$~33 & 36

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

\+ ITA 893/2011
\+ ITA 1024/2011

CIT ..... Appellant
Through Ms. Rashmi Chopra, sr. standing counsel

versus

SELECT HOLIDAY RESORTS PVT LTD ..... Respondent
Through Ms. Kavita Jha and Mr. Somnath Shukla, Advs.

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

ORDER

% **02.12.2011**

Ld. counsel for both the parties submit that the matter is covered by decision dated 18.11.2011 of jurisdictional High Court in ITA No.687/2009, ***Maxopp Investment Ltd. v. Commissioner of Income Tax*** *and other connected cases.*

2. By the impugned order dated 8.10.2010, which relates to assessment year 2006-07, the tribunal had remitted the matter to

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the Assessing Officer in terms of directions issued by Bombay High Court in the case of Godrej Boyce Mfg. Co. The Assessing Officer while dealing with and computing the disallowance under Section 14A of the Income Tax Act, 1961 will ~~be~~ keep~~ing~~ in mind the observations and apply the judgment in the case of ***Maxopp Investment Ltd.*** (supra).

3. The appeal is disposed of.

SANJIV KHANNA,J

R.V.EASWAR, J

DECEMBER 02, 2011
vld

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

% Judgment delivered on: 18.11.2011

\+ **ITA 687/2009**

MAXOPP INVESTMENT LTD ... Appellant

- versus –

COMMISSIONER OF INCOME-TAX, NEW DELHI ... Respondent

Advocates who appeared in this case:

For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

For the Respondent/Revenue : Mr Sanjeev Sabharwal with Ms P. L. Bansal and Ms Sonia Mathur

AND

\+ **ITA 112/2010**

M/S EICHER GOODEARTH LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX NEW DELHI ... Respondent

Advocates who appeared in this case:

For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

\+ **ITA 263/2010**

MOHAIR INVESTMENT & TRADING CO. (P) LTD ... Appellant

- versus –

COMMISSIONER OF INCOME TAX, NEW DELHI ... Respondent

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Advocates who appeared in this case:
For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva
For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

\+ **ITA 805/2009**

EICHER LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX, NEW DELHI ... Respondent

Advocates who appeared in this case:
For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva
For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

\+ **ITA 98/2009**

COMMISSIONER OF INCOME TAX DELHI-IV ... Appellant

- versus -

ESCORTS FINANCE LTD ... Respondent

Advocates who appeared in this case:
For the Appellant/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha
For the Respondent : Mr R. M. Mehta

AND

\+ **ITA 853/2009**

CHEMINVEST LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX, NEW DELHI ... Respondent

Advocates who appeared in this case:
For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and

Mr Amit Sachdeva
For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

+ **ITA 856/2009**

CHEMINVEST LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX, NEW DELHI ... Respondent

Advocates who appeared in this case:
For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva
For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

+ **ITA 932/2009**

THE COMMISSIONER OF INCOME TAX, DELHI-V ... Appellant

- versus -

M/S NALWA INVESTMENTS LTD ... Respondent

Advocates who appeared in this case:
For the Appellant/Revenue : Ms Sonia Mathur
For the Respondent : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

AND

+ **ITA 958/2009**

MINDA INDUSTRIES LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX, NEW DELHI ... Respondent

Advocates who appeared in this case:
For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

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For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

+ **ITA 1060/2009**

MAXPAK INVESTMENT LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX, NEW DELHI ... Respondent

Advocates who appeared in this case:
For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva
For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

+ **ITA 1096/2009**

JAGATJIT INDUSTRIES LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX & ANR ... Respondents

Advocates who appeared in this case:
For the Appellant : Mr Satyen Sethi with Mr Arta Trana Panda
For the Respondent/Revenue : Ms P. L. Bansal

AND

+ **ITA 1114/2009**

COMMISSIONER OF INCOME TAX, LTU ... Appellant

- versus -

SHARDA MOTORS INDUSTRIES LTD ... Respondent

Advocates who appeared in this case:
For the Appellant/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha
For the Respondent : Mr Satyen Sethi with Mr Arta Trana Panda

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AND

+ **ITA 936/2009**

EICHER LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX, NEW DELHI ... Respondent

Advocates who appeared in this case:

For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

+ **ITA 416/2010**

MEDICARE INVESTMENTS LTD ... Appellant

- versus -

COMMISSIONER OF INCOME TAX, NEW DELHI ... Respondent

Advocates who appeared in this case:

For the Appellant : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

For the Respondent/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha

AND

+ **ITA 57/2008**

COMMISSIONER OF INCOME TAX, DELHI-VI ... Appellant

- versus -

VOU INVESTMENT PVT LTD ... Respondent

Advocates who appeared in this case:

For the Appellant : Ms P. L. Bansal

For the Respondent/Revenue : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

AND

+ **ITA 139/2009**

THE COMMISSIONER OF INCOME TAX, DELHI-V ... Appellant

- versus -

M/S HCL PEROT SYSTEMS LTD ... Respondent

Advocates who appeared in this case:

For the Appellant : Ms P. L. Bansal and Ms Sonia Mathur
For the Respondent/Revenue : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

AND

+ **ITA 77/2009**

THE COMMISSIONER OF INCOME TAX, DELHI-V ... Appellant

- versus -

M/S HCL PEROT SYSTEMS LTD ... Respondent

Advocates who appeared in this case:

For the Appellant : Ms P. L. Bansal and Ms Sonia Mathur
For the Respondent/Revenue : Mr Ajay Vohra with Ms Kavita Jha, Ms Akanksha Aggarwal and Mr Amit Sachdeva

AND

+ **ITA 683/2008**

COMMISSIONER OF INCOME TAX, DELHI-IV ... Appellant

- versus -

ICRA LTD ... Respondent

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Advocates who appeared in this case:
For the Appellant : Ms Prem Lata Bansal
For the Respondent : Dr Rakesh Gupta with Ms Poonam Ahuja and Mr Johnson Bara

