IN THE INCOME TAX APPELLATE TRIBUNAL
LUCKNOW BENCH "A", LUCKNOW

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER
AND SHRI. A. K. GARODIA, ACCOUNTANT MEMBER

ITA No.538/LKW/2012
Assessment Year:2009-10

U.P. Electronics Corporation Ltd. 10, Ashok Marg Lucknow	v.	DCIT (TDS) Lucknow
TAN/PAN:AAACU3391H		
(Appellant)		(Respondent)

Appellant by:	Shri. R. C. Jain, C.A.		
Respondent by:	Shri. K. C. Meena, D.R.		
Date of hearing:	21	11	2014
Date of pronouncement:	23	01	2015

O R D E R

PER SUNIL KUMAR YADAV:

This appeal is preferred by the assessee against the order of the ld. CIT(A), inter alia, on various grounds, which are as under:-

1.1. Because the funds parked by the assessee company in Bank FOR were given by the Government for a specific purpose and were to be utilized for that purpose only and the assessee corporation being only a trustee of these funds, the interest income of Rs.13,75,418/- on such funds ought not to have been assessed as the income of the assessee corporation.

1.2. Because the funds being made available by the Government of U.P. only for disbursement to the employees of UPTRON India Limited under the Voluntary Retirement Scheme (VRS) and the Government having decided that the interest on such funds could not be appropriated by the assessee company towards its income, the learned CIT(Appeals) erred in upholding the action of the learned

Assessing Officer of treating such interest of Rs.13,75,418/- as income of the assessee company.

1.3. Because, in any case, the deposit account having been seized/ attached by the Provident Fund Commissioner and the assessee company having no control over these funds, the interest on such funds of Rs.13,75,418/- ought not to have been treated as income of the assessee company.

2.1. Because the learned 1st appellate authority erred in confirming the addition made by the Assessing Officer u/s 14A of the Income Tax Act, 1961 read with rule 8D of the Income Tax Rules, 1962.

2.2. Because the learned 1st appellate authority failed to appreciate that the Assessing Officer applied Rule 8D in a mechanical manner without application of mind and without regard to facts and reply of the assessee; so much so that the learned assessing officer recorded an erroneous finding by stating that the 'assessee submitted that no expenditure has been incurred on this account' though the assessee on its own had determined expenditure of Rs.47,564 for earning the exempt income and made disallowance on its own and gave detailed submissions during hearing in this regard and even the disallowance of Rs.47,564/- made by the assessee on its own was not excluded by the learned assessing officer from the total disallowance.

2.3. Because the learned assessing officer having failed to give any finding on the correctness of the claim of expenditure made by the assessee, the determination of expenditure as per sub-rule (2) of Rule 8D of the Income Tax Rules, 1962 was beyond the jurisdiction of the learned assessing officer and the learned first appellate authority erred in sustaining the addition made without jurisdiction.

2.4. Because the learned first appellate authority had no warrant to state that 'the appellate has nowhere given any detail of expenditure directly incurred in earning the exempt dividend income' as no such expenses were incurred by the assessee and even the assessing

officer has not considered any direct expenditure in making the disallowance.

2.5. Because the learned first appellate authority erred in concluding that once the direct expenses are not identifiable then the indirect expenses are to be calculated in the manner provided in Clause iii of Rule 8D(2).

2.6. Because the learned first appellate authority had no warrant to hold that there is no anomaly in computation of disallowable expenditure done by the AO by applying Rule 8D(2)(iii).

3. Because the order appealed against is contrary to the fact, law and principles of natural justice.

2. Apropos ground No.1, it was contended on behalf of the assessee that this ground is covered by the order of the Tribunal in the assessee's own case for assessment years 2005-06 and 2006-7, in which the Tribunal has restored the issue to the file of the Assessing Officer with a direction to re-examine the issue afresh in the light of the order of the State Government dated 3.4.1980. Therefore, in this appeal also, this matter should go back to the Assessing Officer, as while dealing with the issue, the ld. CIT(A) has followed his order for assessment year 2005-06.

3. The ld. D.R. did not dispute this factual aspect of the matter.

4. Having carefully examined the orders of the lower authorities in the light of the rival submissions and the order of the Tribunal in the assessee's own case for assessment year 2005-06, we find that while adjudicating the impugned issue, the ld. CIT(A) has followed his earlier order for assessment year 2005-06 and rejected the ground of the assessee. During assessment year 2005-06, the Tribunal has examined this issue and has restored the matter to the file of the Assessing Officer with a direction to re-adjudicate the issue in the light of the order of the State Government dated 3.4.1980.

