IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 04.12.2018

CORAM

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MR.JUSTICE N.SATHISH KUMAR

Tax Case (Appeal) No.775 of 2018

M/s.Roca Bathroom Products Pvt Ltd.,
KGN Towers, 4th Floor,
Ethiraj Salai, Egmore,
Chennai - 600 105.

... Appellant/Appellant

-vs-

Principal Commissioner of Income Tax 1,
Large Tax Payers Unit,
121, Mahatma Gandhi Road,
Chennai.

... Respondent/Respondent

Tax Case (Appeal) filed under Section 260-A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal Bench 'D', Chennai, dated 29.05.2018 in ITA.No.3328/CHNY/2016 for the assessment year 2012-13.against the order of the Deputy Commissioner of Income Tax Large Tax Payers Unit-I 1775, Jawaherlal Nehru inner Riz Road, Anna Nagar Western Extension Chennai-600 101. dt:24/10/2016 PAN.AAACE9982 E for the Assessent year 2012-13.

For Appellant : Mr.N.V.Balaji

For Respondent : Mr.R.Hemalatha
Standing Counsel

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JUDGMENT
(Judgment was delivered by T.S.Sivagnanam, J.)

This appeal filed by the appellant under Section 260A of the Income-tax Act, 1961 (hereinafter referred to as "the Act"), is directed against the order passed by the Income Tax Appellate

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Tribunal Bench 'D', Chennai (hereinafter referred to as "the Tribunal") dated 29.05.2018 in ITA.No.3328/CHNY/2016 for the assessment year 2012-13.

2.The appeal has been filed by the appellant by raising the following substantial questions of law:-

> "1.Whether under facts and circumstances of the case, the Tribunal was right in upholding the disallowance of interests on debentures under Section 14A of the Act, particularly when the interest expenditure was incurred on debentures issued in the financial year 2008-09 for the specific purpose of acquiring a company in the past and not for investing in mutual funds?
>
> 2.Is the finding of the tribunal that the interest incurred by the assessee is not specifically towards acquisition of shares in M/s.Glamouroom Taps Pvt Ltd. not perverse?"

3.The assessee is engaged in the business of manufacturing and marketing of bathroom products and other allied products. During the assessment year 2012-13, the assessee filed return of income returning a total income of Rs.62,96,87,490/-. During the financial year relevant to the assessment year 2012-13, the appellant earned a dividend income of Rs.2.65 Crores from Mutual Fund investments. The Assessing Officer in the draft assessment order disallowed a sum of Rs.56,63,018/- under Section 14A of the Act r/w. Rule 8D of Income Tax Rules, 1962 (hereinafter referred to as "the Rules"). While doing so, the Assessing Officer rejected the claim of the appellant that the interest expenditure disallowed does not pertain to capital borrowed for investing in mutual fund but predominantly pertains to debenture issued in the past for acquiring shares of a Company, which was subsequently merged with the assessee. Aggrieved by such order, the assessee filed objections before the Dispute Resolution Panel (DRP) which upheld the disallowance. Consequently, the Assessing Officer passed the assessment order dated 24.10.2016 as he is mandated to do so by following the order passed by the DRP. Aggrieved by the same, the assessee filed an appeal before the Tribunal contending that an interest of Rs.3,35,62,633/- out of Rs.3,47,63,663/- was in relation to a loan specific for investment made in M/s.Glamouroom Taps Pvt. Ltd. and therefore, there can be no disallowance under Section 14A of the Act r/w. Rule 8D of the Rules. The Tribunal did not agree with the assessee and dismissed the appeal by an order dated 15.03.2017 which is impugned before us.

4.We have heard Mr.N.V.Balaji, learned counsel for the appellant and M/s.R.Hemalatha, learned Senior Standing Counsel for the respondent/revenue.

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5.Before the DRP, while filing objections the following contentions were raised by the assessee against the draft assessment order relating to addition proposed by the Assessing Officer. The objections are contained in paragraph 3.10 and the objections are under two heads, namely, (A) Non-applicability of Section 14A of the Act; and (B) No nexus between the borrowed capital and investment made by the Company.

