement for the corresponding financial year 2007-08 was relied upon and is annexed as Annexure A-9 to this appeal. The net funds generated during the year was ₹ 2,91,55,000/- whereas the fresh investments in securities yielding exempt income were only about ₹ 150 crores. In other words the interest free funds available to the assessee were more than the value of the investment in securities yielding exempt income.

6. The CIT(Appeals) held that the question of apportionment comes only in respect of such expenditure which are composite or indivisible and that section 14A has within it the implicit notion of apportionment in cases where expenditure is incurred for composite/individual activities in which taxable and non-taxable income is received. It is further held that when the assessee claims that no expenditure had been incurred or allocates the expenditure in relation to the exempt income, the Assessing Officer would be entitled to determine the amount of expenditure incurred in relation to the tax free income if the circumstances specified in Section 14A are satisfied. The CIT(Appeals), therefore, accepts that if bifurcation is possible, there would be no question of invoking Rule 8D for apportioning the expenses relating to taxable income and tax free income. The CIT (Appeals) then held as under:-

"In this case, evidently the expenditure is incurred for composite activities in which taxable and non-taxable income is received. It is only for this reason that the

A.O. has applied his method of determining expenditure incurred for earning the tax free income. However, in the present scenario, in my opinion, Rule 8D is the appropriate method for determination of expenditure incurred for the purpose of earning tax free income which has been prescribed by the Income Tax Rules, 1962. The A.O. has duly recorded his satisfaction also that expenditure is incurred for earning the tax free income. Moreover, the appellant has also not substantiated with proof that investments are not made out of borrowed fund. Under the facts and circumstances of the case, disallowance of expenditure is called for under the provisions of section 14A on the tax free income earned from the investments etc. The appellant himself has also given a suo moto calculation for disallowance to be made under Rule 8D(ii) and has also contended that the method adopted by the A.O. is not correct. The case laws cited by the appellant are distinguishable as rule 8D has not been apparently considered therein. Considering the entirety of the facts, I am of the opinion that the tax free income calls for disallowance under section 14A. The A.O. is directed to verify the working given by the appellant and thereafter apply rule 8D to compute the disallowance under section 14A. The A.O. during the course of assessment proceeding has made the additions u/s 14A of the I.T. Act '61 in line with previous year and initiated penal proceedings. As discussed above, because of the changed circumstances in this year, in my opinion, the addition made by the A.O. is not covered by the order of the Hb' ITAT (supra) and therefore it is held that section 14A is applicable subject to application of rule 8D. Penal proceedings may be considered by A.O. as per law."

7. We will deal with these observations after referring to the impugned order passed by the Tribunal.

8. The Income Tax Appellate Tribunal rejected the contention that the Assessing Officer had not given any reasons nor pointed out which expenditure was allocable to the exempt income before invoking Rule 8D. After quoting the relevant part of the assessment order, the Tribunal held that the Assessing Officer had given his reasoning. The Tribunal observed as under:-

"..... It is a common knowledge that the investments in shares and mutual fund by the Corporate sector requires big financial efforts and are handled by a department known as Treasury operations. In fact this is one of the important functions of the Finance Department to handle surplus funds with respect to liquidity, safety and at the same time to generate maximum returns. Therefore, it cannot be said that no expenditure is required to be incurred for making investments and receiving dividends. Firstly the Treasury Department has to identify the surplus funds and availability of same at the various points of time then investments have to be identified keeping the liquidity requirements of the company in mind and then the financial investments are made and rotated as per the liquidity and other requirements of the company. All these activities require involvement of various management and finance personnel which involves expenditure. Therefore to say that the assessee has not incurred any expenditure or the Assessing Officer has not pointed out any reason, is totally incorrect. In view of this matter, Rule 8D has been rightly invoked by the Assessing Officer.....
sic- CIT(Appeals)."

The last two words "Assessing Officer" are admittedly an error. What was meant is the Commissioner of Income Tax (Appeals).

"19. We also agree that if no interest expenditure has been incurred in assessment year 2009-10, then no proportionate disallowance can be made out of interest and accordingly we

direct the Assessing Officer to verify this aspect and then if no interest expenditure has been incurred then no disallowance should be made."

Although paragraph-19 refers to the assessment year 2009-10, it is a general proposition. For reasons we will shortly state we are entirely in agreement with the observations made in paragraph-19.

