(fit for publication sd/-)
IN THE INCOME TAX APPELLATE TRIBUNAL
(DELHI BENCH "G" DELHI)

BEFORE SHRI G.E. VEERABHADRAPPA, HON'BLE PRESIDENT
AND SHRI A.D. JAIN, JUDICIAL MEMBER

ITA No. 2431(Del)2010
Assessment year: 2006-07

Asstt.Commissioner of Income Tax, Cir.8(1), New Delhi.	V.	SIL Investment Ltd., (Formerly Sutlej Industries Ltd.), Panchpahar Rd.Bhawani Mandi, Jhalawar.

C.O. No.349(Del)2010
(In ITA 2431(Del)2010)
Assessment year: 2006-07

SIL Investment Ltd. (Formerly Sutlej Industries Ltd.), Panchpahar Rd.Bhawani Mandi, Jhalawar	v.	Asstt.Commissioner of l. Tax, Cir. 8(1), New Delhi.
(Appellant)		(Respondent)

Department by: Shri S, Mohanty, DR
Assessee by: S/Shri Ajay Vohra, Advocate,- Rohit Jain, CA & Ms. Janpriya Rooprai, Adv.

ORDER

PER A.D. JAIN, J.M.

These are Department's appeal and the assessee's cross objections against the order dated 4.2.2010 passed by the CIT(A), XI, New Delhi. The following grounds have been taken by the Department:-

1. *"Ld. Commissioner of Income Tax (Appeals) erred, in law and on the facts and circumstances of the case, in restricting the disallowance of ` 2,08,83,181/- made by the AO u/s 14A of the I.T. Act to ` 16,54,531/-*

2. *Ld. Commissioner of Income Tax (Appeals) erred, in law and on the facts and circumstances of the case, in deleting the disallowance of ` 5,000/- made by the AO on account of fines & penalties.*

3. *Ld. Commissioner of Income Tax (Appeals) erred, in law and on the facts and circumstances of the case, in directing the AO as under :-*

   i) *To verify the claim of the assessee and exclude interest income from UTI from income after due verification.*

   ii) *To allow the balance 50% of additional depreciation after verifying the contention of the assessee that 50% of additional depreciation was claimed and allowed in immediately preceding year i.e. A.Y. 2005-06.*

   iii) *Verify the claim of the assessee and allow credit of the TDS.*

   Since the CIT(A), as per the provisions of section 251 (1)(a) of the I.T. Act, may confirm, reduce, enhance or annul the assessment and the above directions of the CIT(A) amount to setting aside the grounds of appeal."

2. The assessee has raised the following cross objections:-

1. *"That the CIT(A) erred on facts and in law in confirming the disallowance of expenditure amounting to ` 16,54,525/- under section 14A Income-tax Act, 1961 (the Act), alleged to have been incurred for earning tax free dividend income.*

That the CIT(A) erred on facts and in law in not holding that disallowance under section 14A of the Act, could not have been worked out as per the method provided in Rule 8D of the Income-tax Rules, 1962 ('the Rules') since the same was prospective in operation and was not applicable to the year under consideration.

2. That the CIT(A) erred on facts and in law in not directing the assessing officer to allow deduction under section 801A/80IB of the Act in respect of the three units of the appellant.

2.1 That the CIT(A) erred on facts and in law in not appreciating that deduction under section 80IA/80IB of the Act was not allowed in respect of the profits of the three units for the period 01.04.2005 to 30.06.2005 to the appellant as well as the resulting company."

3. Apropos ground No.1 of the Department's Appeal & Cross Objection No.1 of the assessee, as per the assessment order, the AO noticed that the assessee had earned dividend income of ` 17,32,701/- and long term capital gain of ` 12,15,93,111/-, against which, no expenses had been claimed to have been incurred. The AO asked the assessee to explain as to why disallowance u/s 14A of the I.T. Act be not made in respect of expenses attributable to income exempt u/s 10 of the Act. The assessee submitted that no expenses had been incurred to earn the exempt income. The AO, however, disagreed with the stand taken by the assessee. It was observed that the assessee had an opening balance of investment of ` 88,85,47,596/- and a closing balance of ` 1,00,47,31,991/-, from which, the assessee had earned the exempt income; that as available from the assessee's Profit and Loss Account, the assessee had incurred an interest cost of ` 3,22,99,963/-

during the year; that the assessee company had been carrying on the business of manufacture of yarn, which had been transferred to Sutlej Textiles and Industries Ltd. ('STIL', for short), with effect from 1.7.2007, as per the scheme of arrangement sanctioned by the Hon'ble Rajasthan High Court; that the assessee company had retained the investment business; that as such, 50% of the expenses on account of interest were being treated as incurred for investment business, from which, the assessee had earned income in the form of dividend and capital gains; and that it was clear that the assessee had earned exempt income at the costs debited to the Profit and Loss Account. The AO further held that following the Special Bench decision of the Tribunal in "ITO, Mumbai v. Daga Capital Management Pvt. Ltd.", 2008 – TIOL – 509-Mumbai-(SB), Rule 8 D of the I.T. Rules read with Sections 14A(2) & (3) of the Act are applicable with retrospective effect. Holding so, the AO worked out the disallowance u/s 14 A of the Act as follows:-

A) Direct cost	
(50% of Interest)	1,61,49,981/-
B) Indirect cost	
Opening balance of Investment	88,85,47,596/-
Closing balance of Investment	100,47,31,991/-
	189,32,79,587/-
	94,66,39,793/-
	47,33,200/-
Total disallowance u/s 14A (A+B)	2,08,83,181/-

