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IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 08.10.2020

CORAM :

THE HON'BLE DR.JUSTICE VINEET KOTHARI  
AND  
THE HON'BLE MR.JUSTICE M.S.RAMESH

TAX CASE (APPEAL) NO.355 OF 2017

Shri Arumugam Olaganathan  
12/A, Spartan Nagar,  
Mugappair,  
Chennai - 600 050.

.. Appellant

-vs-

Commissioner of Income Tax 1  
Chennai.

.. Respondent

PRAYER:

Tax Case Appeal filed under Section 260A of Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal 'B' Bench, Chennai, dated 12.05.2016 passed in ITA Nos.1563/Mds/2015, for the Assessment Year 2010-2011.

Against the order of the Commissioner of Income Tax (Appeals)-11, Chennai in ITA.No.508/13-14/A-1, New No ITA.No.236/CIT(A)-1/2013-14, dated 24.03.2015 and against the Assessment order of the Deputy Commissioner of Income Tax Company Circle - 1(1), Chennai, in GIR/PAN.703-0, dated 06.02.2013 for the Assessment year 2010-11.

For Appellant : Ms.N.V.Lakshmi  
for Mr.N.V.Balaji

For Respondent : Ms.R.Hemalatha  
Senior Standing Counsel

J U D G M E N T

(Judgment of the Court was made by Dr. VINEET KOTHARI, J.)

This Tax Case Appeal has been filed by the Assessee, challenging the order passed by the Income Tax Appellate Tribunal, 'B' Bench, Chennai, dated 12.05.2016, for the



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Assessment Year 2010-11, by raising the following substantial questions of law:

"1. Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in upholding the disallowance made under Section 14A of the Income Tax Act?

2. Whether under the facts and circumstances of the case, the Tribunal could have concluded that the appellant had incurred expenditure in relation to income not includable in the total income warranting application of the Section 14A read with Rule 8D?

3. Whether under the facts and circumstances of the case, the disallowance under Section 14A could be made without any satisfaction that the appellant had incurred expenditure in relation to the income not includable in the total income?

4. Whether under the facts and circumstances of the case, the disallowance under Section 14A could exceed the income not includable in the total income?

5. Whether based on materials available before the Income Tax Appellate Tribunal, the tribunal could have concluded that the expenditure incurred by the appellant is in relation to income not includable in total income?

6. Whether under the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in not following the order of the coordinate bench in the appellant's case on the same issue for the earlier year?"

2. Both the learned counsel submitted that the issues raised in the present appeal filed by the Assessee is covered by a recent Division Bench judgment of this Court to which one of us [Dr. Vineet Kothari, J.] is a Party in the case of M/S. MARG LIMITED VS. COMMISSIONER OF INCOME TAX, CHENNAI [TCA NOS. 41 TO 43 OF 2017 DECIDED ON 30.09.2020]. The Division Bench of this Court in the aforesaid judgment has held as under:



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"13. The provisions of Section 14A themselves are very clear and without recording satisfaction by the Assessing Authority that the expenditure incurred to earn exempted income, as computed by the Assessee is not acceptable for the specified reasons, the Assessing Authority cannot even resort to computation of such disallowance under Rule 8D of the Rules. Despite this being the position of law crystal clear and there being no other contrary view from any other High Court, one fails to understand how the Tribunal in the impugned order could still take a view contrary to this legal position and uphold the disallowance under Rule 8D read with Section 14A of the Act, much beyond the quantum of exempted income of dividend earned by the Assessee in this year. The misconception of the Assessing Authority as well as Tribunal appear to have arisen because they have read Rule 8D providing for computation method of disallowance in isolation, as if it were an island provision or stand alone charging provision and they assumed that the disallowance as computed under Rule 8D is to be taxed as a notional income of the Assessee. This is absolutely impermissible in law. The reach of computation provision, namely Rule 8D cannot be read beyond the parent provision of Section 14A itself, which itself is not a charging provision, but a restriction on allowance of expenditure incurred to earn exempted income. The Assessing Authority has to mandatorily record his satisfaction with regard to the proportionate disallowance of expenditure under Section 14A of the Act as made by the Assessee that it is not satisfactory for such cogent reasons as specified and therefore, the same is liable to be rejected and therefore, the computation method under Rule 8D can be invoked as a legislative way out to compute the quantum of disallowance. Unfortunatley, the Revenue Authority and the Tribunal have read Rule 8D without context and as an independent provision of disallowance, as if it was an island provision of law and the disallowance computed as per Rule 8D of the Rules can go beyond the exempted income itself and can be added as a taxable income in the



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hands of the Assessee. Such an interpretation put by Revenue Authorities is pathetic, to say the least.

14. It is well settled that the Rule cannot go beyond the main parent provision. Therefore, what has been provided as computation method in Rule 8D cannot go beyond the roof limit of Section 14A itself under any circumstances. The Courts have time and again reiterated this correct, reasonable and clear position of law. But, merely to somehow make more disallowance and impose tax on the hypothetical income of the Assessee, in contrast to the concept of "real income" to be taxed as per Section 5 of the Income Tax Act, the authorities under the Income Tax Act keep on adopting such absurd procedures. The disallowance to this extent, if it was to have its way, will constitute a hypothetical 'income' taxable in the hands of the Assessee, which could never be the intention of Section 14A of the Act, providing for a proportionate disallowance of expenditure incurred to earn the exempted income.

