

**IN THE INCOME TAX APPELLATE TRIBUNAL
VISAKHAPATNAM BENCH, VISAKHAPATNAM**

**BEFORE SHRI V. DURGA RAO, HON'BLE JUDICIAL MEMBER &
SHRI D.S. SUNDER SINGH, HON'BLE ACCOUNTANT MEMBER**

**ITA No. 341/VIZ/2018
(Asst. Year : 2014-15)**

M/s. Ramya Constructions,
C/o T. Chaitanyakumar, Adv.,
Flat No. 102, Gouri Apartment,
Urdu Lane, Himayath Nagar,
Hyderabad.

vs. DCIT, Circle-2(1),
Vijayawada.

PAN No. AADCR 1165 K
(Appellant)

(Respondent)

Assessee by : Shri T. Chaitanya Kumar- Adv.
Department By : Shri D.V. Subba Rao - Sr.DR

Date of hearing : 24/01/2019.
Date of pronouncement : 06/02/2019.

ORDER

PER V. DURGA RAO, JUDICIAL MEMBER

This appeal by the assessee is directed against the order of Commissioner of Income Tax (Appeals)-2, Guntur, dated 05/03/2018 for the Assessment Year 2014-15.

2. The only issue involved in this appeal relates to disallowance under section 14A read with Rule 8D of the IT Rules, 1962.

3. In the assessment order, the Assessing Officer has observed that on verification of the information furnished, it is noticed that

the assessee has raised loans/advances in respect of which, he claimed interest expenditure of Rs. 29,91,118/-. Since, the return from these investments do not constitute taxable income, the proportionate interest requires to be disallowed and brought to tax under section 14A r.w.r. 8D of the IT Rules, 1962. Accordingly, he calculated the interest as follows: -

$$\begin{array}{r}
 \text{Average value of assets from which returns are exempt} \\
 \text{(as on 31/03/2014 + 31/03/2013)} \\
 \hline
 \text{Average value of total assets} \\
 \text{(as on 31/03/2014 + 31/03/2013)} \\
 \\
 = \frac{[79585468 + 109476580] / 2}{[377535974 + 422432715] / 2} \times 16822813 \\
 \\
 = \frac{94531024}{399984345} \times 16822813 = 3975850/-
 \end{array}$$

Rs. 3975850 + 0.5% of exempt investment

Rs. 3975850 + 472655 = Rs. 44,48,505/-

Hence, from the total interest expenditure claimed, the interest expenditure of Rs. 44,48,505/- is hereby disallowed u/s 14A of the Income Tax Act, 1961 read with rule 8D of the Income Tax Rules, 1962 and added to the total income admitted for which the ARs of the assessee has no objection.

4. Before the Id. CIT(A), it was submitted by the assessee that assessee has not received any dividend income, therefore no disallowance can be made under sec. 14A r.w.r. 8D of the Rules, 1962. However, Id. CIT(A) without considering the case of the assessee on merits, decided the appeal on the ground that the

assessee has already given a consent for addition, therefore, he cannot file an appeal and dismiss the same.

5. Before us, Id. counsel for the assessee has submitted that simply because assessee has given consent before the Assessing Officer, addition cannot be made and particularly, when this has been raised before the Id. CIT(A), Id. CIT(A) under obligation to adjudicate the issue on merits and submitted that the order passed by the Id. CIT(A) may be reversed.

6. Id. Departmental Representative has relied on the orders of the authorities below.

7. The case of the assessee is that during the year under consideration, assessee is not having any dividend income, therefore, no disallowance can be made under section 14A r.w.r. 8D of the Rules, 1962. However, we find from the assessment order that he has not raised any objection before the Assessing Officer to make the addition. However, he has raised an objection before the Id. CIT(A) by stating that when there is no dividend income, no disallowance can be made under rule 8D r.w.s. 14A of the Act. The Id. CIT(A) without considering the merits of the case, decided the appeal on the ground that the assessee has given a consent to make the addition, therefore, he cannot file an appeal against the order of the Assessing Officer, for which he gave

consent. Considering the facts and circumstances of the case, we find that assessee gave a consent before the Assessing Officer. Accordingly, Assessing Officer has made the addition. Before the Id. CIT(A) when assessee has raised a specific issue that when there is no dividend income, no disallowance can be made under rule 8D r.w.s. 14A of the Act. Under these facts and circumstances of the case, Id. CIT(A) ought to have examined the facts of the case i.e. whether there is any dividend income or not and decide the issue on merits. In spite of deciding the issue on merits simply dismissed the appeal on technical ground that the addition made by the Assessing Officer is on the basis of consent. In our opinion, Id. CIT(A) is not correct in dismissing the appeal. The issue on merits, the coordinate bench of the tribunal in the case of *M/s. Flash Forge Private Ltd. Vs. ACIT*, by order dated 20/12/2018 in ITA No. 379/VIZ/2018, wherein by following the decision of the Hon'ble Madras High Court in the case of *Redington (India) Ltd. Vs. Addl.CIT* (77 taxman.com 257) has held as under: -