4. Before the ld. CIT(A), the assessee contended that as per the Scheme of demerger, the entire interest bearing liabilities, namely, secured and unsecured loans, belonging to the assessee company as on 30.6.05, the date preceding the date of demerger, were relatable to the demerged Textile Division and were transferred to the resulting company, i.e., STIL, as part of the demerger. The assessee supported such contention with documentary evidence, i.e., Schedule of assets and liabilities in respect of the residual undertaking forming part of the Scheme of demerger, the Profit and Loss Account of the Company for the period from 1.7.2005 to 31.3.2006, wherein nil interest expenses had been debited and comparative Profit and Loss Account for the demerger period and for the complete year, showing that the entire interest expenditure related to the pre-demerger period from 1.4.2005 to 30.6.2005. The assessee thus contended that there was no interest expenditure actually related to the investment activity and so, no part of interest expenditure was disallowable u/s 14A of the Act. It was submitted that during the post demerger period, the assessee only had investment activity; that expenses of only ` 9,26,788/- had been claimed as deduction towards remuneration to Director, Audit Fee, etc., which also could not be said to be related to the earning of exempt income; that during the pre-

demerger period, disallowance, if any called for, could be of only ` 7,27,743/-, since the rest of the expenditure related to Haridwar Holiday Home and Dehradun Holiday Home, which had also demerged with the Textile business; and that Rule 8D of the I.T. Rules was applicable only prospectively and not retrospectively.

5. The ld. CIT(A) asked for a remand report from the AO. In the remand report, the AO stated that interest expenditure also related to the investment activity and that the assessee was wrong in contending that no expenses related to the dividend income.

6. So far as regards the applicability of Rule 8D of the Income Tax Rules, the ld. CIT(A) confirmed the AO's view of the said Rule being retrospectively applicable. In doing so, the ld. CIT(A) also went by "Daga Capital Management"(supra).

7. So far as regards the merits of the disallowance, the ld. CIT(A) observed that the disallowance had been made on account of interest expenditure and other administrative and operative expenses. Concerning the interest expenditure, the ld. CIT(A) had asked the assessee to file the audited financial statements of STIL, i.e., the resulting company, as on 31.3.2006. There-from, the ld. CIT(A) observed that the entire loan, on which the interest expenditure had been incurred, actually stood transferred

from the assessee company to STIL, pursuant to the scheme of demerger sanctioned by the Hon'ble Rajasthan High Court. The ld. CIT(A) observed that it stood established that the entire interest expenditure actually related to the earning of taxable income from the Textile Division and not to the earning of any exempt income. It was held that therefore, no part of the interest expenditure was disallowable u/s 14A of the Act read with Rule 8D of the Rules.

8. Regarding the disallowance of ` 47,33,200/- out of administrative and operative expenses, the ld. CIT(A) observed that the entire expenditure during the pre-demerger period, excepting ` 12,99,537/- related to the demerged Textile Division; that for the post-demerger period, the total expenditure was of ` 21,06,266/-, out of which, the assessee had itself disallowed ` 11,79,478/- and had claimed only the balance of ` 9,26,788/-; and that thus, the total pre-demerger and post-demerger expenses, from which, disallowance could be made, aggregated to ` 22,26,325/-. The ld. CIT(A) observed that the disallowance of ` 47,33,000/-, as made by the AO u/s 14A of the Act read with Rule 8D of the Rules could not be sustained, since such disallowance had to be restricted to the actual expenditure incurred. The ld. CIT(A) further observed that, on the other hand, the contention of the assessee that no part of the expenditure of ` 22,26,000/-

was disallowable, was also not acceptable; and that the assessee had *actually earned* exempt dividend income, due to which, the expenditure incurred in relation to such income needed to be disallowed in terms of section 14A of the Act. Observing that the expenditure of ` 5,71,794/- related to Haridwar Holiday Home and Dehradun Holiday Home, which also stood demerged as part of the Textile Division, the ld. CIT(A) reduced this amount from the amount of ` 22,26,000/- and held the entire balance expenditure of ` 16,54,531/- to be relating to the investment activity of the assessee company. It is this amount of ` 16,54,531/-, to which the disallowance of ` 2,08,83,181/-, as determined by the AO, was restricted by the ld. CIT(A).

9. The Department has raised ground No.1 of its appeal against this action of the ld. CIT(A), seeking confirmation of the entire disallowance of ` 2,08,83,181/-, as made by the AO. The assessee, on the other hand, has taken Cross Objection No.1, requesting for the deletion of the entire disallowance as against that restricted by the ld. CIT(A) to ` 16,54,531/-.

10. The learned counsel for the assessee has made oral arguments and a chart of issues had been filed as well. It has been contended that the provisions of section 14A of the Act are applicable only to expenditure incurred in relation to income not forming part of the total income. Reliance in this regard has been placed on "CIT v. Walfort Share and Stock

Brokers", 326 ITR 1(SC) and "Godrej & Boyce Manufacturing Co. Ltd., Bombay v. DCIT", 328 ITR 81(Bom). It has been contended that in the present case, during the year, no expense, having either any direct or any indirect relation with the earning of exempt income, was incurred by the assessee; that no part of the interest expenditure actually related to the investment division, as also noted by the ld. CIT(A), since the entire loan on which the interest had been paid, had been transferred to STIL, the resulting company, pursuant to the scheme of demerger, with effect from 1.7.05. The learned counsel for the assessee has drawn attention to a copy of the scheme of demerger [pages 1 to 20 of the Assessee's Paper Book ('APB' for short)] . Reference has, then, been made to the Schedule of assets and liabilities in respect of the residual undertaking of the assessee company (APB 21 to 76). Further, the Profit and Loss Account of the residual company for the period from 1.7.05 to 31.3.06 (APB 78), the comparative Profit and Loss Account for the segregated period from 1.4.05 to 30.6.05, of the consolidated company and that for the year ending 31.3.06 (APB 79 to 80) have also been referred to. It has been contended that if no nexus is shown between the borrowed funds and the tax free investment, no disallowance of interest on the borrowed funds can be made. For this proposition, reliance has been placed on the following case laws:-

1. "CIT v. Hero Cycles", 323 ITR 518(P&H);
2. "CIT v. K. Raheja Corporation Pvt. Ltd.", decision dated 8.8.11 in ITA No. 1260/2009, rendered by the Hon'ble Bombay High Court (Copy at pages 31 to 33 of the Case Laws Paper Book filed by the assessee, "CLPB" for short);
3. "DCIT v. Jindal Photo Ltd.", authored by one of us, the J.M., on 22.12.10, in ITA No. 4539(Del)2010 (copy at CLPB 39 to 45);
4. "Maruti Udyog Ltd. v. DCIT", 92 ITD 119(Del);
5. "ACIT v. Eicher Ltd.", 101 TTJ 369(Del); and
6. "DCIT v. Maharashtra Seamless Ltd.", 138 TTJ 244(Del).

