IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.1081 OF 2018

Principal Commissioner of Income Tax-2
Aayakar Bhavan, M.K.Road,
Mumbai 400 020. ...Appellant

Versus

M/s. Tata Capital Ltd.
One Forbes, Dr. V.B.Gandhi Marg,
Fort, Mumbai-400 001
PAN AADCP9147P ...Respondent

Mr. Suresh Kumar for Appellant.
Mr. J.D.Mistri, Senior Advocate, with Mr. Paras Savla & Mr. Pratik Poddar, for Respondent.

CORAM: K. R. SHRIRAM &
DR. NEELA GOKHALE, JJ.
DATED: 3rd April 2024

ORAL JUDGMENT :- (Per K.R.Shriram, J.)

1. This Appeal filed under Section 260A of the Income Tax Act, 1961 ("**the Act**") impugns an order dated 9th May 2017 passed by the Income Tax Appellate Tribunal, Mumbai ("**ITAT**").

2. The Assessee/Respondent has filed for Assessment Year ("**AY**") 2008-09 its Return of Income ("**ROI**") on 30th September 2008 declaring NIL income (Loss of Rs.6,76,80,285/-). During the course of assessment proceedings when the case of Assessee was selected for scrutiny, the Assessing Officer ("**AO**") observed that the Schedule 14 forming part of the P&L A/c. for the year ended on 31st March 2008,

Assessee had received dividend of Rs.214 Lakhs from long term investment, Rs.985 Lakhs from mutual funds and Rs.2065 Lakhs under the head 'Capital Gains'. The AO also observed that Assessee had claimed above dividends aggregating to Rs.11,98,44,042/- as exempt under Section 10(34) of the Act besides Rs.12,15,13,871/- out of the capital gains under Section 10(38) of the Act. The AO also observed from Schedule 16 forming part of the P&L A/c that Assessee has claimed expenditure of Rs.94,00,00,000/- on account of interest expenses. Subsequently, Assessee was called upon to show cause as to why expenditure should not be disallowed under Section 14A of the Act read with Rule 8D of the Income Tax Rules ("**IT Rules**"). Assessee's reply, was not accepted by the AO. The AO recomputed the disallowance by applying Rule 8D of the IT Rules at Rs.18,46,00,000/- and an assessment order dated 26th October 2010 under Section 143(3) of the Act came to be passed.

3 Being aggrieved, Assessee filed an appeal before the Commissioner of Income Tax (Appeals), Bombay [**CIT(A)**]. By an order dated 9th December 2011, Assessee's appeal was allowed by the CIT(A). The CIT(A) deleted the disallowance made by the AO holding that the AO has not recorded his findings about the correctness of the claim of Assessee in respect of such expenditure in relation to exempt income. The CIT(A) had further observed that Rule 8D is not automatic and the AO ought to have given reasons.

Paragraphs 4.2 and 4.3 of the CIT(A)'s order read as under:

> *"4.2 Section 14A(2) provides that Rule 8(D) is to be applied "if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act."*
>
> *4.3 The part of the assessment order wherein the AO has supposedly recorded his reasons for not being satisfied with the accounts of the assessee is quoted above at Para 4.1 of this order. No analysis of the AO's order is warranted as a mere reading of the words of the AO clearly indicate the inconsistencies, mistakes and errors of various kinds. The fact is that the AO has not given any reason nor has mentioned how and why or even whether he is dissatisfied with the correctness of the claim of the assessee. As the application of Rule 8D is not automatic and the AO has not recorded valid reasons, in fact, any reason for his being not satisfied with the correctness of claim of the assessee in respect of expenditure relating to exempt income, the addition made by AO u/s.14A is deleted."*

4 Being unhappy with the CIT(A), Revenue preferred an appeal before the ITAT. The ITAT dismissed the appeal by the impugned order dated 9th May 2017. The ITAT concurred with the view expressed by the CIT(A) and also relied upon a decision of the ITAT Panaji Bench in the case of Sesa Goa Ltd. v. JCIT dated 8th March 2013-I.T.A. No. 72 and 85/PNJ/2012.