9. We had reserved the judgment in this appeal. Subsequently Mrs. Suri, the learned senior counsel appearing on behalf of the appellant-assessee requested us not to deliver the judgment stating that she had come across certain judgments in view of which our judgment dated 19.09.2016 in *Commissioner of Income Tax (Central) Ludhiana v. M/s Hero Cycles Limited, Ludhiana*, ITA No. 44 of 2003 which was relied upon by Mr.Klar for the respondent is per-incurium. By our order dated 01.12.2016, we recorded that this appeal alongwith certain other appeals had been placed on board for further arguments in the circumstances and for the reasons stated in our order dated 30.11.2016 passed in ITA Nos. 457 and 461 of 2015. In the order dated 30.09.2016, we recorded that even on an earlier occasion Mrs. Suri requested us not to deliver the judgment in this matter as she contended that our judgment dated 19.09.2016 in ITA No. 44 of 2003 *Commissioner of Income Tax, Ludhiana v. M/s Hero Cycles Ltd.* relied upon by Mr.Klar was under Section 80M and was, therefore, distinguishable and in any event contrary to at least five judgments of this Court which were specifically under Section 14A of the Act.

We were also to hear Income Tax Appeal No. 244 of 2016 *Pr. Commissioner of Income Tax, Patiala v. State Bank of*

Patiala. Some of the issues that arise in these appeals also arose in those appeals. She, therefore, requested us not to deliver the judgment till after the hearing in those appeals.

We accordingly heard further submissions and now proceed to deliver our judgment. By our order and judgment dated 30.01.2017 we disposed of Income Tax Appeal No. 244 of 2016 *Pr. Commissioner of Income Tax, Patiala v. State Bank of Patiala*. We, however, did not in that judgment deal with the issues that arise in this judgment as we held in favour of the assessee on another point altogether. We held that the assessee in that case held the securities not as investments but as stock-in-trade and that, therefore, section 14-A was not applicable.

Re; Questions (i) and (ii)

10. Section 14-A of the Income Tax Act, 1961 and Rule 8-D of the Income Tax Rules, 1962 read as under:-

"Section 14-A

Expenditure incurred in relation to income not includible in total income.

14A. (1) For the purposes of computing the total income under this Chapter, 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 this Act.

(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.

(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act:

Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001."

"RULE 8-D

[Method for determining amount of expenditure in relation to income not includible in total income.

8D. (1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with—

- a. the correctness of the claim of expenditure made by the assessee; or
- b. the claim made by the assessee that no expenditure has been incurred, in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

(2) The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely:—

- i) the amount of expenditure directly relating to income which does not form part of total income; and
- ii) in a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt, an amount computed in accordance with the following formula, namely:—

$$\frac{A \times B}{C}$$

Where A = amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year.

B = the average of value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

C = the average of total assets as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

iii) *an amount equal to one-half percent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year."*

(3) For the purposes of this rule, the "total assets" shall mean, total assets as appearing in the balance sheet excluding the increase on account of revaluation of assets but including the decrease on account of revaluation of assets but including the decrease on account of revaluation of assets."

11. Section 14A specifies the circumstances in which the Assessing Officer is entitled to determine the amount of expenditure incurred in relation to exempt income in accordance with such method as may be prescribed. The method prescribed is in Rule 8D of the Income Tax Rules, 1962 which was introduced with effect from the assessment year 2008-09. The conditions specified in sub-sections (2) and (3) of Section 14-A must exist in order to entitle the Assessing Officer to invoke Rule 8D. This is clear from the language of these sub-sections. Sub-section (2) provides that the Assessing Officer shall determine the amount of expenditure incurred in respect of exempt income in accordance with the method prescribed i.e. Rule 8D "if" having regard to the accounts of the assessee, he is not satisfied with the correctness of the assessee's claim in respect of such expenditure in relation to exempt income. The word "if" indicates that to invoke the method prescribed namely Rule 8D, the Assessing Officer must not be satisfied with the correctness of the assessee's said claim.

12. Sub-section (3) provides that the provisions of sub-section (2) shall apply in relation to a case where the assessee claims that no expenditure has been incurred by him in relation to exempt income. The opening words of sub-

section (3) make the provisions of sub section (2) applicable in relation to cases under sub section (3). Thus where an assessee claims that no expenditure has been incurred by him in relation to exempt income, the Assessing Officer can resort to Rule 8D only if having regard to the accounts of the assessee he is not satisfied with the correctness of the claim of the assessee that no expenditure has been incurred by him in relation to the income which does not form part of the total income under this Act.

13. Thus under sub sections (2) and (3) of Section 14A, an Assessing Officer can resort to Rule 8D only if he is not satisfied with the correctness of the assessee's claim in respect of the expenditure in relation to the income which does not form part of the total income under the Act or if he is not satisfied with the correctness of the assessee's claim that no expenditure has been incurred by him in relation to such income.

14. It is not necessary that the conditions specified both in sub-section (2) and sub-section(3) must be satisfied in order to enable the Assessing Officer to invoke Rule 8D. Sub-section (3) states that sub-section (2) "shall also apply" in relation to a case specified therein. The word "also" establishes this. For the purpose of invoking Rule 8D, it is not necessary, therefore, that the conditions in both the sub-sections exist. It is sufficient if the condition in either of the sub sections exist.

