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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **ITA 499/2022**

PRINCIPAL COMMISSIONER OF INCOME TAX-04

..... Appellant

Through: Mr. Gaurav Gupta, Sr.SC with
Mr. Shivendra Singh Jr. SC
along with Mr. Namit Gupta,
Adv.

Versus

M/S IFCI LTD

..... Respondent

Through: Mr. Udit Naresh and Mr.
Himanshu Aggarwal, Advs.

CORAM:

HON'BLE MR. JUSTICE YASHWANT VARMA

HON'BLE MR. JUSTICE PURUSHAINDR KUMAR

KAURAV

ORDER

04.04.2024

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1. This appeal is directed against the order of the Income Tax Appellate Tribunal ["ITAT"] dated 08 October 2020 and in the backdrop of which the appellant has proposed the following questions of law for our consideration:

"A. Whether on facts and in the circumstances of the case and on the prevailing law, Hon'ble ITAT is justified in confirming the order of Ld. CIT(A) by which the addition of Rs. 5,04,64,963/- made by the AO on account of section 14A r.w.r. 8D was deleted?

B. Whether on facts and in the circumstances of the case and on the prevailing law, Hon'ble ITAT is justified in restoring the issue of disallowance u/s 14A of the I.T Act, 1961 to the Assessing Officer with direction to decide the issue without resorting to the rule 8D of the Income Tax Rules for disallowing expenditure in relation to the exempt income by working out the book profit?"

2. The issue stands restricted to the invocation of Section 14A of



the Income Tax Act, 1961 [**“Act”**] and Rule 8D of the Income Tax Rules, 1962 [**“Rules”**].

3. It is common ground that in the Assessment Year [**“AY”**] in question, the assessee had earned dividend income of Rs.63,82,22,092/- which was claimed as exempt under Section 10(34) of the Act. It had also attributed a sum of Rs.10,00,000/- as expenditure incurred in earning of that income. While responding to a communication addressed to it, the assessee had drawn the attention of the Assessing Officer [**“AO”**] to the fact that the disallowance of Rs.10,00,000/- was made in terms of an order passed by the Commissioner of Income Tax (Appeals) [**“CIT(A)”**] dated 02 March 2010 and which had subsequently been followed for AYs’ 2006-07 and AY 2007-08.

4. While proceeded to deal with the aforesaid, the AO proceeded to observe as follows:

“4.2 In view of the above, expenses attributable to earning of dividend income will have to be determined and disallowed as per provisions of section 14A of the Act read with Rule 8D of the Income Tax Rules as under:

Accordingly, the disallowance is worked out under Rule 8D as under:-”

Clau	Particular	Calculation	Amount
i.	Expenditure directly related to exempt income	Nil	Nil
ii)	Disallowance of interest expenditure A. Interest expenditure Incurred during the year	Nil	Nil
	B. Average Value of Investment	(10169354755 +10416630443)/2	Rs.1029 2992599/ -
	c. Average of		



	total assets		
	Disallowance = A *B/C		Nil
iii)	Aggregate of Opening and Closing value of investment (Average Value of Investment) ½% of above as per Rule 8D	Rs.10292992599/- x0.5%=	Rs. 5,14,64, 63/-
	Total disallowance (i+ii+iii) as per rule 8D		Rs.5,14, 64,963/-

The assessee has already disallowed an amount of Rs.10 lacs which is not commensurate with the amount of income earned by the assessee. Therefore, Rule 8D is being applied on the assessee's case and therefore, difference of Rs.5,04,64,963/- is being disallowed and added to the total income of the assessee.

[Addition of Rs.5,04,64,963/-]

5. The ITAT has proceeded to interfere with the view so expressed observing as follows:

“6. The third ground of the appeal relates to disallowance made under section 14A of the Act read with rule 8D of Income-tax Rules, 1962.

