IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON: 15.09.2020
DELIVERED ON: 30.09.2020

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE KRISHNAN RAMASAMY

Tax Case Appeal Nos.41 to 43 & 220 of 2017

M/s. Marg Limited
Marg Axis, No.4/318, Rajiv Gandhi Salai
Kottivakkam
Chennai 600 041 .. Appellants in all TCAs.

Vs.

Commissioner of Income Tax
Chennai .. Respondents in all TCAs.

Tax Case Appeals filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal 'B' Bench, Chennai dated 06.04.2016 passed in ITA Nos.344/Mds/2016, the Income Tax Appellate Tribunal 'C'Bench, Chennai dated 20.05.2016 passed in ITA.No.345/Mds/2016, 346/Mds/2016 & 543/Mds/2016 for the Assessment Years 2009-10, 2010-11, 2011-12 and 2012-13 respectively, against the Commissioner of Tax(Appeals)-8 Chennai, dated 31/12/2015 passed in ITA.No.55/2011-12, ITA 96/2014-15, ITA No.72/2014-15, dated 29.02.2016 passed in ITA 168/2015-16 for the Assessment years 2009-10, 2010-11, 2011-12, 2012-13 and the Joint Commissioner of Income Tax Company Range IV, Chennai, dated 30.12.2011 passed in PAN/GIR No.AACCM8770G Assessment year 2009-10, the Deputy commissioner of Income Tax Company Circle IV(1), Chennai, dated 30.05.2014 passed in PAN/GIR No.AACCM8770G, Assessment year 2010-11, the Joint Commissioner of Income Tax Company Rannge IV, Chennai dated 31.03.2014 passed in PAN No.AACCM8770G Assessment year 2011-12, the Deputy Commissioner of Income Tax Corporate Circle 4(1), Chennai dated 31.03.2015 passed in PAN/GIR No.AACCM8770G, Assessment year 2012-13.

For Appellant : Mr.R.Sivaraman

For Respondent : Mr.Karthik Ranganathan,
Senior Standing Counsel

JUDGMENT

Dr.Vineet Kothari,J

What seems to be the settled legal position repeated times over by various High Courts and even Hon'ble Supreme Court of India, still seems to have not settled down upon the final fact finding Tribunal under the Income Tax Act with reference to Section 14A read with rather badly drafted or rather hugely misinterpreted Rule 8D of the Income Tax Rules, 1962.

2. This appears to be more so on account of lack of judicial discipline which deserves to be maintained by the Sub-ordinate Courts and Tribunals, while the controversies are dealt with by them and which are covered by judgments of Constitutional Courts. But, without proper application of the judgments of the Constitutional Courts, such Tribunals continue to take illogical views citing some of their own precedents rendered by their own Co-ordinate Benches on the said issues without assigning any reasons why the law applicable on the subject is not applicable to the facts before them. Such unscrupulous tendency on the part of the Tribunals is the main reason for continuous inflow of litigation on the same point of law in the Constitutional Courts, which entails loss of precious time of Courts and learned counsel appearing in the matter and unnecessary litigation expenditure and also loss of man hours.

3. The question of law involved in the present appeal under Section 260A of the Income Tax Act before us has been dealt with and is being decided in the present Covid times when the Courts are functioning through virtual hearings of the matters through video conferencing. What was settled by the Co-ordinate Bench of Madras High Court itself and other High Courts like Karnataka, Delhi, Punjab and Haryana and Hon'ble Supreme Court in the case of Maxopp Investment Ltd. v. Commissioner of Income Tax [(2018) 91 taxmann.com 154 (SC)] that 'the disallowance of expenditure incurred to earn exempted income under Section 14A of the Income Tax Act, cannot exceed such exempt income itself during the relevant assessment year' is still sought to be re-agitated in the present appeal filed by the Assessee because the Tribunal took a wrong view of the matter and the learned counsel for the Revenue still wanted us to give it a second thought.

