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IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 08.02.2022

CORAM :

THE HON'BLE MR.JUSTICE R.MAHADEVAN
AND
THE HON'BLE MR.JUSTICE J.SATHYA NARAYANA PRASAD

T.C.A.NOS.509 TO 511 OF 2010

M/s.The Karur Vysya Bank Ltd.,
Central Office, Erode Road
Karur

... Appellant in all T.C.As

Versus

Commissioner of Income-Tax-I
Tiruchirapalli

... Respondent in all T.C.As

Appeals preferred under Section 260-A of the Income Tax Act, 1961 against the common order of the Income Tax Appellate Tribunal "D" Bench, Chennai, dated 27.05.2009 passed in I.T.A.Nos.1572, 1573 and 1574/Mds/2005, against the order of the Commissioner of Income Tax(Appeals) No.4, Williams Road, Contonment, Tiruchirapalli - 620001, dated 31.03.2005 passed in i) I.T.A. Nos.35/99-2000, 39/00-01, A63/01-02 respectively, against the order of the Joint Commissioner of Income Tax, Special Range, Trichy dated 09.03.1999 and against the order of the Additional Commissioner of Income Tax, Special Range, Tiruchirapalli dated 15.03.2000 and 21.03.2001 made in G.I.No.102-T/AACT/3373 J, 102-A/AACT/3373/J respectively for the assessment year 1996-97, 1997-98 & 1998-99.

For Appellant in all T.C.As : Mr.Subbaraya Aiyar

For Respondent in all T.C.As : Mr.M.Swaminathan, SSC
and Mrs.V.Pushpa, JSC



COMMON JUDGMENT

(Judgment of the court was delivered by R.MAHADEVAN, J.)

These tax case appeals have been filed by the appellant / Revenue, challenging the common order of the Income Tax Appellate Tribunal "D" Bench, Chennai, dated 27.05.2009 passed in I.T.A.Nos.1572, 1573 and 1574/Mds/2005, relating to the respective assessment years 1996-97, 1997-98 and 1998-99.

2.By order dated 16.08.2010, this court admitted these appeals on the following substantial questions of law:

(i)Whether on the facts and in the circumstances of the case, the order of the Tribunal directing the assessing officer to apply Section 14A read with Rule 8D is valid in law, especially when no expenditure was incurred or claimed towards earning of those exempt incomes?

(ii)Whether the Tribunal was justified in law in directing to apply section 14A and Rule 8D for working out the proportionate disallowance when the accounts are maintained in accordance with the Banking Regulation Act and the correctness of those accounts are also not disputed?

3.To appreciate the issues involved herein, it is but necessary to look into the findings of the Tribunal rendered in the order impugned herein, as regards the issues relating to "disallowance of proportionate expenses" and "disallowance of depreciation on tax free securities applying section 14A of the I.T. Act", which read as under:

"10.We have heard the rival submissions and considered the facts and material on record. The learned D.R. relied on the decision of Special Bench of the ITAT, Mumbai Bench in the case of Income Tax Officer v. Daga Capital Management Pvt Ltd (2009) 312 ITR (AT) 1 (Mumbai) (SB) whereby the Tribunal held that Rule 8 is to be followed in disallowing such expenses and the said Rule is retrospective. Hence, he submitted that the matter may be restored to the file of the Assessing officer to follow the ratio laid down by the Special Bench of the Tribunal in the above cited order. We find force in the contention of the learned D.R that the point at issue is now governed by the decision of the Special Bench of the Tribunal cited surpa and hence, we restore this issue back to the file of the Assessing officer with a direction to follow the decision of the Special Bench cited supra and decide the issue afresh according to law, of course, after



giving effective opportunity of being heard to the assessee. ..."

"23. We have heard the rival submissions and considered the facts and material on record. We find some force in the contention of the learned D.R. that section 14A is applicable and hence, the decision of the Special Bench cited supra is to be followed by the Assessing Officer. Since the CIT (Appeals) himself has restored the matter to the Assessing Officer, we direct the Assessing Officer to consider the decision of Madras High Court in the assessee's own case reported in 273 ITR 510 and the decision of Special Bench in the case cited supra and then decide the issue according to law, of course, after giving effective opportunity of being heard to the assessee. The assessee is also directed to produce necessary details that may be required by the Assessing Officer for deciding the issue."

Thus, it is apparent from the above extract that the Tribunal remanded the matter to the Assessing officer for fresh consideration of the issues raised herein, in the light of the decisions of this court as well as the Special Bench cited supra.