6.M/s.R.Hemalatha, learned Senior Standing Counsel placed reliance on the decision of the Hon'ble Supreme Court in the case of Maxopp Investment Ltd. vs. Commissioner of Income Tax, New Delhi reported in (2018) 402 ITR 640 (SC), wherein the Hon'ble Supreme Court held that only expenses proportionate to earning exempt income could be disallowed under Section 14A of the Act and with regard to the order of the Assessing Officer in one of the appeals before the Hon'ble Supreme Court in the case of M/s.Avon Cycles Limited, Ludhiana wherein the Assessing Officer invoked Section 14A of the Act r/w.Rule 8 of the Rules, the Hon'ble Supreme Court approved the finding of the Tribunal which had examined the balance sheet of the assessee and recorded a finding of fact that the funds utilized by the assessee being mixed funds the interest paid by the assessee is also an interest on investments made.

7.In our considered view, in the instant case, the question is with regard to applicability of Section 14A of the Act, but, on applying Section 14A of the Act, the Assessing Officer has to necessarily fall back on the machinery provision provided under Rule 8D of the Rules. Rule 8D(2) of the Rules reads as follows"

> "8D(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:-
>
> 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;

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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."

8.In terms of the above rule, the expenditure in relation to income which does not form part of the total income shall be the aggregate of the amount of expenditure directly relating to income which does not form part of the total income. The other contingency is 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, then, the formula stipulated in Rule 8D(2)(ii) should be applied. The assessee's case before the DRP as well as before the Tribunal was that the assessee has incurred expenditure by way of interest during the previous year which is directly attributable to a particular income or receipt. For better appreciation, the objection filed by the assessee before the DRP is quoted herein before:

B.No nexus between the borrowed capital and investment made by the Company

In the Draft Order, the AO has not substantiated the fact that there is a nexus between the borrowed funds and the investment which is a pre-requisite for application of Sec.14A of the Act read with Rule 8D. During the FY 2011-12, the assessee debited following interest expenditure in the Profit & Loss Account:

Table 11: Interest expense debited in Profit & Loss Account

Nature of Interest	Amount (Rs. in Crores)
Debenture Interest	3.35
Interest on others	0.13
Total	3.48

With regard to the above, the assessee wishes to submit the following:

(i) Interest Paid on CCDs

During the FY 2008-09, Roca India issued CCDs to Keramik Holdings AG, Switzerland amounting to Rs.35.24 Crores. The issue proceeds had been utilized for the purchase of shares in M/s.Glamourrom Taps Private Limited (which was amalgamated with the company w.e.f. 01.04.2008). As per the terms of the

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CCD Agreement entered into in July 2008, Roca India paid interest at the rate of 9.5% per annum which amounts to Rs.3.35 Crores.

Reference is drawn to Cash Flow Statement of the assessee for the year FY 2008-09, wherein it was clearly stated in the financing activities the assessee has received proceeds from issue of CCDs amounting to Rs.35.24 Crores. Further under the investing activities, there is a cash outflow towards consideration paid towards purchase of Glamouroom Taps amounting to Rs.35.24 Crores. Hence the assessee humbly submit that debenture interest has no nexus with investments.

(ii) Source of Funds for Investments

The assessee wishes to submit that it has made investments out of own funds and not from the borrowed funds. The source of funds as on 31.03.2012 are as follows:

Particulars	Amount (Rs. in Lakhs)
Reserve and Surplus as on 31.03.2011	26,112.97
Cash Flow from Operations activities during the year	4,609.05
Total Funds Available	30,722.02
Total Investments as on 31 March 2012	4,752.229

From the above it can be observed that assessee has enough surplus funds for the purpose of making investment and there is no requirement for the assessee to borrow funds for the purpose of investments.

Given the above arguments, the Assessee humbly submits that there is no nexus between investments and borrowed capital. Further the Assessee had utilized only non-interest bearing funds in making the said investments, therefore disallowance under Section 14A of the Act is not attracted in the instant case.

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9.Thus, the assessee's argument before the DRP was that there is no nexus between the investment and borrowed capital and the assessee has utilized only non-interest bearing funds in making the said investments and therefore, disallowance under Section 14A of the Act cannot be made.