The relevant observations of the Tribunal are extracted hereunder for the sake of reference:-

> *"6. Having heard the rival submissions and from a careful perusal of the record, we find that before the lower authorities the assessee has taken a stand that the accounts were attached by the Regional Provident Fund Commissioner and assessee was not able to operate that account, therefore, the interest could not be offered to tax but before us the assessee has filed an order of the Statement Government containing the rider on the funds given to the assessee to meet the expenditure to be incurred for VRS. From a careful perusal of this order it appears that whatever fund was given by the Government to the assessee, it was given subject to certain conditions and one of the important contention is that whatever interest is earned on its deposits with the bank, it belongs to the State Government and the assessee has no right over it. If this is the fact the interest income earned on SDR cannot be charged in the hands of the assessee. Since this new evidence is filed before us and it is goes to the root of the case, we are of the view that in the interest of justice and the stand taken by the assessee before us, this issue should be reexamined by the Assessing Officer. We accordingly set aside the order of CIT(A) and restore the matter to the file of the Assessing Officer with the direction to reexamine the issue afresh in the light of this order of the State Government dated 03/04/1980."*

5. Since the Tribunal has taken a particular view in similar set of facts, we find no justification to take a contrary view on this issue. Accordingly, following the aforesaid order of the Tribunal, we set aside the order of the ld. CIT(A) and restore the matter to the file of the Assessing Officer with a direction to re-adjudicate the issue afresh in the light of the order of the State Government dated 3.4.1980.

6. Apropos ground No.2, the facts in brief borne out from the record are that the Assessing Officer has made addition of Rs.40,31,477/- under section 14A of the Income-tax Act, 1961 (hereinafter called in short "the Act") read with rule 8D of the rules, having noticed that the assessee has shown dividend income of Rs.7,52,120/- which were exempted from tax. He accordingly computed the corresponding expenditure as per rule 8D (iii) of the rules at Rs.40,31,477/- and made addition of the same.

7. Assessee preferred an appeal before the ld. CIT(A) with the submission that before invoking rule 8D of the rules, the Assessing Officer has not recorded any finding with regard to the correctness of computation furnished by the assessee. It was further contended that the claim of disallowance under section 14A of the Act cannot exceed the income. In support of this contention, the ld. counsel for the assessee has placed reliance upon the decision of the Chandigarh Bench of the Tribunal in the case of ACIT vs. Punjab State Coop & Marketing Fed. Ltd. in I.T.A. No. 548/CHD/2011, dated 30.9.2011. The ld. CIT(A) re-examined the claim of the assessee, but was not convinced with it and he confirmed the disallowance.

8. Now the assessee has preferred an appeal before the Tribunal with the submission that whatever investment was made, it was made in the 100% owned subsidiary concerns of the assessee. In support of the contention, the ld. counsel for the assessee has invited our attention to Schedule 'E' containing details of investment appearing at page 31 of the compilation of the assessee, according to which investments were made in Uptron India Limited; Uptron Powertronics Ltd. and Uplease Financial Services Ltd. The total investments made in these companies in the impugned assessment year was Rs.60,90,10,559/-. Since the investment was in 100% owned subsidiaries, no disallowance can be made after invoking the provisions of rule 8D and 14A of the Act. In support of his

contention, the ld. counsel for the assessee has placed reliance upon the order of the Mumbai "J" Bench of the Tribunal in the case of M/s JM Financial Limited vs. Addl. CIT, I.T.A. No. 4521/Mum/2012. Copy of the order of the Tribunal is also placed on record. Besides, reliance was also placed on the order of the Pune Bench of the Tribunal in the case of Kalyani Steels Ltd. vs. Addl. CIT, I.T.A. No. 1733/PN/2012, in which it has been held that the Assessing Officer was required to record objective satisfaction with regard to the correctness of the claim of the assessee which is mandatorily required in terms of section 14A(2) of the Act. The ld. counsel for the assessee has further invited our attention to the assessment order, in which before computing the disallowance under rule 8D(2) of the rules, the Assessing Officer has not recorded satisfaction with regard to the correctness of the computation of disallowance as per rule 8D.