15. Our view is supported by the judgment of the Division Bench of the Bombay High Court in *Godrej and Boyce MFG. Co. Ltd. v. Deputy Commissioner of Income Tax and*

another, [2010] 328 ITR 81 (Bom). The Division Bench held as under:-

"33. Under sub-section (2), the Assessing Officer is required to determine the amount of expenditure incurred by an assessee in relation to such income which does not form part of the total income under the Act in accordance with such method as may be prescribed. The method, having regard to the meaning of the expression 'prescribed' in Section 2(33), must be prescribed by rules made under the Act. What merits emphasis is that the jurisdiction of the Assessing Officer to determine the expenditure incurred in relation to such income which does not form part of the total income, in accordance with the prescribed method, arises if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of the expenditure which the assessee claims to have incurred in relation to income which does not part of the total income. Moreover, the satisfaction of the Assessing Officer has to be arrived at, having regard to the accounts of the assessee. Hence, Sub section (2) does not ipso facto enable the Assessing Officer to apply the method prescribed by the rules straightaway without considering whether the claim made by the assessee in respect of the expenditure incurred in relation to income which does not form part of the total income is correct. The Assessing Officer must, in the first instance, determine whether the claim of the assessee in that regard is correct and the determination must be made having regard to the accounts of the assessee. The satisfaction of the Assessing Officer must be arrived at on an objective basis. It is only when the Assessing Officer is not satisfied with the claim of the assessee, that the legislature directs him to follow the method that may be prescribed. In a situation where the accounts of the assessee furnish an objective basis for the Assessing Officer to arrive at a satisfaction in regard to the correctness of the claim of the assessee of the expenditure which has been incurred in relation to income which does not form part of the total income, there would be no warrant for taking recourse to the method prescribed by the rules. For, it is only in the event of the Assessing Officer not being so satisfied that recourse to the prescribed method is mandated by law. Sub section

(3) of Section 14A provides for the application of sub section (2) also to a situation where the assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under the Act. Under the proviso, it has been stipulated that nothing in the section will empower the Assessing Officer, for an Assessment Year beginning on or before 1 April 2001 either to reassess under Section 147 or pass an order enhancing the assessment or reducing the refund already made or otherwise increasing the liability of the assessee under Section 154."

16. A Division Bench of the Delhi High Court has taken a similar view in *Maxopp Investment Ltd. v. Commissioner of Income Tax* [2012] 347 ITR 272 (Delhi). The Division Bench held as under:-

"41. Sub-section (2) of section 14A, as we have seen, stipulates that the Assessing Officer shall determine the amount of expenditure incurred in relation to income which does not form part of the total income "in accordance with such method as may be prescribed". Of course, this determination can only be undertaken if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. This part of section 14A(2) which explicitly requires the fulfillment of a condition precedent is also implicit in section 14A(1) [as it now stands] as also in its initial avatar as section 14A. It is only the prescription with regard to the method of determining such expenditure which is new and which will operate prospectively. In other words, section 14A, even prior to the introduction of sub-sections (2) & (3) would require the assessing officer to first reject the claim of the assessee with regard to the extent of such expenditure and such rejection must be for disclosed cogent reasons. It is then that the question of determination of such expenditure by the assessing officer would arise. The requirement of adopting a specific method of determining such expenditure has been introduced by virtue of sub-section (2) of section 14A. Prior to that, the assessing was free to adopt any reasonable and acceptable method."

17. We are in respectful agreement with the judgments of the Bombay High Court and the Delhi High Court in this regard.

18. The next question is as to whether it is necessary for the Assessing Officer to record his reasons for not being satisfied with the correctness of the assessee's claim.

19. It is mandatory for the Assessing Officer to record that 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 in relation to income which does not form part of the total income under the Act or that he is not satisfied with the assessee's claim that no expenditure had been incurred by him in relation to the income which does not form part of the total income under the Act.

20. The matter stands concluded by a judgment of this Court dated 27.01.2015 in *Commissioner of Income Tax-1, Ludhiana v. M/s Abhishek Industries Ltd. Ludhiana, ITA No. 320 of 2013*, where the Division Bench held:-

"Section 14A of the Act requires the Assessing Officer to record satisfaction that interest bearing funds have been used to earn tax free income. The satisfaction to be recorded must be based upon credible and relevant evidence....."

21. The judgment in *Maxopp Investment Ltd. (supra)* also supports this view namely that the Assessing Officer must record reasons for not being satisfied with the correctness of the assessee's contentions with regard to the aspects mentioned in sub sections (2) and (3) of Section 14A. It is true that the Delhi High Court merely states that such rejection must be for disclosed cogent reasons. The disclosure, however, can only be in writing. It can

hardly be suggested that the disclosure remains in the Assessing Officer's mind. The assessee is entitled to test the basis of the rejection of his contentions. This can be done only if the Assessing Officer records his reasons for his not being satisfied in writing.

