

**IN THE HIGH COURT OF PUNJAB AND HARYANA AT
CHANDIGARH**

**Income Tax Appeal No.320 of 2013
Date of Order: 27.01.2015**

Commissioner of Income Tax-I, Ludhiana

..Appellant

Versus

M/s Abhishek Industries Ltd., Ludhiana

..Respondent

**CORAM: HON'BLE MR. JUSTICE RAJIVE BHALLA
HON'BLE MR. JUSTICE B.S.WALIA**

**Present: Mr. Rajesh Katoch, Advocate,
for the appellant.**

**Ms. Radhika Suri, Sr. Advocate, with
Ms. Rinku Dahiya, Advocate,
for the respondent.**

RAJIVE BHALLA, J (Oral)

The revenue is before us challenging order dated 17.04.2013, passed by the Income Tax Appellate Tribunal, Chandigarh Bench 'B'. Chandigarh (hereinafter referred to as 'the ITAT').

Before we record our opinion, it would be necessary to briefly refer to the facts. The assessee filed a return of income on 30.09.2008, declaring an income of Rs.13,05,01,310/-, followed by a revised return, declaring an income of Rs.1,04,37,640/-. The Assessing Officer completed assessment under Section 143(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') by making numerous additions, and disallowing certain exemptions claimed by

the assessee. The present appeal relates to Rs.2,37,67,894/-, disallowed by the Assessing Officer, under Section 14A of the Act read with Rule 8D of the Income Tax Rules (hereinafter referred to as 'the Rules'), by holding that interest bearing funds had been used to earn tax free dividend etc.

Aggrieved by this order, the assessee filed an appeal. The CIT(A)-I, Ludhiana, deleted the addition by holding that the revenue has not been able to prove that interest bearing funds were used. The revenue filed an appeal before the ITAT, Chandigarh Bench 'B', Chandigarh, which was dismissed on 17.04.2013, by affirming the order passed by the CIT(A)-I, Ludhiana.

Counsel for the revenue submits that the ITAT has erred in confirming the deletion made by the CIT(A). The onus to prove that interest bearing funds were not used while making investments that earned dividend in the shape of exempted income lay upon the assessee. The Assessing Officer rightly drew an inference against the assessee as he failed to discharge the onus. The CIT(A) has by wrongly placing the onus upon the revenue and by holding that the revenue has failed to discharge its onus, deleted this addition. The ITAT has affirmed the order passed by the CIT(A) without appraising the record which reveals that interest bearing funds were used to earn dividend, which was claimed as exempted income.

Counsel for the revenue has framed the following substantial questions of law:-

- “i) Whether on the facts and circumstances of the case and in law, the Hon'ble ITAT is correct in confirming

the order of CIT(A) deleting the disallowance of Rs.2,37,67,894/- made under Section 14A read with Rule 8D, on account of interest on loans, on investments earning tax free income in the form of dividend.

- ii) Whether on the facts and in the circumstances of the case and in law the Hon'ble Income Tax Appellate Tribunal was justified in relying on the decision of jurisdictional High Court in the case of M/s Hero Cycles Ltd. for the Assessment Year 2004-05 ignoring the provision of Rule 8D inserted w.e.f. 24.03.2008 and applicable from assessment year 2008-09.”

Counsel for the assessee submits that a perusal of the impugned orders reveals that the Assessing Officer admitted that it is not possible to refute or rebut the assessee's statement that investments were not sourced from interest bearing funds. The Assessing Officer having failed to adduce or refer to any evidence that could prove that interest bearing funds were utilised for earning tax free income, the CIT(A) rightly deleted these additions. The ITAT has rightly affirmed the order passed by the CIT(A). It is further submitted that the questions of law framed by the revenue have already been answered against the revenue in **CIT v. Hero Cycles Ltd. [2006] 323 ITR 518 (P&H)**, **CIT v. Winsome Textile Industries Ltd. [2009] 319 ITR 204 (P&H)** and **Commissioner of Income Tax v. Deepak Mittal [2014] 361 ITR 131 (P&H)**.

We have heard counsel for the parties and perused the impugned order.

The Assessing Officer disallowed dividend earned by the assessee by holding that interest bearing funds had been used to earn this income. The CIT(A) set aside this finding by holding that the Assessing Officer has failed to prove that interest bearing funds were used by the assessee. The ITAT has affirmed this finding by holding that as the Assessing Officer has failed to prove that interest bearing funds were used, it would not invite disallowance under Section 14A of the Act. A relevant extract from the order passed by the ITAT reads as follows:-

“8. I have considered the facts of the case and it is seen that the appellant has made a categorical submission of fact before the AO that no interest bearing funds had been diverted to make investments leading to tax exempt income. The AO has not established as a matter of fact that the contention put forwarded by the assessee was erroneous or misleading. In fact the AO has observed that it was not possible to disprove the claim of the assessee in this regard. It clearly meant that the mandatory requirement as stipulated by Section 14A with regard to the satisfaction that certain expenditure had been incurred to earn the tax exempt income, has not been fulfilled.”

