

**IN THE INCOME TAX APPELLATE TRIBUNAL
DIVISION BENCH 'A', CHANDIGARH**

BEFORE SHRI SANJAY GARG, JUDICIAL MEMBER
AND MS. ANNAPURNA GUPTA, ACCOUNTANT MEMBER

ITA No.15/Chd/2017
(Assessment Year : 2012-13)

M/s Ludhiana Stock Exchange Ltd., Ludhiana.	Vs.	The A.C.I.T., Circle-7, Ludhiana.
PAN: AAAC5495M (Appellant)		(Respondent)

Appellant by :	Shri Sudhir Sehgal	
Respondent by :	Shri Sandeep Dahiya, CIT DR	
Date of hearing	:25.07.2017	
Date of Pronouncement	:17.10.2017	

ORDER

PER ANNAPURNA GUPTA, A.M.:

This appeal filed by the assessee is directed against the order of learned Commissioner of Income Tax(Appeals)-4, Ludhiana dated 7.4.2015 relating to assessment year 2012-13.

2. The only issue in the present appeal pertains to the disallowance made u/s 14A amounting to Rs.3,13,578/-.

3. Briefly stated, the assessee company is engaged in the business of promotion of regulation of trade of stocks and shares. Assessment u/s 143(3) was framed for the impugned assessment year making disallowance u/s 14A of the Act r.w.r. 8D on account of expenses amounting to Rs. 3,13,578/-incurred for earning exempt income in relation to investments made in equity instruments of the subsidiary

company of the assessee i.e. LSE Securities Limited to the extent of Rs.3,45,17,625/-. The same was upheld by the Ld.CIT(Appeals).

4. Aggrieved against which the assessee has filed present appeal before us raising the following grounds:

1. *That the Ld. CIT (A) has erred in confirming the order of the Assessing Officer in sustaining the addition of Rs. 3,13,578/- by invoking the provisions of section 14A because of the following facts:-*
 - i). *That no specific satisfaction has been recorded by the Assessing Officer with regard to disallowance made u/s 14A since the Assessing Officer has not recorded any reason for rejecting the claim of assessee and, as such, no disallowance could have made as per the binding judgment of Jurisdictional Hon'ble Punjab & High Court in the case of CIT Vs Kapson Associates as reported in 381 ITR 204.*
 - ii). *That the investment made by the assessee was statutory requirement of the Govt. and being strategic investment, no disallowance could be made u/s 14A since such investments are attributable to commercial expediency.*
 - iii). *That the assessee had sufficient interest free funds in the shape of 'Reserves and Surplus' and share capital and, thus, no borrowed funds having been utilized for the purpose of making the investment and, as such, no disallowance u/s 14A was required to be made.*
2. *Without prejudice to above, the Ld. CIT(A) has erred in stating that interest paid on member's security amounting to Rs.11,80,000/- should be considered for the purpose of the disallowance under Section 14A read with sub rule(2)ofRule8Donthecontention that the appellant had mixed funds and it could not be ascertained that which funds have been used for which purpose. The finding of the CIT (A) in this regard is not sustainable.*

5. During the course of hearing before us, learned counsel for the assessee challenged the disallowance made on several counts as under:

- 1) Absence of satisfaction recorded by the Assessing Officer of the incorrectness of the claim of the

assessee that no expenditure was incurred vis-à-vis these investments.

2) That in any case the entire investments were made out of own interest free funds of the assessee and no interest bearing funds has been used. Therefore no disallowance on interest expenditure could be made.

3) With prejudice to the above, the interest paid on securities received from members could not have been considered for the purpose of disallowance since the securities were required to be and were also kept in FDRs and thus no question arose of having used them for the purpose of the impugned investment.

4) That the said investments were strategic investments and, therefore no disallowance u/s 14A was warranted.

6. We shall be taking up each contention of the assessee one by one. Coming to the first contention that the disallowance u/s 14A could not have been made in the absence of any satisfaction recorded by the Assessing Officer vis-à-vis the incorrectness of the claim of the assessee that no expenditure had been incurred vis-à-vis the impugned investment, Ld. Counsel for the assessee drew our attention first to the claim made by the assessee before the Assessing Officer that no expenditure had been

incurred by the assessee vis-à-vis these investments, reproduced at page 6 of the order as under:

“In view of the above, it is submitted that, no direct expenditure was incurred by the assessee and no borrowed funds was utilized for the purpose of investing in equity shares. As a result, no expenditure on account of interest payment can be said to have been incurred for the purpose of earning tax free income. The entire investments, the income from which would not form part of the total income under the Act, have been made out of internal accrual without having incurred any interest expenditure during the year.