9. Having carefully examined the orders of the lower authorities in the light of the rival submissions, we find that out of total investments of Rs.82,16,45,416/-, investment in subsidiary companies were of Rs.60,90,10,559/- as per balance sheet appearing at pages 26 to 38 of compilation of the assessee. The assessee has raised a specific dispute with regard to the invocation of provisions of rule 8D with the contention that before invoking the provisions of rule 8D, the Assessing Officer has to record objective satisfaction with regard to the correctness of the accounts relating to provisions of section 14A of the Act. In support of his contention, the ld. counsel for the assessee has invited our attention to the judgment of the Hon'ble Bombay High Court in the case of Godrej And Boyce Mfg. Co. Ltd. vs. Dy. CIT & Another [2010] 328 ITR 81 (Bom.) and the orders of the Tribunal in the cases of M/s JM Financial Limited vs. Addl. CIT (supra) and Kalyani Steels Ltd. vs. Addl. CIT (supra).

10. In the case of M/s JM Financial Limited vs. Addl. CIT (supra), the Tribunal has examined the issue of recording objective satisfaction by the

Assessing Officer before proceeding for computation of corresponding expenditures as per rule 8D and possibility of disallowance in case where strategic investment was made in the subsidiary companies and the Tribunal has finally concluded that sub-section (2) of section 14A of the Act does not ifso facto empower the Assessing Officer to apply the method prescribed by Rules straightaway without considering whether the claim made by the assessee is correct.

11. With regard to the investment in subsidiary companies, the Tribunal has also held that in the absence of any finding that any expenditure has been incurred for earning exempted income, the disallowance made by the Assessing Officer is not justified. The relevant observations of the Tribunal in the case of M/s JM Financial Limited vs. Addl. CIT (supra) are extracted hereunder for the sake of reference:-

> *"7. Having considered the rival submissions as well as relevant material on record, we note that so far as applicability of Rule 8D is concerned, there is no quarrel on this point that for the A.Y. under consideration Rule 8D is applicable. Further for the A.Y. 2008-09, the Tribunal held in para 15 as under:-*
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> *"We have considered the rival arguments made by both the sides, perused the orders of the AO and CIT(A) and the paper book filed on behalf of the assessee. We have also considered the various decisions cited before us. In the instant case, the only dispute is regarding determination of disallowance of expenditure for earning tax free dividend income of Rs. 18,17,68,458/- the assessee disallowed on its own Rs.16.50 lakhs u/s 14A. Despite being asked by the AO to furnish the disallowance under rule 8D, the assessee did not furnish the details. The provisions of rule 8D inserted by the IT (Fifth Amendment) Rules 2008 with effect from 24.3.2008 are applicable for A.Y. 2008-09 and onwards. Therefore, the revenue authorities are bound to follow the mandatory provisions for calculation of disallowance u/s 14A. Therefore, we do not find any infirmity in the order of the CIT(A) upholding the action of the Assessing Officer for disallowing*

the deduction u/s 14A read with rule 8D. The contention of the assessee that the AO without satisfaction being reached invoked the provisions of Rule 8D, in our opinion, does not hold good especially in absence of non-furnishing of details for the purposes of calculation of disallowance at Rs. 16.50 lakhs by the assessee on its own. In this view of the matter and in absence of any distinguishable feature brought to our notice by the learned Counsel for the assessee against the order of the CIT(A), we do not find any infirmity in the same. Accordingly the same is upheld and the ground raised by the assessee is dismissed."

8. As it is clear from the finding of Tribunal that the assessee failed to furnish the details of disallowance under section 14A and, therefore, the disallowance made by the AO was found by the Tribunal without any infirmity. For the year under consideration the assessee has specifically raised a point before the AO that 97.82% of the investment is in the subsidiary companies and joint venture companies and, therefore, no expenditure was incurred for maintaining the portfolio on these investments or for holding the same. The assessee has also pointed out that these investments are long term investment and no decision is required in making the investment or disinvestment on regular basis because these investments are strategic in nature in the subsidiary companies on long term basis and, therefore, no direct or indirect expenditure is incurred. We find that the department has not disputed this fact that out of the total investment about 98% of the investment are in subsidiary companies of the assessee and, therefore, the purpose of investment is not for earning the dividend income but having control and business purpose and consideration. Therefore, prima facie the assessee has made out a case to show that no expenditure has been incurred for maintaining these long term investment in

subsidiary companies. The Assessing Officer has not brought out any contrary fact or material to show that the assessee has incurred any expenditure for maintaining these investments or portfolio of these investments. In the case of Godrej & Boyce Mfg. Co. Ltd. (supra) Hon'ble Jurisdictional High Court while dealing with the issue of disallowance u/s 14A and application of Rule 8D has recorded the principles as laid down by the Hon'ble Supreme Court in the case of WalfortShare and Stock Brokers P. Ltd. [2010] (326 ITR 1,) in para 31 as under:-

(a) "The mandate of section 14A is to prevent claims for deduction of expenditure in relation to income which does not form part of the total income.