11. Apropos the administrative expenditure, it has been contended on behalf of the assessee that firstly, no part of the administrative expenditure related to the investment division; that the AO did not bring anything on record to show that expenditure to have been incurred for earning exempt income; that the disallowance u/s 14A of the Act was made on an entirely adhoc basis, without discharging the onus of justifying the disallowance of such expenditure; and that this is impermissible in law, as laid down in -

1. "Chemical and Metallurgical Design Co. Ltd.", ITA No. 803/2008 …..?
2. "PTC India Ltd. v. DCIT", ITA Nos. 580 & 581(Del)09(Del) …?
3. "Wimco Seedlings Ltd. v. DCIT", 107 ITD 267(Del)(TM); and
4. "CIT v. Ms. Sushma Kapur", 319 ITR 299(Del).

12. It has been further contended that even otherwise, the provisions of sections 14A(2) and (3) of the Act and Rule 8D of the Rules are prospective

and cannot be applied for any assessment year prior to assessment year 2008-09. For this, reliance has been placed on –

1. "Godrej & Boyce Manufacturing Co. Ltd. v. DCIT", 328 ITR 81(Bom);
2. "Godrej Agrovet Ltd. v. ACIT", 326 ITR 81(Bom); and
3. "Continental Carriers (P)Ltd. v. ACIT", 138 TTJ 249(Del).

13. Explaining the administrative expenditure actually incurred by the assessee, it has been contended that so far as regards the pre-demerger expenditure, the total expenditure was of ` 12,99,537/-. Reference in this regard had been made to APB 82 to 87. It has been submitted that this entire expenditure related to activities other than the activities of the Textile Division; that an amount of ` 11,76,500/- out of the said expenditure of ` 12,99,537/- was debited as "miscellaneous expenditure"; that out of this expenditure, expenditure of ` 5,71,794/- related to Haridwar Holiday Home and Dehradun Holiday Home, which were also demerged under the scheme, (with regard to which, APB 199 has been referred to); and that therefore, only the balance expenditure of ` 7,27,743/- was incurred during the three months period from 1.4.05 to 30.6.05, under the head of "miscellaneous expenditure". Referring to the post-demerger expenditure from 1.7.05 to 31.3.06, the learned counsel for the assessee has argued that the total expenditure during this period amounted to ` 21,06,266/- (APB 81 referred

to); that this expenditure primarily comprised of a restructuring/demerger expenditure of ` 14,74,347/- and balance other expenses, with regard to which, our attention has been drawn to APB 78 to 80; that in the revised return of income, out of the demerger expenses of ` 14,74,347/-, an amount of ` 2,94,869/- had been claimed u/s 35 DD of the Act, whereas the balance expenditure of ` 11,79,478/- was disallowed in the return (reference made to APB 283); that therefore, a total expenditure of only ` 16,54,531/- had been claimed and disallowance, if at all, could have been made only out of the said expenditure of ` 16,54,531/-; that so, the ld. CIT(A) went wrong in disallowing the entire expenditure, particularly when there is no evidence available to suggest that even any *part* of such expenditure was incurred to earn exempt income; and that further more, this expenditure includes expenditure towards remuneration of Director and Audit Fees, which expenditure *had to be incurred*, irrespective of exempt income being received or not and these expenses also could not be held to be related to the earning of exempt income.

14. The learned DR, on the other hand, has contended that the ld. CIT(A) has erred in restricting the disallowance of ` 2,08,83,181/- made by the AO u/s 14A of the Act to ` 16,54,531/-; that while doing so, the ld. CIT(A) has failed to take into consideration that the assessee had an opening balance of

investment of ` 88,85,47,596/- and a closing balance of ` 1,00,47,31,991/-; that it was therefrom that the assessee had earned exempt income; that during the year, the assessee had incurred interest cost of ` 3,22,99,963/-, as available from the Profit and Loss Account; that the assessee had earned exempt income at the costs debited to the Profit and Loss Account; that undisputedly, a loan had been taken, on which, interest was being paid; that as such, the AO was right in holding 50% of the interest expenditure to be directly relatable to the earning of exempt income; that as such, the AO was correct in making the disallowance accordingly; that even though agreeing with the AO to the applicability of formula as per Rule 8D of the Rules, the ld. CIT(A) erred in restricting the disallowance made by the AO at ` 47,33,000/- being 0.5% of the average investment, to ` 22,26,000/-; that the ld. CIT(A) further erred in reducing a sum of ` 5,71,794/- and thereby restricting the disallowance to only ` 16,54,531/-; that even otherwise, the matter needs to be remitted to the AO to examine the expenses regarding the exempt income in the light of "Godrej & Boyce"(supra), as per which, even if the assessee has utilized its own funds for making investments which have resulted in income which does not form part of the total income under the Act, the expenditure which is incurred in the earning of that income would have to be disallowed, which expenditure is what the AO has to determine.

