IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'F' NEW DELHI

BEFORE SHRI G.D. AGRAWAL, VICE PRESIDENT
AND
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER

ITA No. 3461/Del/2013
AY: 2006-07

M/s Pepsico India Holdings Pvt. Ltd., **No.54, Lower Ground Floor,** **World Trade Centre,** **Barakhamba Road,** **New Delhi-110001** **(PAN: AAACP1272G)**	**vs**	**ACIT,** **Circle 14(1),** **C.R. Building,** **New Delhi.**
(Appellant)		**(Respondent)**

Appellant by: Shri C.S. Aggarwal, Sr. Adv.
Shri Vishal Kalra, Adv.
Respondent by: Ms Susan D. George, Sr. DR

Date of hearing: 26.05.2016
Date of pronouncement: 02.06.2016

ORDER

PER SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER

The present appeal is preferred by the assessee against the order dated 28.03.2013 passed by the Ld. CIT(A)-XVII, New Delhi for assessment year 2006-07.

2. The facts of the case are that the assessee, a company incorporated under the Companies Act, 1956 on 28.01.1994, is engaged in the business of production and sale of aerated and non-aerated soft drink beverages, snack food products, export of

traded and manufactured goods. One of the objects of the assessee was to provide loans and also to hold shares of the companies involved in the business of manufacture of soft drink beverage. For the year under consideration, assessee filed its return of total income on 29.11.2006 declaring a loss of Rs 27,74,73,990 under the normal provisions of the Act and a book loss of Rs 39,49,30,120 under the provisions of section 115JB of the Act. It is the assessee's contention that during the year under consideration, it had received a miniscule sum of Rs. 34,563 as dividend income on the shares of seven companies which had been claimed as exempt under section 10(34) of the Act. The AO, however, disallowed an amount of Rs. 6,04,09,910 under section 14A of the Act. The findings of the AO are stated in para 16 of the assessment order which for the sake of convenience is extracted herein below:

> *"16. In view of the above, assessee's contention that no expenditure was incurred in respect if exempt income in rejected and expenses disallowable in this regard is computed as under as per procedure given in Rule 8D of the Income Tax Rule, 1962-*

Direct Expenditure Nil

b. Interest not attributable to any specific Income or receipt Rs. 4,86,05,050/-
(420383000x2360972000/20419946000)

c. *0.5% of average investment* *Rs. 1,18,04,860/-*
(2360972000x0.5%)

Total Expenses disallowable u/s 14A *Rs.6,04,09,910/-*

Thus an amount of Rs. 6,04,09,910/- is disallowed and added to the assessee's income computed under normal provisions as well as u/s 115JB of the Act. "

3. The Ld. AR submitted that no expenditure was incurred in respect of such income which was not includible in the total income and thus no expenditure as debited in the profit and loss account is disallowable under section 14A of the Act. It was also submitted that neither any direct expense was incurred nor any indirect expense was incurred by the assessee on the investments yielding dividend income. The Ld. AR drew our attention to a chart which shows the dividend income earned during the year. The chart is reproduced as under:-

S.No.	Name of the investment	Value of the investment (Rs	Dividend income (Rs.)
i.	Hindalco Industries Ltd.	21,000	3,320
ii.	Torrent Pharmaceuticals Ltd.	40,000	3,200
iii.	Reliance Industries Ltd.	1,000	750
iv.	Forbes Gokaka Ltd.	24,000	3,000
v.	Ultratech Cement Ltd.	99,000	735
vi.	Indo Gulf Fertilizers Ltd.	50,000	2,120
vii.	Larsen and Turbo Ltd.	99,000	21,437
	Total	3,34,000	34,562

4. The Ld. AR also submitted that none of the aforesaid shares were acquired by the assessee, instead such shares had been acquired by M/s Gujarat Bottling Company Private Limited ("GBCPL") which company was eventually amalgamated with the Appellant. It was submitted that aforesaid investments were acquired by GBCPL in the financial year 1995 out of their own funds. Subsequently, on December 20, 2002, the aforesaid company was amalgamated with Aradhana Beverages and Foods Company Private Limited ("ABFL") which in turn got amalgamated with the assessee. Thus, in pursuance of the amalgamation of GBCPL with ABFL and subsequent amalgamation of ABFL with the assessee, aforesaid investments are recorded in the books of the assessee. Thereafter, there has been no addition / deletion in these investments during the

subject AY. It was further submitted that by no stretch of imagination, it could be alleged that the assessee has either incurred expenditure or even could have incurred any expenditure in relation to such income which is not includible in the total income of the assessee. The Ld. AR also submitted that from the perusal of schedule 5 of the Audited Balance Sheet it would be seen that the assessee has also made investment of Rs. 2,37,79,77,000 in the shares of the subsidiaries and companies involved in the business of manufacture of soft drink beverage and Rs 1,00,000/- in the shares of other companies on which no dividend income was earned during the year.

