IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SHRI KESHAV DUBEY, JUDICIAL MEMBER

ITA No. 527/Bang/2024
Assessment Year : 2018-19

M/s. Plaza Agencies Pvt. Ltd. # 41, Mantri House, Vittal Mallya Road, Bengaluru – 560 001. **PAN: AACCP0589Q**	**Vs.**	The Deputy Commissioner of Income Tax, Circle – 3[1][1], Bangalore.
APPELLANT		**RESPONDENT**

Assessee by	:	Ms. Sunaina Bhatia, Advocate
Revenue by	:	Shri V. Parithivel, JCIT-DR

Date of Hearing	:	07-05-2024
Date of Pronouncement	:	05-07-2024

ORDER

PER KESHAV DUBEY, JUDICIAL MEMBER

This appeal at the instance of the assessee is directed against the CIT(A)/NFAC order dated 22.02.2024 vide DIN & Order No. ITBA/NFAC/S/250/2023-24/1061309577(1) passed u/s. 250 of the IT Act, 1961 for the A.Y. 2018-19.

2. The assessee has raised the following grounds-

> *"1. The orders of the authorities below in so far as they are against the appellant are opposed to law, equity, weight of*

evidence, probabilities, facts and circumstances of the case.

2. The learned CIT [A] is not justified in upholding the order of assessment passed u/s 143(3) of the Act dated 29/03/2021, which is bad in law and is void ab initio in as much as the assessment order has been passed contrary to the procedure prescribed under the Faceless Assessment Scheme as no draft assessment order was issued calling for objections of the appellant and, thus impugned order passed contrary to "Faceless Assessment Scheme, 2019" deserves to be annulled.

3. Without prejudice to the above, the learned CIT[A] is not justified in upholding the disallowance of Rs. 1,32,40,428/- made u/s.14A of the Act, which is opposed to law and facts of the appellant's case in as much as the appellant has not earned any exempt income during the year and therefore, the disallowance made deserves to be deleted.

4. For the above and other grounds that may be urged at the time of hearing of the appeal, your appellant humbly prays that the appeal may be allowed and Justice rendered and the appellant may be awarded costs in prosecuting the appeal and also order for the refund of the institution fees as part of the costs."

3. The brief facts of the case are that the assessee being a private limited company engaged in business filed its return of income for the A.Y. 2018-19 on 31.10.2018 declaring a loss of Rs.9,35,81,944/-. The Audited financial Statement along with Audit Report in Form 3CA & 3CD were also filed. The case of the assessee company was selected for scrutiny under CASS for the reasons :-

1) Business Loss
2) Ind-AS Compliance and Adjustment
3) Expenses incurred for earning exempt income

4. Thereafter after considering the details/particulars furnished as well as reply to show cause, the Assessing Officer (AO) completed the assessment u/s. 143(3) r.w.s 143(3A) & 143(3B) of IT Act, 1961 on 10.03.2021 by making the sole disallowance of Rs.1,32,40,428/- u/s. 14A r.w. Rule 8D(ii) resulting in assessed total loss of Rs.8,03,41,516/-.

5. Aggrieved by the disallowance made by the AO in the Assessment Order dated 10/03/2021, the assessee preferred an appeal before the Ld. CIT(A)/NFAC.

6. The Ld.CIT(A) dismissed the appeal on the opinion that AO has rightly disallowed Rs.1,32,40,428/- as explained u/s. 14A r.w.Rule 8D(ii) of the act with the following observations summarised as below-

1) AO in the impugned assessment order had very much recorded his specific satisfaction before invoking the provision of section 14A giving detailed and specific reasons for the same and established the requisite reasonable nexus between the expenditure disallowed and the earning of the exempt income in question as per the judgment of the Hon'ble Supreme Court in the case of Godrej & Boyce Manufacturing Co. Ltd. Vs DCIT reported in 394 ITR 449 referred by the appellant.
2) With regard to the alternative claim of the appellant that the amount of disallowance cannot exceed the amount of exempt income, the Ld.CIT(A) observed that to address

potential conflicts arising due to conflicting judicial interpretations, the Finance Act of 2022 effective from 01.04.2022 introduced a crucial clarificatory amendment by inserting **explanation to section 14A** clarifying that the disallowance u/s. 14A shall be applicable even where no exempt income is earned during the year. The explanation uses the phrase "and shall be deemed to have always applied in a case" which makes it clear that provisions of amended section 14A apply to case of assessment year 2018-19 under consideration in the present appeal also.