15. We have heard the parties and have perused the material on record with regard to this issue. The assessee is a limited company and is in the business of making investments, besides other business. Earlier, it was carrying on the activity of manufacturing and dealing in Textiles. The Textile Division of the assessee, however, got demerged into the resulting company, STIL, with effect from 1.7.05. The AO made disallowance of interest expenditure of ` 1,61,49,987/- and of other administrative and operative expenses of ` 47,33,200/-, total amounting to ` 2,08,83,181/-. The ld. CIT(A), apropos the interest expenditure, held that the entire loan on which the interest expenditure had been paid actually stood transferred from the assessee company to STIL, the resulting company, pursuant to the scheme of demerger. This fact, as found by the ld. CIT(A), has remained established. Nothing to the contrary has been brought out . It remains undisputed that in the audited financial statement of STIL, as on 31.3.2006, this loan stood transferred pursuant to the scheme of demerger, from the assessee company to STIL. This was in accordance with the scheme of demerger as approved by the Hon'ble Rajasthan High Court. A copy of the said scheme of demerger is at APB 1 to 20. As per this scheme, the liabilities, duties and obligations of the assessee company relating to the demerged Textile Division were to be transferred to the resulting company,

STIL. Then, as per the Schedule of assets and liabilities in respect of the residual undertaking forming part of the scheme of demerger, the relevant portion whereof is at APB 62 to 64, after the demerger, the books of the assessee do not show any outstanding loans, signifying that all the loans pertaining to the demerged Textile Division stood transferred. APB 64, states, inter alia, :-

Secured loans - Nil

Unsecured loans - Nil

APB 62 to 64 constitute the statement of assets and liabilities in respect of the residual undertaking of SIL (the assessee) as on the date immediately preceding the appointed date. Further, the details of Profit and Loss Account of SIL (the assessee), from July, 2005 to March, 2006 (APB 78) gives the details of the expenditure, as per which, the total expenditure was of ` 21,06,266/-. The comparative Profit and Loss Account for the segregated period, i.e., from 1.4.05 to 30.6.05, of the consolidated company, and for the year ending 31.3.06, are at APB 79 to 80. Therein, no interest expenditure stands shown as relating to the period from 1.7.05 to 31.3.06, i.e., the period during which the assessee company was only an investment company. It was only to the three months period prior to the said period, i.e., from 1.4.05 to 30.6.05, that the total interest expenditure pertained.

This clearly shows that the expenditure on interest concerned the demerged Textile Division of the assessee Company and not its investment activity.

16. As such, no nexus was brought by the AO between the borrowed funds and the tax free investment. That being so, disallowance of interest on borrowed funds was entirely uncalled for.

17. In "K. Raheja Corporation Pvt. Ltd." (supra), it was held by the Hon'ble Bombay High Court that in the absence of any material or basis to hold that the interest expenditure directly or indirectly was attributable for earning the dividend income, the decision of the Tribunal in deleting the disallowance of interest made u/s 14A of the Act could not be faulted. In the facts of the present case, as discussed, "K. Raheja Corporation Pvt. Ltd." (supra), is squarely applicable.

18. In "CIT v. Hero Cycles" (supra), it was held by the Hon'ble Punjab & Haryana High Court, inter alia, that the contention of the Revenue that directly or indirectly some expenditure was always incurred, which must be disallowed u/s 14A of the Act and the impact of the expenditure so incurred could not be allowed to be set off against the business income which may nullify the mandate of section 14A, could not be accepted; and that the disallowance u/s 14A required a finding of incurring of expenditure and where it was found that for earning exempted income, no expenditure had

been incurred, disallowance u/s 14A could not stand. In the present case, as seen, the AO has not established any nexus whatsoever between the borrowed funds and the investment made. Therefore, "Hero Cycles" (supra), is applicable.

19. In "ACIT v. Eicher Ltd." (supra), it has been held that the burden is on the AO to establish the nexus of the expenditure incurred with the earning of exempt income, before making any disallowance u/s 14A of the Act.

20. In "Maruti Udyog"(supra), it has been held that before making any disallowance u/s 14A of the Act, the onus to establish the nexus of the same with the exempt income, is on the Revenue.

21. In "Jindal Photo"(supra), following "Hero Cycles"(supra), "Eicher Ltd."(supra), "Maruti Udyog"(supra) and other decisions, we have held as follows:-

> *"18. Now, as per section 14A(2) of the Act, if the AO, having regard the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of expenditure incurred in relation to income which does not form part of the assessee's total income under the Act, the AO shall determine the amount incurred in relation to such income, in accordance with such method as may be prescribed, i.e. under Rule 8D of the I.T. Rules. However, in the present case the assessment order does not evince any such satisfaction of the AO regarding the correctness of the claim of the assessee. As such, Rule 8D of the Rules was not appropriately applied by the AO as correctly held by the CIT (A). It has not been done by the AO that any expenditure*

had been incurred by the assessee for earning its dividend income. Merely, an ad hoc disallowance was made. The onus was on the AO to establish any such expenditure. This onus has not been discharged. In "CIT vs. Hero Cycles: (P & H) 323 ITR 518, under similar circumstances, it was held that the disallowance u/s 14A of the Act requires a clear finding of incurring of expenditure and that no disallowance can be made on the basis of presumptions. In "ACIT vs. Eicher Ltd.", 101 TTJ (Del.) 369, that it was held that the burden is on the AO to establish nexus of expenses incurred with the earning of exempt income, before making any disallowance u./s 14A of the Act. In "Maruti Udyog vs. DCIT, 92 ITD 119 (Del.), it has been held that before making any disallowance u/s 14A of the Act, the onus to establish the nexus of the same with the exempt income, is on the revenue. In "Wimco Seedlings Limited vs. DCIT", 107 ITD 267 (Del.) ™, it has been held that there can be no presumption that the assessee must have incurred expenditure to earn tax free income. Similar are the decisions in :

1. *"Punjab National Bank vs. DCIT", 103 TTJ 908 (Del.);*
2. *"Vidyut Investment Ltd." 10 SOT 284 (Del.) ; and*
3. *"D.J. Mehta vs. ITO", 290 ITR 238 (Mum.) (AT).*

19. In view of the above, finding no error with the order of the CIT(A) on the point at issue , the same is hereby confirmed. Ground No. 3 is thus rejected."