5. The Ld. AR further submitted that while making the aforesaid disallowance, the Assessing Officer has held that in view of Rule 8D of the Rules, there is no onus on the AO to establish direct nexus between the exempted income and expenses. He submitted that the AO has made a general observation that the investment is not a mindless activity which does not involve expertise or use of a conscious mind. The AO has stated in the order that investments decisions are very important as well as complicated decision are taken only at the top level of management. In view of the aforesaid, the AO rejected

the claim of the assessee that no expenditure was incurred to earn the income which does not form part of the total income.

6. The Ld. AR submitted that on appeal, the Ld. CIT(A) granted partial relief to the assessee but upheld the disallowance made by the AO under rule 8D(2)(iii) of the Rules amounting to Rs 1,18,04,860. He submitted that the Ld. CIT (A) has grossly erred in firstly failing to appreciate that there was absolutely no basis to hold that the assessee had incurred any expenditure in relation to an income which was not includible in the total income. Secondly, Rule 8D (2)(iii) of the Rules had no application (in so far as the AY 2006-07 is concerned). Thirdly**,** no-income had been earned / received during the year on any investment made by the assessee . And fourthly**,** in fact no investment had been made by the assessee for the purpose of earning such income which was not includible in the total income, as all such investments (except Rs. 1,00,000 which is miniscule) were made by GBCPL on which dividend of Rs 34,562 had been received. It was submitted that the Ld. CIT (A) has erred in holding that any expenditure was disallowable when no such expenditure had been incurred. In fact, there was no nexus between the

expenditure incurred and investments made, more so when it is admitted fact that the assessee has not borrowed fund for making any investment in the subsidiaries. In this regard, reliance is placed on the decision of the Gujarat High Court in the case of CIT vs Gujarat Narmada Valley Fertilizers Co Ltd (Tax Appeal No 1151 of 2013), wherein it was held that no disallowance under section 14A of the Act is warranted if the dividend income is earned from the investments made in earlier years and no new investments were made during the year under consideration. It was further submitted that it is no more *res integra* that the provisions of rule 8D of the Income Tax Rules, 1962 are applicable from AY 2008-2009 onwards and disallowance cannot be made by applying the Rule 8D for the assessment years prior thereto as held in case of Maxopp Investment Ltd. vs. CIT (347 ITR 272) (Del). It is submitted that since the instant assessment year is AY 2006-07, as such, disallowance made of Rs 1,18,04,860 *per-se* is untenable and unsustainable in law. It was further submitted that before invoking the provisions of section 14A of the Act, the AO has to record a satisfaction vis a vis books of accounts of the assessee that expenditure debited in the books of the assessee are in

relation to the income which are exempt. It was submitted that in absence of such a satisfaction, provisions of section 14A of the Act cannot be invoked.

7. It was further submitted that so far as the assessee is concerned, it had made investment only of Rs. 100,000 in other shares (refer page 15 of the paper book), on which it has earned no dividend. It has earned dividend of Rs. 34,562 in respect of only such shares which were received by the assessee as a result of amalgamation of GBCPL. As stated above, all the remaining investments of Rs 237,79,77,000 has been made out of own funds (interest free) in the subsidiary companies and bottler companies and on such investments, no dividend income has been earned. It was submitted that since the aforesaid investments have not been made with an intention to earn dividend but have been made only to acquire the controlling interest in such companies as such, such investments were outside the purview of section 14A of the Act. Reliance was placed on the judgment of the Hon'ble Delhi High Court in the case of CIT vs Oriental Structural Engineers Pvt. Ltd (ITA No 605/2012), wherein investments made in the shares of

subsidiary companies out of commercial expediency was not taken into consideration for making the disallowance under section 14A of the Act. The Ld. AR also submitted that apart from the investment of Rs 3,34,000, on the remaining investment of Rs 237,80,77,000/- no dividend income has been earned and unless dividend income is earned, such investments cannot be considered for making the disallowance.