AND

\+ **ITA 702/2008**

COMMISSIONER OF INCOME TAX, DEHI-IV ... Appellant

- versus -

ICRA LTD ... Respondent

Advocates who appeared in this case:
For the Appellant : Ms Prem Lata Bansal
For the Respondent : Dr Rakesh Gupta with Ms Poonam Ahuja and Mr Johnson Bara

AND

\+ **ITA 217/2009**

COMMISSIONER OF INCOME TAX, DELHI-I ... Appellant

- versus -

GLAD INVESTMENTS PVT LTD
(Now merged with AKM SYSTEMS PVT LTD ... Respondent

Advocates who appeared in this case:
For the Appellant/Revenue : Ms P. L. Bansal with Ms Anshul Sharma
For the Respondent : Mr Ajay Nair with Mr Rajat Joneja

AND

\+ **ITA 389/2010**

THE COMMISSIONER OF INCOME TAX (LTU) ... Appellant

- versus -

SHARDA MOTORS INDUSTRIES LTD ... Respondent

Advocates who appeared in this case:
For the Appellant/Revenue : Mr Sanjeev Sabharwal with Mr Utpal Saha
For the Respondent : Mr Satyen Sethi with Mr Arta Trana Panda

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CORAM:
HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE SIDDHARTH MRIDUL

1.	Whether Reporters of local papers may be allowed to see the judgment?	YES
2.	To be referred to the Reporter or not?	YES
3.	Whether the judgment should be reported in Digest?	YES

BADAR DURREZ AHMED, J

1. This is a batch of twenty one (21) appeals under section 260A of the Income Tax Act, 1961. Eleven (11) of these have been filed by assessees and ten (10) by the revenue. Eight of these appeals – four by assessees and four by the revenue -- have been admitted and questions have been framed in them. The other appeals were tagged along therewith. It was, however, clearly understood by all the counsel appearing on both sides that the appeals which had not been formally admitted would be deemed to have been admitted for hearing and it was on this basis that arguments were addressed. All these appeals are concerned with section 14A of the Income Tax Act, 1961 and Rule 8D of the Income Tax Rules, 1962. In particular, we are called upon to examine as to whether interest paid on funds borrowed for investing in shares of operating companies for acquiring and retaining a controlling interest therein is allowable under section 36(1)(iii) and is not hit by section 14A of the Income tax Act, 1961? And, consequently, we are also required to examine the retrospective applicability of the sub-sections (2) & (3) of the said section 14A and of the said Rule 8D to the assessment years in question which range from 1998-99 to 2005-06.

Questions

2. Since, across these appeals, there were some minor differences in language insofar as the admitted and/or proposed questions were concerned, it was agreed that

the following substantial questions of law would, in general, cover all the cases before us:-

1. Whether expenditure (including interest paid on funds borrowed) in respect of investment in shares of operating companies for acquiring and retaining a controlling interest therein is hit by section 14A of the Income tax Act, 1961 inasmuch as the dividend received on such shares does not form part of the total income?
2. Whether the provisions of sub-section (2) and sub-section (3) of section 14A inserted by the Finance Act, 2006 with effect from 01/04/2007, would apply retrospectively to all pending proceedings?
3. Whether Rule 8D inserted by the Income -tax (Fifth Amendment) Rules, 2008 with effect from 24/03/2008 was procedural in nature and hence would apply retrospectively to all pending proceedings?

3. In order to provide some factual basis behind the above mentioned questions, we shall refer to the appeal in the case of Maxopp Investment Limited v. CIT [ITA No.687/2009]. The assessee company is in the business of finance, investment and of dealing in shares and securities. The assessee held shares and securities, partly as investments on the "capital account" and partly as "trading assets" for the purpose of acquiring and retaining control over its group companies, primarily Max India Ltd. As per the assessee, any profit resulting on the sale of shares held as trading assets was duly offered to tax as business income of the assessee. During the previous year relevant to the assessment year 2002-03, the assessee incurred total interest expenditure of Rs. 1,61,21,168/-, which was claimed as business expenditure under section 36 (1) (iii) of the Income Tax Act, 1961 (hereinafter referred to as "the said act"). According to the assessee, the expenditure claimed was not hit by section 14A of the said act, on the ground that although borrowed funds were partly utilised for investment in shares held as trading assets, such investment was made with the intention to acquire and retain a controlling interest in the aforesaid company and that the receipt of dividend thereon was merely incidental.

4. In respect of the said assessment year 2002-03, the assessee had filed a return of income declaring an income of Rs.78,90,430/-. The assessee had received the following incomes: –

1.	Interest on loans advanced	Rs. 1,94,70,181
2.	Dividend received	Rs. 49,90,860
3.	Profit on sale of shares	Rs. 1,49,285

The aforesaid dividend of Rs. 49,90,860/- was received on the shares of Max India Ltd, held by the assessee as "trading assets". By an order dated 27/08/2004, the assessing officer, invoking section 14A of the said act, apportioned the said interest expenditure in the ratio of investment in shares of Max India Ltd, on which dividend was received, to the principal amount of unsecured loans, which worked out to Rs. 67,74,175/-. However, the assessing officer restricted the disallowance under section 14A of the said act to Rs. 49,90,860/-, being the amount of dividend received. On appeal, the CIT (A), by the order dated 12/01/2005, upheld the order of the assessing officer. Thereafter, the case of the assessee was heard by a Special Bench constituted in the case of Daga Capital Management (P) Ltd. The Special Bench of the Tribunal held that the expenditure claimed was hit by the provisions of section 14A of the said Act. Pursuant to the majority decision of the Special Bench of the Tribunal, the issue of quantum of expenditure to be disallowed was restored to the assessing officer to be recomputed in terms of Rule 8D of the Income Tax Rules, 1961 (hereinafter referred to as "the said rules"), which was held to be retrospective.

