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**[2014] 50 taxmann.com 138 (Chennai - Trib.)/[2015] 152 ITD 844 (Chennai - Trib.)**

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**IT : Disallowance cannot made under section 14A where assessee had not earned/received any exempt income during relevant year**

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**[2014] 50 taxmann.com 138 (Chennai - Trib.)**

**IN THE ITAT CHENNAI BENCH 'B'**

**Assistant Commissioner of Income-tax, Company Circle -I(2), Chennai**

**v.**

**M. Baskaran\***

A.MOHAN ALANKAMONY, ACCOUNTANT MEMBER  
AND CHALLA NAGENDRA PRASAD, JUDICIAL MEMBER  
IT APPEAL NO. 1717 (MDS.) OF 2013  
[ASSESSMENT YEAR 2009-10]  
JULY 31, 2014

**Section 14A of the Income-tax Act, 1961, read with rule 8D of the Income-tax Rules, 1962 - Expenditure incurred on in relation to income not includible in total income (Conditions precedent) - Assessment year 2009-10 - Whether disallowance under section 14A cannot be made where assessee had not earned/received exempt income during relevant year - Held, yes [Para 11] [In favour of assessee]**

## **FACTS**

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- The Assessing Officer while completing the assessment, disallowed a certain sum under section 14A read with rule 8B as expenditure incurred for earning exempt income as the assessee was holding investments and incurred interest expenses.
- On appeal, the Commissioner (Appeals) deleted the disallowance holding that assessee had not derived any income out of investments and investments were made from his own source which did not suffer from any interest.
- On appeal, the assessee submitted that assessee had not received any exempt income and in the absence of the assessee receiving any exempt income, there was no justification in deriving expenses attributable for earning income which was not received by the assessee.

## **HELD**

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- The disallowance made under section 14A be deleted as the assessee has not earned/received exempt income during the previous year relevant to the assessment year under appeal. Thus, the order of the Commissioner (Appeals) on this issue was to be sustained. [Para 11]

## **CASE REVIEW**

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*CIT v. Shivam Motors (P.) Ltd.* [IT Appeal No. 88 of 2014, dated 5-5-2014]; Gujarat High Court in the case of *CIT v. Corrttech Energy (P.) Ltd.* [\[2014\] 223 Taxman 130/45 taxmann.com 116 \(Guj.\)](#); *Delite Enterprises (P.) Ltd. v. ITO* [\[2008\] 22 SOT 245 \(Bom.\)](#); *CIT v. Lakhani Marketing Incl.* [IT Appeal No. 970 of 2008 dated 2-4-2014] and *CIT v. Winsome Textile Industries Ltd.* [\[2009\] 319 ITR 204 \(Punj. & Har.\)](#) (para 15) followed.

## **CASES REFERRED TO**

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*CIT v. Hero Cycles Ltd.* [\[2010\] 323 ITR 518/189 Taxman 50 \(Punj. & Har.\)](#) (para 2), *Cheminvest Ltd. v. ITO* [\[2009\]121 ITD 318 \(Delhi\)](#) (para 3), *CIT v. Sivam Motors (P.) Ltd.* [IT Appeal No. 88 of 2014, dated 5-5-2014] (para 4), *CIT v. Corrttech Energy (P.) Ltd.* [\[2014\] 223 Taxman 130/45 taxmann.com 116 \(Guj.\)](#) (para 4), *Delite Enterprises (P.) Ltd. v. ITO* [\[2008\] 22 SOT 245 \(Bom.\)](#) (para 4), *Rainy Investments (P.) Ltd. v. Asstt. CIT* [\[2013\] 56 SOT 61 \(URO\)/30 taxmann.com 169 \(Mum.\)](#) (para 4), *CIT v. Lakhani Marketing Incl.* [IT Appeal No. 970 of 2008, dated 2-4-2014] (para 10) and *CIT v. Winsome Textile Industries Ltd.* [\[2009\] 319 ITR 204 \(Punj. & Har.\)](#) (para 11).