22. Moreover, as rightly contended, the finding of fact recorded by the ld. CIT(A), to the effect that no part of the interest expenditure actually related to the investment activity, has not been challenged by the Department.

23. Therefore, we hold that the ld. CIT(A) has correctly deleted the disallowance of the interest expenditure of ` 1,61,49,987/-.

24. Further, the AO made disallowance of ` 4,77,33,200/- out of administrative and operative expenses at 0.5% of the average investment of the assessee company, under the formula given in Rule 8D(2)(iii) of the Rules. The ld. CIT(A) observed that the entire expenditure incurred during the pre-demerger period related to the demerged Textile Division, but for ` 12,99,537/-. It was also noticed that the total expenditure for the post demerger period was of ` 21,06,266/-. Out of this amount, the assessee had itself disallowed ` 11,79,478/- and had claimed only the balance expenses of ` 9,26,788/-. The total expenses pre-demerger and post-demerger thus amounted to ` 22,26,325/-. The ld. CIT(A) observead that it was out of this amount that the disallowance could be made. The CIT(A) agreed in principle with the argument of the assessee that just since the AO had worked out the disallowance of ` 47,33,000/- u/s 14A of the Act, being 0.5% of the average investment under Rule 8D of the Rules, and this amount exceeded the total expenditure incurred in connection with the earning of the exempt income, the expenditure as worked out as per the Rules, could not be disallowed. The ld. CIT(A) was of the view that the disallowance was to be restricted to the total expenditure of ` 22,26,325/- (rounded off to the figure of ` 22,26,000/-), lest the disallowance exceeded even the actual expenditure incurred. However, the assessee's stand that no part of the

expenditure determined at ` 22,26,000/- was disallowable, was not accepted by the ld. CIT(A), observing that the assessee had actually earned exempt income by way of dividend and in terms of section 14A of the Act, the expenditure incurred in relation to *that* income was required to be disallowed. As such, out of the expenditure determined at ` 22,26,000/-, the ld. CIT(A) subtracted the amount of ` 5,71,794/- representing expenditure relating to Haridwar Holiday Home and Dehradun Holiday Home, which were found to be demerged under the Demerger Scheme, and arrived at the figure of ` 16,54,531/-. The ld. CIT(A) held this amount to relate to the investment activity of the assessee company and disallowed it as against the disallowance of ` 47,33,200/- made by the AO.

25. The assessee maintains that the ld. CIT(A) has erred in disallowing the sum of ` 16,54,531/- also, as according to the assessee, no part of the administrative expenditure related to the investment division of the assessee. This contention of the assessee, it is seen, carries force. To start with, it cannot be gainsaid that the disallowance u/s 14A of the Act cannot be made on an ad-hoc basis and it is the Department's responsibility to justify any such disallowance by bringing material on record to show that any expenditure was incurred for earning the exempt income. Reference in this regard has correctly been made to "Wimco Seedlings Ltd. v. DCIT"(supra),

wherein it has been held that there can be no presumption that the assessee must have incurred expenditure to earn tax free income. "Wimco Seedlings Ltd." (supra) was followed by us in "Jindal Photo" (supra).

26. In "Ms. Sushma Kapur" (supra), it has been held by the Tribunal that to the extent it could be proved that the investment was made from borrowed funds, the expenses had been disallowed u/s 14A. This finding of fact recorded by the Tribunal was upheld by the Hon'ble jurisdictional High Court.

27. In the present case, the AO did not bring any evidence on record to establish that any expenditure had been incurred by the assessee company for earning the exempt income. In the absence of such evidence, it was wrong on the part of the AO to proceed to compute disallowance of the expenses u/s 14A of the Act by merely applying Rule 8D(2)(iii) of the Rules.

28. Apropos the assessee's contention regarding the applicability of the provisions of Sections 14A(2) and (3) of the Act and Rule 8D of the Rules being prospective with effect from assessment year 2008-09, such contention is supported by "Godrej & Boyce"(supra) and "Godrej Agrovet Ltd."(supra). It is, however, well established, as held in "Continental Carriers P.Ltd. v. ACIT", 138 TTJ 249(Del), that even prior to assessment

year 2008-09, when Rule 8D of the Rules was not applicable, the AO was duty bound to determine the expenditure incurred in relation to income not forming part of the total income, by adopting a reasonable basis. Therefore, nothing stopped the AO from determining the expenditure incurred in relation to the exempt income earned by the assessee. But for doing so, a "reasonable basis" had to be adopted. And the most reasonable basis, rather, the first reasonable basis for such determination can be none else than the nexus between the expenditure incurred and the exempt income earned. Now, evidently, the AO did not establish any such nexus between the expenditure incurred and the exempt income earned by the assessee Company.

29. Even the ld. CIT(A), though he restricted the disallowance from ` 47,33,200/- to ` 16,54,531/-, did not establish any such nexus and it was merely observed that this amount related to the investment activity of the assessee Company, without clarifying as to how it was found to be so.

30. We find that apropos the pre-demerger expenditure incurred during the period from 1.4.05 to 30.6.06, the total expenditure relating to the activities other than those of the Textile Division of the assessee Company, as available from the consolidated Profit and Loss Account for the year

ended 31.3.06 of STIL (copy at APB 83 to 87), was ` 12,99,537/-, as follows:-

		`
1. Salary, wages, bonus etc.		61,353/-
2. Employees' contribution to PF	..	2,792/-
3. Rates and Taxes	..	3,440/-
4. Insurance Premium(Net)	..	50,000/-
5. Misc. expenses		11,76,500/-
Total:		12,99,537/-

Out of the above expenditure of ` 12,99,537/-, it is seen, an amount of ` 11,76,500/- stands debited as misc.expenditure. The break up of these misc.expenses, as appended at APB 82, is as follows:-