5. As regards Question 1, it has been contended on behalf of the assessees that holding of shares for acquiring and retaining control of operating companies amounts to business and, consequently, dividend income on such shares is in the nature of business income. It was further submitted that the intention behind acquiring such shares was not to earn dividend but to acquire and retain a controlling interest in the

operating companies. Dividend was merely incidental. It was thus contended that the interest paid on the funds borrowed to acquire such shares was allowable as a business expenditure as it was not directed at earning dividend income, which was incidental.

Legislative History of Section 14A and Rule 8D

6. Before we delve deeper into the questions at hand it would be appropriate to not only examine the provisions of section 14A of the said act but also to notice its legislative history. Section 14A was inserted into the said Act by the Finance Act, 2001 with retrospective effect from 01/04/1962.

> **"Expenditure incurred in relation to income not includible in total income.**
>
> **14A.** For the purposes of computing the total income under this Chapter, 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 this Act."

7. By virtue of the Finance Act, 2002, the following proviso was inserted in section 14A and was deemed to have been inserted with effect from 11/05/2001:-

> "**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."

8. As a result of the insertion of the said proviso, Section 14A was as follows:-

> **"Expenditure incurred in relation to income not includible in total income.**
>
> **14A.** For the purposes of computing the total income under this Chapter, 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 this Act.

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> **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."

9. Then, by the Finance Act, 2006, Section 14A was numbered as sub-section (1) thereof and after sub-section (1) as so numbered, the following sub-sections were inserted, with effect from 01/04/2007:-

> "(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."

10. Consequent upon the Finance Act, 2006, section 14A as it now stands is as under:-

> **"Expenditure incurred in relation to income not includible in total income .**
>
> **14A.** (1) For the purposes of computing the total income under this Chapter, 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 this Act.
>
> (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."

11. By Notification No.45/2008 dated 24/03/2008, the Central Board of Direct Taxes (CBDT), in exercise of its powers under section 295 of the said Act read with sub-section (2) of section 14A of the said Act, made the "Income-tax (Fifth Amendment) Rules, 2008" to further amend the said Rules (i.e., the Income-tax Rules, 1962) by introducing Rule 8D therein. Clause 1(2) of the Income-tax (Fifth Amendment) Rules, 2008 clearly stipulated that the rules would come into force from the date of publication in the Official Gazette. The said Rule 8D is as under:-

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

8D.(1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with—

(a) the correctness of the claim of expenditure made by the assessee; or

(b) the claim made by the assessee that no expenditure has been incurred,

in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

(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:—

$$A \times \frac{B}{C}$$

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."

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The law prior to insertion of Section 14A

12. Prior to the introduction of section 14A in the said Act, the position in law was as laid down by the Supreme Court in ***CIT v. Maharashtra Sugar Mills Ltd:*** ***82 ITR 452 (SC)*** and ***Rajasthan State Warehousing Corporation v. CIT:*** ***242 ITR 450 (SC)***. In ***Maharashtra sugar Mills Ltd*** *(supra)* the assessee's business comprised of two parts, namely, (1) cultivation of sugar cane and (2) the manufacture of sugar. The revenue had contended that as the income from the cultivation of sugar cane, being the result of an agricultural operation, was not exigible to tax, therefore, any expenditure incurred in respect of that activity was not deductible. The Supreme Court repelled this contention in the following manner:-

> "This contention proceeds on the basis that only expenditure incurred in respect of a business activity giving rise to income, profit or gains taxable under the Act can be given deduction to and not otherwise. We see no basis for this contention. *To find out whether the deduction claimed is permissible under the Act or not, all that we have to do is to examine the relevant provisions of the Act. Equitable considerations are wholly out of place in construing the provisions of a taxing statute. We have to take the provisions of the statute as they stand. If the amount claimed is permissible under the Act then the same has to be deducted from the gross profit. If it is not permissible under the Act, it has to be rejected.* As mentioned earlier, it is not disputed that the cultivation of sugar-cane and the manufacture of sugar constituted one single and indivisible business. Section 10(2) says that profits under section 10(1) in respect of a business should be computed after deducting the allowances mentioned therein. One of the allowances allowed is that mentioned in section 10(2)(xv) which says that any expenditure laid out or expended wholly an exclusively for the purpose of such business shall be deducted as an allowance. The mandate of section 10(2)(xv) is plain and unambiguous. *Undoubtedly, the allowance claimed in this case was laid out or expended for the purpose of the business carried on by the assessee. The fact that the income arising from a part of that business is not exigible to tax under the act is not a relevant circumstance.*"
>
> (Emphasis supplied)

13. In ***Rajasthan State warehousing Corporation*** *(supra)*, the Supreme Court after, *inter alia*, considering its earlier decisions in ***CIT v. Indian bank Ltd: 56 ITR 77 (SC)*** and ***Maharashtra Sugar Mills Ltd*** *(supra)* laid down the following principles:-

> "(i) if income of an assessee is derived from various heads of income, he is entitled to claim deduction admissible under the respective head whether or not computation under each head results in taxable income;
>
> (ii) if income of an assessee arises under any of the heads of income but from different items, e.g., different house properties or different securities, etc., and income from one or more items alone is taxable whereas income from the other item is exempt under the Act, the entire permissible expenditure in earning the income from that head is deductible; and
>
> (iii) in computing "profits and gains of business or profession" when an assessee is carrying on business in various ventures and some among them yield taxable income and the others do not, the question of allowability of the expenditure under section 37 of the Act will depend on:
>
> (a) fulfilment of requirements of that provision noted above; and
>
> (b) on the facts whether all the ventures carried on by him constituted one indivisible business or not; if they do, the entire expenditure will be a permissible deduction but if they do not, the principle of apportionment of the expenditure will apply because there will be no nexus between the expenditure attributable to the venture not forming an integral part of the business and the expenditure sought to be deducted as the business expenditure of the assessee."

14. Thus, prior to the introduction of section 14A in the said Act, the law was that when an assessee had a composite and indivisible business which had elements of

both taxable and non-taxable income, the entire expenditure in respect of the said business was deductible and, in such a case, the principle of apportionment of the expenditure relating to the non-taxable income did not apply. However, where the business was divisible, the principle of apportionment of the expenditure was applicable and the expenditure apportioned to the 'exempt' income or income not exigible to tax, was not allowable as a deduction.