(b) Section 14A(1) is enacted to ensure that only expenses incurred in respect of earning taxable income are allowed;

(c) The principle of apportionment of expenses is widened by section 14A to include even the apportionment of expenditure between taxable and nontaxable income of an indivisible business;

(d) The basic principle of taxation is to tax net income. This principle applies even for the purpose of section 14A and expenses towards non-taxable income must be excluded;

(e) Once a proximate cause for disallowance is established – which is the relationship of the expenditure with income which does not form part of the total income – a disallowance has to be effected. All expenditure under the provisions of the Act has to be disallowed under section 14A Income which does not form part of the total income is broadly adverted to as exempt income as an abbreviated appellation."

9. After considering these principles as emerged from the decision of Hon'ble Supreme Court in the case of Walfort Share and Stock Brokers P. Ltd. (supra), Hon'ble Jurisdictional High Court has held in para 32 and 33 as under:-

"32. Sub-section (2) and (3) to section 14A were inserted by an amendment brought about by the Finance Act of 2006 with

effect from April 1, 2007. Sub Sections (2) and (3) Provide as follows.

"14A.(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."

(The proviso was inserted earlier by the Finance Act of 2002 with retrospective effect from May 11, 2001)

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 April 1,2001, 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."

10. It has been made clear by the Hon'ble High Court that sub-section (2) does not ifso facto empower the AO to apply the method prescribed by Rules straightaway without considering whether the claim made by the assessee is correct.

11. The assessee has relied upon various decisions of this Tribunal wherein an identical issue has been considered. In the case of Garware Wall Ropes Limited Vs. Addl. CIT (supra), the Tribunal while deciding an identical issue has held in para 2.4 as under:-

"We have considered the rival submission and carefully perused the relevant records. So far as the issue regarding disallowance u/s 14A in the case where no dividend has been received, the same is covered against the assessee by the order of Tribunal in assessee's own case for the assessment year 2008-09, wherein the Tribunal has followed the decision of special bench of Tribunal while deciding the issue. Therefore, we do agree with the finding of the Tribunal on this point. Further since the assessee has raised the new plea in the year under consideration that no expenditure had been incurred by the assessee for earning the exempt income or for the investment in question. We find merit and substance in the contention of the assessee on this point because the investment has been made by the assessee in the group concern and not in the shares of any un-related party. Therefore, the primary object of investment is holding controlling stake in the group concern and not earning any income out of investment. Further the investment were made long back and not in the year under consideration. Therefore, in view of the fact that the investment are in the group concern we do not find any reason to believe that the assessee would have incurred any administrative expenses in holding these investments. The Assessing Officer has not brought on record any material to show that the assessee has incurred any expenditure in relation to the income which does not form part of the total income. Section 14A has within it implicit the notion of apportionment in the cases where the expenditure is incurred for composite/indivisible activities in which taxable and non taxable income is received but when no expenditure has been incurred in relation to the exempt income then principle of apportionment embedded in section 14A has no application. The object of section 14A is not allowing to reduce tax payable on the non exempt income by deducting the expenditure incurred to earn the exempt income. In the case in hand it is not the case of the revenue that the assessee has incurred any direct expenditure or any interest expenditure for earning the exempt income or keeping the investment in question. If there is expenditure directly or indirectly incurred in relation to exempt income the same cannot be claimed against the income which is taxable. For attracting the provisions of section 14A- "there should be proximate cause for disallowance which has relationship with the tax exempt income as held by the Hon'ble Supreme Court in case of CIT Vs. Walfort Share and Stock Brokers P. Ltd. (326 ITR 1).

