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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% **Date of Decision** : 28th February, 2012.

\+ ITA 92/2011

CIT ..... Appellant
Through Mr. Sanjeev Sabharwal, sr. standing counsel

versus

MACHINO PLASTIC LTD ..... Respondent
Through Dr. Rakesh Gupta with Ms. Rani Kiyala, Advs.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

SANJIV KHANNA,J: (ORAL)

This appeal by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act', for short) pertains to assessment year 2001-02. After hearing counsel for the parties, we frame the following substantial question of law :

"Whether Income Tax Appellate Tribunal was justified

in deleting the disallowance under Section 14A of the Income Tax Act, 1961?"

2. The assessee is a company and has made investment in equity shares, preference shares and bonds as per details given below :

S. No.	Particulars	Year of Investment	Amount Invested	Source of Fund	Dividend Received during the Fin. Year 2000-01	Interest Received during the Fin. Year 2000-01
1.	Equity Share capital of Caparo Maruti Limited	1994-95	1,25,00,000	Retained earning of the Business	18,75,000	--
2.	Equity Share capital of Machino Basell India Limited.	1997-98	4,00,00,000	Issue of Share Capital in consideration of Re-arrangement of business.	--	--
3.	Preference Share capital of Machino Basell India Limited.	1998-99	2,60,00,000	Issue of Preference Share Capital in consideration of Re-arrangement of business.	44,12,877	--
4.	Bond of ICICI	1999-00	5,00,00,000	Capital gain on sale of	--	59,83,562

	Bank			Business invested u/s 54EA for exemption form capital gain tax		
5.	Investment in Mutual Funds.	1999-00	5,72,50,000	Capital gain on sale of Business invested u/s 54EA for exemption from capital gain tax.	50,01,671	--
	Total Investment		18,57,50,000		1,12,89,548	59,83,562

3. At the outset, we may note that the interest earned on bonds issued by the ICICI Bank were taxable and therefore in respect of the said bonds, Section 14A was not applicable. The aforesaid findings recorded by the CIT(Appeals), were not challenged by the Revenue before the Income Tax Appellate Tribunal ('tribunal', for short). Therefore, we are concerned only with the items at serial nos.1 to 3 and 5 of the aforesaid table.

4. The tribunal in the impugned order has examined the factual matrix relating to acquisition/purchase of the equity shares

mentioned at serial nos.1 to 3 and the investment in mutual funds. It has reached a categorical and a firm conclusion that the borrowed funds were not utilized for purchase of the equity share capital mentioned at serial nos.1 to 3 and the investment in the mutual funds. The aforesaid findings are findings of fact and we do not see any reason to go into the said aspects. However, we notice that the Assessing Officer, while making disallowance under Section 14A, had observed as under:

> "In the computation of income assessee has shown a dividend income of Rs.1,12,89,548/- and claimed the same as exempt u/s 10(33) of I.T. Act. In response to query as to why expenses relatable to dividend income be not disallowed, assessee has filed letters dated 4.3.2003, 5.11.2003 and 17.12.2003 stating that
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> i) no expenses including interest was incurred to earn dividend income.
>
> ii) Provisions of section 14A are not applicable since investment is old.
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> iii) Dividend was not earned on investment which were made out of borrowed funds.
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> The assessee has-not (sic) segregated or lead evidence to show funds used for making investment in shares etc. (18.57 crores) were not out of borrowed funds. I

may add here that investment are old and coming from the past years but onus is on the assessee to show that investment in instruments earning Dividend/exempt income is not out of borrowed funds. The plea of the assessee that it is an old investment cannot discharge the onus cast upon assessee. If the funds invested in various assets can not be identified by the assessee the only other alternative is to apportion these in the ratio of investments. Assessee has not discharged the onus to identify fund invested in assets yielding exempt income."

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"The provisions of sec. 14A have been placed after section 14 classifying various heads of income and in the chapter-iv relating to computation of total income. This means that provisions of section 14-A are clearly applicable to all heads of income mentioned in section 14 under chapter IV including Business Income.

The reply of the assessee has been considered and as per provisions of sec. 14A as mentioned above, the expense relatable to earning of exempt income are not allowable. Scope of Section 14A is wide. Section 14A does not specify that expenditure incurred by the assessee for earning income which is excluded from the total income is to be disallowed. The section provides that expenditure incurred "in relation" to income which does not form part of the income will not be allowed. The assessee is earning dividend income which is exempt u/s 10(33). It is apparent that assessee is making investments the gains from which are assessed under the head capital Gains. Therefore, the assessee derives income from various activities like business, earning of interest, capital Gains. In the case of

waterfall Estate 219 ITR 563 the bifurcation of expenses attributable to earning the exempt income was upheld. Therefore, I am apportioning interest expenses between exempt income and other income as under. Therefore provisions of section 14A are applicable in the case of assessee.