“6.1 The assessee earned dividend income of Rs.63,82,22,092/- as exempt income and made suo motu disallowance of Rs.10 lakh against such exempted income. It was claimed that all the investment/ subscription in shares had been made out of the interest-free funds and no borrowings were made for the purpose of the investment/ subscription into shares. However, the Assessing Officer invoked rule 8D of Income-tax Rules and determined the disallowance at Rs.5,14,64,963/- and after reducing the suo motu disallowance of Rs. 10 lakh, addition for the balance amount of Rs.5,04,64,963/- was made by the Assessing Officer. The assessee could not succeed before the Learned CIT(A). The Ld. CIT(A) upheld the disallowance observing as under:

"The appellant itself has admitted that it was incurring expenditure in respect of earning exempt dividend income



along with the taxable income and expenditure was claimed by the appellant is not separable. In such situation, the applicability of Rule 8D is perfectly justified. So far as the appellant's argument that the nature of appellant's business is such that the shares are part of 'stock-in-trade' is concerned, it is observed that the appellant failed to provide complete details in respect of such stock-in-trade and the quantum of dividend received from such stocks. Therefore, there remains no basis for giving allowance in respect of equities which are not held by the appellant as investment. From the arguments of the appellant, it appears that the entire investments are being categorized by the appellant as 'stock-in-trade' and therefore, it is being argued that disallowance u/s 14A read with Rule 8D should not be applicable in appellant's case. Such argument of the appellant is devoid of merits as the appellant is getting huge dividend income out of such investments even if these are used in regular business of the appellant company. Therefore, the AO's action in making disallowance of ₹5,14,64,963/- as against the disallowance of ₹10,00,000/- made by the appellant is fully justified. The same is hereby upheld. The ground of appeal is dismissed."

6.2 Before us, the Learned Counsel of the assessee, however relied on the order of the Tribunal in assessment year 2008-09 and 2009-10 and submitted that identical disallowance made by the Assessing Officer under section 14A read with Rule 8D has been deleted by the Tribunal in absence of any dissatisfaction recorded by the Assessing Officer on the claim of the assessee of expenditure against exempted income. The learned DR on the other hand relied on the order of the lower authorities.

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6.4 The Tribunal in the above decision noted that no proper satisfaction for invoking Rule 8D has been recorded by the Assessing Officer. The Tribunal has observed that rejection of the contention of the assessee with some general statement and reproduction of section 14A of the Act, does not amount to recording satisfaction that claim of the assessee of expenditure relatable to exempted income, was not correct. In the year under consideration before us, also the Assessing Officer has recorded following observations and thereafter invoked Rule 8D of Income-tax Rules:

4.1 The submissions made by the assessee has been considered but not acceptable for the reasons discussed below:



(i) The assessee has earned income which is not liable to tax. The provisions of section 14A clearly prescribe that 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. The invocation of section 14A is automatic and comes into operation, without any exception, as soon as, the dividend income is claimed exempt. Since the entire dividend income has been claimed exempt and is not part of the total income under this Act, hence section 14A is clearly attracted in this case and any expenditure relatable to earning of dividend income shall have to be disallowed.

(ii) No evidence has been furnished by the assessee company to establish that no expense has been incurred in earning of the dividend income. This is especially required in light of the fact that certain expenses like cost of borrowings, salary, employee welfare expenses, postage/ telegram expenses, traveling and conveyance expenses, rent etc. are common expenses with regard to earning of dividend income/ interest income and normal/ regular business activity of the assessee company.

(iii) The assessee company is also entitled to claim long term capital loss on sale/ purchase of bonds on which dividend income has accrued to the assessee company. Thus, it is seen that on one hand the assessee company is claiming dividend income totally exempt u/ s 10(34) and at the same time it is also getting benefited by the fact that due to earning of dividend income, the redemption price of the said bonds has also gone down. The assessee is not entitled to avail this double benefit. Hence, it is all the more necessary to apportion the expenses u/s 14A in respect of dividend income earned by the assessee company.

(iv) The disallowance of administrative expenses and interest expenses on earning of dividend income claimed exempt, is also held / permitted by the verdict of Hon'ble Supreme Court in the case of CIT vs. United General Trust Ltd. 200 ITR 488 (SC).