4. We are not at all inclined to do this as such disallowance of expenditure purportedly incurred for earning the exempted income cannot exceed the actual exempt income in the hands of the assessee, is not only a concluded position in law, but no other possible view appeals to us at all. The exempted income in the present case is Dividends earned by Assessee on the investments made by it in the Equity Shares of other companies.

5. What seems to have caused this continuous problem is the CBDT Circular No.5/2014 dated 11.02.2014, referred to in paragraph 5 of the impugned order of the Tribunal dated 06.04.2016 before us in the present case. In that Circular, the CBDT has clarfied that Rule 8D read with Section 14A of the Act provides for disallowance of expenditure even where the taxpayer in a particular year has not earned any exempt income. This argument of Revenue, which prevailed with the Tribunal, is not at all tenable.

6. The position of four assessment years, AY 2009-10, 2010-11, 2011-12 and 2012-13 involved before us in the case of the Assessee about the actual exempted income in the form of dividends earned by it, on the investment made by it in the shares of its subsidiary companies and disallowance voluntarily made by it in the computation of income with the return of income filed by it as well as the disallowance made by the Assessing Authority and upheld by the Tribunal in the impugned orders given in the form of a Table produced before us, is quoted below:

ASST. YEAR	TCA No.	Exempted Income as per Financials in (Rs.)	Disallowance voluntarily made in the Tax Computation	14A Disallowance r.w.r. 8D(iii) @ 0.5% in (Rs.) made in the Assessment
2009-10	41/2017	41,042/-	2,38,575/-	98,16,104/- (refer page 2 of the index to Paper Book)
2010-11	42/2017	1,48,000/-	5,35,000/-	1,69,84,915/- (refer page 2 of the index to Paper Book)

ASST. YEAR	TCA No.	Exempted Income as per Financials in (Rs.)	Disallowance voluntarily made in the Tax Computation	14A Disallowance r.w.r. 8D(iii) @ 0.5% in (Rs.) made in the Assessment
2011-12	43/2017	*74,000/-	9,58,443/-	2,39,01,020/- (refer page 4 of the index to Paper Book)
2012-13	220/2017	NIL	8,50,000/-	2,61,96,790/- (refer page 3 of the index to Paper Book)
* As per the Audited Financials in the P&L A/c. under the head other income a sum of Rs.84,12,476/- was disclosed as dividend income. It is submitted that Rs.83,38,476/- was received from foreign company and offered to tax under the head Income from other sources as evident from the tax computation sheet. Thus only Rs.74,000/- was claimed as exempt income.				

7. The question of law which is raised before us in the present case, as suggested in the memo of appeal filed by the Assessee is as under:

> "Whether the Tribunal was justified in confirming the disallowance of Rs.98,16,104/- as expenditure incurred on earning the exempt income, in excess of Rs.41,042/- earned during the Assessment Year 2009-10, where the assessee made investments mostly in subsidiary companies shares to gain control over the same, but not for the purpose of earning exempt income in the form of dividends of such shares?"

8. We have heard Mr.R.Sivaraman, learned counsel appearing for the Assessee and Mr.Karthik Ranganathan, learned Senior Standing Counsel appearing for the Revenue.

9. A Co-ordinate Bench of this Court, in the case of CIT v. M/s. Tidel Park Limited [TCA Nos.732 & 733 of 2018 decided on 07.07.2020], has relied upon the decisions of the Delhi High Court in the case of Joint Investments Private Limited v. CIT

[(2015) 372 ITR 694 (Del.)] and CIT v. Taikisha Engineering India Limited [ITA No.115 of 2014 decided on 25.11.2014] and Bombay High Court decision in the case of Godrej & Boyce Manufacting Company Limtied v. DCIT [(2010) 328 ITR 81] and categorically held that the Assessing Officer was not justified in making excessive disallowance beyond the dividend income declared by the Assessee.

