

IN THE INCOME TAX APPELLATE TRIBUNAL
COCHIN BENCH, COCHIN
BEFORE S/SHRI N.R.S.GANESAN, JM and CHANDRA POOJARI, AM

I.T.A. No. 261/Coch/2014
Assessment Year : 2008-09

M/s. Geojit Investment Services Ltd., 34/659, Civil Line Road, Padivattom, Kochi-682 024. [PAN: AACCG 2328J]	Vs.	The Assistant Commissioner of Income-tax, Circle-1(2), Ernakulam.
(Assessee -Appellant)		(Revenue-Respondent)

Assessee by	Shri A.S. Narayanamoorthy, CA
Revenue by	Smt. Latha V. Kumar, Jr. DR

Date of hearing	25/08/2014
Date of pronouncement	28/08/2014

ORDER

Per CHANDRA POOJARI, Accountant Member:

This appeal filed by the assessee is directed against the order dated 23-01-2014 passed by the Ld. CIT(A)-II, Kochi for the assessment year 2008-09.

2. The first ground in the appeal for our consideration is with regard to the disallowance of Rs. 5,60,565/- u/s. 14A of the I.T. Act.

3. The brief facts of the case are that during the assessment year under consideration, the cumulative investment in the mutual funds at Rs. 3,20,75,000/- and the assessee earned dividend income of Rs.5,46,453/-. The

assessee also claimed expenses incurred for earning the dividend income at Rs.5000/-. However, the Assessing officer was of the opinion that it is not correct and thus, he invoked the provisions of sec. 14A read with Rule 8D of the I.T. Rules and thereafter disallowed Rs.5,60,565/-. On appeal, the CIT(A) confirmed the same. Against this, the assessee is in appeal before us.

4. The Ld. AR submitted that the assessee is having enough own funds in the form of share capital, reserves in surplus. More so, in the assessment year under consideration, the assessee earned profit of Rs.2,53,25,000/- and incremental investment is only Rs. 1,36,00,000/- and it cannot be presumed that investment in the mutual funds is out of borrowed funds. He drew our attention to the balance sheet and assets and liabilities as on 31-03-2008 to explain the above position. He also drew our attention to the profit and loss account as on 31-03-2008. According to the Ld. AR, even otherwise computation of the disallowance u/s. 14A is not correct. The Assessing officer considered the gross current assets instead of net current assets while applying the formula under Rule 8D of I.T. Rules. The Ld. AR also submitted that the disallowance is as per assessee's calculation.

5. The Ld. AR further submitted that the CIT(A) erred in disallowing a sum of Rs. 5,60,565/- u/s. 14A of the Act. The CIT(A) erred in confirming the disallowance u/s. 14A without proper appreciation of the facts. The capital and

reserves of the company at the beginning of the year was Rs.728.85 lakhs and at the close of the year was Rs.1119.49 lakhs. The profit before tax for the year was Rs.595.20 lakhs and the incremental investment during the year was only Rs. 135 lakhs which could be considered having been made out of the profit for the year. A comparative statement of the investment in each year along with the profit for each year was furnished from which it was clear that the investment were out of own funds and in such cases the disallowance was not to be attracted.

5.1 The Ld. AR further submitted that in addition to the fact that no borrowed funds were used for investments, the CIT(A) failed to note that disallowance u/s. 14A requires finding by the Assessing officer that an expenditure has been incurred. When the assessee had admitted that only a sum of Rs.5000 was incurred for earning tax free income, the Assessing officer should have established that a higher expenditure was incurred before making disallowance under Rule 8D. Sub-section(2) of section 14A 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 as in that regard is correct and the determination must be made having regard to the accounts of the assessee.

6. On the other hand, the Ld. DR relied on the order of the lower authorities and submitted that there was no borrowed funds and the assessee has incurred huge interest amounting to Rs.15,94,933/-. Therefore, the Assessing officer as well as the CIT(A) has rightly disallowed the same.

7. We have heard both the parties and perused the record. We find that in terms of the provisions of section 14 A (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..." and rule 8 D prescribes this method as follows:

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

(1)

(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;

(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 :-

$A \times B$

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 per cent 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.