Objective behind insertion of section 14A

15. The object behind the insertion of section 14A in the said Act is apparent from the Memorandum explaining the provisions of the Finance Bill 2001 which is to the following effect:-

> "Certain incomes are not includable while computing the total income as these are exempt under various provisions of the Act. There have been cases where deductions have been claimed in respect of such exempt income. This in effect means that the tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income. This is against the basic principles of taxation whereby only the net income, i.e., gross income minus the expenditure is taxed. On the same analogy, the exemption is also in respect of the net income. Expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income.
>
> It is proposed to insert a new section 14A so as to clarify the intention of the Legislature since the inception of the Income - tax Act, 1961, that no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income under the Income-tax Act.
>
> The proposed amendment will take effect retrospectively from April 1, 1962 and will accordingly, apply in relation to the assessment year 1962-63 and subsequent assessment years."

16. As observed by the Supreme Court in the case of ***CIT v. Walfort Share and Stock Brokers P Ltd:*** ***326 ITR 1 (SC),*** the insertion of section 14 A with retrospective effect reflects the serious attempt on the part of Parliament not to allow deduction in respect of any expenditure incurred by the assessee in relation to income, which does not form part of the total income under the said act against the taxable income. The Supreme Court further observed as under:-

> ".. In other words, section 14 A clarifies that expenses incurred can be allowed only to the extent that they are relatable to the earning of taxable income. In many cases the nature of expenses incurred by the assessee may be relatable partly to the exempt income and partly to the taxable income. In the absence of section 14A, the expenditure incurred in respect of exempt income was being claimed against taxable income. *The mandate of section 14A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail of the tax incentive by way of an exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income...*"
>
> "..Expenses allowed can only be in respect of earning taxable income. This is the purport of section 14A. In section 14A, the first phrase is "for the purposes of computing the total income under this Chapter" which makes it clear that various heads of income as prescribed in the Chapter IV would fall within section 14A. *The next phrase is, "in relation to income which does not form part of total income under the Act". It means that if an income does not form part of total income, then the related expenditure is outside the ambit of the applicability of section 14A..*"
>
> (Emphasis supplied)

17. The Supreme Court also clearly held that in the case of an income like dividend income which does not form part of the total income, any expenditure/deduction relatable to such (exempt or non-taxable) income, even if it is of the nature specified in sections 15 to 59 of the said Act, cannot be allowed against any other income which

is includable in the total income. The exact words used by the Supreme Court are as under:-

> "Further, section 14 specifies five heads of income which are chargeable to tax. In order to be chargeable, an income has to be brought under one of the five heads. Sections 15 to 59 lay down the rules for computing income for the purpose of chargeability to tax under those heads. Sections 15 to 59 quantify the total income chargeable to tax. *The permissible deductions enumerated in sections 15 to 59 are now to be allowed only with reference to income which is brought under one of the above heads and is chargeable to tax.* If an income like dividend income is not a part of the total income, the expenditure/deduction though of the nature specified in sections 15 to 59 but related to the income not forming part of the total income could not be allowed against other income includable in the total income for the purpose of chargeability to tax. *The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14 A.*"
>
> (emphasis supplied)

Analysis of section 14A

18. Sub-section (1) of section 14A clearly stipulates that for the purposes of computing total income under Chapter IV (Computation of 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 said Act. A lot of emphasis was laid on the expressions "incurred" and "in relation to". It was contended by Mr Ajay Vohra, who appeared on behalf of most of the assesses, that the word "incurred" must be taken literally in the sense that the expenditure must have actually taken place. Moreover, the expenditure must also have taken place in relation to income which does not form part of total income. Mr Vohra contended that the expression "in relation to" implies that there must be a direct and proximate connection with the subject matter. In other words, according to Mr Vohra, only that actual expenditure which is made directly and for the object of earning exempt income (in the present appeals – dividend income) could be disallowed under section 14A.

He submitted that if the dominant and main objective of spending was not the earning of 'exempt' income then, the expenditure could not be disallowed under section 14A provided it was otherwise allowable under sections 15 to 59 of the said Act. Mr Satyen Sethi and Dr Rakesh Gupta, who appeared for some of the assesses, also adopted the arguments of Mr Vohra and emphasized that the expenditure must be actual and cannot be computed on the basis of some formula as stipulated under Rule 8D read with sub-sections (2) & (3) of section 14A.

"in relation to"

19. Let us examine the expression "in relation to". Mr Vohra had referred to the Supreme Court decision in ***Madhav Rao Scindia v. Union of India:*** ***AIR 1971 SC 530*** where, in paragraph 134, it is observed as under:-

> ".. The expression "provisions of this Constitution relating to" in article 363 means provisions having a dominant and immediate connection with: it does not mean merely having a reference to."

20. According to Mr Vohra, the expression "in relation to" appearing in section 14A of the said Act has to be considered in similar light. He submitted that the expenditure incurred must have a dominant and immediate connection with the exempt income. Thus, according to him, since the shares were acquired for the purpose of acquiring and retaining control of the operating company, the expenditure in respect of such acquisition of shares would not have a dominant and immediate connection with the dividend income, which was merely incidental. As such, Mr Vohra submitted, the expenditure could not be disallowed under section 14 A of the said act.