10. A Division Bench of Karnataka High Court, to which one of us (Vineet Kothari,J) was a party, held in the case of Pragathi Krishna Gramin Bank v. Joint Commissioner of Income Tax [(2018) 95 taxman.com 41 (Kar.)] that disallowance under Section 14A beyond and in excess of actual exempted income is per se asburd and hypothetical and it cannot be so made. The relevant extract of the said Karnataka High Court judgment is quoted below for ready reference:

> "6. Drawing the attention of the Court towards Rule 8D of the Income Tax Rules, 1962, the learned counsel for assessee has urged that the amount of disallowance under Section 14A of the Act read with Rule 8D of the Rules, cannot exceed the total expenditure claimed by the assessee for earning such exempted income. He submitted that in the present case the assessee earned "dividend income" from the SLR investments made by it, which is exempted from income tax to the extent of Rs.1,80,30,965/- for the assessment year 2011-12 but the learned Assessing Authority vide the aforesaid order has disallowed the expenditure to the extent of Rs.2,48,85,000/- which is exfacie illegal and impermissible. He also submits that the expenditure incurred to earn the exempted income in the form of Dividend was really not incurred by the Bank during the year but the said computation of expenses of Rs.2,48,85,000/- was made as per the direction of Assessing Authority in terms of Rule 8D of the Rules with a clear submission made by the assessee that no expenditure deserves to be disallowed in the hands of assessee Bank under Section 14A of the Act r/w Rule 8D of the Rules but ignoring such factual submissions as well as the provisions of law, the assessing authority has disallowed the said sum and unfortunately the Appellate Authorities have also casually upheld the said findings.

7. On the other hand, Sri Y.V.Raviraj learned counsel for the Revenue urged before the Court that though the disallowance in excess of the dividend income earned by the assessee to the extent of Rs.1,80,30,965/- may not be justified, but the assessee himself has computed the said figure of Rs.2,48,85,000/- in terms of Rule 8D of the Rules and had supplied the same to the assessing authority and therefore the assessing authority was justified in disallowing the same.

8. We are not impressed with the said contention raised by the learned counsel for Revenue. The said disallowance, under Section 14A of the Act r/w Rule 8D of the Rules, of the expenditure incurred to earn an exempted income has to be computed in accordance with Rule 8D of the Rules, which in essence stipulates that the expenditure directly relatable to the earning of such exempted income, can only be disallowed under Section 14A of the Act.

9. The assessee in the present case had claimed that he had not incurred any expenditure for earning of the said dividend income on such statutory SLR investments made by it. The amount of investments itself cannot be considered as an expenditure for earning an exempted income viz., the dividends. The computation of disallowance under Section 14A of the Act has to be made as per Rule 8D of the Rules.

10. Therefore, on the basis of actual expenditure incurred by the assessee for earning such exempted income or an average estimated basis, on the basis of the total value of investments was required to be computed by the assessing authority. We do not find, any such computation on the part of the assessing authority in this regard. Apparently, the expenditure, so calculated to the extent of Rs.2,48,85,000/- which was disallowed by Assessing Authority is far in excess of the dividend income of Rs.1,80,30,965/-. The same prima facie appears to be incorrect. While the assessee claimed that no expenses was incurred in this regard, the assessing authority has disallowed the said expenditure even in excess of the dividend income itself. The said calculations do not appear to be computed in accordance with

Rule 8D of the Rules. We do not find any rational basis for the same.

11. The obligation is cast upon the assessing officer under Section 14A of the Act to determine the said amount of expenditure incurred for earning the exempted income of dividends.

12. The provision of Section 14A of the Act and Rule 8D of the Rules are quoted below for reference;

"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".

Rule 8D: 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; and

(ii) an amount equal to one percent of the annual average of the monthly averages of the opening and closing balances of the value of investment, income from which does not or shall not form part of total income:

Provided that the amount referred to in clause (i) and clause (ii) shall not exceed the total expenditure claimed by the assessee] (3) [deleted w.e.f. 02.06.2016]]"

Rule 8D has been amended from time to time.