From the above discussion and in view of the fact that the assessee has not been able to segregate/ earmark expenses relatable to earning of dividend income, I allocate the same in the ratio of total funds and investment yielding exempt income' (sic) The interest expenses which are incurred for various activities are: -

Interest expenses other than Term Loan	Rs.1,25,40,940/-
Total investment in all activities i.e. source of funds	Rs.51,70,04,404/-
Investment in Dividend yielding Investments	Rs.18,57,50,000/-

Disallowance: $\frac{185750000 \times 12540940}{517004404} = 45,05,724$

(Addition: Rs.45,05,724/-)"

Accordingly, this addition/disallowance of Rs.45,05,724/- was made by the Assessing Officer.

5. The CIT(Appeals), as observed above, held that the investment with reference to the applicability of section 14A should be taken as Rs.13,57,50,000/- and not as Rs.18,57,50,000/- after *inter alia* holding that the investment of Rs.5,00,00,000/- in bonds of ICICI Bank had not resulted in tax-free income. Accordingly, the disallowance was proportionately reduced.

6. However, the Tribunal in the impugned order has completely deleted the disallowance. In the case of ***Maxopp Investment Ltd. Vs. Commissioner of Income Tax, New Delhi***, ITA No.687/2009 (delivered on 18.11.2011), a Division Bench of this Court has 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.

42. Thus, the fact that we have held that sub-sections (2) & (3) of section 14A and Rule 8D would operate prospectively (and, not retrospectively) does not mean that the assessing officer is not to satisfy himself with the correctness of the claim of the assessee with regard to such expenditure. If he is satisfied that the assessee has correctly reflected the amount of such expenditure, he has to do nothing further. On the other hand, if he is satisfied on an objective analysis and for cogent reasons that the amount of such expenditure as claimed by the assessee is not correct, he is required to determine the amount of such expenditure on the basis of a reasonable and acceptable method of apportionment. It would be appropriate to recall the words of the Supreme Court in ***Walfort*** *(supra)* to the following effect:-

> "The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14 A."

So, even for the pre-Rule8D period, whenever the issue of section 14A arises before an Assessing Officer, he has, first of all, to ascertain the correctness of the claim of the assessee in respect of the expenditure incurred in relation to income which does not form part of the total income under the said Act. Even where the assessee claims that no expenditure has been incuured (sic) in relation to income which does not form part of total income, the assessing officer will have to verify the correctness (sic) of such claim. In case, the assessing officer is satisfied with the claim of the assessee with regard to the expenditure or no expenditure, as the case may be, the assessing officer is to accept the claim of the assessee insofar as the quantum of disallowance under section 14A is concerned. In such eventuality, the assessing officer cannot embark upon a determination of the amount of expenditure for the purposes of section14A(1). In case, the assessing officer is not, on the basis of objective criteria and after giving the assessee a reasonable opportunity, satisfied with the correctness of the claim of the assessee, he shall have to reject the claim and state the reasons for doing so. Having done so, the assessing officer will have to determine the amount of expenditure incurred in relation to income which does not form part of the total income under the said Act. He is required to do so on the basis of a reasonable and acceptable method of apportionment."

7. In spite of the said directions, Dr. Rakesh Gupta, ld. counsel for the assessee, has submitted that there is no need to remit the matter to the Assessing Officer as the Assessing Officer had not

made any disallowance under Section 14A, except in respect of interest expenditure. He further says that the contention now raised by the revenue does not emanate from the order of the Tribunal. We are not inclined to accept the said contention. We have noted the observations made by the Assessing Officer while making disallowance under Section 14A. The Assessing Officer was handicapped, because of failure of the assessee to furnish relevant details and particulars while making the disallowance. It is clear from the observations made by the Assessing Officer, in the assessment order, that his intention was to segregate and compute the disallowance to be made of expenses under Section 14A. We may note that in the case of Maxopp Investment Ltd. (supra) also, the issue raised was whether the interest paid on borrowed funds for investing in shares for the purpose of acquiring and retaining a controlling interest therein was allowable under Section 36(1)(iii) and was not hit by Section 14A of the Act. We may, however, clarify that the disallowance, if any, to be made by the Assessing

Officer will not exceed the disallowance which was made in the original assessment order as reduced by the CIT(Appeals).

8. In view of the said decision, we are inclined to pass an order of remit to the Assessing Officer to examine the aforesaid aspects/ ratio and, if required and necessary, compute the disallowance under Section 14A. We may note that this order should not be construed as an expression of opinion by this Court that some disallowance must be made under Section 14A. The quantum, if any, has also not been examined. The Assessing Officer will examine the said questions keeping in mind the directions and ratio in the case of Maxopp Investment Ltd. (supra). The question of law is accordingly answered. We clarify that the Assessing Officer will not go into the question of disallowance of interest. No costs.

SANJIV KHANNA, J.

R.V.EASWAR, J.

FEBRUARY 28, 2012/vld