**Pramod Nangia**, CIT for the Appellant. **M. Karunagaran**, Advocate for the Respondent.

## **ORDER**

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**Challa Nagendra Prasad, Judicial Member** - This appeal is filed by the Revenue against the order of the Commissioner of Income Tax (Appeals)-VI, Chennai dated 22.02.013 for the assessment year 2009-10. The only grievance of the Revenue in this appeal is that the Commissioner of Income Tax (Appeals) erred in deleting disallowance made under section 14A read with Rule 8D holding that assessee has not received any exempt income and hence disallowance is unwarranted.

2. The Assessing Officer while completing the assessment disallowed Rs. 19,28,666/- under section 14A read with Rule 8D of the Act as expenditure incurred for earning exempt income as the assessee was holding investments worth Rs.14.05 crores and incurred interest expenses of Rs. 34.80 lakhs. On appeal the Commissioner of Income Tax (Appeals) deleted the disallowance holding that assessee has not derived income out of investments and investments are made from his own source which did not suffer any interest. The Commissioner of Income Tax (Appeals) also observed that Assessing Officer should have excluded share application money from the working of the qualifying amount. Therefore Commissioner of Income Tax (Appeals) following the ratio of the decision in the case of *CIT v. Hero Cycles Ltd.* [\[2010\] 323 ITR 518/189 Taxman 50 \(Punj. & Har.\)](#) deleted the disallowance made under section 14A of the Act.

3. Departmental Representative relying on the decision of the Special Bench of the Tribunal in the case of *Cheminvest Ltd. v. ITO* [\[2009\]121 ITD 318 \(Delhi\)](#) submits that even if the assessee has not earned any exempt income, still disallowance under section 14A read with Rule 8D has to be made and it is mandatory. Departmental Representative also places reliance on Circular No.5/2014 dated 11.2.2014 issued by CBDT and submits that even in the case of the assessee not receiving any exempt income during the financial year still the disallowance under section 14A has to be made.

4. Counsel for the assessee submits that assessee has not received any exempt income and in the absence of the assessee receiving any exempt income, there is no justification in deriving expenses attributable for earning income which is not received by the assessee. He places reliance on the recent decision of the Hon'ble Allahabad High Court in the case of *CIT v. Sivam Motors (P.) Ltd.* [IT Appeal No.88 of 2014, dated 5-5-2014] for the assessment year 2008-09, the decision of the Hon'ble Gujarat High Court in the case of *CIT v. Corrttech Energy (P.) Ltd.* [\[2014\] 223 Taxman 130/45 taxmann.com 116](#) in Tax Appeal No.239 of 2014 dated 24.3.2014 for the assessment year 2009-10 and the decision of Hon'ble Bombay High Court in the case of *Delite Enterprises (P.) Ltd. v. ITO* [\[2008\] 22 SOT 245](#) in Tax Appeal No.110 of 2009 dated 26.2.2009. Counsel for the assessee submits that even otherwise the Assessing Officer should have excluded share application money in various companies which will not produce any exempt income. He submits that if such share application money is excluded the disallowance under section 14A of the Act will works out to Rs. 5,61,125/- as against disallowance of Rs.19,28,666/- made by the Assessing Officer. For the proposition that share application money is not investment for the purpose of section 14A, he places reliance on the decision

of the Tribunal in the case of *Rainy Investments (P.) Ltd. v. Asstt. CIT* [[2013\] 56 SOT 61 \(URO\)/30 taxmann.com 169 \(Mum.\)](#).

5. Heard both sides. Perused orders of lower authorities and submissions made by the assessee and the decisions in relied on. No doubt in the decision of the Special Bench of Delhi Tribunal in the case of *Cheminvest Ltd. (supra)*, the Special Bench held that disallowance under section 14A can be made even in the year in which no exempt income has been earned or received by the assessee. This decision of Special Bench of the Tribunal has been impliedly overruled by the decisions of High Courts in the following cases:

6. In the case of *Sivam Motors (P.) Ltd. (supra)*, before the Hon'ble Allahabad High Court, the Revenue raised the following question of law:—

"Whether on the facts and in the circumstances of the case and in law, the Income Tax Appellate Tribunal was justified in upholding the decision of CIT(A) in deleting the disallowance of Rs. 2,03,752/- u/s.14A ignoring the fact that there is difference of opinion of various courts on the view taken by the ITAT that in the absence of tax free income, no disallowance u/s.14A is permissible."