3) The Ld.CIT(A) also of the opinion that in view of the CBDT Circular 05/2014 dated 11.02.2014 which also brings out the legislative intent that section 14A shall be operative even when there is no exempt income earned in a particular year.

4) Further, with regard to appellant's alternative argument that no exempt income was earned in the relevant year from some of the investments in debentures and bonds, the Ld.CIT(A) was of the view that though some of the investment might not have yielded any exempt income during the year under consideration but as these investment by their very nature are capable of yielding exempt income in future which is not "includable" in total income, these investment have to be reckoned for the purpose of computing the amount of disallowance u/s. 14A as the disallowance u/s. 14A is not related to the amount of exempt income earned during the year. Accordingly, the

Ld.CIT(A) held that the appellant's argument anchored on the premise of actual generation of exempt income during the year is contradicted by the statutory provisions of section 14A and hence not found acceptable.

5) Further the other contention of the appellant made before the AO that it has not made the concerned investment out of any interest bearing fund is also found not relevant by the Ld.CIT(A) to decide the issue in hand after the amendment to Rule 8D w.e.f. 02.06.2016 by way of notification by CBDT.

7. Aggrieved by the order of Ld. CIT(A), the assessee has filed the present appeal before this Tribunal.

8. The solitary issue that is raised before us is whether the authorities below were justified in rejecting / disallowing Rs. 1,32,40,428/- u/s. 14A r.w. Rule 8D under the facts & circumstances

9. We have heard the rival submissions and perused the material on record.

10. The ground nos. 1 and 4 are general in nature and do not require any adjudication.

11. During the course of hearing, the Ld.AR of the assessee has not pressed ground no. 2 and hence dismissed as not pressed.

12. Before adjudicating ground no. 3 on the merits of the case, let us take note of the relevant statutory provision applicable for A.Y. 2018-19 which are reproduced below for the sake of reference.

> *"[84][Expenditure incurred in relation to income not includible in total income[85].*
>
> *14A. [(1)] For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred[88] by the assessee in relation to[88] income which does not form part of the total income[88] 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[89], 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 :]*
> *[90][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.]"*

13. On the plain reading of the above section, it is deduced that 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. Further, sub-section(2) states that if the AO

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 or in case an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of total income, the AO shall determine the amount of expenditure incurred in relation to such income in accordance with such method as maybe prescribed.

14. Now this method has been prescribed under Rule 8D. The Rule 8D read as follows:

*"[**Method for determining amount of expenditure in relation to income not includible in total income.***

***8D.** (1) Where the Assessing Officer, having regard to the accounts of the assessee 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 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 average 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.**]**"*

15. The proviso to 8D(2) of the Rules states that the amount referred to in clauses 1 and 2 shall not exceed the total expenditure claimed by the assessee.

16. Before us, the Ld.AR submitted that disallowance of Rs.1,32,40,428/- u/s. 14A of the IT Act, 1961 is not justified especially when the appellant has not earned any exempt income during the year. Further, the Ld.AR of the appellant vehemently submitted that in any case, the total disallowance u/s. 14A r.w.Rule 8D if any made ought to be restricted to the extent of exempt income earned and thus the total disallowance u/s. 14A of the I.Tax Act,1961 cannot exceed Rs.55,56,958/-. Further, the Ld.AR of the assessee also relied upon the decision of Coordinate Bench in case of Brindavan Beverages Pvt. Ltd. vs. DCIT in ITA Nos. 1999, 2002 & 2003/Bang/2016 by order dated 13.06.2022 in support of his claim.