However, the amount of dividend received is directly credited to the account of Company through e-banking. Therefore, no direct or indirect expenditure has been incurred by the assessee and therefore no disallowance under section 14A applicable to the company.

In view thereof, the applicability of Rule 8D does not arise in the case of the assessee.

Further, Hon'ble Supreme Court in case of CIT vs. Walfort Share & Stock Brokers P. Ltd. (2010) 192 Taxmann 211 held that for the purpose of invoking the provision of section 14A of the Act, there has to be a proximate cause of the expenditure with the exempt income. In the absence of the proximate cause for disallowance, the provision of section 14A cannot be invoked.

In the case of High Court of Punjab & Haryana (Commissioner of Income Tax, Jalandhar) Vs Deepak Mittal, (Section 14A of the Income Tax Act, 1961, read with rule 8D of the Income Tax Rules, 1962-Expenditure incurred in relation to income not includible in total income [Dividend income]-Assessment year 2007-08) – Assessee had earned dividend income and consistent case of assessee was that he had not made any expenditure on earning such income. However. Assessment proceedings disagreeing with the plea pf assessee held that interest bearing funds had been invested for generating dividend income and had made an addition by making disallowance under section 14A, read with rule 8D. Whether since Assessing Officer instead of proceeding to collect material or evidence to determine expenditure incurred by

assessee, relied upon rule 8D and applied it as a formula, disallowance was to be deleted. Held, yes [Para 9] (in favour of assessee).”s

7. Thereafter our attention was drawn to the order of the Assessing Officer where purportedly satisfaction of the incorrectness of the claim of the assessee was recorded by the Assessing Officer at para 2.4 as under:

2.4 In view of the observations above and having regard to the accounts of the assessee I am not satisfied with the correctness of the claim of expenditure made by the assessee in relation to the income which does not form part of the total income under the act for the previous year. The method adopted by assessee cannot be accepted because it has been worked upon administrative expenses only on proportionate basis and a part of interest paid only. However, the expression of 'expenditure incurred' in section 14A of the I.T. Act refers to other expenditures also including rent, taxes, salaries interest etc. which cannot be apportioned unless Rule 8D is applied. Hence the amount of expenditure in relation to such income is required to be determined in accordance with the provisions of sub-rule 2 of rule 8D of the I.T. Rules.

8. Ld. Counsel for the assessee pointed out that the Assessing Officer had summarily dismissed the claim of the assessee and no objective satisfaction was recorded having regard to the accounts of the assessee that expenses in relation to the impugned investments had been incurred by the assessee. Ld counsel for the assessee pointed that the Assessing Officer had merely harped on the method adopted by the assessee being not acceptable since it worked only on the administrative expenses and part of interest only and further referred that other expenses also had to be included. Ld counsel for the assessee pointed that firstly

no working or calculation was submitted to the AO at all and therefore the observations of the AO in this regard were without any basis. Further Ld.Counsel stated that clearly nowhere in the satisfaction recorded, the Assessing Officer has mentioned as to why the claim of the assessee that since no borrowed funds were used for making the investments no interest expenditure was to be disallowed or since the dividend received is directly credited to the account of the assessee no expenses are incurred for the purpose of earning dividend income, was incorrect. Ld counsel for the assessee pointed out that no reference to the expenditure debited in the books of accounts of the assessee has been made by the AO pointing out that such expenditure could be said to have been incurred for the purpose of earning exempt income from the impugned investment for objective reasons. Ld. counsel for the assessee therefore stated that the satisfaction recorded by the Assessing Officer could not said to be an objective satisfaction. Ld counsel for the assessee relied on number of judicial decisions in this regard as under:

- 1) CIT Vs. Kapsons Associates,(2016) 381 ITR 204(P&H)
- 2) Ganeshay Overseas Industries Ltd. Vs. DCIT, ITA No.186/Chd/2015 dated 19.10.2015
- 3) DCIT Vs. Loil Healthfood, ITA No.235/Chd/2015 dated 09.09.2015

9. The Ld DR, on the other hand, stated that due satisfaction had been recorded by the AO as pointed out by the Ld.Counsel for the assessee at para 2.4 of the assessment order and the case laws relied upon by the assessee were not applicable in the facts of the present case.

