IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 24.11.2020

CORAM :

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

TAX CASE (APPEAL) NOS.777 TO 779 OF 2017
AND CMP NOS.19684 AND 19685 OF 2017

M/s.Siva Industries and Holdings Limited
(Formerly known as Sterling Infotech Ltd.,)
First Floor, Block 1, Beliciaa Towers,
Door No.71/1, MRC Nagar Main Road,
Raja Annamalaipuram, Chennai - 600 028. ...Appellant in all TCAs'

-vs-

Commissioner of Income Tax 6
121, Mahatma Gandhi Road,
Nungambakkam, Chennai - 600 034. ...Respondent in all TCAs'

PRAYER: Tax Case Appeals filed under Section 260A of Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, Chennai "D" Bench dated 07.10.2016 in ITA Nos.1039/Mds/2014, 2108/Mds/2012 and 884/Mds/2015 respectively.

(a) against the order of the Assistant Commissioner of Income Tax, Company Circle VI(3), Chennai dated 28/03/2013 Draft assessment order (21/02/2014) Final Assessment order for the assessment year 2009-2010,(in T.C.No.777/17).

(b) against the order of the Assistant Commissioner of Income Tax, Company Circle VI(4), Chennai 34 dated 30/12/2011 Draft assessment order (27/09/2012) Final Assessment order for the assessment year 2008-2009,(in T.C.No.777/17).

(c) against the order of the Joint Commissioner of Income Tax, Company Range VI, Chennai dated 24/03/2014 (Draft assessment order) (dated 06/02/2015 final Assessment order) for the assessment year 2010-11 in T.C.779/2017 respectively.

:

For Appellant in all TCAs' : Mr.N.V.Balaji

For Respondent in all TCAs' : Mr.J.Narayanaswamy

COMMON JUDGMENT

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

These Tax Case Appeals have been filed by the Assessee, challenging the order passed by the Income Tax Appellate Tribunal, 'D' Bench, Chennai, dated 07.10.2016, for the Assessment Years 2009-10, 2008-09 and 2010-11, by raising the following substantial questions of law:

> "1.Whether, on the facts and circumstances of the case, the Tribunal was right in confirming the disallowance made by the assessing officer under section 14A of the Act, in respect of the strategic investment made by the appellant?
>
> 2.Whether, on the facts and circumstances of the case, the Tribunal was right in confirming the disallowance under section 14A of the Act when the assessing officer has not recorded satisfaction for invoking section 14A of the Act?
>
> 3.Whether, on the facts and circumstances of the case, the Tribunal was right in not restricting the disallowance under Section 14A of the Act to exempt income?
>
> 4.Whether, on the facts and circumstances of the case, the Tribunal was justified in disregarding the order of the Tribunal in the Appellant's own case for earlier year, when facts, circumstances and law is unchanged? "

2.Both the learned counsel submitted that the controversy involved in the present appeals 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 issue is with regard to disallowance under Section 14A of the Income Tax Act, 1961, read with Rule 8(D) of the Income Tax Rules, 1962. The Division Bench of this Court, in the aforesaid judgment, has held as under:

> "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:

Subsidiarie	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."

3.In view of the aforesaid judgment, the impugned order of the learned Tribunal dated 07.10.2016, for the Assessment Years 2009-10, 2008-09 and 2010-11 respectively, with regard to disallowance under Section 14A of the Income Tax, 1961, is set aside and the appeals are restored on the file of the learned Tribunal to decide the appeals de novo afresh, in accordance with the law laid down by this Court in the judgment in M/s.Marg (cited supra). Accordingly, we do not see any need to answer the questions at this stage and we leave it to the Tribunal to decide the appeals on the said issues again in accordance with law.

4.The Tax Case Appeals are accordingly disposed of. No costs. Consequently, connected Civil Miscellaneous Petitions are closed.

Sd/-
Assistant Registrar

//True Copy//

Sub Assistant Registrar

TK

To

1.The Commissioner of Income Tax 6
121, Mahatma Gandhi Road,
Nungambakkam,
Chennai - 600 034.

2.The Income Tax Appellate Tribunal,
Chennai D Bench, Chennai.

3.The Assistant Commissioner of Income Tax
Company Circle VI(3), Chennai.

4.The Assistant Commissioner of Income Tax
Company Circle VI(4), Chennai.

5.The Joint Commissioner of Income Tax,
Company Range VI, Chennai.

+3cc to Mr.N.V.Balaji, Advocate, SR.NO.38299

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SSI(CO)
KKV/16/12/2020