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

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Date of Decision : 03.12.2024

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**ITA 24/2024 & CM APPL. 1047/2024, CM APPL. 70067/2024,
CM APPL. 70068/2024**

PR. COMMISSIONER OF INCOME TAX-7, DELHIAppellant

Through: Mr. Puneet Rai, SSC with Mr.
Ashvini Kumar and Mr. Rishabh
Nangia, JSCs.

versus

UK PAINTS INDIA PVT. LTD.

.....Respondent

Through: Ms. Kavita Jha, Sr. Advocate with
Mr. Vaibhav Kulkarni and Mr.
Himanshu Aggarwal, Advocates

CORAM:

HON'BLE MR. JUSTICE VIBHU BAKHRU

HON'BLE MS. JUSTICE SWARANA KANTA SHARMA

VIBHU BAKHRU, J. (ORAL)

1. The Revenue has filed the present appeal under Section 260A of the Income Tax Act, 1961 (hereafter *the Act*) impugning an order dated 16.06.2023 passed by the learned Income Tax Appellate Tribunal (hereafter *the ITAT*) in ITA No. 4115/Del/2013 and CO No. 244/Del/2013.

QUESTION OF LAW

2. The controversy in the present appeal is confined to the claim of the respondent (hereafter *the Assessee*) in regard to the quantum of disallowance under Section 14A of the Act. This Court had, on 01.05.2024, framed the following question for consideration of this Court in this appeal:



“A. Whether on the facts and circumstances of the case and in law, the ITAT was right in restricting the amount of disallowance under Section 14A to INR 7,50,000/- without appreciating that the computation of disallowance was made by the Assessing Officer in accordance with Section 14A of the Act read with Rule 8D of the Rules.”

THE CONTEXT

3. The aforesaid question arises in the following context. The Assessee had filed its return of income for assessment year (AY) 2008-09 electronically on 30.09.2008, declaring a total income of ₹10,43,43,498/-. The same was picked up for scrutiny and culminated in an assessment order dated 31.12.2010 passed under Section 143(3) of the Act.

4. The Assessee had, during the previous year relevant to AY 2008-09, earned income by way of dividend amounting to ₹8,55,88,493/-, which was exempt under Section 10(34) of the Act. The Assessee had *suo moto* attributed expenses amounting to ₹7,50,000/- as incurred towards earning the said exempt income, and had accordingly not claimed the same as a deduction from its taxable income.

5. During the course of the assessment proceedings, the Assessee provided the justification for confining the expenditure attributable to dividend income, to ₹7,50,000/-. A plain reading of the Assessee's explanation, as is set out in the assessment order, indicates that the Assessee had claimed that the bulk of the dividend was received in respect of its holding in Berger Paints (described as old investment) which was made in prior years. It is the Assessee's case that the same is a passive investment and, therefore, it did not require the Assessee to incur any significant



expenditure. The Assessee claimed that the expenditure for earning the exempt income was minimal.

6. The Assessee also provided a brief analysis of the income earned in comparison to the earlier years. It claimed that during the relevant year, the Assessee had received dividend income of ₹8.55 crores, as compared to ₹20.75 crores earned in the prior year. It also claimed that during the year in question, its turnover had increased to almost 40%, that is, from ₹18.67 crores in the previous year to ₹24.66 crores. Thus, whilst the increase in the turnover was around 40%, the exempt income had decreased by almost 60%.

7. Given the nature of income and the Assessee's involvement in maintaining the same, the Assessee *suo moto* computed the disallowance under Section 14A of the Act to ₹7,50,000/-. The breakup of the said expenditure, which was attributable to maintaining its investment, is set out below:

(i) Part Salary of Mr. K.S. Dhingra, Director (Who look after the investment activities)	Rs. 5,00,000
(ii) Part Salary of Mr. K.S. Nair and Tejinder Singh (Administrative staff who look after banking work)	Rs. 1,00,000
(iii) Other administrative expenses	Rs. 1,50,000
Total	Rs. 7,50,000

8. The Assessing Officer (hereafter *the AO*) computed the disallowance under Section 14A of the Act by applying Rule 8D of the Income Tax Rules, 1962 (hereafter *the Rules*), at ₹93,62,120/-. After adjusting the amount of ₹7,50,000/- allocated by the Assessee, the net disallowance was computed at



₹86,12,120/-.

9. The Assessee also contested the computation of the amount of expenditure attributable to earning exempt income as computed under Rule 8D of the Rules. The Assessee claimed that the correct computation under Rule 8D of the Rules amounted to ₹44,00,176/-. However, the said contention was not accepted by the AO.

10. Aggrieved by the assessment order, the Assessee preferred an appeal before the learned Commissioner of Income Tax (Appeals) [CIT(A)]. The learned CIT(A) considered the rival contentions and observed that the Assessee's computation of ₹7,50,000/- as the expenditure attributable to earning exempt income, was not found defective. The learned CIT(A) faulted the AO for not recording its adequate satisfaction before invoking Rule 8D of the Rules. Notwithstanding the aforesaid finding, the learned CIT(A) proceeded to make a disallowance of ₹20,00,000/- on an *ad hoc* basis. The relevant extract of the decision of the learned CIT(A) is set out below:

“7. I have carefully considered appellant's submissions and observations of AO in impugned assessment order. To meets ends of justice, in totality of facts and circumstances that assessee has suo motto made disallowance of some of the expenses (Rs. 750,000), **same is not found to be defective by AO**, the investments made by assessee yields taxable income also, there is no adequate satisfaction of AO before invoking Rule 8D, assessee has emphatically stated all expenses debited in P&L account pertains to manufacturing activities, there is increase in business turnover by 40% and decrease in exempt income by 60% in comparison to last year, saga of errors is there in AO's calculation of rule 8D disallowance, and other factors as pointed, I hereby sustain the lump sum disallowance at Rs. 20,00,000 in totality. Thus, AO is directed to recompute



the disallowance keeping the total disallowance u/s 14A read with rule 8D at Rs. 20,00,000 in which disallowance already made by assessee shall be reduced (Rs. 750,000). Rest of the addition is directed to be deleted. In view of the above discussion, grounds No. 4 is partly allowed.”