22. The next question, therefore, is whether the Assessing Officer has disclosed cogent reasons for invoking the method prescribed in section 14A(1), namely Rule 8D. Mrs. Suri's submission that the Assessing Officer had not recorded his satisfaction for invoking Rule 8D is not well founded. In our view, however, he has.

23. We have already quoted the relevant part of the assessment order. The Assessing Officer concluded this aspect by observing that the assessee had deployed sufficient staff/officers to handle its investment portfolio for which it would have incurred substantial expenditure for various operations. Infact the Assessing Officer came to the conclusion that a decision to invest a large amount of about ₹ 150 crores would require not merely the funds but also the deployment and use of the assessee's administrative machinery. The assessee claimed that it had not incurred any expenditure whatsoever. It is reasonable to presume that an investment of this nature would require the deployment of the assessee's intellectual, physical and financial resources.

24. In *Commissioner of Income Tax (Central) Ludhiana v. Hero Cycles Ltd.* [2016] 74 Taxmann.com 254 (P&H) we considered a case under section 80M of the Act. We had raised the following substantial question of law:-

- (v) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in deleting the proportionate management expenses allocated against dividend income for purpose of computation of deduction u/s 80M?

Although the judgment is under section 80M, the ratio would apply equally to section 14A of the Act. Paragraphs 15 to 25 of the judgment read as under:-

"15. Section 80(M) (1) (ii) and 80AA of the Act, as they stood at the relevant time, read as under:-

"80M. Deduction in respect of certain inter-corporate dividends:-

1. Where the gross total income of a domestic company in any previous year, includes any income by way of dividends from another domestic company, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of such domestic company, a deduction of an amount equal to:-

i)

ii) In the case of any other domestic company, so much of the amount of income by way of dividends from another domestic company as does not exceed the amount of dividend distributed by the first mentioned domestic company on or before the due date.

..... .

80-AA. Computation of deduction under Section 80-M

Where any deduction is required to be allowed under Section 80-M in respect of any income by way of dividends from a domestic company which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, the deduction under that section shall be computed with reference to the income by way of such dividends as computed in accordance with the provisions of this Act (before making any deduction under this chapter) and not with reference to the gross amount of such dividends."

16. Admittedly, Section 80M applies only to income from other sources. Both the counsel agreed that in view of the judgment of the Supreme Court in *Distributors (Baroda) P. Ltd. vs. Union of India and others*, [1985] 155 ITR 120, it is the net dividend on which the deduction is to be determined for the purpose of Section 80M.

18. Mr. Mittal contended that in the present case the assessee's gross dividend is also the net dividend as the assessee has not incurred any expenses for earning the dividend received. No amount had been borrowed and no interest was paid in connection therewith.

19A. The Assessing Officer enumerated under a table the management expenses incurred by the assessee debited under the head "Administrative expenses".....

22. The Tribunal then observed that the assessee had not incurred any expenditure to earn the dividend income and that it had not even incurred any expenditure for the purpose of realizing the dividend. It was further observed that the assessee had not claimed any deduction under section 57 of the Act and that the Assessing Officer had not allowed any deduction while computing income by way of dividend.

This observation is without any basis. In the computation of income, there is no bifurcation of expenses for the investment.....

23. The Tribunal thereafter held that section 80(M) does not authorize an Assessing Officer to estimate the expenditure and recompute the income by way of dividend for the purpose of deduction allowable under section 80(M) of the Act.

24. Where the assessee does not provide any bifurcation of the expenditure incurred in respect of its income, the Assessing Officer has no option but to estimate the expenditure

and to recompute the income by way of dividend to arrive at the deduction that may be allowed under section 80M of the Act. Assuming that some portion of the expenditure is attributable to the dividend earned, the Assessing Officer must estimate the extent thereof. If the assessee furnishes proof or details of such expenditure to the satisfaction of the the Assessing Officer he may accept the same. however, the assessee does not furnish a bifurcation of the expenses or any reasonable basis for arriving at the same, the Assessing Officer has no option but to make a reasonable estimate of the same.