Particulars	2005—06	3 Months	9 Months
*Detail of M/s. Expenses			
-Filing Fee	4000	0	4000
-General Expenses	12361	12361	0
-Postage & Telegram	118478	4929	113549
-Printing and Stationery	231675	469	231206
-Bank Commission	135	135	0
-Books and Periodicals	2497	2497	0
-Traveling Expenses	38696	38696	0
-Trunk & Telephone Exp.	1888	1888	0
-Haridwar Holiday Home	171231	171231	0
-Legal & Professional	80407	80407	0
-Electricity charges	2769	2769	0
-Water charges	425	425	0
-Advertisement	77570	77570	0
-Listing Fee	84250	58000	26250
-Maintenance Charges	3940	3940	0
-Directors Traveling	668018	178511	489507
-conveyance Charges	620	620	0

-Depository Fees	44080	44080	0
-Demat Expenses	46653	0	46653
-Dehradun Holiday Home Exp.	400563	400563	0
-Motor Car Exp.	80910	80910	0
-Press Conference Exp.	16500	16500	0
	2087666	1176501	911165

31. As noted above, an amount of ` 5,71,794/- was expenditure related to Haridwar Holiday Home (` 1,71,231/-) and Dehradun Holiday Home (` 4,00,563/-). These properties, pertinently, were shown in the Schedule forming part of the Balance Sheet as on 31.3.06 (copy at APB 199), as fixed assets of the company. Both these Holiday Homes, undeniably, were demerged under the Demerger Scheme and so, the ld. CIT(A) rightly did not disallow the expenditure on these Holiday Homes.

32. So, what remained as balance under the head of misc.expenditure incurred during the three months period from 1.4.2005 to 30.6.2005, was the amount of ` 7,27,743/-. Even this part of the expenditure has not been co-related by the Authorities below to the exempt income earned by the assessee Company.

33. So far as regards the post-demerger expenditure incurred by the assessee from 1.7.05 to 31.3.06, as available from the details of expenses in the Profit and Loss Account in March, 2006 and June, 2005, i.e., for the year

ended 31.3.06 and for the period ended 30.6.05 (copy at APB 81), that is, the difference of expenses in the Profit and Loss Account for the period from 1.4.05 to 30.6.05 and 1.7.05 to 31.3.06, i.e., to say, the pre-demerger and the post-demerger periods, during the post-demerger period, the assessee had only investment activity and there was no activity of manufacture of Textiles, the Textile Division having been demerged. The total expenditure incurred during this period was of ` 21,06,266/-. This comprised of (as available from the copy of the details of the Profit and Loss Account of the assessee Company from July 2005 to March, 2006, at APB 78), of operative and other expenses of ` 14,78,766/- and Director's fees and commission of ` 6,27,500/-. The operative and other expenses of ` 14,78,766/- constituted, mainly, restructuring/demerger expenses of ` 14,74,347/- (APB 79). The balance operating and other expenses were of ` 4,419/-. A revised computation of income for the assessment year 2006-07 (copy at APB 283 to 286) was filed by the assessee before the AO along with letter dated 27.11.06 (copy at APB 287 to 292). In the revised return of income, out of the demerger expenses of ` 14,74,347/-, the assessee claimed an amount of ` 2,94,869/- as being allowable u/s 35 DD of the I.T. Act, being 1/5th of the said amount of ` 14,74,347/-. The balance expenditure of ` 11,79,478/-

was disallowed. The revised computation (APB 283), in this regard, reads as follows:-

A. Income from Business

Adjustments in accordance with sections 28 to 44

…….

7. Expenditure on account of demerger	` 14,74,347/-
Less: Allowable u/s 35DD (1/5th of ` 14,74,347/-)	` 2,94,869/-
	` 11,79, 478/-

As such, it is evident that the assessee had claimed expenditure only of ` 16,54,531/-. The ld. CIT(A) has duly taken this into consideration. No doubt, the disallowance, if any, could have been made out of this amount only. However, in order to validate such a disallowance, as discussed hereinabove, what was required to be established was the nexus of the expenditure with the earning of the exempt income. The ld. CIT(A), in this regard, has merely observed that the entire balance expenditure of ` 16,54,531/- relates to the investment activity of the assessee Company. There is, however, nothing in the impugned order as to how this finding has been arrived at by the ld. CIT(A). It cannot be gain-said that the onus to prove the nexus between the expenditure incurred and the earning of income not forming part of the total income is squarely on the Department. In the

absence of discharging this onus, no disallowance in this regard can be made, much less sustained, as has been done by the ld. CIT(A). There is absolutely nothing on record to show that any part of the expenditure was incurred to earn the exempt income. And not only this, as rightly canvassed, this expenditure of ` 16,54,531/- even included expenditure towards remuneration to Director and Audit Fees. Now this kind of expenditure, irrespective of the fact whether or not income not forming part of the total income is earned, *has* to be incurred. Therefore also, these expenses cannot, in any manner, be said to be relatable to earning of exempt income by the assessee company.

34. Thus, looked at from any angle, the ld. CIT(A), in our considered opinion, was not at all justified in holding the entire balance expenditure of ` 16,54,531/- incurred by the assessee company as liable to disallowance u/s 14A of the Act. The grievance of the assessee in this regard is, therefore, found to be justified and is accepted as such. The grouse of the Department, on the other hand, is found to be baseless and ground No. 1 raised by the Department is, hence, rejected, whereas Cross Objection No. 1 taken by the assessee is accepted.

35. Turning to ground No.2 raised by the Department, it has been contended that the ld. CIT(A) has erred in deleting the disallowance of `

5,000/- made by the AO on account of fines and penalties. The AO, it is seen, made disallowance of the expenditure of ` 5,000/- incurred by the assessee Company on account of fines towards traffic violation. Before the ld. CIT(A), the assessee contended that a similar amount had been allowed as a deduction in the case of the assessee for the assessment year 1990-91 by the Tribunal in ITA No. 2856(Del)93. The ld. CIT(A) deleted the disallowance following the said order of the Tribunal. Before us, the assessee has again pressed into service the Tribunal's order (supra) for the assessment year 1990-91 (copy at APB 225 to 228)in response to the ld. DR's argument that the payment for fines towards traffic violation and the AO had correctly made the disallowance.