Therefore, there should be a proximate relationship between the expenditure and the income which does not form part of the total income. In the case in hand the assessee has claimed that no expenditure has been incurred for earning the exempt income, therefore, it was incumbent on the AO to find out as to whether the assessee has incurred any expenditure in relation to income which does not form part of the total income and if so to quantify the expenditure of disallowance. The AO has not brought on record any fact or material to show that any expenditure has been incurred on the activity which has resulted into both taxable and non taxable income. Therefore, in our view when the assessee has prima facie brought out a case that no expenditure has been incurred for earning the income which does not form part of the total income then in the absence of any finding that expenditure has been incurred for earning the exempt income the provisions of section 14A cannot be applied. Accordingly we delete the addition/disallowance made by AO u/s 14A r.w. Rule 8D."

12. A similar view was taken by the Delhi Bench of this Tribunal in the case of M/s Oriental Structural Engineers (P) Ltd (supra) which has been confirmed by the Hon'ble Delhi High Court vide decision dated 15.01.2013 in para 6.3 as under:-

"'6.3 We have carefully considered the submissions and perused the records. We find that Ld. Commissioner of Income Tax (Appeals) has given a finding that only interest of Rs 2,96,731/- was paid on funds utilized for making investments on which exempted income was receivable. Further, Ld. Commissioner of Income Tax (Appeals) has observed that in respect of investment of Rs 6,07,775,000/- made in subsidiary companies as per documents produced before him, they are attributable to commercial expediency, because as per submission made by the assessee, it had to form Special Purpose Vehicles (SPY) in order to obtain contracts from the NHAI and the SPVs so formed engaged the assessee company as contract to execute the works awarded to them (i.e. SPVs) by the NHAI. In its profit and loss account for the year, the assessee has shown the turnover from execution of these contracts and therefore no expense and interest attributable to the investments made by the appellant in the PSVs can be disallowed u/s 14A LW. Rule 8D because it cannot be termed

as expense/interest incurred for earning exempted income. Under the circumstances, Ld. Commissioner of Income Tax (Appeals) is correct in holding that disallowance of a further sum Rs 40,556/- calculated@2%ofthedividend earned is sufficient. Under the circumstances, we do not find any infirmity in the order of the Ld. Commissioner of Income Tax (Appeals), hence we uphold the same."

13. In view of the above discussion and facts and circumstances of the case we agree with the view taken by this Tribunal in the above stated cases and accordingly hold that the assessee has brought out a case to show that no expenditure has been incurred for maintaining the 98% of the investment made in the subsidiary companies, therefore, in the absence of any finding that any expenditure has been incurred for earning the exempt income, the disallowance made by the AO is not justified, accordingly the same is deleted."

12. The issue of recording objective satisfaction by the Assessing Officer, before proceeding to determine the amount of expenditure incurred in relation to such income which does not form part of the total income under the Income-tax Act, was also examined by the Pune Bench of the Tribunal in the case of Kalyani Steels Ltd. vs. Addl. CIT (supra) and the Pune Bench, following the judgment of the Hon'ble Bombay High Court in the case of Godrej And Boyce Mfg. Co. Ltd. vs. Dy. CIT & Another (supra), was also of the view that recording of objective satisfaction by the Assessing Officer with regard to the correctness of the claim of the assessee is mandatorily required in terms of section 14A(2) of the Act. The relevant observations of the Tribunal are also extracted hereunder:-

"8. We have carefully considered the rival submissions. Section 14A of the Act contemplates that for the purposes of computing the total income, 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 the Act. Sub-section (2) of section 14A of the Act prescribes that the Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income in accordance with such method as may be prescribed, such prescribed method being contained in rule 8D of the Rules. However, the aforesaid empowerment of the Assessing Officer to invoke application of rule 8D of the Rules is superscribed by a condition contained in sub-section (2) of section 14A of the Act which is to the effect that 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 expenditure incurred in relation to the income which does not form part of the total income. Therefore, the invoking of rule 8D of the Rules in order to compute the disallowance u/s 14A of the Act is neither automatic and nor is triggered merely because assessee has earned an exempt income. The invoking of rule 8D of the Rules is permissible only when the Assessing Officer records the satisfaction in regard to the incorrectness of the claim of the assessee, having regard to the accounts of the assessee. In other words, section 14A(2) of the Act envisaged a condition precedent for invoking rule 8D of the Rules and computing disallowance thereof only if the Assessing Officer records that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure, having regard to the account of the assessee. In this context, it would be appropriate to refer to the following observations of the

Hon'ble Bombay High Court in the case of Godrej & Boyce Manufacturing Co. Ltd. (supra) :-