21. There are several difficulties with the argument advanced by Mr Vohra. The first of them is that in ***Madhavrao Scindia*** *(supra)* the Supreme Court was concerned

with the interpretation of a constitutional provision dealing with the jurisdiction of courts, inter alia, concerning any dispute in respect of any right accruing under or any liability or obligation arising out of any of the provisions of the Constitution relating to a treaty, agreement, covenant, engagement, sanad or other similar instrument which was entered into or executed before the commencement of the Constitution by any Ruler of an Indian State and to which the Government of the Dominion of India or any of its predecessor governments was a party and which is or has been continued in operation after such commencement. In the present appeals we are not concerned with a provision of the Constitution and that too dealing with the jurisdiction of a court. Secondly, what needs to be emphasised is that in the very same paragraph 134, the Supreme Court observed that the meaning of a word or expression used in the Constitution often is coloured by the context in which it occurs and that the simpler and more common the word or expression, the more meanings and shades of meaning it has. The Supreme Court further held that it is the duty of the court to determine in what particular meaning and particular shade of meaning the word or expression was used by the Constitution makers and in discharging the duty the court will take into account the context in which it occurs, the object to serve which it was used, it's collocation, the general congruity with the concept or object it was intended to articulate and a host of other considerations. It is in this backdrop that the Supreme Court concluded that the expression "provisions of this Constitution relating to" in Article 363 meant provisions having a dominant an immediate connection with and the said expression did not mean merely having a reference to. The Supreme Court clearly explained that a wide meaning of the expression might exclude disputes from the jurisdiction of the courts in respect of rights or obligations, however indirect or tenuous the connection between the constitutional provision and the covenant may be. It is therefore clear that the expression "relating to" would depend upon the context in which it occurs.

22. In ***Doypack Systems Pvt Ltd v. Union of India:*** ***AIR 1988 SC 782***, the Supreme Court observed that the expressions "pertaining to", "in relation to" and "arising out of", used in the deeming provision, are used in the expansive sense. The Supreme Court further observed as under:-

> "49. *The expression "in relation to" (so also "pertaining to"), is a very broad expression which presupposes another subject matter. These are words of comprehensiveness which might both have a direct significance as well as an indirect significance depending on the context*..."
>
> "... In this connection reference may be made to 76 Corpus Juris Secundum at pages 620 and 621 where it is stated that the term "relate" is also defined as meaning to bring into association or connection with. *It has been clearly mentioned that " relating to" has been held to be equivalent to or synonymous with as to "concerning with" and "pertaining to". The expression "pertaining to" is an expression of expansion and not of contraction.*"
>
> (emphasis supplied)

23. Mr Vohra also placed reliance on ***Navin Chemicals Manufacturing and Trading Co Ltd v. Collector of Customs:*** ***1993 (68) the LT 3 (SC)***. In the said decision the controversy was with regard to the meaning to be given to the expression "*determination of any question having* ***a relation to*** *the rate of duty of customs or to the value of goods for the purposes of assessment*". The Supreme Court was of the view that the key was to be found in the words "for purposes of assessment". It held that where the appeal involved the determination of any question which had a relation to the rate of customs duty for the purposes of assessment, that appeal must be heard by a Special Bench. It further held that, similarly, where the appeal involved the determination of any question which had a relation to the value of goods for the purposes of assessment, that appeal must also be heard by a Special Bench. In this context the Supreme Court observed as under: –

> "The phrase "relation to" is, ordinarily, of wide import but, in the context of its use in the said expression in section 129C, it must be read as meaning a direct and proximate relationship to the rate of duty and to the value of goods for the purposes of assessment."

This decision also makes it clear that the expression "in relation to" is, ordinarily, of wide import. In the normal course, the said expression would have an expansive meaning unless, of course, the context would otherwise suggest.

24. We do not agree with the submission of the learned counsel appearing on behalf of the assessees that a narrow meaning ought to be ascribed to the expression "in relation to" appearing in section 14A of the said act. The context does not suggest that a narrow meaning ought to be given to the said expression. It is pertinent to note that the provision was inserted by virtue of the Finance Act, 2001 with retrospective effect from 01/04/1962. In other words, it was the intention of Parliament that it should appear in the statute book, from its inception, that expenditure incurred in connection with income which does not form part of total income ought not to be allowed as a deduction. The factum of making the said provision retrospective makes it clear that Parliament wanted that it should be understood by all that from the very beginning, such expenditure was not allowable as a deduction. Of course, by introducing the proviso it made it clear that there was no intention to reopen finalised assessments prior to the assessment year beginning on 01/04/2001. Furthermore, as observed by the Supreme Court in ***Walfort*** *(supra)*, the basic principle of taxation is to tax the net income, i.e., gross income minus the expenditure and on the same analogy the exemption is also in respect of net income. In other words, where the gross income would not form part of total income, it's associated or related expenditure would also not be permitted to be debited against other taxable income.

25. We are of the view that the expression "in relation to" appearing in Section 14 A of the said act cannot be ascribed a narrow or constricted meaning. If we were

to accept the submission made on behalf of the assessees then sub-section (1) would have to be read as follows:-

> "For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee **with the main object of earning** income which does not form part of the total income under this Act."

That is certainly not the purport of the said provision. The expression "in relation to" does not have any embedded object. It simply means "in connection with" or "pertaining to". If the expenditure in question has a relation or connection with or pertains to exempt income, it cannot be allowed as a deduction even if it otherwise qualifies under the other provisions of the said Act. In ***Walfort*** *(supra)*, the Supreme Court made it very clear that the permissible deductions enumerated in sections 15 to 59 are now to be allowed **only** with reference to income which is brought under one of the heads of income and is chargeable to tax. The Supreme Court further clarified that if an income like dividend income is not part of the total income, the expenditure/deduction related to such income, though of the nature specified in sections 15 to 59, cannot be allowed against other income which is includable in the total income for the purpose of chargeability to tax.

"expenditure incurred"

26. It was contended by the learned counsel for the assessees that the words "expenditure incurred" as appearing in section 14A(1) clearly mean that there must be actual expenditure. Of course, the actual expenditure must be for earning the exempt income. We have already pointed out above, that we do not subscribe to the narrow interpretation sought to given to the words "in relation to" which the learned counsel for the assessees are espousing. Thus, we will have to consider the argument of the asssessees in respect of the expression "expenditure incurred" in the context of the

expenditure being in connection with or pertaining to income which does not form part of the total income under the said Act.