"4. We have heard both the parties and perused the material placed on record. In the impugned assessment year, the assessee made the investment out of interest free surplus fund available to the assessee and the assessee did not earn the income which is exempt u/s 14A of the Act. The above facts were not disputed by the lower authorities. The AO made the addition placing reliance on the Circular No.5/2014 of the CBDT and the

Ld.CIT(A) confirmed the addition. Hon'ble High Court of Delhi in the case of Pr.Commissioner of Income Tax Vs. IL &FS Energy Development Company Ltd. (supra) considered the Board Circular and held that the Circular cannot override the express provisions of section 14A r.w.Rule 8D of I.T.Rules. After considering various decisions, Hon'ble High Court of Delhi held that no disallowance u/s 14A of the Act was called for in case of no exempt income earned by the assessee, in the relevant assessment year. For the sake of clarity and convenience, we extract relevant part of the order of the Hon'ble High Court of Delhi which reads as under :

"12. Section 14A of the Act, which was inserted with retrospective effect from 1st April 1962, provides for disallowance of the expenditure incurred in relation to income exempted from tax. From 11th May 2001, a proviso was inserted in Section 14A to clarify that it could not be used to reopen or rectify a completed assessment. Sub-sections (2) and (3) of Section 14A were inserted with effect from 1st April, 2007 to provide for methodology for computing of disallowance under Section 14A. However, the actual methodology was provided in terms of Rule 8D only from 24th March 2008. There was a further amendment to Rule 8D with effect from 2nd June 2016 limiting the disallowance the aggregate of the amount of expenditure directly relating to income which does not form part of total income and an amount equal to one per cent of the annual average of the monthly average of the opening and closing balances of the value of investment, income from which does not form part of the total income. It is also provided that the amount shall not exceed the total expenditure claimed by the Assessee.

13. In the above background, the key question in the present case is whether the disallowance of the expenditure will be made even where the investment has not resulted in any exempt income during the AY in question but where potential exists for exempt income being earned in later AYs.

14. In the Explanatory Memorandum to the Finance Act 2001, by which Section 14A was inserted with effect from 1st April 1962, it was clarified that "expenses incurred can be allowed only to the extent they are relatable to the earned income of taxable income" The object behind Section 14A was to provide that "no deduct/on shall be made in respect of any expenditure incurred by the Assessee in relation to income which does not form part of the total income under the Income Tax Act".

15. What is taxable under Section 5 of the Act is the "total income" which is neither notional nor speculative. It has to be 'real income'. The subsequent amendment to Section 14A does not particularly clarify whether the disallowance of the expenditure would apply even where no exempt income is earned in the AY in question from investments made, not in that AY, but earlier AYs.

16. Rule 8D (1) of the Rules is helpful, to some extent, in understanding the above issue. It reads as under:

"8D. (1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with—
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)."

17. The words 'in relation to income which does not form part of the total income under the Act for such previous year' in the above Rule 8D(1) indicates a correlation between the exempt income earned in the AY and the expenditure incurred to earn it. In other words, the expenditure as claimed by the Assessee has to be in relation to the income earned in 'Such previous year'. This implies that if there is no exempt income earned in the AY in question, the question of disallowance of the expenditure incurred to earn exempt income in terms of Section 14A read with Rule 8D would not arise,

18. The CBDT Circular upon which extensive reliance is placed by Mr. Hossain does not refer to Rule 8D(1) of the Rules at all but only refers to the word "includible" occurring in the title to Rule 8D as well as the title to Section 14A, The Circular concludes that it is not necessary that exempt income should necessarily be included in a particular year's income for the disallowance to be triggered.

19. In the considered view of the Court, this will be a truncated reading of Section 14 A and Rule 8D particularly when Rule 8D (1) uses the expression 'such previous year'. Further, it does not account for the concept of 'real income'. It does not note that under Section 5 of the Act, - the question of taxation of 'notional income' does not arise. As explained in Commissioner of Income Tax v. Walfort Share and Stock Brokers Pvt. Ltd [2010] 326 ITR 1 (SC), the mandate of Section 14A of the Act is to curb the practice of claiming deduction of expenses incurred in relation to exempt income being taxable income and at the same time avail of the tax incentives by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. Consequently, the Court is not persuaded that in view of the Circular of the CBDT dated 11th May 2014, the decision of this Court in Cheminvest Ltd. (supra) requires reconsideration.