[emphasis added]

11. Aggrieved by the decision of the learned CIT(A), the Revenue filed an appeal being ITA No. 4115/Del/2013. The Assessee also filed cross objections being CO No. 244/Del/2013. The learned ITAT concurred with the decision of the learned CIT(A) that the AO had not recorded its dissatisfaction in regard to the Assessee’s computation before proceeding to compute the disallowance under Rule 8D of the Rules. However, the learned ITAT did not concur with the learned CIT(A) that in the circumstances, an *ad hoc* disallowance of ₹20,00,000/- was required to be made under Section 14A of the Act. The relevant extract of the decision of the learned ITAT is set out below:

“24. We have heard the rival submissions and perused the material available on record. The issue in the present ground is with respect to the disallowance u/s 14A of the Act. It is an undisputed fact that assessee had made *suo moto* disallowance of Rs. 7,50,000/- u/s 14A of the Act being the salary of Directors and expenses attributable to the tax free income earned by assessee. It is also a fact that CIT(A) while deciding the issue has noted that *suo moto* disallowance made by assessee was not found to be defective by AO and no adequate satisfaction as mandated u/s 14A(2) of the Act was recorded by AO before invoking Rule 8D. Before us, no fallacy in the findings of CIT(A) to the extent of his recording finding that no proper satisfaction was recorded by AO before invoking Rule 8D has been pointed out by Revenue. We are of the view that once the procedure prescribed under Section 14A(2) r.w. Rule 8D has not been followed by Revenue then in that case the



Revenue cannot proceed to work out the disallowance on ad hoc basis over and above that has been made by assessee. We therefore, direct the AO to restrict the disallowance u/s 14A at Rs. 7,50,000/- that was made by assessee and **thus the ground of Revenue is dismissed and the Ground of assessee in CO is allowed.**”

12. It is clear from the above that neither the AO nor any of the appellate authorities – CIT(A) or ITAT – had found that the Assessee’s computation of expenditure, which was allocable to earning exempt income, was erroneous or inadequate. None of the authorities had determined that the Assessee’s computation of expenditure attributable to the exempt income was erroneous or had faulted the same. In the aforesaid circumstances, it was not permissible for the AO to proceed to compute disallowance under Rule 8D of the Rules. It is well settled that recourse to Rule 8D of the Rules for computing the disallowance under Section 14A of the Act is available only if the Assessee’s computation of expenses attributable to earning exempt income, is found to be inadequate. In *Coforge Limited v. ACIT: (2021) 436 ITR 546*, the Coordinate Bench of this Court had examined the aforesaid issue and had concluded as under:

“13. Therefore, what emerges is, if the assessee claims a certain amount of expenditure was incurred by him to earn the income which does not form part of the total income, the Assessing Officer is required to examine the accounts, and thus, satisfy himself as to the correctness of the claim made by the assessee about the expenditure incurred in that regard. It is when an Assessing Officer is not satisfied as to the correctness of the claim made by the assessee, about the expenditure said to have been incurred by him on such income which does not form part of the total income under the Act, he then proceeds to determine the amount of expenditure, by following such method as is prescribed, i.e., Rule 8D of the Rules.



13.1. This methodology, as envisaged under Rule 8D of the Rules, is required to be followed even where the assessee claims that no expenditure was incurred by him concerning income which does not form part of the total income under the Act.

13.2. The approach of the Tribunal has been that, since a disallowance was made, it follows logically, that the Assessing Officer was not satisfied. This, according to us, is not what is envisaged under the provisions of Section 14A of the Act. The satisfaction has to be arrived at by the Assessing Officer having regard to the assessee's accounts and not otherwise. Concededly, there is nothing in the record to suggest that the Assessing Officer examined the accounts from this perspective.

13.3. Furthermore, in our view, because the appellant/assessee had itself offered an amount which could be disallowed under Section 14A of the Act, the onus shifted onto the Revenue to ascertain, after examination of the accounts, as to whether or not the appellant's/assessee's claim was correct. It is only after the aforesaid exercise was conducted, could the Assessing Officer have taken recourse to the prescribed method i.e. Rule 8D of the Rules, for determining the expenditure, which, according to him, needed to be disallowed under Section 14A of the Act."

13. It is also apposite to refer to the decision of a Coordinate Bench of this Court in *H.T. Media Ltd. v. Pr. CIT: 2017:DHC:4694-DB*, whereby this Court examined the issue and concluded as under:

"35. In order to disallow this expense the AO 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."

14. In *Maxopp Investment Ltd. v. Commissioner of Income Tax, New Delhi: (2018) 402 ITR 640*, the Supreme Court has held as under:



“51. 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.”

15. In the present case, it is clear that the AO had not found fault with the Assessee's computation of expenditure allocable to exempt income and, therefore, recourse to Rule 8D of the Rules for determining the expenditure incurred for earning exempt income, was not available. It is also relevant to highlight that the learned CIT(A) had also noted that the AO had not found the Assessee's computation expenditure for earning exempt income as inadequate.

16. In view of the above, we find no reason to interfere with the decision of the learned ITAT. The question of law as framed is answered by this in favour of the Assessee and against the Revenue.

17. The appeal is accordingly dismissed. Pending applications also stand disposed of.

VIBHU BAKHRU, J

SWARANA KANTA SHARMA, J

DECEMBER 03, 2024/zp