

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "A", HYDERABAD**

**BEFORE SMT P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER**

**ITA No. 1541/Hyd/2017
Assessment Year: 2013-14**

VBC Ferro Alloys Ltd.,
Hyderabad.

vs. Income-tax Officer,
Ward – 17(1), Hyderabad.

PAN – AAACV 7258A

(Appellant)

(Respondent)

Assessee by : Shri V. Siva Kumar
Revenue by : Smt. B.K. Vishnu Priya

Date of hearing : 28/06/2018
Date of pronouncement : 31/07/2018

ORDER

PER S. RIFAUR RAHMAN, A.M.:

This appeal filed by the assessee is directed against the order dated 28/06/2017 of CIT(A) – 5, Hyderabad for AY 2013-14.

2. Briefly the facts of the case are, the Assessee is a Company engaged in the business of manufacture and sale of Ferro Alloys, having its factory at Rudraram village, Patancheru Mandal, Medak District. The assessee filed its return of income for the AY 2013-14 originally on 15.09.2013 declaring loss of Rs.8,77,20,449/-. Later a revised return was filed declaring loss of Rs. 8,35,36,788/- on 30-09-13, the same was again revised on 25-09-2014 by declaring loss at Rs.8,38,14,180/-. The case was taken up for scrutiny by issue of notices u/s.143(2) and 142(1). The AO completed the assessment u/s 143(3) on 31/03/2016 determining the assessee's loss at Rs. 7,48,33,819/- by disallowing an amount of Rs. 78,74,968/- u/s 14A

and Rs. 11,05,393/- u/s 43B of the Income-tax Act, 1961 (in short 'the Act').

3. When the assessee preferred an appeal before the CIT(A), the CIT(A) confirmed the order of AO.

4. Aggrieved with the order of CIT(A), the assessee is in appeal before us raising the following grounds of appeal:

"1. The Order of the Commissioner of Income-Tax (Appeals)-5, Hyderabad dated 28-06-2017 is erroneous, contrary to law and facts of the case.

2. a) The Commissioner of Income Tax (Appeals) erred in law in conforming the disallowance of Rs.78,74,968/- made by the Assessing Officer for the assessment year 2013-14 applying Sec.14A r.w.r.8D(2)(iii) on the ground that provisions of said section are applicable to Appellant's case stating that irrespective of the fact whether investments has yielded income or not, disallowance is in conformity with Rule 8D(2)(iii) and is therefore justified.

b) The Commissioner of Income Tax (Appeals) ought to have seen that the Appellant's investments both as at 31.03.2012 and 31.03.2013 remained same and therefore no activity had taken place on account of investments during this year. Thus since neither activity in investments had taken place during the year, nor dividend was received during the year on investments, the Appellant did not incur any expenditure on account of investments. Hence confirming the disallowance of Rs.78,74,968/- is not justified. It is also relevant to note that the investments were made by the Appellant only due to commercial expediency.

3. The Commissioner of Income Tax (Appeals) erred in confirming the disallowance of Rs.1,76,564/- out of Rs. 11,05,393/- of unpaid statutory liabilities made by the Assessing Officer. The Commissioner of Income Tax (Appeals) ought to have seen that provisions of Sec,43B are not attracted to Rs.1,76,564/- comprising of interest paid to a bank and on delayed payments of statutory dues. Hence confirming such disallowance is not justified.

4. For all of the above and such other grounds as may be urged at the time of hearing it is most respectfully prayed that this

Hon'ble Tribunal may be pleased to direct the respondent herein to delete the disallowances made in Asst. Order."

4. Ground No. 1 & 4 are general in nature, hence, need no adjudication.

5. As regards ground No. 2 with regard to disallowance u/s 14A of the Act, the AO observed that from the information filed by the assessee, the company made non-current investments amounting to Rs. 157,49,93,744/- and according to him, the assessee company must have incurred some sort of administrative/managerial expenditure to manage the investments, especially since there is no set up in this regard. He therefore applying the provisions of section 14A r.w.r. 8D, worked out the disallowance at Rs. 78,74,9658/- (Rs. 157,49,93,744/- x 0.5%)

6. Before the CIT(A), the assessee submitted that investments held by it as at 31/03/2012 at Rs. 157,49,93,744/- continued till 31/03/2013, thus, during the year, neither any fresh investments were made nor there were any sale of investments. Hence, no activity was there in the investments portfolio during the year. It was argued that since no expenditure was incurred during the year, AO was not justified in disallowing Rs. 78,74,968/- u/s 14A r.w.r. 8D(2)(iii) of the Act.

7. The CIT(A) confirmed the disallowance on the ground that the disallowance made is in conformity with rule 8D(2)(iii), hence, do not call for any interference in the order of AO.