15. The expenditure incurred to earn any income has to be always below the extent of income itself and bear a reasonable proportion thereto, as the commercial prudence does not permit any one to spend more and earn less. The investment in shares of which dividend is earned and dividend being exempted income, the expenditure incurred for earning such dividend in the form of interest on the borrowed funds, which are employed to buy such shares can obviously be not more than the dividend itself and even if the interest paid on such borrowed funds is more than the actual dividend earned during the year in question, the disallowance of interest cannot go beyond the amount of dividend itself. As such, interest paid on borrowed funds by the Assessee does not constitute 'income of Assessee for that year'. Section 14A has been introduced not to allow expenditure incurred to earn such exempted income in the form of dividend as an allowable expenditure against the exempted income of the Assessee and therefore, obviously the



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disallowance too cannot exceed the extent of dividend itself. The Tribunal itself in many such cases has upheld the disallowance under Section 14A only to the extent of 2% of the Dividend income or other exempted income even if Assessee claimed that no expenditure was incurred to earn such Dividend income and even appeals filed by the Assessee against such 2% disallowance have been dismissed by this Court. Therefore, such an inconsistent approach on the part of the Tribunal cannot be sustained.

16. The contention raised on behalf of the Revenue by Mr.Karthik Ranganathan that even if the dividend income is not earned in the present year, since the investment is made for the strategic purposes to have control over the subsidiary companies, whenever in future a huge dividend can be declared, it will be earned by the Assessee and in that future year, the Assessee will not have incurred any expenditure to earn that income and therefore, a larger disallowance under Rule 8D should be allowed, is only an ingenuity of argument covered by the absurdity thereof. The disallowance of expenditure incurred for the year in question only can be considered under Section 14A of the Act and no such hypothetical earning in future as against no expenditure incurred for that, is envisaged under Section 14A of the Act.

17. With respect to the learned counsel for the Revenue, we cannot accept such unfounded and imaginary situations and submissions. The nature of investment has nothing to do with Section 14A of the Act. It is the exempted income in the form of dividend which forms the cap or roof limit for disallowance. Firstly, the Assessee has to apportion the expenditure incurred in the form of interest on borrowed funds if any or the expenditure incurred by him to earn such dividend income, which is exempt from tax and if at all the Assessing Authority is not satisfied with that declaration of the assessee, after recording such reasonable and cogent satisfaction only, he can resort to the computation method under Rule 8D of the Rules



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and compute such disallowance with a caveat that under no circumstances, the disallowance can exceed the amount of dividend income earned, received or accrued to the Assessee in the present year, which was taxable but for the exemption as per the provisions of the Act. If no dividend income is declared by the investee company or subsidiary company as the case may be, the disallowance computed under Rule 8D cannot be taxed as a "hypothetical income" of the Assessee, by providing a negative figure beyond the dividend income earned during that year, to be added to the taxable income of the Assessee. That will make the mockery of the concept of "real income" of the Assessee being taxed and it is the bedrock of the Income Tax Act itself.

18. The computation of disallowance made by the Assessing Authority and upheld by the Tribunal, as given in paragraph 6 of its impugned order, are quoted below for ready reference:

"6. We have heard both the parties and perused the material on record. The assessee made total investment in the assessment year 2009-10 as follows:

|                                          |                      |
|------------------------------------------|----------------------|
| Subsidiaries                             | Rs. 2,38,89,48,500/- |
| UTI Infrastructure Advantage Fund Series | Rs. 10,00,000/-      |
| Investment in sister concerns            | Rs. 1,59,39,000/-    |

6.1. For the assessment year 2010-11, the total investment is as follows:

|                                          |                      |
|------------------------------------------|----------------------|
| Subsidiaries                             | Rs. 4,35,42,53,360/- |
| UTI Infrastructure Advantage Fund Series | Rs. 10,00,000/-      |
| Investment in sister concerns            | Rs. 1,59,39,000/-    |

6.2. For the assessment year 2011-12, the total investment is as follows:

|                                          |                      |
|------------------------------------------|----------------------|
| Subsidiaries                             | Rs. 5,17,41,16,895/- |
| UTI Infrastructure Advantage Fund Series | Rs. 8,53,000/-       |



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Subsidiaries Rs. 5,17,41,16,895/-  
Investment in sister concerns Rs. 1,59,39,000/-

6.3. In this case, the assessee made average investment which yields no income or exempted income is as follows:

|         |                      |
|---------|----------------------|
| 2009-10 | Rs. 1,96,32,20,750/- |
| 2010-11 | Rs. 3,39,69,83,166/- |
| 2011-12 | Rs. 4,78,02,04,127/- |