7. The High Court while answering the said question held as under:—

"As regards the second question, Section 14A of the Act provides that for the purposes of computing the total income under the 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 the Act. Hence, what Section 14A provides is that if there is any income which does not form part of the income under the Act, the expenditure which is incurred for earning the income is not an allowable deduction. For the year in question, the finding of fact is that the assessee had not earned any tax free income. Hence, in the absence of any tax free income, the corresponding expenditure could not be worked out for disallowance. The view of the CIT(A), which has been affirmed by the Tribunal, hence does not give rise to any substantial question of law. Hence, the deletion of the disallowance of Rs.2,03,752/- made by the Assessing Officer was in order."

8. The Gujarat High Court in the case of *Corrtech Energy (P.) Ltd. (supra)* held as under:—

"We have given our thoughtful consideration to the facts and the decision relied upon by the Id AR. The Hon'ble Punjab & Haryana High Court in the case of *CIT v. Winsome Textile Industries Ltd.* reported at [[2009\] 319 ITR 204 \(P&H\)](#) has held that in the present case, admittedly, the assessee did not make any claim for exemption. In such a situation, section 14A could have no application. In this case also, the assessee has not claimed any exempt income in this year. Therefore, respectfully following the judgement of Hon'ble High Court of Punjab & Haryana in the case of *CIT v. Winsome Textile Industries Ltd. (supra)*, we hereby allow this ground and direct the AO to delete the addition. Therefore, ground Nos 1 to 1.2 raised by the assessee in its cross objection are allowed."

4. Counsel for the Revenue submitted that the Assessing Officer as well as CIT(Appeals) had applied formula of rule 80 of the Income Tax Rules, since this case arose after the assessment year 2009-2010. Since in the present case, we are concerned with the assessment year 2009-2010, such formula was correctly applied by the Revenue. We however, notice that subsection (1) of section 14A provides that for the purpose of computing total income under chapter IV of the Act, 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 the Act. In the present case, the tribunal has recorded the finding of fact that the assessee did not make any claim for exemption of any income from payment of tax. It was on this basis that the tribunal held that disallowance under section 14A of the Act could not be made. In the process tribunal relied on the decision of Division Bench of Punjab and Haryana High Court in case of *Commissioner of Income Tax v Winsome Textile Industries Ltd* reported in (2009) 319 ITR 204 (Punj & Har) in which also the Court had observed as under:

"7. We do not find any merit in this submission. The judgement of this court in *Abhishek Industries Ltd* [[2006\] 286 ITR 1](#) 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. The

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. We do not find any question of law arising, Tax appeal is therefore dismissed."

9. The Hon'ble Bombay High Court in the case of *Delite Enterprises (P.) Ltd. (supra)* held as under:—

"*The Revenue is in appeal on the following questions:—*

Whether on the facts and in the circumstance of the case and in law the Hon 'ble Tribunal was right in deleting the disallowance made by the Assessing Officer of interest paid by the Assessee Company on borrowed funds amounting to Rs.241.10 lakhs overlooking the fact that the borrowed funds were used by the Assessee Company to invest in the Capital of another Partnership Firm and since profits derived by the Assessee Company from a Partnership firm were exempt from tax u/s.10(2A) of the Income-tax Act, the interest expense related to such tax free profits is to be disallowed u/s.14A of the Income Tax Act?

(B) Whether on the facts and in the circumstance of the case and in law the Hon'ble Tribunal was right in holding that the Assessing Officer cannot consider notional interest on deposit received by the Assessee Company while arriving at the fair market value u/s.23(1) (a) of the Income-tax Act?"

2. In so far as Question (A) is concerned, on facts we find that there is no profit for the relevant assessment year. Hence the question as framed would not arise."

