

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI ' J ' BENCH
MUMBAI BENCHES, MUMBAI**

BEFORE SHRI G E VEERABHADRAPPA, PRESIDENT & SHRI VIJAY PAL RAO, JM

**ITA No. 3889/Mum/2011
(Asst Year 2008-09)**

Justice Sam P Bharucha Premises of Meneksha & Shethana Advocates Solicitors & Notaries 8 Amabala Doshi Marg(Hamam Street) Mumbai 23	Vs	The Addl Commr of Income Tax 11 (3), Mumbai
(Appellant)		(Respondent)

PAN No.	AADPB3345G
Assessee by	Sh K K Ved
Revenue by	Sh A K Nayak
Dt.of hearing	16 th July 2012
Dt of pronouncement	25th, July 2012

PER VIJAY PAL RAO, JM

This appeal by the assessee is directed against the order dated 24/03/2001 of CIT(A) for the assessment year 2006 – 07.

2 The assessee has raised the following grounds in this appeal:

1. *The learned CIT(A) has erred in confirming the disallowance of expenditure of Rs. 2,26,58 1 under section 14A of the Income Tax Act, 1961 read with Rule 8D of the Income Tax Rules, 1962.*

2. *The learned CIT(A) has erred in not appreciating the fact that the AO applied the provisions of rule 8D of the Income Tax Rules, 1962 without giving any finding on why he was not satisfied with the appellant's books of accounts and submissions that he did not incur any expenditure for earning the exempt income.*

3 During the year the assessee has earned dividend of ₹. 30,43,306 from mutual funds and ₹. 6, 71, 468/- from shares besides interest on RBI tax free bonds of ₹ 13,73,750/- which are exempt income. The assessing officer disallowed a sum of

₹ 2, 26, 581/-under section 14 A by applying rule 8D of Income Tax Rules by following the decision of this Tribunal in case of M/s Daga Capital Management Pvt Ltd.

3.1 On appeal, the Commissioner of Income Tax (Appeals) has confirmed the disallowance made by the Assessing Officer under section 14 A.

4 Before us, the learned A.R. of the assessee has submitted that the assessee has not incurred any expenditure on earning the dividend and other exempt income. The assessee has not claimed any expenditure incurred for earning the exempt income and the expenses claimed by the assessee are in the nature of expenditure for earning professional income. Therefore, all expenses incurred and claimed by the assessee are in the nature of expenditure for earning professional income and no expenses have been incurred in relation to the dividend income from mutual funds. Thus, it was submitted that the provisions of section 14 A under r.w.r 8D of I T Rules is applicable in the case of the assessee.

4.1 Even otherwise, Rule 8D is applicable only with effect from 1.4.2008 and therefore, in view of the decision of honourable jurisdictional High Court in case of Godrej Boyce Mfg Co Ltd,, Rule 8D is not applicable for the assessment year under consideration.

4.2 The Id AR of the assessee has referred the computation of total income and details of expenditure incurred during the year. He has pointed out that none of the expenditure incurred and claimed by the assessee is related to the dividend income, which is exempted under section 10 (35) of the Income Tax Act. He has further submitted that the assessee is maintaining separate books of account for the purpose of profession and no expenditure, which is personal in nature, has been shown in the books of account maintained for business or profession of the assessee.

Since the investments in mutual funds are made by the assessee in his personal capacity and out of his own capital funds, no disallowance is called for under section 14 A on account of earning of dividend income on such investment. In support of his contention, he has relied upon the decision of Co-ordinate Bench of this Tribunal dated 11th Jan 2011 in case of Sh Pawan Kumar Parameshwarlal vs ACIT in ITA No. 530/Mum/2009 as well as in case of M/s Auchtel Products Ltd vs ACIT reported in 22 Taxman.com.99 (Mum).

4.3 On the other hand, the learned DR has relied upon the orders of the authorities below and submitted that the assessee has not taken this plea before the authorities below that the assessee is maintaining separate accounts for business /profession of the assessee and the investment in question were made by the assessee in personal capacity out of his own funds.

5 We have considered the rival submissions as well as relevant material on record. Section 14A has within it implicit notion of apportionment in the cases where the expenditure is incurred for the composite/indivisible activities in which taxable and non-taxable income is received. But when it is possible to determine the actual expenditure in relation to the exempt income or when no expenditure has been incurred in relation to the exempt income, then principle of apportionment embedded in section 14 A has no application. The objective of section 14 A is not allowing to reduce tax payable on the normal exempt income by debiting the expenditure incurred to earn the exempt income. Thus, the expenses incurred to earn exempt income cannot be allowed and the expenses shall be allowed only to the extent they are related to the earning of taxable income. If there is expenditure directly or indirectly incurred in relation to exempt income, the same cannot be claimed against the income, which is taxable as it is held by the honourable

Supreme Court in case of Commissioner of Income-tax v. Walfort Share and Stock Brokers P. Ltd. reported in 326 ITR 1 that for attracting the provisions of section 14 A, there should be proximate cause for disallowance which as relationship with the tax exempt income.

5.1 The expenditure incurred in relation to the income which does not form part of total income has to be disallowed. However, it should be proximate relationship between the expenditure and the income, which does not form part of total income. Once such proximity relationships exist, the disallowance is to be effected. In case the assessee had claimed that no expenditure has been incurred for earning the exempt income, it was for the assessing officer to determine as to whether the assessee had incurred any expenditure in relation to income which did not form part of total income and if so to quantify the extent of disallowance. Thus, in order to disallow the expenditure under section 14A, there must be a live nexus between the expenditure incurred and the income not forming part of total income. No notional expenditure can be apportioned for the purpose of earning exempt income unless there is an actual expenditure in relation to earning the income not forming part of total income. If the expenditure is incurred with a view to earn taxable income and there is apparent dominant and immediate connection between the expenditure incurred and taxable income, then no disallowance can be made under section 14A merely because some tax exempt income is received by the assessee.