25. The Tribunal's observation that when an assessee claims that it has not incurred any expenditure for earning the dividend income, the onus of proof lies on the Assessing Officer to prove otherwise namely that the assessee has incurred the expenditure is correct. The Tribunal's further observation that the Assessing Officer had not brought out any material or evidence on record which may establish that the assessee had incurred any expenditure for the purpose of earning the dividend, is, however, incorrect. In cases such as this, the Assessing Officer is justified in presuming that some expenditure had been incurred for the purpose of earning the dividend. Even if the investments yielding the dividend are in group companies, it cannot be said that no expenditure for making the investments which yielded the dividend had been incurred. For instance there is a decision making process that is undertaken before making the investment. Group companies do not blindly invest in each other. Even the decision whether or not to invest in the group companies requires application of mind. If the investment is merely to yield the dividend the management of the investing company is bound to apply its

mind as to whether it would be a prudent investment or not. Even if an investment is only for the larger benefit of the group itself or for the benefit of the particular company in the group, the management of the investing company would have to apply its mind on a variety of issues including as to whether the investment would serve this purpose; whether the investment would be detrimental to the investing company and to weigh the pros and cons of such investment for itself and for the members of the group. Further the management of the funds on a regular basis and monitoring the investment even in group companies would be imperative. It is not even the assessee's case that there was an over all policy decision by which the investments had to be made irrespective of the facts and circumstances obtaining at any given point of time. Indeed it would be difficult to envisage such a situation. In cases such as this, therefore, there would arise a justifiable presumption that some expenditure would be required for the purpose of earning dividend on such investments. The onus would then shift to the assessee to establish that no expenditure whatsoever was incurred for earning the dividend. The Assessing Officer was, therefore, justified in coming to the conclusion that the assessee had incurred expenditure towards earning the said dividend. The assessee has not furnished any material in this regard. As we observed earlier, the Assessing Officer must, therefore, estimate the same if he satisfied that some expenditure for earning the dividend had been incurred."

25. Mrs. Suri firstly submitted that the observations in paragraph-25 of the judgment are incorrect. Till the observations are set-aside by the Supreme Court or by a larger Bench of this Court, we are bound by the same.

26. The contention that the observations must be restricted to cases under section 80M is not well founded. The basis on which we arrived at those conclusions would apply equally to a case under section 14A of the Act.

27. Mrs. Suri then submitted that the observations in paragraph-25 of the judgment are per-incurium being contrary to the earlier judgments of this Court in *Commissioner of Income Tax v. Winsome Textile Industries* [2009] 319 ITR 204 (P&H); *Commissioner of Income Tax v. Hero Cycles Ltd.* [2010] 323 ITR 518 (P&H); *Commissioner of Income Tax, Jalandhar-1, Jalandhar v. Deepak Mittal* [2014] 361 ITR 131 and unreported judgment of this Court dated 27.01.2015 in *Commissioner of Income Tax-1 Ludhiana v. M/s Abhishek Industries Ltd. Ludhiana*, ITA No. 320 of 2013. We will now deal with each of the judgments.

28. In *Commissioner of Income Tax v. Winsome Textile Industries* [2009] 319 ITR 204 (P&H), a Division Bench of this Court upheld the observations of the Tribunal which were set out extensively. The decision was based on the findings of fact that the assessee had not incurred any expenditure for making investments in the purchase of shares referred to therein and that, therefore, no disallowance was warranted under section 40A. The entire discussion by the Tribunal was related to whether the assessee had made the investment for purchase of shares out of the borrowed funds or invested its own funds. The question of administrative expenses and the effect thereof on Section 14A was neither raised before nor decided by this Court. Our judgment in *Commissioner of Income Tax v. Hero Cycles Ltd.* [2010] 323 ITR 518 (P&H) cannot be held to be per-incurium in view of the judgment of

Commissioner of Income Tax v. Winsome Textile Industries (supra).

29. For the same reason our judgment in *Commissioner of Income Tax (Central) Ludhiana v. Hero Cycles Ltd. [2016] 74 Taxmann.com 254 (P&H)* cannot be said to be per-incurium in view of the judgment in *Commissioner of Income Tax v. Hero Cycles Ltd. [2010] 323 ITR 518 (P&H)*. Here again the Division Bench set out the observations of the Tribunal in considerable detail and we will presume, affirmed them. These observations make it clear that the discussion related to the utilization of funds. The assessee contended that the entire investment had been made out of the dividend proceeds, sale proceeds, debenture redemption etc. The Tribunal found that the funds flow position showed that only the non-interest bearing funds had been utilized for making the investments. The Tribunal, therefore, held that on facts it did not find any evidence to show that the assessee had incurred interest expenditure in relation to earning the tax exempt income. It is in this context that the Tribunal observed that there was no nexus established by the Revenue in this regard and therefore, on a mere presumption the provisions of Section 14A cannot be applied.

These observations do not suggest that a presumption can never be made and an inference can never be drawn. The facts established did not warrant such a presumption. The Division Bench also held that in view of the findings of the Tribunal it was clear that the investment in the shares and funds were out of the dividend proceeds i.e. the assessee's own funds. It is in this back ground that

paragraph-5 of the judgment relied upon strongly by Mrs. Suri must be read. The Division Bench held:-

"5. Learned counsel for the appellant relies upon section 14A(2) and rule 8D(1)(b) to submit that even where the assessee claimed that no expenditure had been incurred, the correctness of such claim could be gone into by the Assessing Officer and in the present case, the claim of the assessee that no expenditure was incurred was found to be not acceptable by the Assessing Officer and thus disallowance was justified. We are unable to accept the submission.