"70. Now, in dealing with the challenge it is necessary to advert to the position that sub-section (2) of section 14A prescribes a uniform method for determining the amount of expenditure incurred in relation to income which does not form part of the total income only in a situation where 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. It, therefore, merits emphasis that sub-section (2) of section 14A does not authorize or empower the Assessing Officer to apply the prescribed method irrespective of the nature of the claim made by the assessee. The Assessing Officer has to first consider the correctness of the claim of the assessee having regard to the accounts of the assessee. The satisfaction of the Assessing Officer has to be objectively arrived at on the basis of those accounts and after considering all the relevant facts and circumstances. The application of the prescribed method arises in a situation where the claim made by the assessee in respect of expenditure which is relatable to the earning of income which does not form part of the total income under the Act is found to be incorrect. In such a situation a method had to be devised for apportioning the expenditure incurred by the assessee between what is incurred in relation to the earning of taxable income and that which is incurred in relation to the earning of non-taxable income. As a matter of fact, the memorandum explaining the provisions of the Finance Bill, 2006, and the Central Board of Direct Taxes circular dated December 28, 2006, state that since the existing provisions of section 14A did not provide a method of computing the expenditure incurred in relation to income which did not form part of the total income, there was a considerable dispute between taxpayers and the Department on the method of determining such expenditure. It was in this background that sub- section (2) was inserted so as to provide a uniform method applicable where the Assessing Officer is not satisfied with the correctness of the claim of the assessee. Sub-section (3) clarifies that the application of the method would be attracted even to a situation where the assessee has claimed that no expenditure at all was incurred in relation to the earning of non-taxable income.

71. Parliament has provided an adequate safeguard to the invocation of the power to determine the expenditure incurred in relation to the earning of non-taxable income by adoption of the prescribed method. The invocation of the power is made conditional on the objective satisfaction of the Assessing Officer in regard to the correctness of the claim of the assessee, having regard to the accounts of the assessee. When a statute postulates the satisfaction of the Assessing Officer "Courts will not readily defer to the conclusiveness of an executive authority's opinion as to the existence of a matter of law or fact upon which the validity of the exercise of the power is predicated". (M. A. Rasheed v. State of Kerala [1974] AIR 1974 SC 2249). A decision by the Assessing Officer has to be arrived at in good faith on relevant considerations. The Assessing Officer must furnish to the assessee a reasonable opportunity to show cause on the correctness of the claim made by him. In the event that the Assessing Officer is not satisfied with the correctness of the claim made by the assessee, he must record reasons for his conclusion. These safeguards which are implicit in the requirements of fairness and fair procedure under article 14 must be observed by the Assessing Officer when he arrives at his satisfaction under sub-section (2) of section 14A. As we shall note shortly hereafter, sub-rule (1) of rule 8D has also incorporated the essential requirements of sub-section (2) of section 14A before the Assessing Officer proceeds to apply the method prescribed under sub-rule (2). [underlined for emphasis by us]*

9. The aforesaid observations of the Hon'ble High Court clearly show that the satisfaction of the Assessing Officer with regard to the correctness or otherwise of the claim made by the assessee must be based on reasons and on relevant considerations. Ostensibly, the invoking of rule 8D of the Rules in order to compute the disallowance u/s 14A of the Act is to be understood as being conditional on the objective satisfaction of the Assessing Officer with regard to the incorrectness of the claim of the assessee, having regard to the accounts of the assessee. At this stage, we may also touch-

upon a similar view expressed by the Hon'ble Delhi High Court in the case of Maxopp Investment Ltd. & Ors. vs. CIT, (2012) 247 CTR 162 (Del), wherein reference has been made to the judgment of the Hon'ble Bombay High Court in the case of Godrej & Boyce Manufacturing Co. Ltd. (supra). As per the Hon'ble Delhi High Court, the requirement of the Assessing Officer embarking upon a determination of the amount of expenditure incurred in relation to exempt income in term of rule 8D of the Rules would be triggered only if the Assessing Officer records a finding that he was not satisfied with the correctness of the

claim of the assessee in respect of such expenditure. According to the Hon'ble Delhi High Court, sub-section (2) of section 14A of the Act deals with cases where the assessee specifies a positive amount of expenditure in relation to income which does not form part of the total income under the Act and sub-section (3) applies to cases where the assessee asserts that no expenditure has been incurred in relation to such exempt income. Explaining further, as per the Hon'ble High Court in both the cases the recourse to rule 8D of the Rules is possible only if the Assessing Officer records a finding that he was not satisfied with the correctness of the claim of the assessee in respect of such expenditure.