5.2 Averting to the facts of the case in hand, the assessee had made a claim that no expenditure has been incurred or claimed for earning the exempt income. From the details of the expenditure, it is clear that the expenditure incurred and claimed by the assessee has direct nexus with the professional income of the assessee. It is not the case of the revenue that the assessee has used his official

machinery and Establishment for earning the exempt income. The Assessing Officer has not given any finding that any of the expenditure incurred and claimed by the assessee is attributable for earning the exempt income. In other words when the assessing officer has not pointed out that certain expenditure is not incurred for earning the professional income; but are incurred in relation to dividend income or such expenditure is incurred for inseparable and indivisible activities comprising professional as well as the activities on which is exempt income has been earned by the assessee, then in the absence of any such instance of expenditure, finding of Assessing Officer or any material to show that the expenditure incurred and claimed by the assessee against the taxable income has any relation for earning the exempt income, the provisions of section 14A cannot be applied.

5.3 In the case of silicone, permissible Lal versus ACIT supra this tribunal has considered and decided an identical issue in para 4 as under:

"4. After hearing the assessee in person and arguments of the learned D.R. we are of the opinion that no disallowance is called for under section 14A. Obviously the assessee is maintaining separate books of account for purpose of business and these investments are in his personal capacity. The A.O. also has not disallowed any expenditure of personal nature out of the income from business or profession in the computation of income in the assessment order. In view of this we are of the opinion that the expenditure claimed in the business of share dealings cannot be correlated to the incomes earned in personal capacity that too on dividend, PPF interest and tax free interest on RBI bonds. In view of this, we are of the opinion that estimation of expenditure of ₹20,000/- out of business expenditure claimed in business activity cannot be considered for being incurred for this earning of tax free income of above nature. In view of this disallowance so made under section 14A of ₹20,000/- is deleted. Not only that the CIT(A) directed the A.O. to consider the allowance invoking Rule 8D. The Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd. vs. DCIT 328 ITR 81 has considered Rule 8D to be applicable prospective and since the assessment year involved is before the introduction of sub-section (2) & (3) of section 14A, there is no question of disallowing the amounts invoking Rule 8D. Therefore, the CIT(A)'s direction on this is set aside and the additions so made by the A.O. in the computation of business income is deleted. Ground is considered allowed."

5.4 Similarly in case of Auchtel Products Ltd (supra), it was held by this Tribunal in para 15 has under:

"15. A bare perusal of the above provisions indicates that the AO shall determine the amount disallowable as per Rule 8D, if he, "is not satisfied with the correctness of the claim of the assessee" in respect of such expenditure in relation to exempt income. Even if the assessee claims that no expenditure was incurred in respect of exempt income, the AO is supposed to follow the mandate of Rule 8D if he is not satisfied with the correctness of the assessee's claim. To put it simply, the further disallowance u/s.14A is called for when the AO is not satisfied with the assessee's claim of having incurred no expenditure or some amount of expenditure in relation to exempt income. Satisfaction of the AO as to the incorrect claim made by the assessee in this regard is sine qua non for invoking the applicability of Rule 8D. Such satisfaction can be reached and recorded only when the claim of the assessee is verified. If the assessee proves before the AO that it incurred a particular expenditure in respect of earning the exempt income and the AO gets satisfied, then there is no requirement to still proceed with the computation of amount disallowable as per Rule 8D. From the assessment order, it is observed that the AO simply kept the assessee's submissions on record without appreciating as to whether these were correct or not. He proceeded on the premise as if the disallowance as per Rule 8D is automatic irrespective of the genuineness of the assessee's claim in respect of expenses incurred in relation to exempt income. It is an incorrect course adopted by the AO. The correct sequence, in our considered opinion, for making any disallowance u/s. 14A is to, firstly, examine the assessee's claim of having incurred some expenditure or no expenditure in relation to exempt income, If the AO gets satisfied with the same, then there is no need to compute disallowance as per Rule 8D. It is only when the AO is not satisfied with the correctness of the claim of the assessee in respect of such expenditure or no expenditure having been incurred in relation to exempt income, that the mandate of Rule 8D will operate. In the instant case, the authorities below have directly gone to the second stage of computing disallowance u/s. 14A as per Rule 8D without rendering any opinion on the correctness or otherwise of the assessee's claim in this regard. We, therefore, set aside the impugned order on this issue and restore the matter to the file of AO to re-compute disallowance, if any, in accordance with our above observations after duly examining the assessee's claim in this regard."

6 In view of the above discussion and facts and circumstances of the case, we are of the considered opinion that no disallowance under section 14A is called for when the assessee has not incurred and claimed any expenditure for earning the exempt income.

6.1 Needless to say the provisions of Rule 8D are not applicable for the assessment year under consideration as held by the honourable jurisdictional High Court in case of *Godrej & Boyce Mfg. Co. Ltd. vs. DCIT 328 ITR 81*.

7 In the results, the appeal of the assessee is allowed.

Order pronounced in the open court on the 25th, day of July 2012.

Sd/-

Sd/-

(G E VEERABHADRAPPA) President	(VIJAY PAL RAO) Judicial Member
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Place: Mumbai : Dated: 25th, July 2012

Raj*

Copy forwarded to:

1	Appellant
2	Respondent
3	CIT
4	CIT(A)
5	DR

/TRUE COPY/
BY ORDER

Dy /AR, ITAT, Mumbai