6. In view of the finding reproduced above, it is clear that the expenditure on interest was set off against the income from interest and the investment in the share and funds were out of the dividend proceeds. In view of this finding of fact, disallowance under section 14A was not sustainable. Whether, in a given situation, any expenditure was incurred which was to be disallowed, is a question of fact. The contention of the Revenue that directly or indirectly some expenditure is always incurred which must be disallowed under section 14A and the impact of expenditure so incurred cannot be allowed to be set off against the business income which may nullify the mandate of section 14A, cannot be accepted. Disallowance under section 14A requires finding of incurring of expenditure where it is found that for earning exempted income no expenditure has been incurred, disallowance under section 14A cannot stand. In the present case, finding on this aspect, against the Revenue, is not shown to be perverse. Consequently, disallowance is not permissible. We have taken this view earlier also in I.T.A. No. 504 of 2008 in CTT v. Winsome Textile Industries Ltd., [2009] 319 ITR 204 (P&H), (decided on August 25, 2009), wherein it was observed as under (page 207):

"The contention raised on behalf of the Revenue is that even if the assessee had made investment in shares out of its own funds, the assessee had taken loans on which interest was paid and all the money available with the assessee was in common kitty, as held by this court in CIT v. Abhishek Industries Ltd., [2006] 286 ITR 1

and, therefore, disallowance under section 14A was justified."

These observations are in the context of the nature of the funds utilized/deployed for the purpose of making investments. As is evident from the first sentence in paragraph-5, the Division Bench proceeded on the finding of fact that the investment was out of dividend proceeds i.e. the assessee's own funds. It is with respect to such a situation that the Division Bench rejected the contention on behalf of the revenue that directly or indirectly some expenditure is always incurred which must be disallowed under section 14A. The Division Bench did not deal with the issue of administrative expenses.

30. In *Commissioner of Income Tax-1, Ludhiana v. M/s Abhishek Industries Ltd. Ludhiana*, ITA No. 320 of 2013, a Division Bench of this Court by its judgment dated 27.01.2015 quoted the observations of the Tribunal which were quoted by the Division Bench in *Commissioner of Income Tax v. Winsome Textile Industries [2009] 319 ITR 204 (P&H)*. The Division Bench went on to hold:-

"Section 14A of the Act requires the Assessing Officer to record satisfaction that interest bearing funds have been used to earn tax free income. The satisfaction to be recorded must be based upon credible and relevant evidence. The onus, therefore, to prove that interest bearing funds were used, lies squarely on the shoulders of the revenue. Thus, if the Assessing Officer is able to refer to relevant material while recording satisfaction that borrowed funds were used to earn interest free income as opposed to the assessee's own funds, the Assessing Officer may legitimately disallow such a claim. The Assessing Officer, however, cannot, by recording general observations, particularly where the assessee has denied using interest bearing funds, proceed to infer that interest bearing income must have been used to earn

exempted income. Section 14A of the Act, being in the nature of an exception, has to be construed strictly and only where the Assessing Officer records satisfaction, on the basis of clear and cogent material, shall an order be passed under Section 14A of the Act, disallowing such a claim. As there is no tangible material on record that could have enabled the Assessing Officer to record satisfaction in terms of Section 14A of the Act, findings recorded by the CIT(A) and the ITAT that the Assessing Officer has failed to discharge this onus are neither perverse nor arbitrary and, therefore, do not call for interference."

In this case also the dispute centred around whether the interest bearing funds or interest free funds were used. As recorded by the Division Bench, the Assessing Officer disallowed the dividend earned by the assessee that the interest bearing funds had been used to earn tax free income. The CIT (Appeals) set-aside this finding by holding that the Assessing Officer had failed to prove that the interest bearing fund was used by the assessee and the Tribunal affirmed the same.

The question of administrative expenses and the presumption to be drawn in respect thereof were neither raised before nor decided by the Division Bench.

31. Mrs. Suri submitted that the Assessing Officer can resort to Rule 8D only if he determines that the claim of the assessee in respect of expenditure in relation to income which does not form part of the total income under the Act is incorrect or where he determines that the assessee's claim that no expenditure has been incurred by him in relation to such income is incorrect. She further submitted that in order to come to such a conclusion the Assessing Officer must first determine the amount of expenditure incurred in relation to exempt income or he must determine that no expenditure was incurred in relation to exempt income for it is only then

that he would be in a position to come to the conclusion that he is not satisfied with the correctness of the assessee's claim in either case.