Section 14A of the Act empowers an Assessing Officer to

disallow, exempted income if interest bearing funds have been used, by the assessee. The scope and ambit of Section 14A of the Act came up for consideration in **CIT v. Winsome Textile Industries Ltd.** (supra). After appraisal of Section 14A of the Act, a Division Bench of this Court held that Section 14A of the Act, may only be invoked if the assessee has made investments in purchase of shares out of borrowed funds. As a consequence if the assessee has invested his own money in purchase of shares, there is no question of disallowance under Section 14A of the Act. A relevant extract from the judgment in **CIT v. Winsome Textile Industries Ltd.** (supra) reads as follows:-

“Abhishek Industries Ltd. [2006] 286 ITR 1 (P&H) relates to the provisions of Section 36(1) (iii) and Section 14A which has been invoked in this case which stands on a different footing. Even if deduction under Section 36(1)(iii) is ordinarily available in respect of borrowed funds utilised for the purpose of business. Section 14A carves out an exception in so far as any expenditure which is relatable to the earning of dividend income not subject to tax is to be disallowed. It would be relevant to point out that the Hon'ble Supreme Court in the case of Rajasthan State Warehousing Corporation v. CIT [2000] 242 ITR 450 held that in the case of indivisible business where part of business income is exempt the expenditure cannot be apportioned and part relating to income is exempt cannot be disallowed (judgment dated February 23, 2000). However, the Finance Act, 2001, incorporated section 14A with effect from April

1, 1962, which provides for disallowance of expenditure relating to income not included in the gross total income. Therefore, it is to be ascertained as to whether the assessee has made the investment in purchase of shares out of borrowed funds or invested its own funds. If the assessee has invested its own money in the purchase of shares then there is no question of any disallowance in respect of interest on borrowed funds u/s 14A. However, if the borrowed funds have been utilised for purchase of shares of M/s Winsome Yarns Limited, disallowance u/s 14A shall have to be calculated even when investment has been made in the course of business of the assessee and the assessee qualifies for deduction u/s 36(1)(iii). So, however, section 14A provides that no deduction shall be allowed in respect of expenditure incurred by the assessee in relating to income which does not form part of the total income under the Act. So, it is, therefore, necessary to find out if any expenditure was incurred by the assessee for making investment in the shares of Winsome Yarns Limited. During the course of assessment proceedings the assessee had furnished written submission in which it was claimed, the paragraph 5 of the letter that investment in the shares of Winsome Yarn Limited was made out of the assessee's own fund and not out of any borrowed funds. Before the Commissioner of Income Tax (Appeals) also, vide letter dated March 15, 2007 the assessee had reiterated that investment in the purchase of the shares of Winsome Yarn Limited in the year 1993-94 had no nexus with the borrowed funds. The Assessing Officer as per the

assessment order has not refuted the claim of the assessee but has made a disallowance on the ground that had the said invested in shares were available with the assessee, the assessee would not have been required to raise loans to that extent and incur expenditure on interest on such loans. In our considered view, the disallowance has got to be made u/s 14A if any expenditure relating to the earning of income which is not chargeable to tax has been debited to the accounts by the assessee. Since in this case, the assessee has not incurred any expenditure for making investment in the purchase of shares of Winsome Yarn Limited, no disallowance is warranted u/s 14A. We, therefore, find no justification to interfere with the order of the Commissioner of Income Tax (Appeals) in having deleted the disallowance. The ground of appeal raised by the revenue in this regard is thus dismissed.”

Section 14A of the Act requires the Assessing Officer to record satisfaction that interest bearing funds have been used to earn tax free income. The satisfaction to be recorded must be based upon credible and relevant evidence. The onus, therefore, to prove that interest bearing funds were used, lies squarely on the shoulders of the revenue. Thus, if the Assessing Officer is able to refer to relevant material while recording satisfaction that borrowed funds were used to earn interest free income as opposed to the assessee's own funds, the Assessing Officer may legitimately disallow such a claim. The Assessing Officer, however, cannot, by recording general observations, particularly where the assessee has denied using

interest bearing funds, proceed to infer that interest bearing income must have been used to earn exempted income. Section 14A of the Act, being in the nature of an exception, has to be construed strictly and only where the Assessing Officer records satisfaction, on the basis of clear and cogent material, shall an order be passed under Section 14A of the Act, disallowing such a claim. As there is no tangible material on record that could have enabled the Assessing Officer to record satisfaction in terms of Section 14A of the Act, findings recorded by the CIT(A) and the ITAT that the Assessing Officer has failed to discharge this onus are neither perverse nor arbitrary and, therefore, do not call for interference.

Even otherwise, the controversy, in our considered opinion, is squarely covered in favour of the assessee by the judgment in **CIT v. Winsome Textile Industries Ltd.** (supra). We, therefore, find no reason to interfere with findings recorded by the Income Tax Appellate Tribunal, answer the questions of law against the revenue and dismiss the appeal accordingly.

(RAJIVE BHALLA)
JUDGE

January 27, 2015
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(B.S.WALIA)
JUDGE