8. The Ld. AR also sought to place heavy reliance on the judgment in case of REI Agro Ltd vs DCIT (2014) (160 TTJ 107) (Kol) and affirmed by Hon'ble Calcutta High Court in GA 3022 of 2013 of ITAT 161 of 2013 in its judgment December 23, 2013 wherein even in respect of disallowance to be made under Rule 8D (2)(iii), it has been held as under:

> *"8. In respect of provisions of rule 8D (2)(iii), which is the subject-matter of the appeal in the assessee's hand, a perusal of the said provision shows that what is disallow able under rule 8D(2)(iii) is the amount equal to V2 percentage of the average value of investment the income from which does not or shall not form part of the total income. Thus, under sub-clause (iii), what is disallowed is V2 percentage of the numerator B in rule 8D (2)(ii).*
>
> *Again this is to be calculated in the same line as mentioned earlier in respect of Numerator B in rule 8D(2)(ii) of the Act.*

> *8.1 Thus, not all investments become the subject-matter of consideration when computing disallowance under section 14A read with rule 8D. The disallowance under section 14A read with rule 8D is to be in relation to the income which does not form part of the total income and this can be done only by taking into consideration the investment which has given rise to this income which does not form part of the total income. Under the circumstances, the computation of the disallowance under section 14A read with rule 8D(2)(iii), which is issue in the assessee's appeal, is restored to the file of A.O. for recomputation in line with the direction given above. No disallowance under section 14A read with rule 8D (2)(i) and (ii) can be made in this case. "*

9. The Ld. AR submitted that applying the said interpretation, it is evident that in so far as the AY 2006-07 is concerned, the disallowance sustainable could not exceed 0.5% of Rs. 3,34,000 i.e. Rs. 1,670 only. Alternatively, it was submitted that the dividend income (exempt income) earned during the year was only Rs. 34,562/- and the disallowance in any case could not have exceeded the exempt income. It was the submission of the Ld. AR that the disallowance sustained by the CIT (A) deserves to be deleted both while computing the total income and the book profit u/s 115JB of the Act.

10. The Ld. DR relied on the order of the AO and the findings of the Ld. CIT (A).

11. We have heard the rival submissions and carefully perused the relevant material placed on record. Before we proceed to adjudicate the issue at hand, it will be worthwhile to refer to the judgment of the Hon'ble Delhi High Court in the case of Maxopp Investment Ltd. vs CIT 347 ITR 272 (Del) wherein the Hon'ble High Court has discussed the entire controversy surrounding the retrospective application of sub-sections (2) and (3) of section 14A and Rule 8D. Paragraphs 32 to 42 of the High Court judgment lay down the entire law and they are reproduced under for a ready reference:-

> *"32. While examining the legislative history of Section 14A and Rule 8D, we have already noted that Section 14A, as introduced by virtue of the Finance Act, 2001, was with retrospective effect from 01.04.1962. The proviso was inserted by virtue of the Finance Act, 2002 and it was made clear that nothing in Section 14A empowered the Assessing Officer to either re-assess under Section 147 or pass an order enhancing the assessment or reducing the refund already made or otherwise increasing the liability of the assessee under Section 154, for any assessment year beginning on or before the first day of April, 2001. Thus, in respect of all the assessment years prior to the assessment year beginning on or before the 1st day of April, 2001, concluded*

assessments could not be disturbed despite the fact that Section 14A had been expressly made retrospective with effect from 01.04.1962. The provisions of Section 14A, which were retrospective with effect from 01.04.1962 are now encapsulated in sub-section (1) of Section 14A. It is also clear that sub-sections (2) and (3) of Section 14A were introduced subsequently by virtue of the Finance Act, 2006 and were introduced with effect from 01.04.2007. However, although sub-sections (2) and (3) had been introduced with effect from 01.04.2007, they remained empty shells inasmuch as the expression "such method as may be prescribed" got meaning only by the introduction of Rule 8D by virtue of the Income-tax (Fifth Amendment) Rules, 2008 which was notified by the Central Board of Direct Taxes by its notification No.45/2008 dated 24/03/2008.