4. At this juncture, the learned counsel appearing for both sides jointly submitted that the issues involved herein deserve to be answered in favour of the assessee, as per the decision of the Supreme Court in *South Indian Bank Ltd. v. Commissioner of Income-tax* [(2021) 130 taxmann.com 178(SC)], wherein, it was held as follows:

"17. In a situation where the assessee has mixed fund (made up partly of interest free funds and partly of interest-bearing funds) and payment is made out of that mixed fund, the investment must be considered to have been made out of the interest free fund. To put it another way, in respect of payment made out of mixed fund, it is the assessee who has such right of appropriation and also the right to assert from what part of the fund a particular investment is made and it may not be permissible for the Revenue to make an estimation of a proportionate figure. For accepting such a proposition, it would be helpful to refer to the decision of the Bombay High Court in *Pr. CIT v. Bombay Dyeing and Mfg. Co. Ltd* [IT Appeal No.1225 of 2015 dated 28-11-2017] where the answer was in favour of the assessee on the question, whether the Tribunal was justified in deleting the disallowance



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under [Section 80M](#) of the Act on the presumption that when the funds available to the assessee were both interest free and loans, the investments made would be out of the interest free funds available with the assessee, provided the interest free funds were sufficient to meet the investments. The resultant SLP of the Revenue challenging the Bombay High Court judgment was dismissed both on merit and on delay by this Court. The merit of the above proposition of law of the Bombay High Court would now be appreciated in the following discussion.

18. In the above context, it would be apposite to refer to a similar decision in CIT v. Reliance Industries Ltd [(2019) 102 taxmann.com 52/261 Taxman 165/410 ITR 466 (SC)] where a Division Bench of this Court expressly held that where there is finding of fact that interest free funds available to assessee were sufficient to meet its investment it will be presumed that investments were made from such interest free funds.

19. In HDFC Bank Ltd. Vs. Dy CIT [(2016) 67 taxmann.com 42 / 383 ITR 529 (Bom.)] the assessee was a Scheduled Bank and the issue therein also pertained to disallowance under [Section 14A](#). In this case, the Bombay High Court even while remanding the case back to Tribunal for adjudicating afresh observed (relying on its own previous judgment in same assessee's case for a different Assessment Year) that, if assessee possesses sufficient interest free funds as against investment in tax free securities then, there is a presumption that investment which has been made in tax free securities, has come out of interest free funds available with assessee. In such situation [Section 14A](#) of the Act would not be applicable. Similar views have been expressed by other High Courts in CIT v. Suzlon Energy Ltd. [(2013) 33 taxmann.com 157/ 215 Taxman 272/ 354 ITR 630 (Guj)], CIT v. Microlabs Ltd. [(2017) 79 taxmann.com 365 / (2016) 383 ITR 490 (Kar)] and CIT v. Max India Ltd. [(2016) 75 taxmann.com 268 / 388 ITR 81 (Punj & Har.)]. Mr. S Ganesh the learned Senior Counsel while citing these cases from the High Courts have further pointed out that those judgments have attained finality. On reading of these judgments, we are of the considered opinion that the High Courts have correctly interpreted the scope of [Section 14A](#) of the Act in their decisions favouring the assesseees.



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23. It would now be appropriate to advert in some detail to [Maxopp Investment Ltd. v. CIT \[\(2018\) 91 taxmann. Com 154 / 254 Taxman 325/ 402 ITR 640 \(SC\)\]](#). This case interestingly is relied by both sides'



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counsel. Writing for the Bench, Justice Dr. A.K. Sikri noted the objective for incorporation of [Section 14A](#) in the Act in the following words: -

"3..... The purpose behind [Section 14-A](#) of the Act, by not permitting deduction of the expenditure incurred in relation to income, which does not form part of total income, is to ensure that the assessee does not get double benefit. Once a particular income itself is not to be included in the total income and is exempted from tax, there is no reasonable basis for giving benefit of deduction of the expenditure incurred in earning such an income....."

The following was written explaining the scope of [Section 14-A\(1\)](#):

"41. In the first instance, it needs to be recognised that as per [Section 14-A\(1\)](#) of the Act, deduction of that expenditure is not to be allowed which has been incurred by the assessee "in relation to income which does not form part of the total income under this Act". Axiomatically, it is that expenditure alone which has been incurred in relation to the income which is includible in total income that has to be disallowed. If an expenditure incurred has no causal connection with the exempted income, then such an expenditure would obviously be treated as not related to the income that is exempted from tax, and such expenditure would be allowed as business expenditure. To put it differently, such expenditure would then be considered as incurred in respect of other income which is to be treated as part of the total income."

Adverting to the law as it stood earlier, this Court rejected the theory of dominant purpose suggested by the Punjab & Haryana High Court and accepted the principle of apportionment of expenditure only when the business was divisible, as was propounded by the Delhi High Court.