10.The DRP took note of the objections filed and the discussion starts from paragraph 4 of its order dated

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31.08.2016. In this appeal we are not concerned about the discussion which has been made from paragraph 4.1 to 4.4 as the assessee is not on appeal against those findings, but what would be relevant will be from paragraph 4.7 to 4.10. The DRP has stated that the Assessing Officer has recorded his satisfaction and the matter has become final, thereafter they have quoted Section 14A of the Act, referred to the decision in the case of Maxopp Investment Ltd. vs. Commissioner of Income Tax, New Delhi reported in (2018) 402 ITR 640 (SC), quoted Rule 8D of the Rules and we find that the order passed by the DRP confirming the draft assessment order is contained in paragraph 4.10 which reads as follows:

> "4.10.....There is no exception for not considering any income which is exempt from tax, be it the main or incidental. We have deliberated on this matter and it is our considered opinion that the action of the AO is as per law and is being upheld. The objection is therefore dismissed."

11.However, the DRP has failed to take into consideration the specific objections made by the assessee in paragraph 3.10 which we have extracted above. The assessee carried the matter to the Tribunal and before the Tribunal, the discussion is in paragraph 10 and we find that the Tribunal also not undertaken such an exercise to consider the explanation given by the assessee as regards how Section 14A of the Act r/w. Rule 8D(2)(ii) is not attracted. To put it precisely, the assessee has pointed out that the Assessing Officer ought to have considered the fact that the Company has invested out of its own funds and has not incurred any direct and indirect expenditure in relation to maintenance of such expenditure, the Assessing Officer has not established the nexus between the interest expenditure and exempt income and failed to consider that the assessee has enough accumulated reserves and surplus from the previous years and also enough cash flow from operation during the year of their investment. This objection has been raised in paragraph 3.10 in the objections filed before the DRP. However, the Tribunal has not adverted to these contentions and in fact it appears to have committed factual error by stating that the income has gone up by Rs.4.17 Crores.

12.We have perused the financials for the year ended 31.03.2012, more particularly, the note to financial statement for the year ended 31.03.2012 and in column 14, it deals with the current investments and we find that the investment is Rs.45.27 Crores as against the investment of Rs.38.24 Crores for the year ending 31.03.2011. This when compared to cash flow statement for the year ended 31.03.2007 would show that the investment has gone up by about Rs.6.99 Crores. Therefore, we find that there is a factual error crept in in this regard. This in our considered view the proper authority to examine the

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contentions would be the Assessing Officer. The Court is fully conscious of the fact that the Assessing Officer is bound by the directions issued by the DRP under Section 144C of the Act. Nevertheless after the order passed by the DRP, the order has been tested before the Tribunal and it is before us and therefore we will be well within our jurisdiction to remand the matter to the Assessing to take an independent decision on the issues raised before us as pointed out in the preceding paragraphs.

13.The Assessing Officer is required to decide as to whether it was correct for disallowing the interest on debenture under Section 14A of the Act when the assessee's case is that the interest expenditure was incurred on debenture issued in the financial year 2008-09 for the specific purpose of acquiring the Company in the past and not for investment in future. Furthermore, the Assessing Officer has to consider the submission of the assessee that the interest incurred by the assessee is specifically towards acquisition of shares in M/s.Glamouroom Taps Pvt. Ltd. which Company subsequently stood amalgamated with the assessee Company and such amalgamation has been approved by the Court with effect from 01.04.2008. We make it clear that the Assessing Officer shall take an independent decision in the matter without being any manner influenced with the observations made or the directions issued by the DRP on 31.08.2016 or by the Tribunal in its order dated 15.03.2017.

14.With the above directions, the appeal stands disposed of. No costs.

Sd/-
Assistant Registrar(CS VIII)

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Sub Assistant Registrar

cse
To
1.The Income Tax Appellate Tribunal Bench 'D',
Chennai.

2.The Deputy Commissioner of Income Tax,
Chennai.

+1cc to Mr.T.Ravikumar, Advocate, S.R.No.83290

+1cc to Mr.N.V.Balaji & K.Rathinavel, Advocate, S.R.No.83249

T.C.(A) No.775 of 2018

AD(CO)
GSP(28/01/2019)

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