5 In the appeal before us, the following two substantial questions of law are proposed:

> *"1. Whether on the facts and circumstances of the case in law, the Hon'ble ITAT was right in deleting the disallowance made u/s.14A of the Income Tax Act, 1961 read with Rule 8D of Income Tax Rules, by relying on the decision of the Hon'ble ITAT, Panji Bench in the case of Sesa Goa Ltd. v. JCIT in ITA No.72&85/PNJ/2012, when the said decision is distinguishable on facts ?*
>
> *2. Whether on the facts and circumstances of the case and in*

> *law, the Hon'ble ITAT was right in deleting the disallowance made u/s.14A of the Income Tax Act, 1961 read with Rule 8B of the Income Tax Rules, by holding that the Assessing Officer applied Rule 8D without recording satisfaction with reference to the correctness of the claim of the assessee in respect of the expenditure incurred in relation to exempt income in form of dividend and long term capital gain, when the Assessing Officer's satisfaction is discernible from the discussion made in the assessment order?"*

6. Mr. Suresh Kumar submitted that the AO has in fact recorded in the assessment order that Assessee's explanation was not acceptable. We have examined the assessment order where the AO stated as under:

> *"It is pertinent to note that the assessee in his business and the loans taken are the purpose for investing in the shares and financing activities of the assessee. The assessee's explanation is not acceptable."*

7. We agree with the finding of the CIT(A) and the ITAT that though the AO has stated that Assessee's explanation is not acceptable, he has not given reasons why it was not acceptable to him. Subsection (2) of Section 14A and Rule 8D provides that if the Assessing Officer is not satisfied with the correctness of the claim in respect of expenditure made by Assessee in relation to income which does not form part of the total income under the Act, he shall determine the amount of expenditure in relation to such income in accordance with the provisions prescribed. The most fundamental requirement, therefore, is the Assessing Officer should record his dissatisfaction with the correctness of the claim of Assessee in respect

of the expenditure and to arrive at such dissatisfaction, he should give cogent reasons. We find support for this view in a judgment of this Court in ***Principal Commissioner of Income Tax (Central) v. JSW Energy Limited***[1] where paragraphs 5 to 11 read as under:

> "5 Section 14A of the Act reads as under:
>
> *Expenditure incurred in relation to income not includible in total income.*
> *14A. (1) Notwithstanding anything to the contrary contained in this Act, for the purposes of computing the total income under this 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 this Act.*
> *(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.*
> *(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act:*
> *Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001.*
>
> *Rule 8D of the said Rules that was inserted w.e.f. 24th March 2008 by the Income Tax (5th Amendment Rules) 2008, reads as under:*
> *"8D.-(1) Where the Assessing Officer, having regard to the accounts of the assesse of a previous year, is not satisfied with-*
> *(a) 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*

1 [2023] 153 taxmann.com 208(Bom)

year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

2) The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely:-

(i) the amount of expenditure directly relating to income which does not form part of total income; and

(ii) an amount equal to one per cent of the annual average of the monthly averages of the opening and closing balances of the value of investment, income from which does not or shall not form part of total income:

Provided that the amount referred to in clause (i) and clause (ii) shall not exceed the total expenditure claimed by the assessee.]

6 In sub-Section (2) of Section 14A and Rule 8D it is provided that if the Assessing Officer is not satisfied with the correctness of the claim in respect of expenditure made by assessee in relation to income which does not form part of the total income under this Act, he shall determine the amount of expenditure in relation to such income in accordance with the provisions prescribed.

7 Therefore, the most fundamental requirement is the Assessing Officer should record his dis-satisfaction with the correctness of the claim of the assessee in respect of the expenditure and to arrive at such dis-satisfaction he should give cogent reasons.

8 Ms Jain relied upon three judgments of this court, viz., Principal Commissioner of Income Tax Vs. Bajaj Finance Ltd. [(2019) 110 taxmann.com 303 (Bombay)], Principal Commissioner of Income Tax-2 Vs. Bombay Stock Exchange Ltd. [(2020) 113 taxmann.com 303 (Bombay)] and Principal Commissioner of Income Tax Vs. Godrej & Boyce Mfg. Co. Ltd. (2023) 149 taxmann.com 222 (Bombay) to submit that the Assessing Officer must first record a conclusion that having regard to the accounts of the assessee, he is not satisfied with the disallowance offered by the assessee in terms of Section 14A (2) of the Act and it is only on being dissatisfied with the disallowance offered by the assessee, can Rule 8D of the Rules be invoked to compute the disallowance.