20. In M/s. Redington (India) Ltd. v. The Additional Commissioner of Income Tax, Company Range — V. Chennai (order dated 23rd December, 2016 of the High Court of Madras in TCA No. 520 of 2016), a similar contention of the Revenue was negated. The Court there declined to apply the

CBDT Circular by explaining that Section 14A is "clearly relatable to the earning of the actual income and not notional income or anticipated income." It was further explained that,

"The computation of total income 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 thus would be carrying the artifice too far."

21. *The decisions in CIT v. M/s Lakhani Marketing Inc, 2014 SCC Online P&H 20357, CIT v. Winsome Textile Industries Limited [2009] 319 ITR 204 (P&H), CIT v. Shivam Motors (P) Ltd (2014) 272 CTR (All) 277 have all taken a similar view. The decision in Taikisha Engineering India Pvt. Ltd. (supra) does not specifically deal with th s issue.*

22. *It was suggested by Mr. Hussain that, in the context of Section 57(iii), the Supreme Court in Commissioner Of Income Tax, West v, Rajendra Prasad Moody [1978] 115 ITR 519 (SC) explained that deduction is allowable even where income was not actually earned in the AY in question. This aspect of the matter was dealt with by this Court in M/s Cheminvest Ltd. (supra) where it reversed the decision of the Special Bench of the ITAT by observing as under:*

"20. Since the Special Bench has relied upon the decision of the Supreme Court in Rajendra Prasad Moody (supra), it is considered necessary to discuss the true purport of the said decision. It is noticed to begin with that the issue before the Supreme Court in the said case was whether the expenditure under Section 57 (iii) of the Act could be allowed as a deduction against dividend income assessable under the head "income from other sources". Under Section 57 (iii) of the Act deduction is allowed in respect of any expenditure laid out or expended wholly or exclusively for the purpose of making or earning such income. The Supreme Court explained that the expression "Incurred for making or earning such income?", did not mean that any income should in fact have been earned as a condition precedent for claiming the expenditure. The Court explained:

"What s. 57(ii) requires is that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. It is the purpose of the expenditure that is relevant in determining the applicability of s. 57(iii) and that purpose must be making or earning of income. s. 57(iii) does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction. It does not say that the expenditure shall be deductible only if any income is made or earned. There is in fact nothing in the language

of s. 57(iii) to suggest that the purpose for which the expenditure is made should fructify into any benefit by way of return in the shape of income. The plain natural construction of the language of s. 57(iii) irresistibly leads to the conclusion that to bring a case within the section, it is not necessary that any income should in fact have been earned as a result of the expenditure."

21. There is merit in the contention of Mr. Vohra that the decision of the Supreme Court in Rajetidra Prasad Moody (supra) was rendered in the context of allowability of deduction under Section 57(iii) of the Act, where the expression used is "for the purpose of making or earning such income." Section 14A of the Act on the other hand contains the expression 'in relation to income which does not form part of the total income.' The decision in Rajendra Prasad Moody (supra) cannot be used in the reverse to contend that even if no income has been received, the expenditure incurred can be disallowed under Section 14A of the Act."

23. The decisions of the ITAT in ACIT v. Ratan Housing Development Ltd. (supra) and Relaxo Footwear Ltd. V. Addl. CIT (supra), to the extent that they are inconsistent with what has been held hereinbefore do not merit acceptance. Further, the mere fact that in the audit report for the AY in question, the auditors may have suggested that there should be a disallowance cannot be determinative of the legal position. That would not preclude the Assessee from taking a stand that no disallowance under Section 14 A of the Act was called for in the AY in question because no exempt income was earned.

24. For all of the aforementioned reasons, this Court is of the view that the CBDT Circular dated 11th May 2014 cannot override the expressed provisions of Section 14A read with Rule 8D."