10. We have heard both the parties vis-à-vis the contention relating to satisfaction of the AO with regard to the incorrectness of the claim of the assessee that no expenses were incurred for the purpose of making the impugned investments. There is no dispute vis-a-vis the proposition of law that before making disallowance u/s 14A the Assessing Officer has to first of all record that having regard to the accounts of the assessee he is not satisfied with the correctness of the claim of the assessee in respect of expenditure incurred in relation to income which does not form part of total income under the Act. The Hon'ble Punjab & Haryana High Court in a latest decision in Punjab Tractors Ltd. vs. Commissioner of Income Tax reported in 78 taxmann.com 65 while answering the question framed before it whether it is necessary for the Assessing Officer to record his reasons for not being satisfied with the correctness of the claim of the assessee, answered in the affirmative stating that the matter stood concluded in view of the judgement of the jurisdictional High Court in the

case of Abhishek Industries. The Hon'ble High Court held as under:

"The next question is as to whether it is necessary for the Assessing Officer to record his reasons for not being satisfied with the correctness of the assessee's claim.

19. It is mandatory for the Assessing Officer to record that having regard to the accounts of the assessee he 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 the Act or that he is not satisfied with the assessee's claim that no expenditure had been incurred by him in relation to the income which does not form part of the total income under the Act.

20. The matter stands concluded by a judgment of this Court dated 27.01.2015 in Commissioner of Income Tax-1, Ludhiana v. M/s Abhishek Industries Ltd. Ludhiana, ITA No. 320 of 2013, where the Division Bench held:-

"Section 14A of the Act requires the Assessing Officer to record satisfaction that interest bearing funds have been used to earn tax free income. The satisfaction to be recorded must be based upon credible and relevant evidence....."

21. The judgment in Maxopp Investment Ltd. (supra) also supports this view namely that the Assessing Officer must record reasons for not being satisfied with the correctness of the assessee's contentions with regard to the aspects mentioned in sub sections (2) and (3) of Section 14A. It is true that the Delhi High Court merely states that such rejection must be for disclosed cogent reasons. The disclosure, however, can only be in writing. It can hardly be suggested that the disclosure remains in the Assessing Officer's mind. The assessee is entitled to test the basis of the rejection of his contentions. This can be done only if the Assessing Officer records his reasons for his not being satisfied in writing."

11. Having said so, while applying the above proposition to the facts of the present case as pointed out before us and as is evident from a perusal of the order of the Assessing Officer placed before us we find that the assessee had contended before the Assessing Officer that no expenses either in the nature of interest or other had been incurred

by the assessee in relation to the said investment. Reasons for claiming so had also been given by the assessee stating that own funds had been used for making the investments and since dividend is directly credited through e-banking no other expenditure is also incurred. The Assessing Officer, we find, rejected the claim of the assessee though purportedly on the basis of the books of account of the assessee but no objective reasons for rejecting the said claim is found. The Assessing Officer, as rightly pointed out by the Ld.counsel for the assessee has simply summarily dismissed the claim of the assessee without specifically dealing with the contention of the assessee in the context of the books of account of the assessee. The AO we find while dismissing the claim of the assessee has stated that the method adopted by the assessee cannot be accepted, which the Ld.Counsel pointed out was incorrect since no calculation was done by the assessee at all. This contention has not been controverted by the Revenue by pointing out any such calculation submitted by the assessee. Therefore, we hold that the Assessing Officer has proceeded to make the disallowance without recording any satisfaction about the incorrectness of the claim of the assessee and thus the disallowance so made is liable to be quashed for this reasons alone in view of the judicial precedent in this regard cited above.

12. The next contention raised by the Ld. Counsel for the assessee was that no interest bearing funds were utilized by

the assessed for making investments in the equity shares of M/s LSE Securities Limited and, therefore, no disallowance on account of interest was called for. In this regard, ld counsel for the assessee drew our attention to the detail filed before the CIT (Appeals) reflecting the fact that no borrowed funds were utilized whenever investments in shares of MN/s LSE Securities Ltd. was made in different years, reproduced at page 10 of the CIT (Appeals) order. Ld counsel for the assessee pointed out that the aforesaid fact was substantiated from the balance sheet and profit and loss account for the above mentioned years which was also filed before the CIT (Appeals). Ld counsel further stated that it was also demonstrated before the CIT (Appeals) that in all the relevant years when the investment was made the assessee had sufficient own funds for making the investments. Attention was drawn to the detail tabulating the said facts reproduced at para 11 of the CIT (Appeals) order as under:

<i>Financial Year</i>	<i>No. of shares purchased/ (sold)</i>	<i>Borrowed funds as on 1st of April</i>	<i>Borrowed funds as on 31st of March</i>	<i>Remarks</i>
<i>1999-00</i>	<i>27,01,000</i>	<i>2004359</i>	<i>NIL</i>	<i>This was a working capital loan that Was fully repaid on 13.04.1999</i>
<i>2000-01</i>	<i>13,00,000</i>	<i>NIL</i>	<i>NIL</i>	<i>No loan Was outstanding during the</i>

				<i>year</i>
2001-02	(1421,300)	NIL	92,30,450	<i>This was secured loan from Centurion Bank</i>
2004-05	5,10,000	NIL	NIL	<i>No loan Was outstanding during the Year</i>
2009-10	2,41,375	NIL	NIL	<i>No loan Was outstanding during the year</i>

<i>Year</i>	<i>Amount of investment</i>	<i>Cash from operations</i>	<i>Own funds in the beginning of the year</i>
1999-00	2,70,10,000/-	3,64,78,027	12,70,60,836
2000-01	2,16,25,000/-	41608113	13,87,44,036
2004-05	51,00,000/-	91,71,215	15,38,35,753
2009-10	36,20,625/-	1,08,53,140	17,58,76,643

13. Ld counsel stated that it was clearly evident from the above that no borrowed funds had been used for making the investments and that the same had been made entirely out of own funds of the assessee and, therefore, no disallowance of interest expenditure could be made u/s 14A. Reliance was placed on a number of decisions of High Courts in this regard:

- 1) CIT Vs. HDFC Bank Ltd.(2014) 366 ITR 505(Bom)
- 2) CIT Vs. Reliance Utilities & Power Ltd.(2009) 313 ITR 340(Bom)

3) CIT VS. Max India Ltd., ITA No.210/Chd/2013
dt.08-03-2017

14. Ld. DR on the other hand relied upon the order the CIT (Appeals) stating that in view of availability of mixed funds the disallowance was warranted.

15. Having heard the contentions of both the parties, we find merit in the contentions of the ld counsel for the assessee. We find that the assessee had duly demonstrated the fact that the investments made in various years was not out of borrowed funds and having demonstrated the availability of enough own funds the assessee had also duly demonstrated that there were sufficient own interest free funds for making the impugned investments. Therefore, there was no reason for making any disallowance of interest. The reliance placed by the ld counsel for the assessee on the decision of the Jurisdictional High Court in the case of Max India Ltd. (supra) is apt wherein it has been held that if an assessee establishes that its interest free funds were equal to or more than the interest bearing funds it would be open to it to contend that presumption arises that the expenditure for earning interest income was incurred from out of its interest free funds. The relevant findings of the Hon'ble High Court are as under:

"9. This presumption is unfounded. Merely because the interest free funds with the assessee have decreased during any period, it does not follow that the funds borrowed on interest were utilized for the purpose of investing in assets yielding exempt income. If even after the decrease the assessee has interest free funds sufficient to make the investment in assets yielding the exempt income, the presumption that it was such funds that were utilized for the said investment remains. There is no reason for it not to. The basis of the presumption as we will elaborate later is that an assessee would invest its

funds to its advantage. It gains nothing by investing interest free funds towards other assets merely on account of the interest free funds having decreased. In that event so long as even after the decrease thereof there are sufficient interest free funds the presumption that they would be first used to invest in assets yielding exempt income applies with equal force."

16. In view of the above we hold that in any case no disallowance of interest expenditure u/s 14A was liable in the present case and the same needs to be deleted.

17. The next contention raised by the ld counsel for the assessee was that the entire investments were strategic investments and the sole objective of the investment was not to earn dividend or capital gain on sale of such share but to provide trading platform to the general public. Ld counsel for the assessee drew our attention to the detailed submissions made before the lower authorities reproduced at page Nos.17 and 18 of the CIT(Appeals) as under:

- *After the scam in stock market in year 1994 and formation of regulatory i.e. Securities and Exchange Board of India, the regulatory decided to discourage the functioning of regional stock exchanges in India and promoted a national level of stock exchange i.e. National stock exchange.*
- *Later on, it was felt by the regulatory that it was difficult to control and regulate the functions. Then the question arose as to what the members of regional stock exchanges would do in case of closure of stock exchanges and how to provide a trading platform to the investing public in the remote areas.*

