IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.1029 OF 2018

Pr. Commissioner of Income-Tax – 14,]
Aayakar Bhavan, M K Road]
Mumbai 400 007.] ..
Appellant

v/s.

Godrej & Boyce Mfg. Co. Ltd.]
Manufacturing Co. Ltd]
Pirojshah Nagar]
Vikhroli, Mumbai – 400 079].. Respondent

...

Mr. Suresh Kumar for the appellant.

Ms. P. J. Pardiwalla, Senior Advocate a/w. Mr. Nitesh Joshi i/by Mr. Atul K. Jasani for the respondent.

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CORAM : DHIRAJ SINGH THAKUR AND KAMAL KHATA, JJ.
RESERVED ON : 5TH JANUARY 2023.
PRONOUNCED ON : 20TH FEBRUARY 2023.

JUDGMENT

[PER : KAMAL R. KHATA, J.]

1. This appeal is against the impugned order dated 5th April 2017 passed by the Income Tax Appellate Tribunal (ITAT) whereby the

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respondent's appeal was partly allowed and the revenue / appellant's appeal was dismissed.

STATEMENT OF FACTS:

2. The assessee filed its return for income for A.Y. 2011-12 on 21.11.2011 declaring total income at Rs.358,47,29,328/- under normal provisions and book profit of Rs.431,48,93,079/- under section (u/s) 115JB of the I.T. Act. The return was processed u/s 143(1) of the Act on 23.03.2012. The case was selected for scrutiny and notice u/s 143(2) of the I.T. Act 1961 was issued to the assessee on 01.08.2012. The AO made various additions/disallowances – which includes disallowances u/s.14A r.w. Rule 8D amount to Rs.5,11,85,000/- The AO completed assessment vide order dated 03.03.2014.

3. Being aggrieved by order dated 03.03.2014, the assessee company filed an appeal before the CIT(A).

4. The Ld. CIT (A) by his order dated 17.04.2015 partly allowed the assessee company's appeal.

5. Being aggrieved by order dated 17.04.2015, the Assessee company and the Revenue filed an appeal before the Hon'ble ITAT.

6. The Hon'ble ITAT vide order dated 05.04.2017, allowed the appeal of the Assessee company and dismissed the appeal filed by the Revenue.

7. The questions of law averred in the appeal and placed for our consideration are as under:

> *a. Whether in law and on the facts of the instant case, was the Tribunal correct in holding that the AO has not recorded any satisfaction that the working of inadmissible expenditure u/s.14A is incorrect having regard to the books of accounts of the assessee, whereas in para 5 of Assessment order, the AO has clearly mentioned that the assessee has set off interest costs in respect of dividend income against other taxable income which is against the matching concept of income and expenditure.*
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> *b. Whether in law and on the facts of the instant case, was the Tribunal right in endorsing the CIT(A)'s order of presumption of own interest free funds thereby overlooking the changed law w.e.f. 2007-08 followed by introduction of rule 8D in 2008-09 provides for a method of calculation as a result of which there would be no need to rely on any presumption of own funds.*
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> *c. Whether on law and in the facts of the instant case, was the Tribunal right in deleting the addition of interest disallowed by the AO, in the absence of any evidence that indicated that borrowed funds were not used for the purpose of making investments that yielded exempt.*

d. Whether on law and in the facts of the instant case, was the Tribunal justified in not considering interest expenses while calculating disallowance u/s.14A r.w. Rule 8D although assessee has not maintained separate account for the investment related to exempt income.

8. Mr. Suresh Kumar the learned counsel for the appellant submitted that the Assessing Officer (AO) had clearly mentioned in paragraph no.5 of the assessment order that setting-off interest costs of dividend income against other taxable income is against matching concept of income and expenditure. He submitted that there was no need to rely on any presumption of own funds on account of the changed law that came into force from 2007-08 followed by introduction of rule 8D in 2008-09 which provides for a method of calculations. It is submitted that in view of the above, the ITAT erred in endorsing the CIT(A)'s order which drew presumption of own interest free funds. He further submitted that the ITAT ought not to have deleted the addition of interest disallowed by the AO, in the absence of any evidence that indicated that borrowed funds were not used for the purpose of making investments that yielded exemption. He further submitted that the ITAT ought not to have been considered interest while calculating disallowance u/s. 14A read with Rule 5D since the assessee had not maintained a separate account for the investment related to exempt income.

9. Mr. Pardiwalla, learned senior counsel for the respondent took us through the assessment order dated 3rd March 2014, CIT(A)'s order dated 17th April 2015 and the impugned order dated 5th April 2017 and submitted that the interest expenditure was rightly not disallowed u/s. 14A read with Rule 8D (2)(ii) and prayed that the appeal deserves to be dismissed. In support of his submission he relied upon the judgment of the Apex Court in the respondent's case namely ***Godrej & Boyce Manufacturing Co. Ltd. Vs. Deputy Commissioner of Income-Tax And Another***[1] which held as under:

> *"36. Section 14A as originally enacted by the Finance Act of 2001 with effect from April 1, 1962 is in the same form and language as currently appearing in sub-section (1) of Section 14A of the Act. Sections 14A(2) and (3) of the Act were introduced by the Finance Act 2006 with effect from April 1, 2007. The findings of the Bombay High Court in the impugned order that sub-sections (2) and (3) of section 14A is retrospective has been challenged by the Revenue in another appeal which is presently pending before this court. The said question, therefore, need not and cannot be gone into. Nevertheless, irrespective of the aforesaid question, what cannot be denied is that the requirement for attracting the provisions of section 14A(1) of the Act is proof of the fact that the expenditure sought to be disallowed / deducted had*

