

**IN THE HIGH COURT OF PUNJAB AND HARYANA AT
CHANDIGARH**

ITA No. 331 of 2009 (O&M)

Date of decision: November 4, 2009

Commissioner of Income Tax-II

...Appellant

Versus

M/s Hero Cycles Ltd.

...Respondent

**CORAM:- HON'BLE MR. JUSTICE ADARSH KUMAR GOEL
HON'BLE MR. JUSTICE GURDEV SINGH**

Present: Mr. Rajesh Sethi, Advocate, for the revenue.

ORDER

1. The revenue has preferred this appeal under Section 260A of Income Tax Act, 1961 (for short, "the Act") for the assessment year 2004-05 against the order of Income Tax Appellate Tribunal, Chandigarh Bench 'B', passed in ITA No. 247/Chandi/2008 on 4.7.2008, proposing to raise following substantial question of law:-

“(i) Whether on the facts and in law, the Hon'ble ITAT was legally justified in deleting the disallowance of Rs. 3,48,04,375/- under Section 14A of the Income-tax Act, 1961 by ignoring the evidence relied on by the Assessing Officer and holding that a clear nexus has not been established that the interest bearing funds have been vested for investments generating tax free dividend income.”

2. The assessee is engaged in manufacturing of cycles and parts of

two-wheelers in multiple units. It earned dividend income, which is exempted under Section 10 (34) and (35). The Assessing Officer made an inquiry whether any expenditure was incurred for earning this income and as a result of the said inquiry addition was made by way of disallowance under Section 14A (3), which was partly upheld by the CIT (A). The Tribunal held that there was no nexus with the expenditure incurred and the income generated. The finding recorded are as under:-

“We have perused the same and find that the plea of the assessee that the entire investments have been made out of the dividend proceeds, sale proceeds, debenture redemption etc., is borne out of record. In fact the CIT (Appeals) has also come to a categorical finding that in so far as other units are concerned, none of their funds have been utilized to make the investments in question. One aspect which is evident that the interest income earned by the main unit, Ludhiana, exceeds the expenditure by way of interest incurred by it, thus obviating the application of Section 14A of the Act. Even with regard to the funds of the main unit, Ludhiana the funds flow position explained shows that only the non-interest bearing funds have been utilized for making the investments. At pages 3 to 6 of the paper book are placed the details of the Bank accounts, wherein the amount of dividend, sale proceeds of shares, debenture redemption etc. have been received and later on invested in the investments in question. Such funds are ostensibly without any burden of interest expenditure. Thus, on facts we do not find any evidence to show that the assessee has

incurred interest expenditure in relation to earning to the tax exempt income in question. We find that all the details in question were produced before the Assessing Officer and the CIT (Appeals) also. The entire evidence in this regard, which is submitted before the lower authorities have been compiled in the paper book, to which we have already adverted to in the earlier part of the order. Therefore, merely because the assessee has incurred interest expenditure on funds borrowed in the main unit, Ludhiana, it would not ipso-facto invite the disallowance under Section 14A, unless there is evidence to show that such interest bearing funds have been invested in the investments which have generated the 'tax exempt dividend income.' As noted earlier, there is no nexus established by the Revenue in this regard and therefore, on a mere presumption, the provisions of Section 14A cannot be applied. Thus, we find that the CIT (Appeals) erred in part sustaining the addition. In fact, in the absence of such nexus, the entire addition made was required to be deleted. We accordingly hold so.”

We have heard learned counsel for the revenue.

3. Learned counsel for the appellant relies upon Section 14A (2) and Rule 8D (1) (b) to submit that even where the assessee claimed that no expenditure had been incurred, the correctness of such claim could be gone into by the Assessing Officer and in the present case, the claim of the assessee that no expenditure was incurred was found to be not acceptable by the Assessing Officer and thus disallowance was justified. We are unable to accept the submission.

4. In view of finding reproduced above, it is clear that the expenditure on interest was set off against the income from interest and the investment in the share and funds were out of the dividend proceeds. In view of this finding of fact, disallowance under Section 14A was not sustainable. Whether, in a given situation, any expenditure was incurred which was to be disallowed, is a question of fact. The contention of the revenue that directly or indirectly some expenditure is always incurred which must be disallowed under Section 14A and the impact of expenditure so incurred cannot be allowed to be set off against the business income which may nullify the mandate of Section 14A, cannot be accepted. Disallowance under Section 14A requires finding of incurring of expenditure where it is found that for earning exempted income no expenditure has been incurred, disallowance under Section 14A cannot stand. In the present case finding on this aspect, against the revenue, is not shown to be perverse. Consequently, disallowance is not permissible. We have taken this view earlier also in ITA No. 504 of 2008 (**Commissioner of Income Tax Chandigarh II vs. M/s Winsome Textile Industries Limited, Chandigarh**), decided on 25.8.2009, wherein it was observed as under:-

“6. Contention raised on behalf of the revenue is that even if the assessee had made investment in shares out of its own funds, the assessee had taken loans on which interest was paid and all the money available with the assessee was in common kitty, as held by this Court in **CIT v. Abhishek Industries Limited**, (2006) 286 ITR 1 and therefore, disallowance under section 14A was justified.

7. We do not find any merit in this submission. Judgment of

this Court in Abhishek Industries (supra) was on the issue of allowability of interest paid on loans given to sister concerns, without interest. It was held that deduction for interest was permissible when loan was taken for business purpose and not for diverting the same to sister concern without having nexus with the business. Observations made therein have to be read in that context. In the present case, admittedly, the assessee did not make any claim for exemption. In such a situation, Section 14A could have no application.”

5. In view of the above, we are of the opinion that no substantial question of law arise.
6. The appeal is dismissed.

(ADARSH KUMAR GOEL)
JUDGE

November 4, 2009
prem

(GURDEV SINGH)
JUDGE