The aforesaid quoted Rule is from the latest. The said Rule 8D as applicable for Assessment Years 2011-12 & 2013-14 will be relevant.

[Note: The pre-amendment Rule 8D(2), (3) are also quoted here for the sake of completeness.

60. Substituted by the IT (Fourteenth Amdt.) Rules, 2016, w.e.f. 2-6-2016. Prior to its substitution, sub-rule (2) read as under:

(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:-

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

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."

61. Omitted by the IT (Fourteenth Amdt.) Rules, 2016, w.e.f. 2-6-2016. Prior to its omission, sub-rule (3) read as under:

'(3) For the purpose 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.'

13. The manner in which the aforesaid disallowance has been made by the assessing authority and has been upheld by the appellate authorities leaves much to the desired and the same cannot be sustained and therefore the matter deserves to be remanded back to the Assessing Authority.

14. We make it clear that the expenditure for earning exempted income has to have a reasonable proportion to the income, so earned, going by the common financial prudence. Therefore, even if the Assessing Authority has to make an estimate of such an expenditure incurred to earn exempted income, it has to have a rational nexus with the amount of income earned itself. Disallowance under Section 14A of Rs.2,48,85,000/- as expenses to earn exempted Dividend income of Rs.1,80,30,965/- is per se absurd and hypothetical. The disallowance under Section 8D cannot exceed the expenses claimed by assessee under the Proviso to Rule 8D. Therefore, where the assessee claimed that assessee did not incur any such expenditure during the year in question to earn Dividends of Rs.1,80,30,965/-, the burden was upon the assessing authority to compute the interest on such borrowed funds which were dedicatedly used for investment in securities to earn such exempted Dividend income. The disallowance under Section 14A cannot be a wild guesswork bereft of ground realities. It has to have a reasonable and close nexus with the factually incurred expenses. It is not deemed disallowance under Section 14A of the Act but an enabling provision for assessing authority to compute the same on the given facts and figures in the regularly maintained Books of Accounts. The assessing authority also could not have called upon the Assessee himself to undertake the exercise of computing the disallowance under Section 8D of the Rules. Such abdication of duty in not permissible in law. Since no such exercise has been undertaken by the assessing authority, the case calls for a remand.

15. In this view of the matter, the findings of all the three authorities below for Section 14A of the Act are set aside and the matter is remanded back to the Assessing Authority for re-computing the disallowance of expenditure, if any, under Section 14A of the Act, in accordance with law.

(emphasis supplied) "

11. Affirming the view of the Punjab and Haryana High Court in the case of Principal Commissioner of Income Tax v. State Bank of Patiala [(2017) 78 taxmann.com 667 (P&H)], the Hon'ble Supreme Court in the case of Maxopp Investment Ltd. v. Commissioner of Income Tax [(2018) 91 taxmann.com 154 (SC)], held in paragraphs 40 and 41 as under:

"40) We note from the facts in the State Bank of Patiala cases that the AO, while passing the assessment order, had already restricted the disallowance to the amount which was claimed as exempt income by applying the formula contained in Rule 8D of the Rules and holding that section 14A of the Act would be applicable. In spite of this exercise of apportionment of expenditure carried out by the AO, CIT(A) disallowed the entire deduction of expenditure. That view of the CIT(A) was clearly untenable and rightly set aside by the ITAT. Therefore, on facts, the Punjab and Haryana High Court has arrived at a correct conclusion by affirming the view of the ITAT, though we are not subscribing to the theory of dominant intention applied by the High Court. It is to be kept in mind that in those cases where shares are held as 'stock-in-trade', it becomes a business activity of the assessee to deal in those shares as a business proposition. Whether dividend is earned or not becomes immaterial. In fact, it would be a quirk of fate that when the investee company declared dividend, those shares are held by the assessee, though the assessee has to ultimately trade those shares by selling them to earn profits. The situation here is, therefore, different from the case like Maxopp Investment Ltd. where the assessee would continue to hold those shares as it wants to retain control over the investee company. In that case, whenever dividend is declared by the investee company that would necessarily be earned by the assessee and the assessee alone. Therefore, even at the time of investing into those shares, the assessee knows that it may generate dividend income as well and as and when such dividend income is generated that would be earned by the assessee. In contrast, where the shares are held as stock-in-trade, this may not be necessarily a situation. The main purpose is to liquidate those shares whenever the share price goes up in order to earn profits. In the result, the appeals filed by the Revenue challenging the judgment of the Punjab and Haryana High Court in State Bank of Patiala also fail, though law in this respect has been clarified hereinabove.