Finally adjudicating the issue of expenditure on shares held as stock-in-trade, the following key observations were made by Justice Sikri:



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" 50. 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. \[Maxopp Investment Ltd. v. CIT, \[2011 SCC OnLine Del 4855 : \(2012\) 347 ITR 272\]](#) 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....."

The learned Judge then considered the implication of Rule 8D of the Rules in the context of [Section 14-A \(2\)](#) of the Act and clarified that before applying the theory of apportionment, the Assessing Officer must record satisfaction on Suo Moto disallowance only in those cases where, the apportionment was done by the assessee. The following is relevant for the purpose of this judgment:

"51.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....."



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24. Another important judgment dealing with [Section 14A](#) disallowance which merits consideration is [Godrej and Boyce Manufacturing Company Ltd. V. DCIT \[\(2017\) 1 SCC 421\]](#). Here the assessee had access to adequate interest free funds to make investments and the issue pertained to disallowance of expenditure incurred to earn dividend income, which was not forming part of total income of the Assessee. Justice Ranjan Gogoi writing the opinion on behalf of the Division Bench observed that for disallowance of expenditure incurred in earning an income, it is a condition precedent that such income should not be includible in total income of assessee. This Court accordingly concluded that for attracting provisions of [Section 14A](#), the proof of fact regarding such expenditure being incurred for earning exempt income is necessary. The relevant portion of Justice Gogoi's judgment reads as follow:

"36. what cannot be denied is that the requirement for attracting the provisions of [Section 14-A](#) (1) of the Act is proof of the fact that the expenditure sought to be disallowed/deducted had actually been incurred in earning the dividend income....."

25. Proceeding now to another aspect, it is seen that the Central Board of Direct Taxes (CBDT) had issued the Circular no. 18 of 2015 dated 02.11.2015, which had analyzed and then explained that all shares and securities held by a bank which are not bought to maintain Statutory Liquidity Ratio (SLR) are its stock-in-trade and not investments and income arising out of those is attributable, to business of banking. This Circular came to be issued in the aftermath of CIT Vs. Nawanshahar Central Cooperative Bank Ltd. [(2007) 160 Taxman 48 / 289 ITR 6 (SC)] wherein this Court had held that investments made by a banking concern is part of their banking business. Hence the income earned through such investments would fall under the head Profits & Gains of business. The Punjab and Haryana High Court, in the case of [Pr. CIT v. State Bank of Patiala \[\(2017\) 88 taxmann. com 667 / 393 ITR 476 \(Punj & Har\)\]](#) while adverting to the CBDT Circular, concluded correctly that shares and securities held by a bank are stock in trade, and all income received on such shares and securities must be considered to be business income. That is why [Section 14A](#) would not be attracted to such income.



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26. Reverting back to the situation here, the Revenue does not contend that the Assessee Banks had held the securities for maintaining the Statutory Liquidity Ratio (SLR), as mentioned in the circular. In view of this position, when there is no finding that the investments of the Assessee are of the related category, tax implication would not arise against the appellants, from the said circular.

27. The aforesaid discussion and the cited judgments advise this Court to conclude that the proportionate disallowance of interest is not warranted, under Section 14A of Income Tax Act for investments made in tax free bonds/ securities which yield tax free dividend and interest to Assessee Banks in those situations where, interest free own funds available with the Assessee, exceeded their investments. With this conclusion, we unhesitatingly agree with the view taken by the learned ITAT favouring the assessees."

5. In the light of the aforesaid decision of the Supreme Court, which applies to the facts of the present case and as agreed by the learned counsel appearing for both sides, we remand the matter to the Assessing Officer to decide the issues raised herein afresh, taking note of the observations made in the Supreme Court decision as referred to above and pass appropriate orders, within a period of three months from the date of receipt of a copy of this judgment. It is needless to state that such an exercise shall be completed by the Assessing officer, after providing reasonable opportunity to the appellant to place their oral and documentary evidences.

6. All these tax case appeals are disposed of in the above terms. No costs.

Sd/-

Assistant Registrar(CS-II)

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Sub Assistant Registrar

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To

1. The Commissioner of Income-Tax-I
Tiruchirapalli.



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

3. The Assistant Commissioner of Income Tax
Company circle 1, Trichy.

4. The Joint Commissioner of Income Tax,
Special Range, Trichy.

5. The Additional Commissioner of Income Tax,
Circle I, Trichy.

+1cc to M/s.Subbaraya Aiyar Padmanabhan, Advocate, S.R.No.8225

+1cc to Mr.M.Swaminathan, Advocate, S.R.No.7922

T.C.A.Nos.509 to 511 of 2010

NRL(CO)
RLP(28/02/2022)