10. Similar view has been taken by the Hon'ble Punjab & Haryana High Court in the case of *CIT v. Lakhani Marketing Incl.* [IT Appeal No. 970 of 2008, dated 2-4-2014]. The Hon'ble High Court while affirming the decisions of CIT(A) as well as the Tribunal in deleting the disallowance made under section 14A observed as under:—

"7. After hearing learned counsel for the parties, we do not find any merit in the appeals.

8. The primary issue that arises for consideration in these appeals is whether the CIT(A) as well as the Tribunal were right in allowing deduction of interest liability out of other income and the claim of the revenue to disallow the same under section 14A of the Act was justified.

9. The CIT(A) vide order dated 24.6.2004 annexure A.II recorded as under:

7.2 Keeping in view the above facts and circumstances of the case it is held that the AO was not correct in applying section 14A of the IT Act in disallowing the expenditure on account of interest amounting to Rs. 46,91,684/-. It was incumbent on the AO to establish a nexus between the expenditure incurred and the income which was exempt under the Act. Facts clearly do not support the action of the AO. Disallowance is accordingly deleted. The AO is directed to recompute the income accordingly."

10. Vide order dated 16.5.2008, Annexure A.III, the Tribunal on appeal by the revenue while upholding the finding recorded by the CIT(A) noticed as under:-

"We have heard rival submissions and have perused the material on record. From the reading of section 14A of the Act, it is clear that before making any disallowance the following conditions are to exist:—

- (a) That there must be income taxable under the Act, and
- (b) That this income must not form part of the total income under the Act, and
- (c) That there must be an expenditure incurred by the assessee, and
- (d) That the expenditure must have a relation to the income which does not form part of the total income under the Act.

9. Therefore, unless and until, there is receipt of exempted income for the concerned assessment years (dividend from shares), we are of the view, Section 14A of the Act cannot be invoked. In this appeal, the revenue has not dispelled the findings of the CIT(A), nor the statement of the assessee before AO that

assessee is not in receipt of any dividend income and hence according to us, the Assessing Officer has erred in invoking Section 14A of the Act, to disallow various interest payments on capital account, security deposits and unsecured loans. This conclusion of ours finds support in the decision of Bombay Bench of the Tribunal in the case of Joint Commissioner of Income Tax v. Holland Equipment Co. B.V. reported in [\(2005\) 3 SOT 810 \(Mumbai\)](#) and the relevant portion of the order of the Bombay Bench of the Tribunal is reproduced below:—

'Regarding application of Section 14A of the Act, the contention of the learned Department Representative has to be rejected on the face of it inasmuch as the entire income of the assessee is taxable under the Act. Section 14A is applicable only when any part of the income is not to be included in the total income of the assessee and the expenditure relating to that part of income is claimed by the assessee as deduction. In such cases only, the expenditure relating to the exempted income can be disallowed and not otherwise. Since in the present case the entire income is found to be taxable, no disallowance can be made under section 14A of the Act.'

10. Moreover, the AO has not established the nexus between invested funds and the interest bearing funds, since the investments in shares are in the years 1995-96, 1998-99 and 1999-2000 and the interest disallowance is for the assessment years 2000-01 and 2001 -02. On the contrary perusal of the balance sheet for the year ending 31.3.1995, 31.3.1998 and 31.3.1999, it is clear that interest bearing funds have not been utilized for investment for purchase of shares.

11. For the aforesaid reasons, we see no reason to interfere with the order of CIT(A) concerning assessment year 2000-01 and 2001-02 and hence the decision of CIT (A) in deleting the disallowance of interest by invoking section 14A of the Act is correct and in accordance with law."

12. In view of the aforesaid findings, which could not be shown to be erroneous, the plea of the revenue cannot be accepted.'

**11.** In the case of *CIT v. Winsome Textiler Industries Ltd.* [\[2009\] 319 ITR 204](#), the Hon'ble Punjab & Haryana High Court held that when there is no claim for exemption of income in such situation section 14A has no application. Respectfully following the above decisions, we delete the disallowance made under section 14A as the assessee has not earned / received for exempt income during the previous year relevant to the assessment year under appeal. Thus, we sustain the order of the Commissioner of Income Tax (Appeals) on this issue.

**12.** In the result, appeal of the Revenue is dismissed.

POOJA

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\*In favour of assessee.