41) Having regard to the language of Section 14A(2) of the Act, read with Rule 8D of the Rules, we also make it clear that before applying the theory of apportionment, the AO needs to record satisfaction that having regard to the kind of the assessee, suo moto disallowance under Section 14A was not correct. It will be in those cases where the assessee in his return has himself apportioned but the AO was not accepting the said apportionment. In that eventuality, it will have to record its satisfaction to this effect. Further, while recording such a satisfaction, nature of loan taken by the assessee for purchasing the shares/making the investment in shares is to be examined by the AO.

(emphasis supplied)"

12. Another Bench of Madras High Court in the case of CIT v. Chettinad Logistics P. Ltd. [(2017) 80 taxmann.com 221 (Madras)] wherein the Division Bench of the Court followed another Division Bench judgment in the case of Redington (India) Ltd. v. Additional Commissioner of Income Tax [(2017) 77 taxmann.com 257 (Mad.)] and held that the view of the Central Board of Direct Taxes in Circular No.5 of 2014 dated 11.02.2014, which has been relied by the Tribunal in the impugned order cannot be upheld and the disallowance under Section 14A of the Act cannot go beyond the extent of exempted income itself. Paragraph 12.3 of the said judgment is quoted below for ready reference.

" 12.3.The reasoning of the Division Bench is contained in the following part of the judgment:

> "4. The admitted position is that no exempt income has been earned by the assessee in the financial year relevant to the assessment year in issue. The order of assessment records a finding of fact to that effect. The issue to be decided thus lies within the short compass of whether a disallowance in terms of s.14A of the Act read with Rule 8D of the Rules can be contemplated even in a situation where no exempt income has admittedly been earned by the assessee in the relevant financial year.
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> 7.Per contra, Sri.T.Ravikumar appearing on behalf of the revenue drew our attention to the marginal notes of s.14 A pointing out that the provision would apply not only where exempted income is 'included' in the total income, but also where exempt income is 'includable' in total income.
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> 8. He relied upon a Circular issued by the Central Board of Direct taxes in Circular No.5 of 2014 dated 11.2.2014 to the effect that s.14A was intended to cover even those situations whether there is a possibility of exempt income being earned in future. The Circular, at paragraph 4, states that it is not necessary for exempt income to have been included in the income of a particular year for the disallowance to be triggered. According to the Learned Standing Counsel, the provisions of s.14A are made applicable, in terms of sub section (1) thereof to income 'under the act' and not 'of the year' and a disallowance under s.14A r.w. Rule 8D can thus be effected even in a situation where a tax payer has not earned any taxable income in a particular year.
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> 9.We are unable to subscribe to the aforesaid view. The provisions of section 14A were inserted as a response to the judgments of the Supreme Court in Commissioner of Income Tax Vs. Maharashtra Sugar Mills Limited (1971) (82 ITR 452) and Rajasthan State Ware Housing Corporation Vs.

Commissioner of Income Tax ((2002) 242 ITR 450) in terms of which, expenditure incurred by an assessee carrying on a composite business giving rise to both taxable as well as non-taxable income, was allowable in entirety without apportionment. It was thus that s.14A was inserted providing that no deduction shall be allowable in respect of expenditure incurred in relation to the earning of income exempt from taxation. As observed by the Supreme Court in the judgment in the case of Commissioner of Income Tax vs. Walfort Share and Stock Brokers (P) Ltd. (2010 326 ITR 1' .... The mandate of s.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.'