9 Paragraph 9 of Bajaj Fiance Ltd. (Supra) reads as under:

"9. Question No. (ii) pertains to disallowance made by the Assessing Officer under Section 14A of the Act read With Rule SD. The Tribunal, however, deleted the disallowance on the ground that the Assessing Officer had not recorded

the necessary satisfaction for not accepting the disallowance offered by the assessee. As is well the amount of expenditure incurred in relation to income which is examined for tax if he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. The satisfaction of the Assessing Officer about the correctness of the expenditure offered for disallowance by the assessee therefore is a pre-condition. In the present case, we have perused the order of assessment in which the Assessing Officer had called assessee to justify the limited disallowances voluntarily offered. The assessee made detailed representation upon the inter alia pointed out that the assessee had not made any expenditure in the nature of administrative expenses. However, to avoid proceedings, a suo motu disallowance was made. The Assessing Officer did not in any manner reject this explanation of the assessee but merely proceeded to make disallowance by invoking Section 14A and applied Rule 8D which the Tribunal correctly reversed."

Paragraph 9 of Bombay Stock Exchange (Supra) reads as under:

"*9. We note that it is evident from the extracted part of the assessment order referred to hereinabove that the Assessing Officer has come to the conclusion that the disallowance claimed by the Respondent was not consistent with Rule 8D of the said Rules. It is only in view of the disallowances not being worked out as per Rule 8D of the Rules, that the Assessing Officer is not satisfied with the disallowance offered by the Respondent. This, to our mind, is putting the cart before the horse. The Assessing Officer must first record a conclusion that having regard to the accounts of the assessee, he is not satisfied with the disallowance offered by the Respondent in terms of section 14A(2) of the Act. It only on being dissatisfied with the above, does Rule 8D of the Rules can be invoked to compute the disallowance."*

Paragraph 11 of Godrej & Boyce Mfg. Co. Ltd. (Supra) reads as under:

"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 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 proviston 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/s 14A r.w. Rule 8D(2) (ii) under any circumstances."*

10 Now let us examine the assessment order to see whether this mandatory conclusion that the Assessing Officer is not satisfied with the disallowance made by the assessee, has been arrived at. The only place where the Assessing Officer has come to his findings is at paragraph 5.2 of the assessment order, which reads as under:

> *5.2. The said submission has been considered. In the assessment order passed u/s 143(3) dated 20.10.2010, the AO has worked out the disallowance u/s 14A as per Rule 8D at Rs.29,66,81,836/-. The assessee has also furnished working u/Rule 8D (though under protest) which amounts to Rs.44,03,33,135/-. Rule 8D is to be applied in the present case based on the various discussions and findings of the AO in the original assessment order passed. However, since the amount worked out by the assessee is higher, the same has been considered for disallowance.*

11 The Assessing Officer has not expressed his satisfaction in the way it should have been. The Assessing Officer does not say he is not satisfied and why he was not satisfied. There are no reasons given.

Moreover, Ms Jain submitted that the Assessing Officer, in paragraph 5.2 of the impugned order quoted above, has relied upon some discussions and findings of some original assessment order passed, but the first assessment order ever to have been passed is the impugned order dated 28th March 2013 where the Assessing Officer has reduced the disallowance. Therefore, it only indicates clear non application of mind by the Assessing Officer. This was not controverted. We would agree with the submissions of Ms Jain since CIT(A) in his order dated 9th December 2014 records "Though not mentioned in assessment

> *order, admittedly a notice u/s 143(2) was issued and assessment proceedings were pending on the date of search which came to be abated. In response to notice u/s 153A dated 24.10.2011 appellant filed return of income on 29.1.2011 declarting Total income of Rs.317,47,69,697/- and Book Profit u/s115JB Rs.666,76,27,404/- In the assessment order dated 28.3.2013 passed u/s 153A r.w.s. 143(3), the Assessing Officer has made certain additions / disallowance which are subject matter of this appeal". The assessment order dated 28th March 2013 is the order that was impugned before the CIT(A). Therefore it clearly indicates that the Assessing Officer's finding in paragraph 5.2 of the assessment order is based relying upon a non existent assessment order and that indicates clear non application of mind."*

8. The order of the ITAT (Panaji Bench) in the case of Sesa Goa Limited has been upheld by the Goa Bench of this Court in CIT, Goa v. Sesa Goa Limited, Panaji, Goa[2] where the Division Bench concurred with the view taken by the ITAT that the Assessing Officer did not record his satisfaction why the disallowance made by Assessee was incorrect.

9. In the circumstances, in our view, no substantial question of law arises. Appeal dismissed.

(DR. NEELA GOKHALE, J.) (K. R. SHRIRAM, J.)

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