32. The first part of Mrs. Suri's submission is well founded but not the second. Both parts require a consideration of the nature of the lack of satisfaction required to entitle the Assessing Officer to invoke Rule 8D. The issue relates to the ambit of the expression "is not satisfied".

33. In our view it is sufficient if the Assessing Officer comes to the conclusion that the claim of the assessee in this regard is not correct. It is not necessary for him to decide the extent or the quantum of the incorrect claim. He must, however, correctly conclude that the claim of the assessee is incorrect. It is necessary for the Assessing Officer to rightly come to the conclusion that the claim of the assessee is incorrect. The language of Section 14(2) is "is not satisfied with the correctness of the claim" and not "reasonably doubts it" or "has reasons to doubt the correctness of the claim".

34. Mrs. Suri's reliance upon the word "determine" in sub section (2) of Section 14A as regards the second part of her submission is misplaced. The term "determination" in Section 14A(2) applies to the computation of the expenditure incurred in relation to exempt income by resorting to the method as may be prescribed. The method is prescribed by Rule 8-D. Under section 14A(2) where the Assessing Officer is not satisfied with the correctness of the claim in respect of the expenditure in relation to exempt income or the assessee's claim that no expenditure has been incurred in relation to

such income, 'he shall' determine the amount of such expenditure in accordance with the method prescribed, namely, Rule 8D. The word 'determine' in Section 14A(2), therefore, is in respect of the exercise to be undertaken for the purpose of computing the expenditure in relation to exempt income in accordance with the method as may be prescribed. The Assessing Officer is not required to quantify the amount prior to the invocation of Rule 8D.

35. For an Assessing Officer not to be satisfied with the correctness of the claim of the assessee, it is not necessary for him to determine the expenditure incurred for earning the exempt income. Indeed, if that were so, Rule 8D would be redundant. It is sufficient for the Assessing Officer to come to the conclusion that the claim of the assessee is not correct. It is not necessary, however, for him to determine the extent to which it is incorrect in order to resort to Rule 8D.

36. There would be several instances where an Assessing Officer can come to the conclusion that the claim is incorrect but would be unable to assess the extent of the inaccuracy. That is precisely the purpose of Rule 8D. For instance in the present case, the Assessing Officer was entitled to presume that a part of the expenses from the common fund are attributable to the expenditure incurred for earning the exempt income. He was entitled to resort to Rule 8D without determining the amount expended by the assessee towards earning the exempt income. Indeed if he could have done so, it would not have been necessary for him to resort to Rule 8D at all.

37. It follows, therefore, that Mrs. Suri's submission that a determination means an actual quantification of the expenditure incurred for earning exempt income is erroneous. As Mr.Klar rightly pointed out an Assessing Officer can on the basis of inferences, adverse inferences and reasonable presumptions come to the conclusion that the claim of the assessee in relation to such expenditure is not correct.

38. In the case before us, the Assessing Officer cannot be faulted for not being satisfied with the claim of the assessee. As we noted earlier the Assessing Officer was entirely justified in presuming that the assessee had incurred expenditure towards administrative activities necessary to earn the exempt income. If the presumption or inference is correct, as we have held it is, the Assessing Officer is entitled to resort to Rule 8D.

39. We are, however, unable to agree with Mr.Klar that the assessee is estopped from challenging the Assessing Officer's application of Rule 8D, as the assessee had itself furnished its working under Rule 8D. The assessee furnished a calculation only to show that the Assessing Officer's calculation is in any event incorrect. That is not an admission by the assessee that Rule 8D was validly invoked. It was only an alternative case assuming that Rule 8D was validly invoked or ought to be invoked.

40. The Assessing Officer on not being satisfied with the correctness of the claim by the assessee in respect of the expenditure incurred to earn exempt income ought to have applied Rule 8D which he did not. Instead he made an estimate on the basis that he considered to be reasonable. This he was not entitled to do. Where an Assessing Officer is not

satisfied with the correctness of the claim of the assessee, in this regard, he is bound by the provisions of sub section (2) of Section 14A to follow the prescribed method which at the relevant time was Rule 8D.

41. Questions (i) and (ii) are, therefore, answered in favour of the Revenue.

Re: Question (iii)

42. Mrs.Suri clarified that what is sought to be contended is that the assessee earned exempt income by investing its own funds and not from the interest bearing funds.

43. The application of Rule 8D does not preclude an assessee from contending that he has not incurred any expenditure towards interest to earn the exempt income. Rule 8D(2) provides that the expenditure in relation to income which does not form part of the total income shall be the aggregate of the three amounts mentioned in clauses (i) (ii) and (iii) thereof. The Assessing Officer must while applying Rule 8D compute each part of it. All the contentions of the assessee in regard thereto would be open. For instance, clause (ii) relates to the expenditure by way of interest which is not directly attributable to any particular income or receipt. It is open to the assessee in this regard to establish that it has not incurred any expenditure by way of interest during the previous year to earn the exempt income. The amount in clause (ii) of sub rule (2) of Rule 8D, would be nil where the assessee establishes that it has not incurred any expenditure by way of interest during the previous year to earn the exempt income.