4.1. This Tribunal also in the case of SLC Projects Pvt. Ltd. vs. ACIT, CC-2 (supra) for the A.Y. 2013-14 held that no disallowance is called for in the absence of exempt income. We extract relevant part of the order of this Tribunal from para No.9 to 10 which reads as under:

"9. We have heard both the parties, perused the materials available on record and gone through the orders of the authorities below. The Ld. A.R. argued that no expenditure required to be disallowed in case the assessee did not earn any exempt income. In the instant case, the assessee has not earned any dividend income which is exempt u/s 14A of the Act. On identical facts, this Tribunal in the case of D. Veerabhadra Reddy (HUF) Vs. JCIT, Kakinada in ITA No.263/Vizag/2014 dated 23.6.2017 for the assessment year 2009-10 placing reliance on Hon'ble Madras High Court

judgement in the case of Redington India Limited Vs. Addl. CIT 77 Taxmann. Com 257 held that no disallowance is called for when there is no exempt income. For ready reference, we extract relevant paragraph No.6 of this Tribunal order which reads as under:

"6. We have heard the rival submissions and perused the material on record. The assessee has rental income from godowns and the business loss. The assessing officer has completed the assessment u/s 143(3) by order dated 04.11.2011. The Ld.CIT has called for the record u/s 263 and issued the notice for revision for incorrect set off of business loss against the rental income. After verification of the material on record, the Ld.CIT has dropped the issue with regard to incorrect set off of business loss against the income from property which was examined by the assessing officer. During the course of revision proceedings, it has come to the notice of Ld.CIT that the assessee has made investments in shares and bonds and did not make disallowance which was required to be made u/s 14A of IT Act. The assessee explained that there were no expenses incurred in relation to the exempt income which was claimed as deduction for the assessment year 2009-10. Hence, the assessee argued before the Ld.CIT that Section 14A is not applicable in assessee's case. As per the observation of the Ld.CIT, the assessee made the investments to the tune of Rs.19,90,625/- in shares and bonds from the borrowed funds and the interest expenditure relating to the earning of dividend income is required to be disallowed u/s 14A. Though CIT opined that the expenditure relating to the earning of dividend income required to be disallowed, there was no finding given by the CIT in his order with regard to earning of dividend income. The CIT also did not rebut the explanation offered by the assessee stating that no expenditure was incurred for making the investments. The Ld.DR did not make any clarification with regard to the quantum of dividend income earned by the assessee. The Ld.AR submitted paper book enclosing the copy of statement of computation, return of income, balance sheet and profit and loss account. It is seen from the profit and loss account and the statement of computation of income that the assessee has not derived any dividend income. When the assessee has no exempt income, the question of disallowance u/s 14A r.w. Rule 8D is not called for. The same view is expressed by the decision of Hon'ble Madras High Court in Redington (India) Ltd. Vs. Addl.CIT, 77 taxman.com 257, Hon'ble Delhi High Court in Chem Investments Vs. CIT, 61 taxman.com 118 and the Hon'ble Gujarat High Court in Principal CIT Vs. Sintex Industries Ltd., 82 taxman.com 171 held that no disallowance is called for when assessee makes small investment from the surplus funds. There was no dividend income earned by the assessee and the case was taken for revision to disallow the business loss claimed against the property income which was examined by the AO and dropped the assessment proceedings and

the Ld.CIT also satisfied that there is no case for revision on account of incorrect set off of business loss. With regard to the issue of disallowance u/s 14A as per the judicial pronouncements no disallowance is called for when there is no exempt income. Therefore, we are of the considered opinion that there is no case for revision of order u/s 263 and accordingly we set aside the orders of the CIT and allow the appeal of the assessee."

10. Since the facts are identical, we hold that no disallowance is called for u/s 14A of the Act in the absence of exempt income. Accordingly, the order of the Ld. CIT(A) on this issue is set aside and this ground of appeal of the assessee is allowed."

5. Since the facts of the case are identical, respectfully following the view taken by the Hon'ble High Court of Delhi as well as the Coordinate Bench of this Tribunal, we set aside the order of the Ld.CIT(A) and allow the appeal of the assessee."

8. In view of the above, we direct the Id. CIT(A) to examine the facts of the case and decide in accordance with the order passed by the Tribunal in the case of *M/s. Flash Forge Private Ltd*, (supra). Thus, this appeal filed by the assessee is allowed for statistical purposes

9. In the result, appeal filed by the assessee is allowed for statistical purposes.

Order Pronounced in open Court on this 06th day of Feb., 2019.

Sd/-
(D.S. SUNDER SINGH)
Accountant Member

sd/-
(V. DURGA RAO)
Judicial Member

Dated:06th Feb., 2019.

vr/-

Copy to:

1. *The Assessee – M/s. Ramya Constructions, C/o T. Chaitanyakumar, Adv., Flat No. 102, Gouri Apartment, Urdu Lane, Himayath Nagar, Hyderabad.*
2. *The Revenue- DCIT, Circle-2(1), Vijayawada.*
3. *The Pr.CIT, Vijayawada.*
4. *The CIT(A)-2, Guntur.*
5. *The D.R., Visakhapatnam.*
6. *Guard file.*

By order

(VUKKEM RAMBABU)
Sr Private Secretary,
ITAT, Visakhapatnam.

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