To solve this issue, a meeting of a group on revival of small stock exchanges was held on 8th September 1999, to discuss the suggestions/ revival plans forwarded by small exchanges for their revival. The group considered the suggestion/ revival plans submitted by small exchanges and recommended that small exchanges may be permitted to promote a subsidiary which can acquire membership rights of larger stock exchanges viz. NSE/BSE/CSEADSE' or any other exchange subject to usual conditions applicable to the other members. Thereafter, a circular no. SMD-II/policy/CIR-37/99 dated 26.11.1999 was passed, wherein it was held that the small stock exchanges may promote/ float a subsidiary company to acquire membership rights of other stock exchanges subject to

certain conditions. Copy of the said circular is enclosed on pages 76 of the paper book.

- *Out of the said conditions, one condition was that the subsidiary company shall be 100% owned by the stock exchange promoting/ floating such a subsidiary/company.*
- *Further, a consequential amendment was made under Rule 17C of the Income tax rules to include the said kind of investments in the forms or mode of investment or deposit by a charitable or religious trust or institution, as specified in the said rule, to claim exemption under section 11 of the Act. The relevant clause of Rule 17C is mentioned below:*

Rule 17C: The forms and modes of investment or deposits under clause (xii) of sub-section (5) of section 11 shall be the following, namely:

A. which is engaged in dealing with securities or mainly associated with the securities market;

B, whose main object is to acquire the membership of another recognised stock exchange for the sole purpose of facilitating the members of the investor to trade on the said stock exchange through the investee in accordance with the directions or guidelines issued under the Securities and Exchange Board of India Act, 1992 (15 of 1992) by the Securities and Exchange Board of India established under section 3 of that Act; and

C. in which at least fifty-one per cent of equity shares are held by the investor and the balance equity shares are held by members of such investor;

- *On the basis of the above legal and factual submissions, it is submitted before your goodself that the investment made by the appellant in the equity shares of its subsidiary company i.e. LSE securities Ltd was not made for the purpose of earning dividend or profit on sale of such shares but for the purpose of creating a subsidiary company to provide a trading platform to the investing public in the remote areas i.e. the said investment was made to promote the objective of promotion of stock and shares.. Therefore, the provisions of Section 14A are not applicable in case of the appellant. In this regard, the appellant places reliance on the following judicial pronouncements:*

18. It was therefore contended that the said investment being strategic in nature no disallowance u/s 14A was warranted. Reliance was placed on the decision of the Delhi High Court in the case of CIT Vs. Oriental Structural Pvt. Ltd. in ITA No.605/2012 dated 15.1.2013.

19. Ld.DR, on the other hand, relied upon the orders of the lower authorities and stated that no differentiation on

account of strategic investments or otherwise was permissible for the purpose of applicability of section 14A.

20. Having heard both the parties, we agree with the ld counsel for the assessee. Undoubtedly and undisputedly, the investment made in share of LSE Securities Ltd. was for the purpose of facilitating and providing a trading platform to the general public by creating a subsidiary company. Having said so, the commercial expediency of making the impugned investment stands established and the interest expenditure incurred thereon cannot therefore be held to be for any non business purpose so as to warrant disallowance of the same u/s 14A of the Act. Reliance placed by ld. counsel for the assessee on the decision of the Delhi High Court in the case of Oriental Structural Engineers Pvt. is apt wherein it has been categorically held that the investment being attributable to commercial expedience, expenses incurred in relation to the same cannot be termed to have been incurred for earning exempt income. We, therefore, hold that since the investments were strategic investments no disallowance could be made u/s 14A of the Act.

21. In view of the above, we, therefore, set aside the order of the Ld. CIT(Appeals) and direct that the disallowance made u/s 14A be deleted. Ground of appeal No.1 raised by the assessee, therefore, stands allowed.

22. In ground No.2 the assessee has contested the inclusion of funds pertaining to members security amounting to Rs.11,80,000/- received by the assessee for

the purpose of calculating the interest expenses disallowable u/s 14A. Since in ground No.1 we have deleted the entire disallowance made u/s 14A including the interest component, the said ground becomes infructuous and need not be adjudicated upon.

23. In the result, the appeal of the assessee is, therefore, allowed in above terms.

Order pronounced in the open court.

Sd/-

(SANJAY GARG)
JUDICIAL MEMBER

Sd/-

(ANNAPURNA GUPTA)
ACCOUNTANT MEMBER

Dated : 17th October, 2017

Rati

Copy to:

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

Assistant Registrar,
ITAT, Chandigarh