10. In the aforesaid background, now, we may examine the facts of the present case. In this case, assessee has earned by way of dividends a sum of Rs.5,45,58,685/-, which is exempt u/s 10(38) of the Act and thus the same does not form part of the total income under the Act. In the computation of income, assessee having regard to section 14A of the Act, determined

the amount of expenditure incurred in relation to such income at Rs.5,00,000/-. The Assessing Officer has not found it acceptable and has instead determined the amount of expenditure in relation to such income by applying rule 8D of the Rules. Ostensibly, the action of the Assessing Officer cannot be upheld unless he has complied with the pre-requisite of invoking rule 8D of the Rules, namely, recording of an objective satisfaction with regard to the claim of the assessee that an expenditure of Rs.5,00,000/- has been incurred in relation to the exempt income, is incorrect. In order to examine the aforesaid compliance with the pre-condition, we have perused the para 4 to 4.2 of the assessment order and find that no reasons have been advanced as to why the disallowance determined by the assessee was found to be incorrect, having regard to the accounts of the assessee. The only point made by the Assessing Officer is to the effect that "the said disallowance was not acceptable". In-fact, we find that the assessee made detailed submissions to the Assessing Officer, which have been reproduced by the CIT(A) in para 3.2.1 of his order. As per the assessee, the determination of disallowance u/s 14A of the Act of Rs.5,00,000/- was based on the employee costs and other costs involved in carrying out this activity. Further, assessee also explained that the shares which have yielded exempt income were acquired long back out of own funds and no borrowings were utilized. The mutual fund investments were claimed to be also made out of surplus funds. It was specifically claimed that no fresh investments have been made during the year under consideration in shares yielding exempt income. All the aforesaid points raised by the

assessee have not been addressed by the Assessing Officer and the same have been brushed aside by making a bland statement that the

disallowance is "not acceptable" . Therefore, in our view, in the present case, the Assessing Officer has not recorded any objective satisfaction in regard to the correctness of the claim of the assessee, which is mandatorily required in terms of section 14A(2) of the Act and therefore his action of invoking rule 8D of the Rules to compute the impugned disallowance is untenable. Accordingly, the orders of the authorities below are set-aside on this aspect and the Assessing Officer is directed to retain the disallowance u/s 14A of the Act to the extent of Rs.5,00,000/-, as returned by the assessee."

13. In that case, before proceeding to determine the amount of expenditure, the Assessing Officer has recorded that the said allowance was not acceptable. The statement recorded by the Assessing Officer was not considered to be objective satisfaction by the Tribunal. In the instant case, the Assessing Officer has simply recorded that the contention of the assessee is not acceptable. Therefore, in the light of the aforesaid orders of the Tribunal and other judicial pronouncements, we are of the view that the Assessing Officer has not recorded any objective satisfaction with regard to the correctness of the claim of the assessee.

14. In the case of DCIT vs. M/s Jindal Photo Limited in I.T.A. No. 814/Del/2011, the Delhi Bench of the Tribunal has also expressed similar view, in which it has been held that satisfaction of the Assessing Officer is pre-requisite to invoke the provisions of Rule 8D. Therefore, in the absence of objective satisfaction by the Assessing Officer, the disallowance made under rule 8D is not sustainable in the eyes of law. Moreover, the

investment was made in the case of subsidiary companies, therefore, in those cases disallowance under section 1A(2) of the Act cannot be worked out unless and until it is established that certain expenditures are incurred by the assessee in these investments.

15. Keeping in view the totality of the facts and circumstances of the case, we are of the considered opinion that invocation of rule 8D without recording objective satisfaction by the Assessing Officer is not proper and we accordingly set aside the order of the ld. CIT(A) on this issue and delete the addition made in this regard.

16. In the result, appeal of the assessee is partly allowed for statistical purpose.

Order was pronounced in the open court on the date mentioned on the captioned page.

Sd/-	Sd/-
[A. K. GARODIA]	[SUNIL KUMAR YADAV]
ACCOUNTANT MEMBER	JUDICIAL MEMBER

DATED:23rd January, 2015

JJ:0901

Copy forwarded to:

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

Assistant Registrar