33. Dr Rakesh Gupta, the learned counsel, who had appeared for some of the assessees, submitted that Section 295 of the said Act empowered the Central Board of Direct Taxes to make rules for the whole or any part of India for carrying out the purpose of the said Act. He referred to sub-section (4) of Section 295 and submitted that the power to make rules conferred on the Central Board of Direct Taxes included the power to give retrospective effect, from a date not earlier than the date of the commencement of the said Act, to the rules or any of them and, unless the contrary was permitted (whether expressly or by necessary implication), no retrospective effect was to be given to any rule so as to prejudicially affect the interests of the assessees. He further submitted that Rule 8D was inserted in the said rules, but the Central Board of Direct Taxes did not make it retrospective. He submitted that whenever the CBDT felt it necessary to introduce a rule with retrospective effect, it did so by making the rule expressly retrospective. As an

example, he referred to Rule 1 1EA which was inserted by the Income-tax (Ninth Amendment) Rules, 1997 with retrospective effect, from 01/10/1994.

34. On the other hand, it was contended on behalf of the revenue and, particularly, by Mr Sanjeev Sabharwal that since Section 14A was introduced with retrospective effect from 01.04.1962, the principles of Section 14A would have to be considered as having always been a part of the said Act and, therefore, sub-sections (2) and (3) of Section 14 A and Rule 8D of the said Rules were only machinery provisions and ought to be read retrospectively so as to give meaning to Section 14A(1).

35. We are of the view that Rule 8D would operate prospectively. We agree with the submissions made by Dr Rakesh Gupta that if the said Rule were to have retrospective effect, nothing prevented the Central Board of Direct Taxes from saying so, particularly, in view of the fact that it had the power to make a rule retrospective by virtue of Section 295(4) of the said Act. Instead of making Rule 8D retrospective, clause 1(2) of the Income-tax (Fifth Amendment) Rules, 2008 made it clear that the rules would come into force from the date of their publication in the Official Gazette. It is, therefore, clear that Rule 8D, which was introduced by virtue of the Notification No.45/2008 dated 24.03.2008, was prospective in operation and cannot be regarded as being retrospective. We may also point out that we have had the benefit of the decision of the Bombay High Court in Godrej and Boyce Mfg. Co. Ltd v DCIT: (2010) 328 ITR 81 (Bom), wherein it has, inter alia, been held that the provisions of Rule 8D of the said Rules has prospective effect and shall apply with effect from assessment year 2008-09 onwards.

36. Insofar as sub-sections (2) and (3) of Section 14A are concerned, they have also been introduced by virtue of the Finance Act, 2006 with effect from 01.04.2007.

This is apparent, first of all, from the Notes on Clauses of the Finance Bill, 2006 [Reported in 281 ITR (ST) at pages 139-140]. The said Notes on Clauses refers to clause 7 of the Bill which had sought to amend Section 14A of the said Act. It is specifically mentioned in the said Notes on Clauses that:-

"This amendment will take effect from 1st April, 2007 and will, accordingly, apply in relation to the assessment year 2007-08 and subsequent years."

37. Furthermore, in the Memorandum explaining the provisions in the Finance Bill, 2006 [281 ITR (ST) at pages 281-281], it is once again stated with reference to clause 7 which pertains to the amendment to Section 14A of the said Act that:- "This amendment will take effect from 1st April, 2007 and will, accordingly, apply in relation to the assessment year 2007-08 and subsequent years."

38. We may also refer to the CBDT Circular No.14/2006 dated 28.12.2006 and to paragraphs 11 to 11.3 thereof. Paragraph 11 dealt with the method for allocating expenditure in relation to exempt income and paragraphs 11.1 and 11.2 explained the basis and logic behind the introduction of sub-section (2) of Section 14A of the said Act. Paragraph 11.3 specifically provided for applicability of the provisions of subsection (2) and it clearly indicated that it would be applicable "from the assessment year 2007-08 onwards".

39. It is, therefore, clear that sub-sections (2) and (3) of Section 14A were introduced with prospective effect from the assessment year 2007-

08 onwards. However, sub-section (2) of Section 14A remained an empty shell until the introduction of Rule 8D on 24.03.2008 which gave content to the expression "such method as may be prescribed" appearing in Section 14A(2) of the said Act.

40. From the above discussion, it is clear that, in effect, the provisions of subsections (2) and (3) of Section 14A would be workable only with effect from the date of introduction of Rule 8D. This is so because prior to that date, there was no prescribed method and sub-sections (2) and (3) of Section 14A remained unworkable.