1 [2017] 394 ITR 449 (SC)

actually been incurred in earning the dividend income. Insofar as the appellant-assessee is concerned, the issues stand concluded in its favour in respect of the assessment years 1998-99, 1999-2000 and 2001-02. Earlier to the introduction of sub-sections (2) and (3) of section 14A of the Act, such a determination was required to be made by the Assessing Officer in his best judgment. In all the aforesaid assessment years referred to above it was held that the Revenue had failed to establish any nexus between the expenditure disallowed and the earning of the dividend income in question. In the appeals arising out of the assessments made for some of the assessment years the aforesaid question was specifically looked into from the standpoint of the requirements of the provisions of sub-sections (2) and (3) of section 14A of the Act which had by then been brought into force. It is on such consideration that findings have been recorded that the expenditure in question bore no relation to the earning of the dividend income and hence the assessee was entitled to the benefit of full exemption claimed on account of dividend income.

37. *We do not see how in the aforesaid fact situation a different view could have been taken for the assessment year 2002-03. Sub-sections (2) and (3) of section 14A of the Act read with rule 8D of the Rules merely prescribe a formula for determination of expenditure incurred in relation to income which does not form part of the total income under the Act in a situation where the Assessing Officer is not*

satisfied with the claim of the assessee. Whether such determination is to be made on application of the formula prescribed under rule 8D or in the best judgment of the Assessing Officer, what the law postulates is the requirement of a satisfaction in the Assessing Officer that having regard to the accounts of the assessee, as placed before him, it is not possible to generate the requisite satisfaction with regard to the correctness of the claim of the assessee. It is only thereafter that the provisions of section 14A(2) and (3) read with rule 8D of the Rules or a best judgment determination, as earlier prevailing, would become applicable.

38. In the present case, we do not find any mention of the reasons which had prevailed upon the Assessing Officer, while dealing with the assessment year 2002-03, to hold that the claims of the assessee that no expenditure was incurred to earn the dividend income cannot be accepted and why the orders of the Tribunal for the earlier assessment years were not acceptable to the Assessing Officer, particularly, in the absence of any new fact or change of circumstances. Neither any basis has been disclosed establishing a reasonable nexus between the expenditure disallowed and the dividend income received. That any part of the borrowing of the assessee had been diverted to earn tax free income despite the availability of surplus or interest free funds available (Rs. 270.51 crores as on April 1, 2001 and Rs. 280.64 crores as on March 31, 2002) remains unproved by any material whatsoever."

10. He further relied upon the Apex Court judgment in the case of ***South Indian Bank Ltd. vs. Commissioner of Income-tax***[2] which held that :

> *"17. In a situation where the assessee has a mixed fund (made up partly of interest free funds and partly of interest -bearing funds) and payment is made out of that mixed fund, the investment must be considered to have been made out of the interest free fund. To put it another way, in respect of payment made out of mixed fund, it is the assessee who has such right of appropriation and also the right to assert from what part of the fund a particular investment is made and it may not be permissible for the Revenue to make an estimation of a proportionate figure. For accepting such a proposition, it would be helpful to refer to the decision of the Bombay High Court in Pr. CIT v. Bombay Dyeing & Mfg. Co. Ltd. [IT Appeal No. 1225 of 2015, dated 28-11-2017], where the answer was in favour of the assessee on the question, whether the Tribunal was justified in deleting the disallowance under section 80M of the Act on the presumption that when the funds available to the assessee were both interest free and loans, the investment made would be out of the interest free funds available with the assessee, provided the interest free funds were sufficient to meet the investments. The resultant SLP of the Revenue challenging the Bombay High Court judgment was dismissed both on merit and on delay by this Court."*

[2] [2021] 130 taxmann.com 178 (SC)

11. In the present case, the assessee had earned an exempt income of Rs. 84,30,37,423/- from shares and mutual funds and submitted a computation of inadmissible expenditure u/s 14A amounting to Rs. 13,66,635/- . The assessee claimed that the disallowance made u/s14A was as per the books of account attributable to earning of exempt income. On a perusal of the assessment order we find that there is no discussion by the AO with regard to the computation of inadmissible expenditure made by the assessee forming part of the return of income. Further, the AO has not recorded any satisfaction that the working of inadmissible expenditure u/s14A is incorrect with regard to the books of account of the assessee. The provision u/s 14(2) does not empower the AO to apply Rule 8D straightaway without considering the correctness of the assessee's claim in respect of expenditure incurred in relation to the exempt income. We agree with the view of the ITAT that in the present case the AO has neither examined the claim in respect of expenditure incurred in relation to exempt income of the assessee nor has recorded any satisfaction with regard to the correctness of assessee's claim with reference to the books of account. Consequently, the disallowance made by applying the Rule 8D is not only against the statutory mandate but contrary to the legal principles laid down. In our view too, the CIT (A) has rightly deleted the addition made on account of

interest expenditure as the assessee had sufficient interest free surplus fund to make the investment and the ITAT has rightly deleted the disallowance made by the AO u/s 14A r.w Rule 8D. Consequently we hold that, the interest expenditure cannot be disallowed u/s14A r.w. Rule 8D(2)(ii) under any circumstances.

12. In view of the aforesaid, we find there is no substantial question of law that is required to be framed and accordingly dismiss the appeal with no order as to costs in favour of the assessee.

(KAMAL KHATA, J.) **(DHIRAJ SINGH THAKUR, J.)**

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