Mrs. Suri's submission that if the value of clause-2 of Rule 8D is nil, Rule 8D would be inapplicable altogether is erroneous. Rule 8D is applicable whether the amount computed in respect of any part of it is nil or not. One variable may be nil and others may have a positive value. A nil value does not make the rule inapplicable. It only reflects upon the aggregate of the amounts determined under the three sub clauses of sub-rule (2).

44. Further to establish this, the assessee is entitled to invite the Assessing Officer to raise a presumption or draw inferences permissible in law. For instance, if an assessee establishes that its interest free funds were equal to or more than the interest bearing funds, it would be open to it to contend that presumption arises that the expenditure for earning exempt income was incurred from out of its interest free funds. By our order and judgment dated 06.09.2016 in *Commissioner of Income Tax, Jalandhar-1, Jalandhar v. M/s Max India Ltd. ITA No. 186 of 2013*, we came to this conclusion both on principle and on authority. We referred to several judgments including of the Supreme Court, the Bombay High Court and of the Delhi High Court. We have referred to these judgments extensively. It is unnecessary to reproduce the relevant portions thereof again in this judgment. It would be sufficient to note the judgments which we referred to in that judgment, namely, *East India Pharmaceutical Works Ltd. v. Commissioner of Income Tax 1997 Income Tax Reports 224 (SC)*, *Commissioner of Income Tax v. Reliance Utilities and Power Ltd. 2009 (313) ITR, 340 (Bombay)*, *HDFC Bank Ltd. v. Deputy Commissioner of Income Tax and others, 2016 (383) ITR 529 (Bombay)*, *Commissioner of Income Tax v. HDFC*

Bank Ltd. 2014 (366) ITR 505 and Bright Enterprises Pvt. Ltd. v. Commissioner of Income Tax 2016 (381) ITR 107.

If the presumption as held by us in *Commissioner of Income Tax (Jalandhar) v. Max India Ltd. (supra)* is applicable, the Assessing Officer is bound to apply the same and to take it into consideration even while considering the correctness of the assessee's claim regarding the expenditure in relation to the exempt income. In other words, in coming to the conclusion as to whether he is satisfied or not satisfied regarding the correctness of the assessee's claim about the expenditure in relation to exempt income, the Assessing Officer must decide whether the presumption ought to be raised or not. If he finds that the presumption ought to be raised then he must raise it before being satisfied or not satisfied regarding the correctness of the assessee's claim.

45. Mr.Klar on the other hand submitted that our judgment is not good law in view of the judgment of this Court in the case of *CIT v. M/s Abhishek Industries Ltd.* [2006] 286 ITR 1. Mrs. Suri, however, submitted that this judgment is in no longer good law in view of the judgment of the Supreme Court in *Hero Cycles Ltd. v. CIT* [2015] 379 ITR 347 (SC).

46. We leave the question as to whether such a presumption is valid and if valid whether it arises in this case open. The Assessing Officer must determine the same after taking all the provisions of law and the precedents into consideration.

47. If the Assessing Officer justifiably is not satisfied with the correctness of the assessee's claim regarding the expenditure, he must resort to Rule 8D entirely for the determination of the expenditure incurred with respect to the exempt income for the purpose of section 14A.

For instance, if the assessee claims that he has not incurred any interest expenditure but has incurred administrative expenses or vice-versa and the Assessing Officer disagrees with either claim, Rule 8D cannot be applied only in respect of any particular clause of sub-rule (2) of Rule 8D. He must then determine the amount of expenditure incurred in relation to exempt income entirely in accordance with Rule 8D.

48. Mr. Klar's submission that Rule 8D(ii) includes amounts other than interest such as bank charges for courier handling etc. is not well founded. Rule 8D(ii) refers only to interest. We cannot read into it words that are clearly not there.

49. In the circumstances, questions (i) and (ii) are answered in favour of the respondent-revenue. It is agreed that the computation under Rule 8D shall be carried out in the first instance by the Assessing Officer. Needless to add that the parties are always at liberty to question the same in accordance with law.

Question (iii) is answered as per the clarification furnished by us above.

Question (iv) was not pressed.

The appeal is accordingly disposed of.

(S.J. VAZIFDAR)
CHIEF JUSTICE

03.02.2017
ravinder sharma

(DEEPAK SIBAL)
JUDGE

NOTE:

Whether speaking/non-speaking: Speaking✓
Whether reportable: Yes✓