27. A reference was made to the decision of the Punjab & Haryana High Court in the case of ***CIT-II v. Hero Cycles Ltd*** [ITA No. 331/2009 (O&M): decided on 4/11/2009] wherein it was observed that:-

> "Disallowance under Section 14A requires finding of incurring expenditure where it is found that for earning exempted income no expenditure has been incurred, disallowance under Section 14A cannot stand."

28. It was contended that unless and until there was actual expenditure for earning the exempted income, there could not be any disallowance under section 14A. While we agree that the expression "expenditure incurred" refers to actual expenditure and not to some imagined expenditure we would like to make it clear that the 'actual' expenditure that is in contemplation under section 14A(1) of the said Act is the 'actual' expenditure in relation to or in connection with or pertaining to exempt income. The corollary to this is that if no expenditure is incurred in relation to the exempt income, no disallowance can be made under section 14A of the said Act.

Scope of sub-sections (2) and (3) of Section 14A

29. Sub-section (2) of Section 14 A of the said Act provides the manner in which the Assessing Officer is to determine the amount of expenditure incurred in relation to income which does not form part of the total income. However, if we examine the provision carefully, we would find that the Assessing Officer is required to determine the amount of such expenditure only 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 the said Act. In other words, the requirement of the Assessing Officer embarking upon a determination of the amount of expenditure incurred in relation to exempt income would be triggered only if the Assessing Officer

returns a finding that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Therefore, the condition precedent for the Assessing Officer entering upon a determination of the amount of the expenditure incurred in relation to exempt income is that the Assessing Officer must record that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Sub-section (3) is nothing but an offshoot of sub-section (2) of Section 14A. Sub-section (3) applies to cases where the assessee claims that no expenditure has been incurred in relation to income which does not form part of the total income under the said Act. In other words, sub-section (2) 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 said Act and sub-section (3) applies to cases where the assessee asserts that no expenditure had been incurred in relation to exempt income. In both cases, the Assessing Officer, if satisfied with the correctness of the claim of the assessee in respect of such expenditure or no expenditure, as the case may be, cannot embark upon a determination of the amount of expenditure in accordance with any prescribed method, as mentioned in sub-section (2) of Section 14A of the said Act. It is only if the Assessing Officer is not satisfied with the correctness of the claim of the assessee, in both cases, that the Assessing Officer gets jurisdiction to determine the amount of expenditure incurred in relation to such income which does not form part of the total income under the said Act in accordance with the prescribed method. The prescribed method being the method stipulated in Rule 8D of the said Rules. While rejecting the claim of the assessee with regard to the expenditure or no expenditure, as the case may be, in relation to exempt income, the Assessing Officer would have to indicate cogent reasons for the same.

Rule 8D

30. As we have already noticed, sub-section (2) of Section 14A of the said Act refers to the method of determination of the amount of expenditure incurred in relation

to exempt income. The expression used is – "such method as may be prescribed". We have already mentioned above that by virtue of Notification No.45/2008 dated 24/03/2008, the Central Board of Direct Taxes introduced Rule 8D in the said Rules. The said Rule 8D also makes it clear that where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with (a) the correctness of the claim of expenditure made by the assessee; or (b) the claim made by the assessee that no expenditure has been incurred in relation to income which does not form part of the total income under the said Act for such previous year, the Assessing Officer shall determine the amount of the expenditure in relation to such income in accordance with the provisions of sub-rule (2) of Rule 8D. We may observe that Rule 8D(1) places the provisions of Section 14A(2) and (3) in the correct perspective. As we have already seen, while discussing the provisions of Sub-sections (2) and (3) of Section 14A, the condition precedent for the Assessing Officer to himself determine the amount of expenditure is that he must record his dissatisfaction with the correctness of the claim of expenditure made by the assessee or with the correctness of the claim made by the assessee that no expenditure has been incurred. It is only when this condition precedent is satisfied that the Assessing Officer is required to determine the amount of expenditure in relation to income not includable in total income in the manner indicated in sub-rule (2) of Rule 8D of the said Rules.

31. It is, therefore, clear that determination of the amount of expenditure in relation to exempt income under Rule 8D would only come into play when the Assessing Officer rejects the claim of the assessee in this regard. If one examines sub-rule (2) of Rule 8D, we find that the method for determining the expenditure in relation to exempt income has three components. The first component being the amount of expenditure directly relating to income which does not form part of the total income. The second component being computed on the basis of the formula given therein in a case where the assessee incurs expenditure by way of interest which is not directly

attributable to any particular income or receipt. The formula essentially apportions the amount of expenditure by way of interest [other than the amount of interest included in clause (i)] incurred during the previous year in the ratio of the average value of investment, income from which does not or shall not form part of the total income, to the average of the total assets of the assessee. The third component is an artificial figure – one half percent of the average value of the investment, income from which does not or shall not form part of the total income, as appearing in the balance sheets of the assessee, on the first day and the last day of the previous year. It is the aggregate of these three components which would constitute the expenditure in relation to exempt income and it is this amount of expenditure which would be disallowed under Section 14A of the said Act. It is, therefore, clear that in terms of the said Rule, the amount of expenditure in relation to exempt income has two aspects – (a) direct and (b) indirect. The direct expenditure is straightaway taken into account by virtue of clause (i) of sub-rule (2) of Rule 8D. The indirect expenditure, where it is by way of interest, is computed through the principle of apportionment, as indicated above. And, in cases where the indirect expenditure is not by way of interest, a rule of thumb figure of one half percent of the average value of the investment, income from which does not or shall not form part of the total income, is taken.

Do sub-sections (2) and (3) of Section 14A and Rule 8D apply retrospectively ?