10.The provision this is clearly relatable to the earning of actual income and not notional or anticipated income. The submission of the Department to the effect that s.14A would be attracted even to exempt income 'includable' in total income would entail the assessment of notional income, assumed to be exempt in the future, in the present assessment year. The computation of total income in terms of s.5 of the Act is on real income and there is no sanction in law for the assessment of admittedly notional income, particularly in the context of effecting a disallowance in connection therewith.

11.The computation of disallowance in terms of Rule 8D is by way of a determination involving direct as well as indirect attribution. Thus, accepting the submission of the Revenue would result in the imposition of an artificial method of computation on notional and assumed income. We believe this would be carrying the artifice too far.

(emphasis is ours)"

> 13.Mr.Senthil Kumar, seeks to distinguish the judgment in M/s.Redington (India) Limited case based on the fact that Rule 8D had not kicked-in by AY 2007-08, which was the AY being considered in the said case."

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 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 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 situtations 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 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/-
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 divident 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 disallownace, 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.

20. Before parting, we may also note with reference to the Table of disallowance voluntarily made by the Assessee, which is part of the Paper Book before us for the four assessment years in question. In the Table quoted in the beginning of the order, shows that the Assessee himself computed and offered the disallowance beyond the exempted income in the particular year, namely AY 2009-10, as against the dividend income of Rs.41,042/- and the Assessee himself computed disallowance under Rule 8D of the Rules to the extent of Rs.2,38,575/-, which was increased to Rs.98,16,104/- by the Assessing Authority. Similarly, for AY 2012-13, against Nil dividend income, the Assessee himself computed disallowance at Rs.8,50,000/-, which was increased to Rs.2,61,96,790/-.

21. We cannot approve even the larger disallowance proposed by the Assessee himself in the computation of disallowance under Rule 8D made by him. These facts are akin to the case of Pragati Krishna Gramin Bank (supra) decided by Karnataka High Court. The legal position, as interpreted above by various judgments and again reiterated by us in this judgment, remains that the disallowance of expenditure incurred to earn exempted income cannot exceed exempted income itself and neither the Assessee nor the Revenue are entitled to take a deviated view of the matter. Because as already noted by us, the negative figure of disallowance cannot amount to hypothetical taxable income in the hands of the Assessee. The disallowance of expenditure incurred to earn exempted income has to be a smaller part of such income and should have a reasonable proportion to the exempted income earned by the Assessee in that year, which can be computed as per Rule 8D only after recording the satisfaction by the Assessing Authority that the apportionment of such disallowable expenditure under Section 14A made by the Assessee or his claim that no expenditure was incurred is validly rejected by the Assessing Authority by recording reasonable and cogent reasons conveyed to Assessee and after giving opportunity of hearing to

the Assessee in this regard.

22. We, therefore, dispose of the present appeal by answering question of law in favour of the Assessee and against the Revenue and by holding that the disallowance under Rule 8D of the IT Rules read with Section 14A of the Act can never exceed the exempted income earned by the Assesee during the particular assessment year and further, without recording the satisfaction by the Assessing Authority that the apportionment of such disallowable expenditure made by the Assessee with respect to the exempted income is not acceptable for reasons to be assigned the Assessing Authority, he cannot resort to the computation method under Rule 8D of the Income Tax Rules, 1962.

23. The appeal is accordingly disposed of. No costs.

Sd/-

Assistant Registrar

//True Copy//

Sub Assistant Registrar

kpl

To

1. The Commissioner of Income Tax(Appeals)-8
Chennai.

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

3.The Joint Commissioner of Income-Tax,
Company Range IV, Chennai.

4.The Income Tax Appellate Tribunal,
'C'Bench, Chennai.

5.The Deputy Commissioner of
Income Tax Company Circle-IV(1),
Chennai.

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