8. There is no dispute about working of this method so far as rule 8D(2)(i) and (iii) is concerned. It is only with regard to the computation under rule 8D(2)(ii) that the Assessing Officer and the assessee have different approaches. This provision admittedly deals with a situation in which "the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt". Clearly, therefore, this sub clause seeks to allocate 'common interest expenses' to taxable income and tax exempt income. In other words, going by the plain wordings of rule 8D(2)(ii) what is sought to be allocated is "expenditure by way of interest.....which is not directly attributable to any particular income or receipt" and the only categories of income and receipt, so far as scheme of rule 8 D is concerned, are mutually exclusive categories of 'tax exempt income and receipt' and 'taxable income and receipt'. No other classification is germane to the context in which rule 8 D is set out, nor does the scheme of Section 14A leave any ambiguity about it.

9. Ironically, however, the definition of variable 'A' embedded in formula under rule 8D(2)(ii) is clearly incongruous inasmuch while it specifically excludes interest expenditure directly related to tax exempt income, it does not exclude interest expenditure directly related to taxable income. Resultantly, while rule 8D(2)(ii) admittedly seeks to allocate "expenditure by way of interest, which is not directly attributable to any particular income or receipt" it ends up allocating "expenditure by way of interest, which is not directly attributable to any particular income or receipt, **plus interest which is directly attributable to taxable income**".

10. The incongruity arises because, as the wordings of rule 8D(2)(ii) exist, out of total interest expenses, interest expenses directly relatable to tax exempt income are excluded, interest expenses directly relatable to taxable income, even if any, are not excluded.

11. The question then arises whether we can tinker with the formula prescribed under rule 8D(2)(ii) of the Income Tax Rules, or construe it any other manner other than what is supported by plain words of the rule 8 D (2)(ii).

12 In our opinion, it is only the interest on borrowed funds that would be apportioned and the amount of expenditure by way of interest that will be taken (as 'A' in the formula) will exclude any expenditure by way of interest which is

directly attributable to any particular income or receipt. Therefore, it is not only the interest directly attributable to tax exempt income, i.e. under rule 8D(2)(i), but also interest directly relatable to taxable income, which is to be excluded from the definition of variable 'A' in formula as per rule 8D(2)(ii), and rightly so, because it is only then that common interest expenses, which are to be allocated as indirectly relatable to taxable income and tax exempt income, can be computed.

13. In our opinion, interest expenses directly attributable to tax exempt income as also directly attributable to taxable income, are required to be excluded from computation of common interest expenses to be allocated under rule 8D(2)(ii).

14. In our opinion, the disallowance u/s. 14A in the assessment year under consideration is warranted. Since there is mistake in computing the disallowance, as rightly pointed out by the Ld. AR, we are inclined to hold that net current assets is to be considered while applying the formula under Rule 8D of the I.T. Rules instead of gross current assets. Accordingly, we direct the Assessing officer to re-compute the disallowance and decide the issue afresh in the light of the above observation. Accordingly, this ground is partly allowed.

15. The next ground is with regard to disallowance of Rs.28,99,882/- on account of speculation loss.

16. The brief facts of the case are that the assessee claimed loss from commodity trading at Rs.28,99,882/-. The assessee-company had purchased commodity item namely pepper (100 MT) valued at Rs.1,12,50,000/- and sold it without actual purchase or delivery. The business of the company is commodity broking to provide a platform for its clients for commodity on line trading. It also offered future trading for its events of multiple exchanges in varied commodities such as agricultural commodities, precious metal, energy, products etc. However, when the company trades its own commodity without actual purchase or delivery it becomes a speculative transaction and the loss is speculative loss. The loss is not allowed to set off against the business income of the assessee hence disallowed the computation.

17. On appeal, the CIT(A) observed that the intention of sec. 43 was to define certain terms in respect of classification of income and for purposes of section 28 to section 41 of the Act. Section 43(5) of the Act defines "speculative transaction" as a transaction in which a contract for the purchase and sell of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scripts. It

excludes certain transactions and derivatives only for a limited purpose, as spelt out in the proviso to this clause.