32. While examining the legislative history of Section 14A and Rule 8D, we have already noted that Section 14A, as introduced by virtue of the Finance Act, 2001, was with retrospective effect from 01.04.1962. The proviso was inserted by virtue of the Finance Act, 2002 and it was made clear that nothing in Section 14A empowered the Assessing Officer to either re-assess 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, for any assessment year beginning on or before the

first day of April, 2001. Thus, in respect of all the assessment years prior to the assessment year beginning on or before the 1st day of April, 2001, concluded assessments could not be disturbed despite the fact that Section 14A had been expressly made retrospective with effect from 01.04.1962. The provisions of Section 14A, which were retrospective with effect from 01.04.1962 are now encapsulated in sub-section (1) of Section 14A. It is also clear that sub-sections (2) and (3) of Section 14A were introduced subsequently by virtue of the Finance Act, 2006 and were introduced with effect from 01.04.2007. However, although sub-sections (2) and (3) had been introduced with effect from 01.04.2007, they remained empty shells inasmuch as the expression "such method as may be prescribed" got meaning only by the introduction of Rule 8D by virtue of the Income-tax (Fifth Amendment) Rules, 2008 which was notified by the Central Board of Direct Taxes by its notification No.45/2008 dated 24/03/2008.

33. Dr Rakesh Gupta, the learned counsel, who had appeared for some of the assessees, submitted that Section 295 of the said Act empowered the Central Board of Direct Taxes to make rules for the whole or any part of India for carrying out the purpose of the said Act. He referred to sub-section (4) of Section 295 and submitted that the power to make rules conferred on the Central Board of Direct Taxes included the power to give retrospective effect, from a date not earlier than the date of the commencement of the said Act, to the rules or any of them and, unless the contrary was permitted (whether expressly or by necessary implication), no retrospective effect was to be given to any rule so as to prejudicially affect the interests of the assessees. He further submitted that Rule 8D was inserted in the said rules, but the Central Board of Direct Taxes did not make it retrospective. He submitted that whenever the CBDT felt it necessary to introduce a rule with retrospective effect, it did so by making the rule expressly retrospective. As an example, he referred to Rule 11EA which was

inserted by the Income-tax (Ninth Amendment) Rules, 1997 with retrospective effect, from 01/10/1994.

34. On the other hand, it was contended on behalf of the revenue and, particularly, by Mr Sanjeev Sabharwal that since Section 14A was introduced with retrospective effect from 01.04.1962, the principles of Section 14A would have to be considered as having always been a part of the said Act and, therefore, sub-sections (2) and (3) of Section 14 A and Rule 8D of the said Rules were only machinery provisions and ought to be read retrospectively so as to give meaning to Section 14A(1).

35. We are of the view that Rule 8D would operate prospectively. We agree with the submissions made by Dr Rakesh Gupta that if the said Rule were to have retrospective effect, nothing prevented the Central Board of Direct Taxes from saying so, particularly, in view of the fact that it had the power to make a rule retrospective by virtue of Section 295(4) of the said Act. Instead of making Rule 8D retrospective, clause 1(2) of the Income-tax (Fifth Amendment) Rules, 2008 made it clear that the rules would come into force from the date of their publication in the Official Gazette. It is, therefore, clear that Rule 8D, which was introduced by virtue of the Notification No.45/2008 dated 24.03.2008, was prospective in operation and cannot be regarded as being retrospective. We may also point out that we have had the benefit of the decision of the Bombay High Court in ***Godrej and Boyce Mfg. Co. Ltd v DCIT: (2010) 328 ITR 81 (Bom)***, wherein it has, *inter alia*, been held that the provisions of Rule 8D of the said Rules has prospective effect and shall apply with effect from assessment year 2008-09 onwards.

36. Insofar as sub-sections (2) and (3) of Section 14A are concerned, they have also been introduced by virtue of the Finance Act, 2006 with effect from 01.04.2007.

This is apparent, first of all, from the Notes on Clauses of the Finance Bill, 2006 [Reported in ***281 ITR (ST) at pages 139-140***]. The said Notes on Clauses refers to clause 7 of the Bill which had sought to amend Section 14A of the said Act. It is specifically mentioned in the said Notes on Clauses that:-

> "This amendment will take effect from 1st April, 2007 and will, accordingly, apply in relation to the assessment year 2007-08 and subsequent years."

37. Furthermore, in the Memorandum explaining the provisions in the Finance Bill, 2006 [281 ITR (ST) at pages 281-281], it is once again stated with reference to clause 7 which pertains to the amendment to Section 14A of the said Act that:-

> "This amendment will take effect from 1st April, 2007 and will, accordingly, apply in relation to the assessment year 2007-08 and subsequent years."

38. We may also refer to the CBDT Circular No.14/2006 dated 28.12.2006 and to paragraphs 11 to 11.3 thereof. Paragraph 11 dealt with the method for allocating expenditure in relation to exempt income and paragraphs 11.1 and 11.2 explained the basis and logic behind the introduction of sub-section (2) of Section 14A of the said Act. Paragraph 11.3 specifically provided for applicability of the provisions of sub-section (2) and it clearly indicated that it would be applicable "from the assessment year 2007-08 onwards".

39. It is, therefore, clear that sub-sections (2) and (3) of Section 14A were introduced with prospective effect from the assessment year 2007-08 onwards. However, sub-section (2) of Section 14A remained an empty shell until the introduction of Rule 8D on 24.03.2008 which gave content to the expression "such method as may be prescribed" appearing in Section 14A(2) of the said Act.

40. From the above discussion, it is clear that, in effect, the provisions of sub-sections (2) and (3) of Section 14A would be workable only with effect from the date of introduction of Rule 8D. This is so because prior to that date, there was no prescribed method and sub-sections (2) and (3) of Section 14A remained unworkable.

How is Section 14A to be worked for the period prior to the introduction of Rule 8D?

41. Sub-section (2) of section 14A, as we have seen, stipulates that the Assessing Officer shall determine the amount of expenditure incurred in relation to income which does not form part of the total income "in accordance with such method as may be prescribed". Of course, this determination can only be undertaken if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. This part of section 14A(2) which explicitly requires the fulfillment of a condition precedent is also implicit in section 14A(1) [as it now stands] as also in its initial *avatar* as section 14A. It is only the prescription with regard to the method of determining such expenditure which is new and which will operate prospectively. In other words, section 14A, even prior to the introduction of sub-sections (2) & (3) would require the assessing officer to first reject the claim of the assessee with regard to the extent of such expenditure and such rejection must be for disclosed cogent reasons. It is then that the question of determination of such expenditure by the assessing officer would arise. The requirement of adopting a specific method of determining such expenditure has been introduced by virtue of sub-section (2) of section 14A. Prior to that, the assessing was free to adopt any reasonable and acceptable method.