(v) Section 14A of the I.T. Act was inserted by the Finance Act, 2001 with retrospective effect from 01.04.1962 which provides as under:-

"For the purpose 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."

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 u/ s 154 for any assessment year beginning on or before the 1st Day of April, 2001. Subsections (2) and (3) of the section 14A were inserted by Finance Act 2006 and with effect from 1st April 2007. Subsection (2) of subsection 14A provided for prescribed method for determining the amount of expenditure incurred in relation to such income which does not form part of the total income under the Act.

Section 2(24) defines income which in addition to all the other income also includes dividend as per clause (ii) to section 2(24) of the I.T. Act. Section 2(45) defines total income as total amount of income referred to in section 5 and computed in the manner in this Act. Section 10 of the I.T. Act specifies the incomes which shall not be included in total income. Section 10(33) provides that income received by way of dividend as referred to in section 115O of the IT Act are exempt from tax. Section 115O of the I. T. Act talks about tax on distributed profits of the domestic company. In other words, the dividend distributed by the domestic company is not taxable in the hands of the recipient.

Rule 8D of the Income Tax Rules was inserted by the IT (Fifth Amendment) Rules, 2008, w.e.f24-03-08 prescribing the "Method for determining amount of expenditure in relation to income not includable in total income".

Further, the earning of exempt income is not in nature of passive activity having no input. In fact in present situation making of Investment, maintaining or continuing investment and time of exit from investment are well informed and well coordinated management decisions involving not only inputs from various source but also acumen of senior management functionaries. Therefore cost is inbuilt into even so called "passive" Investment. There are incidental expenditures of collection, telephone, follow up etc. Therefore, expenses in relation to earning of income are embedded in indirect expenses.



The investment made, being a conscious decision and having deployment of funds clearly brings into picture expenditure by way of cost of funds, “Invested* Composite fund having cost needs to be spread so as to apportion appropriate cost of funds invested in the activity lending to carrying of exempt income.

In view of above, the provisions of sub sections (2) of section 14 A and Rule 8D of IT Rules are in operation and therefore will strictly be adhered to by the assessee”

6.5 We find that the Assessing Officer is under the impression that no expenses have been incurred for earning the dividend income, whereas the assessee has made *suo motu* disallowance of Rs.10 lakh. The Assessing Officer has not pointed out how the said claim of Rs. 10 lakh, is not correct. The Assessing Officer has jumped to the conclusion without examining the claim of the assessee. In our opinion, the facts and circumstances of the year under consideration being identical to the facts and circumstances of assessment year 2008-09, respectfully following the finding of the Tribunal (supra), we hold that no disallowance u /s 14A can be made without recording proper satisfaction as required under the law. Accordingly, the disallowance in dispute is deleted. The ground of appeal is allowed.

6. As would be manifest from an ex facie reading of the order penned by the AO, it had failed to record any satisfaction as warranted in terms of Section 14A(2) of the Act. It becomes pertinent to note that the invocation of Rule 8D of the Rules would have to be predicated upon the AO being satisfied that the amount of expenditure as asserted to have been incurred was not plausible. That provision speaks of a doubt being harboured with respect to the correctness of the claim.

7. As we read the order passed by the AO, it has only been observed that the amount of Rs.10,00,000/- is not commensurate with the amount of income earned by the assessee. The satisfaction which is spoken of in 14A(2) of the Act cannot possibly be made to rest on such *ipse dixit*.



8. In view of the aforesaid and bearing in mind the following observations that appear in the decision in **H. T. Media Ltd. v. PCIT**, [2017 SCC Online Del 10013], we find no ground to interfere with the view ultimately expressed by the ITAT.

9. The relevant observations as appearing in *H.T Media* are reproduced hereinbelow:

“30. Rule 8D(1) states more or less what section 14A(2) of the Act states. It requires the Assessing Officer to first examine the accounts of the assessee and then record that he is not satisfied with (a) the correctness of the assessee's claim of expenditure or (b) the claim made by the assessee that no expenditure has been incurred. Unless this stage is crossed, i.e., the stage of the Assessing Officer recording that he is not satisfied with the claim of the assessee in the manner indicated, i.e., after examining the assessee's accounts, the question of applying the formula under rule 8D(2) does not arise. That this is a mandatory pre-requisite for applying rule 8D(2) is fairly well-settled.