18. The CIT(A) observed that since the assessee has claimed loss from commodity hedging without taking actual delivery and given the nature of its business, it can not fall within the exclusion of clause (b). According to the CIT(A), though the assessee has claimed that it had stock of the commodity and that the account was periodically marked to the market, but the fact remains that the delivery of the commodity was not taken at each step and it was only done on final settlement of account. To this extent the transaction entered into by the assessee is "speculative transaction". The CIT(A) observed that here it is also important to invoke Explanation to section 73 as the assessee has claimed loss on this transaction. According to the CIT(A) Section 73 categorically provides that where any part of the business of the company includes purchase and sale of shares of other company, it shall be deemed to be carrying on speculation business to the extent to which the business consists of that activity. Further, the CIT(A) observed that Explanation to section 73 deems that companies which are into business of purchase and sale of shares, even if delivery based are treated to be carrying on speculative business. Thus, the CIT(A) confirmed the finding of the Assessing officer that the transaction should be treated as speculative transaction and the loss cannot be adjusted against any other kind of income. Against this, the assessee is in appeal before us.

19. The Ld. AR submitted that the Assessing officer disallowed the above loss on the premise that the assessee has not taken the actual delivery of pepper. However, according to the assessee, the assessee has taken the actual delivery of pepper and thereafter sold it and he prayed that this issue may be remitted back to the file of the Assessing officer for fresh consideration.

20. On the other hand, the Ld. DR submitted that the assessee has not produced any evidence before the lower authorities to suggest that the assessee has taken actual delivery of pepper and thereafter sold it.

21. We have heard both the parties and perused the record. In our opinion, it is proper to examine this issue afresh on the plea of the Ld. AR that the assessee has actually taken delivery of pepper. If the assessee has actually taken delivery of pepper and thereafter sold it, then the provisions of sec. 43(5) cannot be applied. Accordingly, with this observation, we remit the issue back to the file of the Assessing officer for fresh consideration.

22. The next ground is with regard to disallowance of bad debts of Rs.19,57,037/-. According to the Ld. AR, the assessee has raised this ground before the CIT(A) which was not properly adjudicated. According to the Ld. AR

all the conditions stipulated u/s. 36(1)(vii) and 36(2) have been complied with and the amounts written off were considered as income in the earlier years.

23. We have heard both the parties and perused the record. Admittedly, the assessee has raised the following grounds before the CIT(A):

The Assistant Commissioner of Income tax is not correct in disallowing the bad debts of Rs.5,24,432/- on the ground that the same was not offered as income in earlier years and hence conditions u/s. 36(2) was not satisfied. The amounts written off were considered as income in the earlier years and hence bad debts written off should have been allowed as expenditure.

The Assistant Commissioner of Income tax is not justified in allowing dues from client written off as bad debts on the ground that the conditions u/s. 36(2) were not satisfied. The assessee is a stock broker and the amounts receivable from clients which includes brokerage payable by the client was a part of the debt and the debt had been taken into account in the computation of income, the conditions stipulated in section 36(1)(vii) and 36(2) stood satisfied. The assessee relied on the decision of Delhi High Court in the case of CIT vs. Bonanza Portfolio Ltd. The Departmental appeal against the above decision was dismissed by Supreme Court in the case of 328 ITR St 9) and hence the decision has become final.

24. Further, the CIT(A) has adjudicated only one issue relating to bad debts of Rs. 5,24,532/-. Admittedly, both the grounds have not been properly adjudicated. In our opinion, actually this issue should go back to the file of the CIT(A) for fresh adjudication. However, since the earlier two issues have been remitted back to the file of the Assessing officer for fresh consideration, this issue shall also be remitted back to the file of the Assessing officer for fresh consideration and to decide in accordance with law.

25. In the result, the appeal of the assessee is partly allowed for statistical purposes.

Pronounced accordingly on 28-08-2014.

sd/-
(N.R.S.GANESAN)
JUDICIAL MEMBER

sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Place: Kochi

Dated: 28th August , 2014

GJ

Copy to:

1. M/s. Geojit Investment Services Ltd., 34/659, Civil Line Road, Padivattom, Kochi-682 024.
2. The Assistant Commissioner of Income-tax, Circle-1(2), Ernakulam.
3. The Commissioner of Income-tax(Appeals)-II, Kochi.
4. The Commissioner of Income-tax, Kochi.
5. D.R., I.T.A.T., Cochin Bench, Cochin.
6. Guard File.