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

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

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

said Act. He is required to do so on the basis of a reasonable and acceptable method of apportionment.

43. At this juncture, we must make it clear that Dr Rakesh Gupta's arguments that Rule 8D of the said Rules exceeds the mandate of section 14A, have not been considered by us because the appeals before us are in respect of assessment years prior to the introduction of Rule 8D. We therefore refrain from expressing any opinion on the issue as to whether Rule 8D (and, to what extent, if at all) is *ultra vires* section 14A of the said Act.

Answers to the questions

44. In view of the foregoing, Question 1 is answered in the affirmative and Questions 2 & 3, in the negative.

Assessees' appeals

45. The appeals on behalf of the assessees are:-

ITA No.	Cause Title	Assessment year
853/2009	*Cheminvest Ltd v. CIT*	2001-02
1060/2009	*Maxpak Investment Ltd v. CIT*	2001-02
687/2009	*Maxopp Investment Ltd v. CIT*	2002-03
856/2009	*Cheminvest Ltd v. CIT*	2002-03
805/2009	*Eicher Ltd v. CIT*	2002-03
936/2009	*Eicher Ltd v. CIT*	2001-02
112/2009	*Eicher Goodearth Ltd v. CIT*	2004-05

263/2010	*Mohair Investments Ltd v. CIT*	2002-03
416/2010	*Medicare Investments Ltd v. CIT*	2002-03
958/2009	*Minda Industries Ltd v. CIT*	2002-03
1096/2009	*Jagatjit Industries Ltd v. CIT*	2004-05

In all these appeals, the Income Tax Appellate Tribunal had, after upholding the disallowance under section 14A of the said Act, restored the matters to the respective files of the concerned Assessing Officers with the direction to re-compute the said disallowance in accordance with Rule 8D of the said Rules. However, since we have held that Rule 8D would be inapplicable to the assessment years prior to 2008-2009, the assessing officers would now have to follow the steps outlined in paragraph 42 above.

Revenue's appeals

46. The appeals filed by the revenue are disposed of as below:-

ITA No. 77/2009 *[CIT v. HCL Perot Systems Ltd]*(AY 2000-01)

ITA No. 139/2009 [*CIT v. HCL Perot Systems Ltd*](AY 2001-02)

The Tribunal did not sustain the disallowance made by the Assessing Officer under Section 14 A and directed the Assessing Officer to re-compute the disallowance in terms of the method of working given by the assessee. The revenue is aggrieved inasmuch as the Tribunal did not direct the Assessing Officer to re-compute the disallowance in terms of Rule 8D read with sub-sections (2) & (3) of section 14A.

While Rule 8D would be inapplicable, the assessing officer would now have to follow the steps outlined in paragraph 42 above.

ITA No.57/2008 [CIT v. Vou Investment Pvt Ltd](AY 1998-99)

The Tribunal deleted the disallowance under section 14A by holding that the earning of dividend was merely incidental to holding of shares and that the Assessing Officer had also failed to pinpoint the expenditure actually incurred in respect of the dividend income. The Tribunal's judgment and order to the extent it deleted the disallowance under section 14A is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

ITA No.932/2009 [CIT v. Nalwa Investments Ltd](AY 2004-05)

The Tribunal restored the matter to the file of the Assessing Officer to re-compute the disallowance under section 14A and directed the Assessing Officer to identify if any expenditure had been incurred for earning exempt income and to disallow only such expenditure. In view of the discussion above, the assessing officer shall now have to follow the steps outlined in paragraph 42 above.

ITA No.98/2009 [CIT v. Escorts Finance Ltd](2001-02)

The Tribunal confirmed the deletion by the CIT(A) of the disallowance made by the Assessing Officer on account of administrative expenses and interest on loan by invoking section 14A of the said Act. The Tribunal's judgment and order, to the extent it deleted the disallowance under section 14A, is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

ITA No.683/2008 [CIT v. ICRA Ltd](AY 2001-02)

ITA No.702/2008 [CIT v. ICRA Ltd](AY 2003-04)

The Tribunal deleted the addition made by the Assessing Officer who had disallowed proportionate expenditure under section 14A of the said Act by apportioning the administrative expenses in respect of exempt income. In both cases, the Tribunal's judgment and order, to the extent it deleted the disallowance under section 14A, is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

ITA No.389/2009 [CIT v. Sharda Motors Industries Ltd](AY 2004-05)

ITA No.1114/2009 [CIT v. Sharda Motors Industries Ltd](AY 2005-06)

The Tribunal had, inter alia, deleted the disallowance made by the Assessing Officer under section 14A of the said Act being the proportionate expenditure incurred in relation to earning dividend income. In both cases, the Tribunal's judgment and order, to the extent it deleted the disallowance under section 14A, is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

ITA No.217/2009 [CIT v. AKM Systems Pvt Ltd](AY 2001-02)

The assessee company received dividend of Rs 81,87,432/- in respect of the assessment year 2001-02. The Assessing Officer invoked the provisions of section 14A of the said Act and disallowed the entire office and administrative expenses of Rs 25,35,482/-. The Tribunal estimated the expenditure in relation to dividend income at 10% of the dividend income and sustained the addition of Rs 8,18,743/- only. The revenue is aggrieved by the fact that the entire expenditure of Rs 25,35,482/- was not disallowed and that the Tribunal estimated the disallowable expenditure by adopting a formula of 10% of the dividend income. The Tribunal's judgment and order, to the

extent it partially deleted the disallowance under section 14A, is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

The appeals stand disposed of as above.

BADAR DURREZ AHMED, J

SIDDHARTH MRIDUL, J

NOVEMBER 18, 2011
HJ