31.1 Illustratively reference may be made to the decision of the Bombay High Court in *Godrej and Boyce Manufacturing Co. Ltd. v. CIT* (supra) which was concurred with by this court in *Maxopp Investment Limited v. CIT* (supra) and reiterated in *CIT v. Taikisha Engineering India Limited* (supra).

31.2 The Bombay High Court in *Godrej and Boyce Mfg. Co. Ltd. v. Deputy CIT* (supra) upheld the constitutional validity of sub-sections (2) and (3) of section 14A of the Act. It was held that section 14A was applicable to the dividend income earned from mutual funds. The exercise that had to be undertaken by the Assessing Officer for applying section 14A was explained thus (page 100 of 328 ITR):

"What merits emphasis is that the jurisdiction of the Assessing Officer to determine the expenditure incurred in relation to such income which does not form part of the total income, in accordance with the prescribed method, arises if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of the expenditure which the assessee claims to have incurred in relation to income which does not form part of the total income. Moreover, the satisfaction of the Assessing Officer has to be arrived at, having regard to the accounts of the assessee. Hence, sub-section (2) does not ipso facto enable the Assessing Officer to apply the method prescribed by the rules straightaway without considering whether the claim made by the assessee in respect of the expenditure incurred in relation to income which does not form



part of the total income is correct. The Assessing Officer must, in the first instance, determine whether the claim of the assessee in that regard is correct and the determination must be made having regard to the accounts of the assessee. The satisfaction of the Assessing Officer must be arrived at on an objective basis. It is only when the Assessing Officer is not satisfied with the claim of the assessee, that the Legislature directs him to follow the method that may be prescribed. In a situation where the accounts of the assessee furnish an objective basis for the Assessing Officer to arrive at a satisfaction in regard to the correctness of the claim of the assessee of the expenditure which has been incurred in relation to income which does not form part of the total income, there would be no warrant for taking recourse to the method prescribed by the rules. For, it is only in the event of the Assessing Officer not being so satisfied that recourse to the prescribed method is mandated by law."

31.3 The Bombay High Court further observed as under (page 120 of 328 ITR):

"Parliament has provided an adequate safeguard to the invocation of the power to determine the expenditure incurred in relation to the earning of non-taxable income by adoption of the prescribed method. The invocation of the power is made conditional on the objective satisfaction of the Assessing Officer in regard to the correctness of the claim of the assessee, having regard to the accounts of the assessee. When a statute postulates the satisfaction of the Assessing Officer 'courts will not readily defer to the conclusiveness of an executive authority's opinion as to the existence of a matter of law or fact upon which the validity of the exercise of the power is predicated'. (M. A. Rasheed v. State of Kerala, AIR 1974 SC 2249). A decision by the Assessing Officer has to be arrived at in good faith on relevant considerations. The Assessing Officer must furnish to the assessee a reasonable opportunity to show cause on the correctness of the claim made by him. In the event that the Assessing Officer is not satisfied with the correctness of the claim made by the assessee, he must record reasons for his conclusion. These safeguards which are implicit in the requirements of fairness and fair procedure under article 14 must be observed by the Assessing Officer when he arrives at his satisfaction under sub-section (2) of section 14A."

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35. In order to disallow this expense the Assessing Officer had to first record, on examining the accounts, that he was not satisfied with the correctness of the assessee's claim of Rs. 3 lakhs being the administrative expenses. This was mandatorily necessitated by section 14A(2) of the Act read with rule 8D(1)(a) of the Rules."



10. The appeal consequently fails and shall stand dismissed on the aforesaid terms.

YASHWANT VARMA, J.

PURUSHAINDRA KUMAR KAURAV, J.

APRIL 04, 2024/p