36. The facts remaining the same for the year under consideration, as those for the assessment year 1990-91 and following the Tribunal order, the action of the ld. CIT(A) in deleting the disallowance is confirmed, rejecting Ground No.2 taken by the Department.

37. Turning to ground No.3, the Department contends that the ld. CIT(A) has erred in directing the AO to verify the claim of the assessee and exclude interest income from UTI from income after due verification and to allow the balance 50% of the additional depreciation after verifying the contention of the assessee that 50% additional depreciation was claimed and allowed in

the immediately preceding year, i.e., in the assessment year 2005-06 and to verify the claim of the assessee and to allow credit of TDS.

38. In this regard, it is seen that the AO refused to allow additional depreciation @ 7.5% in respect of addition of plant and machinery during the immediately preceding assessment year, i.e., assessment year 2005-06. Before the ld. CIT(A), the assessee contended that in the assessment year 2005-06, the assessee had claimed additional depreciation @ 7.5%, being 50% of additional depreciation of 15%, amounting to ` 5,32,65,467/-, in respect of new plant and machinery, installed at the new eligible industrial undertaking of the Company, i.e., Unit No.8, Kathua, u/s 32 (iia) of the Act, since the machinery had been put to use for a period of less than 180 days in that previous year; that the depreciation claimed in the return of income for the assessment year 2005-06 was allowed; that in the return of income for the year under consideration, the assessee had claimed the balance 50% of additional depreciation of 15% of the value of the plant and machinery installed in the immediately preceding assessment year; that this was done through Notes to Accounts appended to the return of income; that this claim was computed at ` 1,32,79,884/-, by apportioning 50% of the gross amount of additional depreciation of ` 5,32,65,467/- in the ratio of 91 days to the

total period; and that however, the AO had not considered this claim made by the assessee.

39. The ld. CIT(A), in the impugned order, observed as follows:-

> *"8.2 Since the appellant is stated to be admittedly eligible for deduction of additional depreciation as 50% of the same has already been duly allowed by the AO in the immediately preceding assessment year 2005-06, there is nothing on record to indicate that the appellant should not be allowed deduction of the balance 50% of deduction in the current assessment year 2006-07. Accordingly, the ld. AO is directed to verify the contention of the appellant that 50% of additional depreciation was claimed and allowed in the immediately preceding assessment year 2005-06 and if this fact is found to be factually correct, the AO is directed to allow the balance 50% of additional depreciation during the year under consideration. This ground of appeal is accordingly treated as allowed for statistical purposes."*

40. There is nothing on record to show that the directions given by the ld. CIT(A) are not proper. The eligibility for deduction of additional depreciation stands admitted, since 50% thereof had already been allowed by the AO in the assessment year 2005-06, i.e., the immediately preceding assessment year. Therefore, obviously, the balance 50% of the deduction is to be allowed in the current year, i.e., assessment year 2006-07. The ld. CIT(A) has merely directed the verification of the contentions of the assessee and to allow the balance additional depreciation after such factual

verification. Accordingly, finding no merit therein, ground No. 3 raised by the Department is rejected.

41. Now the only issue remaining is that comprising Cross Objection No. 2 raised by the assessee, which is to the effect that the ld. CIT(A) has erred in not directing the AO in allowing deduction to the assessee under sections 80 IA/80 IB of the Act in respect of the three units of the assessee.

42. The AO refused to allow deduction under sections 80 IA/80 IB regarding the assessee's three units which stood demerged pursuant to the Demerger Scheme approved by the Hon'ble Rajasthan High Court. This demerger came about 1.7.05, as noted hereinabove. The disallowance was ordered by the AO as per the provisions of section 80 IA(12) read with section 80 IB of the Act.

43. Before the ld. CIT(A), the main contention on behalf of the assessee Company was that deduction u/s 80 IB of the Act had not been allowed for the pre-demerger period from 1.4.05 to 30.6.05, either to the assessee Company or to the resulting Company after the demerger.

44. The ld. CIT(A) held the action of the AO to be correct in view of the provisions of section 80 IA(12), as per which, where the eligible undertaking stands transferred in a Scheme of Amalgamation or Demerger, the deduction is allowable only to the resulting Company.

45. Before us, it has been contended on behalf of the assessee that undisputedly, the deduction under sections 80 IA/80 IB of the Act had been claimed with respect to the profit of certain eligible units of the assessee Company; that these units had been part of the assessee company during the pre-demerger period from 1.4.05 to 30.5.05; that these units had been transferred under the Demerger Scheme with effect from 1.7.05; that the deduction claimed was only with respect to the profits earned by these undertakings for the said pre-demerger period only and such deduction had not been claimed in the computation of income but by way of Notes appended to the return of income filed, the said Notes forming an integral part of the return of income; and that prior to the introduction of section 80 IA(12), CBDT Circular No. 15/5/63 – IT(A-I) dated 13.12.63 clarified that deductions under sections 80 IA and 80 IB of the Act were related to the eligible undertaking and accordingly, they got transferred with the undertaking, notwithstanding the ownership thereof. The learned counsel for the assessee has placed reliance on the following case laws in this regard:-

1. "CIT v. P.K. Engg.& Forging Pvt. Ltd.", 87 Taxmann 101(Cal);
2. "A.G.S. Timber & Chemical Industries Pvt. Ltd. v. CIT", 233 ITR 207(Mad);

3. "ITO v. Hindustan Petroleum Corpn. Ltd.", 25 TTJ (Bom)28;

4. "Shah Granites Pvt. Ltd. v. ITO", 28 TTJ 83(Bom);

5. "ITO v. SLM Maneklal Industries Ltd.", 17 ITD 515(Ahd.);

6. "ACIT v. IIS Infotech Ltd.", 82 TTJ 174(Del);

7. "Tech Books Electronics Services (P)Ltd. v. ACIT", 100 ITD 125(Del);

8. "ACIT v. Prisma Electronics" – ITA Nos. 3378(Del)2009 & 500(Del)2010(Del); and

9. "ITO v. Advance Valves Global" – ITA No. 2096(Del)2008(Del).

