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IN THE HIGH COURT OF DELHI AT NEW DELHI

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DECIDED ON: 25.02.2015

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ITA 117/2015

JOINT INVESTMENTS PVT LTD Appellant
Through: Mr. Piyush Kaushik, Advocate.

versus

COMMISSIONER OF INCOME TAX Respondent
Through: Mr. Balbir Singh, Sr. Standing
Counsel with Mr. Angad Sandhu, Advocate.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE R.K. GAUBA

S.RAVINDRA BHAT, J. (OPEN COURT)

1. Issue notice. Mr. Balbir Singh, Sr. Standing Counsel accepts notice on behalf of the Revenue. With consent the appeal was heard finally.

2. The assessee is aggrieved by the order of the Income Tax Appellate Tribunal (hereafter referred to as "ITAT") in ITA 85/Del/2014 and urges that in the facts and circumstances, the ITAT fell into error in confirming the order of the Assessing Officer (AO)

with respect to the additions made under Rule 8D of the Income Tax Rules.

3. The brief facts are that the assessee is engaged in diverse investment activities and in the course of its business derives income from rent, sale of investments, dividend and interest. For AY 2009-10, it reported a loss of ₹52,56,197/-. *Inter alia* it had declared tax exempt income in the form of dividend to the tune of ₹48,90,000/-. The assessee volunteered ₹2,97,440/- as attributable under Section 14A for the purpose of disallowance. The AO on the basis of his own understanding of Rule 8D of the Income Tax Rules disallowed the sum of ₹52,56,197/- under Section 14A read with Rule 8D. The assessee's grievance was that the entire tax exempt income (₹48,90,000/-) was lower than the disallowance. It, therefore, appealed to the CIT (A) but met with no success. Its further appeal to the ITAT likewise met the same fate.

4. The ITAT upheld the orders of the authorities below and held *inter alia* that: -

“11. Now, we come to various other arguments by the learned counsel wherein he has disputed the quantum of the disallowance worked out by the Assessing Officer. The assessee's counsel has contended that the various expenses, viz., filing fees, house tax, conveyance, insurance of building and cars, electricity, building repair, printing & stationery, telephone expenses, audit fees, office rent, vehicles expenses, depreciation etc. were not incurred for earning of exempt income. From the working of the disallowance by the Assessing Officer which is already reproduced earlier in our order, it would be evident that all those expenses have not been considered by the Assessing Officer. In Part (i), the

Assessing Officer has considered Rs.2,97,440/- which assessee himself has admitted as a direct expenditure incurred for earning exempt income, viz., securities, transaction tax, depository charges and custodian fees. In Part (ii), only the interest has been considered and in Part (iii), half per cent of average investment has been considered. Therefore, these expenses which assessee claimed to have been not incurred for earning of exempt income have not been considered by the Assessing Officer at all. The assessee has also disputed the correctness of the disallowance of interest at Rs.34,08,582/-. However, we find that the disallowance as per Part (iii) itself is Rs.65,36,743/-. The assessee's counsel has not disputed the value of investment as taken by the Assessing Officer for the purpose of computing the disallowance at half per cent as provided by Rule 8D (2) (iii). The disallowance at half per cent of the investment is Rs.65,36,743/- while finally, the Assessing Officer restricted the disallowance to Rs.52,56,197/-. Therefore, whether the working of the disallowance of interest as per Rule 8D(2)(ii) is correct or not is of academic interest and, therefore, we do not wish to go into the details of the assessee's arguments with regard to the correctness of the disallowance of interest. At the cost of repetition, we reiterate that the disallowance worked out by the Assessing Officer which was the aggregate of three components as prescribed under Rule 8D(2) was Rs.99,45,325/-. But, finally, the Assessing Officer restricted the disallowance to Rs.52,56,197/-. Therefore, In our opinion, no relief is due to the assessee from the disallowance made by the Assessing Officer at Rs.52,56,197/-. The same is sustained and the assessee's appeal is dismissed."

5. Learned counsel urges that the mandate of Section 14A [especially the Section 14A (2)] escaped the attention of the ITAT as well as that of the AO and CIT (A). It was urged that in the present case since ₹2,97,440/- was volunteered as disallowance, the AO was

under a duty to first consider the merits of that claim and thereafter for valid grounds, if any, reject the contention before proceeding under Section 14A (3) - read with Rule 8D (2). Learned counsel highlighted that the sum volunteered, i.e., ₹2,97,440/- was in addition to *ad hoc* disallowance which was offered and accepted without scrutiny by the AO.

6. Learned counsel for the Revenue contended that given the structure and phraseology of Rule 8D, the interpretation of the CIT (A) and ITAT cannot be faulted.

7. During the course of hearing, counsel for the petitioner had relied upon a decision of this Court in *Commissioner of Income Tax VI v. Taikisha Engineering India Ltd.*, (ITA 115/2014, decided on 25.11.2014). The court had, in that judgment, highlighted the necessity in view of the peculiar wording of Section 14A (2) that computation or disallowance of the assessee, or claim that no expenditure was incurred for earning exempt income should be examined with reference to the accounts and only if the assessee's explanation is unsatisfactory, can the AO proceed further.

8. The Court in *Taikisha Engineering (supra)* pertinently observed: -

“Thus, Section 14A(2) of the Act and Rule 8D(1) in unison and affirmatively record that the computation or disallowance made by the assessee or claim that no expenditure was incurred to earn exempt income must be examined with reference to the accounts, and only and when the explanation/claim of the assessee is not satisfactory, computation under sub Rule (2) to Rule 8D of the Rules is to be made.

13. We need not, therefore, go on to sub Rule (2) to Rule 8D of the Rules until and unless the Assessing Officer has first recorded the satisfaction, which is mandated by sub Section (2) to Section 14A of the Act and sub Rule (1) to Rule 8D of the Rules.”

9. In the present case, the AO has not firstly disclosed why the appellant/assessee's claim for attributing ₹2,97,440/- as a disallowance under Section 14A had to be rejected. *Taikisha* says that the jurisdiction to proceed further and determine amounts is derived after examination of the accounts and rejection if any of the assessee's claim or explanation. The second aspect is there appears to have been no scrutiny of the accounts by the AO - an aspect which is completely unnoticed by the CIT (A) and the ITAT. The third, and in the opinion of this court, important anomaly which we cannot be unmindful is that whereas the entire tax exempt income is ₹48,90,000/-, the disallowance ultimately directed works out to nearly 110% of that sum, i.e., ₹52,56,197/-. By no stretch of imagination can Section 14A or Rule 8D be interpreted so as to mean that the entire tax exempt income is to be disallowed. The window for disallowance is indicated in Section 14A, and is only to the extent of disallowing expenditure “incurred by the assessee in relation to the tax exempt income”. This proportion or portion of the tax exempt income surely cannot swallow the entire amount as has happened in this case.

10. For the above reasons, the impugned order of the ITAT is set aside. The question of law is answered in favour of the assessee. Consequently, order of the AO is set aside. The initiation of penalty

proceedings also is set aside. The matter is remitted to the AO for fresh consideration in accordance with the above directions. The appeal is partly allowed.

S. RAVINDRA BHAT
(JUDGE)

FEBRUARY 25, 2015
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R.K. GAUBA
(JUDGE)