17. The Ld. DR on the other hand, supported the orders of the income tax authorities below.

18. We have heard the rival submissions and perused the material on record.

19. It is an undisputed fact that the assessee has declared exempt income in the return of income amounting to Rs.55,56,958/- as observed by the Ld.AO in para 3 of the assessment order. Further the Ld.CIT(A) in para 9.1 has also observed that appellant had reported the exempt income amounting to Rs.55,56,958/- in its ITR. Before us, the Ld.AR of the assessee could not produce any evidence to show that the

company has not received any exempt income during the year under consideration.

20. Therefore the contention of the appellant that as it hadn't earned any exempt income during the year and therefore the disallowance made u/s. 14A of the IT Act deserves to be deleted completely is not tenable. The assessing officer disallowed pursuant to the formula devised as per Rule 8D of IT Rules, 1962 as the assessee has stated that no expenditure had been incurred in earning the exempt income and the assessee had not used interest bearing funds to make the investment as such and accordingly, the AO applied Rule 8D(ii) by taking 1% of the average of opening and closing balance of the value of investment as Rs.1,32,40,428/- i.e. 1% of 132,40,42,815/-. It is well settled law that disallowance u/s. 14A cannot exceed the amount of exempt income earned by the assessee. The Coordinate bench of this Tribunal in case of Brindavan Beverages Pvt. Ltd. vs. DCIT (supra) wherein held as under:-

> *"37. We have heard the rival submissions and perused the material on record. It is settled law that disallowance u/s. 14A cannot exceed the amount of exempt income earned by the assessee. The co-ordinate Bench of this Tribunal in the case of GMR Enterprises (supra) has held as under:-*
>
> *"3.4 We have heard rival submissions and perused the material on record. It is settled position of law that disallowance cannot exceed the amount of dividend income earned during the relevant assessment year. In this context, the following judicial pronouncements support the stand of the assessee:-*

(i) Joint Investments Pvt. Ltd. v. CIT (59 Taxmann.com 295) – it was held that disallowance u/s 14A of the Act is to be restricted to the tax exempt income.
(ii)Daga Global Chemicals Pvt. Ltd. v. ACIT [2015-ITRV-ITAT-MUM-123) – has held that disallowance u/s 14A r.w. Rule 8D cannot exceed the exempt income.
(iii) M/s.Pinnacle Brocom Pvt. Ltd. v. ACIT (ITA No.6247/M/2012) – has held that disallowance u/s 14A cannot exceed the exempt income.
(iv) DCM Ltd. v. DCIT (ITA No.4567/Del/2012) – held that the disallowance u/s 14A of the Act cannot exceed the exempt income.
3.5 In view of the above settled position, the amount of disallowance u/s 14A of the I.T. Act needs to be restricted to the extent of exempted income earned during the relevant assessment year. As would be evident that in the facts and circumstances of the present case the amount of exempted income of Rs.27,37,47,187 was earned on investment and consequently the amount of disallowance, if at all, to be made is to be restricted to Rs.27,37,47,187.
3.6 However, in this case, the assessee had made disallowance of Rs.145,02,09,668 voluntarily while filing the return of income. In this context, it is important to refer to the judgment of the Hon'ble Madras High Court in the case of M/s. Marg Limited v. CIT in Tax Case Appeal Nos.41 to 43 & 220 of 2017 (judgment dated 30.09.2020). The Hon'ble Madras High Court followed the judgment of the Hon'ble Karnataka High Court in the case of Pargathi Krishna Gramin Bank v. JCIT[(2018) 95 taxman.com 41 (Kar.)]. In the case considered by the Hon'ble Madras High Court, the assessee therein had made voluntarily disallowance u/s 14A of the I.T. Act more than the dividend income earned and the Tribunal confirmed the disallowance made u/s 14A of the I.T.Act. However, the Hon'ble Madras High Court held that the disallowance u/s 14A of the I.T.Act cannot exceed the exempt income earned during the relevant assessment year. The relevant finding of the Hon'ble Madras High Court reads as follow:-
"20. Before parting, we may also note with reference to the Table of disallowance voluntarily made by the Assessee, which is part of the Paper Book before us for the four assessment years in question. In the Table quoted in the beginning of the order, shows that the Assessee himself computed and offered the disallowance beyond the exempted income in the particular year, namely AY 2009-10, as against the dividend income of Rs.41,042/-and the Assessee himself computed disallowance under Rule 8D of the Rules to the extent of Rs.2,38,575/-, which was

increased to Rs.98,16,104/- by the Assessing Authority. Similarly, for AY 2012-13, against Nil dividend income, the Assessee himself computed disallowance at Rs.8,50,000/-, which was increased to Rs.2,61,96,790/-.