The AO disallowed 0.5% of the average investment as follows:

|         |                   |
|---------|-------------------|
| 2009-10 | Rs. 98,16,104/-   |
| 2010-11 | Rs. 1,69,84,915/- |
| 2011-12 | Rs. 2,39,01,020/- |

The assessee dividend income received and claimed as exempt for these assessment years are as follows:

|         |                |
|---------|----------------|
| 2009-10 | Rs. 41,024/-   |
| 2010-11 | NIL            |
| 2011-12 | Rs. 74,00,00/- |

19. Obviously such disallowance has far exceeded the exempted income in the form of dividends even though computed at the rate of 0.5% of the average investment made by the Assessee. In our opinion, the same is not permissible at all, because this average disallowance as computed under Rule 8D could be disallowed only if Assessee had actually earned Dividend income in excess of such amount of disallowance, that too after recording reasons for rejecting the apportionment of expenditure so incurred or claim that no such expenditure was incurred to earn that much of Dividend income was validly rejected by the Assessing Authority. We do not find any such reasons even recorded by the Assessing Authority in the present case."



3.The learned counsel for the Assessee Ms.N.V.Lakshmi, also urged that the Assessing Authority in the assessment order AY 2009-10 has recorded the reasons for invoking Section 14-A of the Income Tax Act, 1961 (Shortly "the Act") which do not makes any sense. The Assessee is only a Proprietorship concern, whereas the Assessing Authority has sought to disallow even the Directors' remuneration under Section 14-A of the Act, which is not even the fact situation of the legal jurisprudence.

4.We have perused the order of the Assessing Authority. The relevant extract of the same is quoted below:

"2. Disallowance u/s.14A:-

The assessee accounted an amount of Rs.1,21,166/- as dividend during the year and claimed the same as exempt u/s 10(34). As per the provisions of section 14A of the Income Tax Act, 1961, no deduction shall be allowed in respect of expenditure incurred in relation to such income which does not form part of the total income. The assessee was asked to clarify as to why the disallowance shall not be made u/s.14A. The assessee has made submissions that no expenditure has been made for earning the said divided income. The contention of the assessee is not acceptable for the following reasons:

i.It is logical to conclude that a portion of the routine expenditure to maintain its establishment and administration can be attributable towards the activity of making investments to earn dividend. Further, it is a fact that the managerial staff and the Directors are involved in making decisions on investments. Hence, a portion of this managerial remuneration and Directors remuneration definitely be attributable towards earning such exempt income.

ii.Reliance is placed on the decision of the Bombay High Court in the case of Godrej & Boyce Vs. DCIT, wherein it has been held that disallowance under Sec.14A r.w. Rule 8D is "fair and reasonable". To determine the expenses attributable to earning such exempt income, the Finance Act, 2006 had brought in the provisions of Section 14A(2) which requires the Assessing Officer to determine the expenses relating to exempt income in accordance with Rule 8D.

iii.For the reasons stated above, the undersigned is satisfied that without any ambiguity and with certainty, it can be stated



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that the assessee would have definitely incurred expenses towards earning exempt income.

iv. As there is no direct expense relatable to the exempted income and no interest expenses relatable to direct income,  $\frac{1}{2}\%$  of average investments as provided in the 3<sup>rd</sup> limb of Rule 8D worked out as under is disallowed u/s.14A and added back to income under the head "income from business or profession":

| $\frac{1}{2}\%$ OF AVERAGE INVESTMENTS YIELDING |           |
|-------------------------------------------------|-----------|
| EXEMPT INCOME                                   | 986841    |
| INVESTMENTS AS ON 31.3.2010                     | 212191624 |
| INVESTMENTS AS ON 31.3.2009                     | 182544674 |
| AVERAGE INVESTMENTS                             | 197368149 |
| DISALLOWANCE U/S 14A                            | 986841 "  |

5. We find some force in the submission of the learned counsel for the Assessee.

6. However, since both the learned counsel are agreeing that the matter should go back to the Assessing Authority for deciding the case again on the aspect of Section 14-A of the Act in accordance with the Division Bench judgment of this Court in M/s. Marg (cited supra), the appeal is accordingly disposed of, by answering the questions of law in favour of the Assessee and against the Revenue and the matter is remitted back to the Assessing Authority for passing fresh orders on the limited issue under Section 14-A of the Act, by complying with the directions of this Court in the aforesaid judgment with regard to the satisfaction, for invoking Section 14A read with Rule 8D also, in accordance with law.

7. The Tax Case Appeal is accordingly disposed of. No costs.

Sd/-  
Assistant Registrar(CS IX)

//True Copy//

Sub Assistant Registrar

TK



To

1. The Commissioner of Income Tax 1  
Chennai.

2. The Income Tax Appellate Tribunal,  
Madras 'B' Bench, Chennai.

3. The Deputy Commissioner of Income Tax,  
Company Circle I(1), Chennai.

+1cc to Mr.N.V.Balaji, Advocate, S.R.No.33635

+1cc to Mr.T.Ravikumar, Advocate, S.R.No.33394

TAX CASE (APPEAL) NO.355 OF 2017

SS(CO)  
CS/07/12/2020