45. It has thus been contended that as such, the profits of the undertaking earned by the respective companies, i.e., the respective units, for the period the undertaking was owned by the respective companies, are eligible for deduction under sections 80 IA/80 IB of the Act; that the provisions of section 80 IA(12) merely facilitates the grant of deduction under sections 80 IA/80 IB of the Act to the resulting companies also, in the year of transfer/merger; that while bringing into the Statute Book, the said section 80 IA(12); that the Explanatory Note provides that these provisions have been introduced to make the Corporate Reorganizations tax neutral; that by virtue of the provisions of sections 80 IA/80 IB(12) of the Act, benefit of deduction under the profits earned by the demerger companies, for part of the period cannot, and so, ought not, be denied. It has further been

contended that the provisions of the Act which are beneficial to the assessee must be liberally construed, as has been well settled in "Bajaj Tempo v. CIT", 194 ITR 188(SC), "CIT v. Strawboard Manufacturing Co. Ltd.", 177 ITR 431(SC) and "P.R. Prabhakar v. CIT", 284 ITR 548(SC). The learned counsel has then contended that as such, the provisions of sections 80 IA(12) and 80 IB(12) of the Act, being provisions beneficial to the assessee, require to be construed liberally; that deduction under the said sections is allowable to the demerged and resulting company in respect of the profits earned by both the companies for the respective period of ownership of the eligible undertaking in the year of demerger; that the AO has factually erred in observing that no audit report in form No. 10 CCB, as provided under sections 80 IA(12) and 80 IB(12) of the Act was filed; that actually, the audit reports for the respective units were duly filed in the assessment proceedings vide letter dated 7.11.08 by the assessee; that the details of deduction under sections 80 IA(12) and 80 IB(12) of the Act were also given in the tax audit reports, certifying such deduction; that the AO has also wrongly observed that since the deduction was not claimed in the computation of income, it could not be allowed, in view of "Goetze India v. CIT", 284 ITR 323(SC); that in fact, it remains undisputed that the deduction in question *was* claimed by way of a Note appended to the original return of income; that in "CIT v.

Sain Processing and Weaving Mill Pvt. Ltd.", 325 ITR 565(Del), it has been held that the net profit cannot be determined, without taking into account the information disclosed in the Notes appended to the accounts, which Notes form part of the accounts of the assessee Company.

46. The ld. DR, on the other hand, has strongly supported the impugned order in this regard, submitting that it remains undisputed that under the provisions of section 80 IA(12) of the Act, in a case where the eligible undertaking stands transferred in a Scheme of Amalgamation and Demerger, deduction is allowable only to the resulting company and so, the assessee/demerged company is not at all eligible for deduction under sections 80 IA/80 IB of the Act, as has rightly been held by both the Authorities below concurrently. It has further been contended that it would be wrong to canvass, as has been done in the case of the assessee, that the provisions of section 80 IA of the Act require to be read beneficially to the assessee; that the factual findings of the ld. CIT(A) in this regard are abundantly clear and nothing has been brought on record to dislodge them; that moreover, the AO has categorically observed in the assessment order that no report in form No. 10 CCB was filed by the assessee and it is only by way of an alibi that the assessee now contends to have done the needful in this regard before the AO during the assessment proceedings.

47. On this issue, we find that indeed, as per Circular No. 15/5/63 – IT(A-I) dated 13.12.63 (supra) it has been clarified that deduction under sections 80 IA/80 IB of the Act relates to the eligible undertaking and, accordingly, it transfers with that undertaking, notwithstanding the ownership of such undertaking. The Circular relates that the Board agreed that the benefit of section 84 attached to the undertaking and not to the owner thereof and that the successor would be entitled to the benefit of the unexpired period of 5 years, provided the undertaking was taken over as a running concern. The case laws relied on by the assessee are to a similar effect.

48. In "Advance Valves" (supra), following, inter alia, "P.K. Engg. & Forging" (supra) and "A.G.S Timber" (supra), "Prisma Electronics" (supra) and the CBDT Circular (supra) it has been held that it is the successor on demerger, which would be entitled to the benefit for the unexpired period of 5 years, provided the undertaking was taken over as a running concern.

49. So far as regards the claim made by the assessee, it is on record that the assessee had duly filed the audit report in form No. 10 CCB vide letter dated 7.11.08 before the AO, in which audit report, deductions under sections 80 IA(12)/80 IB(12) of the Act were duly certified to have been claimed by the assessee. It is undisputed that the claim was made by way of

a Note appended to the original return of income. It cannot be gain-said that the Note to the return of income formed an integral part of the return. That being the position, obviously, it cannot be held that the deduction was not claimed in the return of income. In this regard, in "Sain Processing" (supra), it has been held that net profit cannot be determined without taking into account the information disclosed in the Notes appended to the Accounts which formed part of the Accounts of the assessee Company.

50. In view of the above, we hold that the AO erred in denying the deduction under sections 80 IA(12)/80 IB(12) of the Act to the assessee and the ld. CIT(A) erred in confirming such disallowance. The grievance of the assessee in this regard is well justified, and Cross Objection No. 2 raised by the assessee is thus accepted.

51. In the result, whereas the appeal filed by the department is dismissed, the Cross Objection filed by the assessee is allowed.

Order pronounced in the open court on 04.05.2012.

Sd/-	sd/-
(G.E. Veerabhadrappa)	(A.D. Jain)
President	Judicial Member

Dated: 04.05.2012.
*RM

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

True copy

By order

Deputy Registrar