21. We cannot approve even the larger disallowance proposed by the Assessee himself in the computation of disallowance under Rule 8D made by him. These facts are akin to the case of ***Pragati Krishna Gramin Bank****(2018) 95 Taxman.com 41 (Kar.) decided by Karnataka High Court. The legal position, as interpreted above by various judgments and again reiterated by us in this judgment, remains that the disallowance of expenditure incurred to earn exempted income cannot exceed exempted income itself and neither the Assessee*
nor the Revenue are entitled to take a deviated view of the matter. Because as already noted by us, the negative figure of disallowance cannot amount to hypothetical taxable income in the hands of the Assessee. The disallowance of expenditure incurred to earn exempted income has to be a smaller part of such income and should have a reasonable proportion to the exempted income earned by the Assessee in that year, which can be computed as per Rule 8D only after recording the satisfaction by the Assessing Authority that the apportionment of such disallowable expenditure under Section 14A made by the Assessee or his claim that no expenditure was incurred is validly rejected by the Assessing Authority by recording reasonable and cogent reasons conveyed to Assessee and after giving opportunity of hearing to the Assessee in this regard.

22. We, therefore, dispose of the present appeal by answering question of law in favour of the Assessee and against the Revenue and by holding that the disallowance under Rule 8D of the IT Rules read with Section 14A of the Act can never exceed the exempted income earned by the Assesee during the particular assessment year and further, without recording the satisfaction by the Assessing Authority that the apportionment of such disallowable expenditure made by the Assessee with respect to the exempted income is not acceptable for reasons to be assigned the Assessing Authority, he cannot resort to the computation method under Rule 8D of the Income Tax Rules, 1962."

(underlining supplied)

3.7 In view of the above judgment of the Hon'ble Madras High Court in the case of M/s.Marg Limited v. CIT (supra), it is clear that the disallowance u/s 14A of the I.T.Act cannot exceed the exempt income earned during the

relevant assessment year irrespective whether larger amount was disallowed by the assessee u/s 14A of the I.T.Act while filing the return of income. Therefore, the AO is directed to restrict the disallowance u/s 14A of the I.T.Act to Rs.27,37,47,187.

37. We also notice that coordinate bench of the Tribunal in assessee's own case (ITA No. 1338/Bang/2012 dated 28.08.2014 had directed the AO to examine and include only interest that is not attributable to any particular income / receipt for the purpose of arriving at the disallowance u/s.8D(2)(ii) of the I.T. Rules. Respectfully following the decision of the coordinate Bench of the Tribunal in GMR Enterprises (supra) and assessee's own case (supra), we direct the AO to recomputed the Interest and the disallowance should be restricted to the amount of exempt income earned by the assessee. We direct accordingly. "

21. In the light of aforesaid discussion & relying on the above, we are of the opinion that in the present case, the amount of exempted income of Rs.55,56,958/- was earned on investments and consequently, the amount of disallowance if at all to be made should be restricted to Rs.55,56,958/-. We are also of the opinion that the disallowance under Rule 8D of IT Rules r.w.s. 14A of the act can never exceed the exempted income earned by the assessee as per proviso to Rule 8D(2) of the IT Rules, 1962. Accordingly, ground no. 3 is partly allowed.

22. In the result, the appeal of the assessee is partly allowed.

Order pronounced in the open court on 5th July, 2024.

Sd/-	**Sd/-**
(CHANDRA POOJARI)	(KESHAV DUBEY)
Accountant Member	Judicial Member

Bangalore,
Dated, the 5th July, 2024.
/MS /

Copy to:

1. Appellant	2. Respondent
3. CIT	4. DR, ITAT, Bangalore
5. Guard file	6. CIT(A)

By order

Assistant Registrar,
ITAT, Bangalore