41. Sub-section (2) of section 14A, as we have seen, stipulates that the Assessing Officer shall determine the amount of expenditure incurred in relation to income which does not form part of the total income "in accordance with such method as may be prescribed". Of course, this determination can only be undertaken if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. This part of section 14A(2) which explicitly requires the fulfillment of a condition precedent is also implicit in section 14A(1) [as it now stands] as also in its initial avatar as section 14A. It is only the prescription with regard to the method of determining such expenditure which is new and which will operate prospectively. In other words, section 14A, even prior to the introduction of sub-sections (2) & (3) would require the assessing officer to first reject the claim of the assessee with regard to the extent of such expenditure and such rejection must be for disclosed cogent reasons. It is then that the question of determination of such expenditure by the assessing officer would arise. The requirement of adopting a specific method of determining such expenditure has been introduced by virtue of sub-section (2) of section

14A. Prior to that, the assessing was free to adopt any reasonable and acceptable method.

42. Thus, the fact that we have held that sub-sections (2) & (3) of section 14A and Rule 8D would operate prospectively (and, not retrospectively) does not mean that the assessing officer is not to satisfy himself with the correctness of the claim of the assessee with regard to such expenditure. If he is satisfied that the assessee has correctly reflected the amount of such expenditure, he has to do nothing further. On the other hand, if he is satisfied on an objective analysis and for cogent reasons that the amount of such expenditure as claimed by the assessee is not correct, h he is required to determine the amount of such expenditure on the basis of a reasonable and acceptable method of apportionment. It would be appropriate to recall the words of the Supreme Court in Walfort (supra) to the following effect:-

> *"The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14A."*

So, even for the pre-Rule 8D period, whenever the issue of section 14A arises before an Assessing Officer, he has, first of all, to ascertain the correctness of the claim of the assessee in respect of the expenditure incurred in relation to income which does not form part of the total income under the said Act. Even where the assessee claims that no expenditure has been incurred in relation to income which does not form part of total income, the assessing officer will have to verify the correctness of such claim. In case, the assessing officer is satisfied with the claim of the assessee with regard to the expenditure or no expenditure, as the case may be, the assessing officer is to accept the claim of the assessee insofar as the

> *quantum of disallowance under section 14A is concerned. In such eventuality, the assessing officer cannot embark upon a determination of the amount of expenditure for the purposes of section14A(1). In case, the assessing officer is not, on the basis of objective criteria and after giving the assessee a reasonable opportunity, satisfied with the correctness of the claim of the assessee, he shall have to reject the claim and state the reasons for doing so. Having done so, the assessing officer will have to determine the amount of expenditure incurred in relation to income which does not form part of the total income under the said Act. He is required to do so on the basis of a reasonable and acceptable method of apportionment."*

12. Coming to the facts of the instant appeal, it is seen that the year under consideration is assessment year 2006-07. Rule 8D was introduced by virtue of notification no.45/2008 dated 24.03.2008 and the Hon'ble Delhi High Court has held it to be prospective in operation in the case of Maxopp Investment Ltd. vs CIT (supra). The Assessing Officer calculated the disallowance u/s 14A by adopting the procedure given in Rule 8D and also made a similar disallowance while computing book profits u/s 115JB of the Act. The Ld. CIT (A) restricted the disallowance both under Rule 8D and u/s 115JB to Rs. 1,18,04,860/-. It is the assessee's plea that the dividend income (exempt income) earned during the year was only Rs. 34,562/- and the disallowance in any case could not have exceeded the exempt

income. We are in total agreement with the contention of the Ld. AR that Rule 8D could not have been applied in assessment year 2006-07. We also concur with the contention of the Ld. AR that the disallowance in any case cannot exceed the exempt income. Therefore, on the facts of the case and respectfully following the ratio laid down by the Hon'ble Delhi High Court in Maxopp Investment Ltd. vs. CIT (supra), we set aside the order of the Ld. CIT (A) and direct the Assessing Officer to re-compute the disallowance restricting it to the amount of dividend earned during the year. The issue is restored to the file of the Assessing Officer for the limited purpose of verification of the dividend income earned by the assessee during the year.

13. In the result, the appeal of the assessee is allowed.

Order pronounced in the Open Court on 2nd June, 2016.

Sd/-	**Sd/-**
(G.D. AGRAWAL)	**(SUDHANSHU SRIVASTAVA)**
VICE PRESIDENT	**JUDICIAL MEMBER**

Dated: the 2nd June 2016
'GS'

Copy forwarded to: -

1. Appellant
2. Respondent
3. CIT 4. CIT(A)
4. DR, ITAT

By Order

ASSTT. REGISTRAR