8. Before us, the Id. AR of the assessee relied on the decisions of coordinate benches of this Tribunal in the case of M/s SNJ Synthetics Ltd. Vs. DCIT in ITA No. 1926/Hyd/2017 dated 11/05/2018 and in the case of M/s Kamadhenu Sukrit Pvt. Ltd. Vs. ITO in ITA No. 460/Hyd/2017 dated 22/11/2017, copies which are filed on record.

9. Ld. DR relied on the orders of CIT(A)/AO.

10. Considered the rival submissions and perused the material on record. The issue in dispute is squarely covered by the decision of the coordinate bench of this Tribunal in the case of SNJ Synthetics Ld. (supra) wherein the coordinate bench has observed as under:

*6. We have considered the rival contentions and perused the facts on record and the case law relied upon. As seen from the order of the AO as well as the CIT(A), there is no finding that assessee has incurred any expenditure for earning the said dividend income. There was no diversion of borrowed funds, hence there is no disallowance interest under rule 8d(2)(ii). The disallowance was only under **Rule 8D(2)(iii)**.*

*6.1. Coming to the disallowance of % of average value of investment, some proportionate expenditure can be disallowed but in no case, it should exceed the amount earned claiming exemption. The Hon'ble High Court of Punjab & Haryana in the case of **Pr. Commissioner of Income Tax Vs. Empire Package Pvt. Ltd.**, (supra), answered the question raised by Revenue in negative, wherein the Revenue has raised whether in the facts and circumstances of the case, the Hon'ble Tribunal is justified in law to hold the disallowance made **u/s. 14A r.w. Rule 8D** cannot exceed the exempt income in the absence of any such restriction being there in the relevant section or rule. Similar opinion was also expressed by the Hon'ble Delhi High Court in the case of Joint Investments Pvt. Ltd., Vs. CIT (supra), wherein the Hon'ble Delhi High Court has clearly held that the proportionate or portion of the tax exempt income surely cannot swallow the entire amount as happened in this case. The Co-ordinate Bench in the case of **M/s. Kamadhenu Sukrit Pvt. Ltd., Vs. ITO** (supra) relied on another decision in the case of **Sahara India Financial Corpn. Ltd., Vs. DCIT** [41 taxmann.com 251] (Delhi-Trib) and has held as under:*

8.1. As can be seen from the nature of expenditure, there is no indication even that the above expenditure is expended for earning dividend income. AO without giving any satisfactory reason, just invoked Rule 8D(iii) and disallowed the amount.

*9. The Co-ordinate Bench in the case of **Sahara India Financial Corpn. Ltd., Vs. DCIT**(supra) has held in para 81 as under: We have heard the rival contentions and perused the material available on record. It has not been disputed that the administration, expenses and books of account of investment division are separately carried out and maintained by the assessee. No infirmity has been found by the department in this behalf. One of the main issue is on whom lies the onus to establish nexus of available funds with free and taxable income.*

Similarly courts have held that a finding in objective terms about assessee working being unsatisfactory is to be recorded by AO in the order. Chandigarh Bench of the Tribunal in the case of Punjab State Co-op. & Marketing Fed. Ltd. (supra) has held that in any case the disallowance u/s 14A cannot exceed tax free income of the assessee. If mechanical method of rule 8D is applied, it leads to manifestly absurd results in as much as for tax free income of Rs.68,37,583/- disallowance of Rs.2,16,51,917 (enhanced by CIT(A) at Rs. 2,19,47,772) is made u/s 14A which is way too much than the exempt income. As the interpretation of **provisions of sec. 14A r/w rule 8D** is leading to unanticipated absurdities which cannot be the intention of legislature. Under these circumstances help of external aids of construction for interpretation of statute is called for. Looking at the varying interpretation offered by various courts and benches of tribunal in relation to sec. 14A, it is quite arduous to precisely decide the issue. In given facts and circumstances without going into all the issues, in our view it is appropriate to take guidance from Chandigarh bench judgment in the case of Punjab State Co-opt Marketing Fed. Ltd. (supra) holding that the disallowance of expenditure in any case cannot exceed the income earned. In our view this judgment takes a holistic view that disallowance in terms of sec. 14A can be maximum to the extent of exempt income, there is no dispute that in this case which is at Rs. 68,37,583/-. This judgment implies that reasonable expenditure less than the exempt income can be disallowed. In our considered opinion, in the interest of justice, it will be reasonable to estimate and disallow, 50% of exempt income (Rs.68,37,583/-) as relatable to exempt income **u/s 14A r/w rule 8D**. We do not go into various plea taken by both sides offering diverse views based on judicial citations. This ground of the assessee is partly allowed.

10. Respectfully following the above principles, as the disallowance made by AO has resulted in absurd situation of disallowing genuine other business expenditure, on which assessee earned more than Rs. 19 Lakhs income (as against Rs. 8,100/- of dividend), I am satisfied that the disallowance u/s. 14A should be restricted to the income earned of Rs. 8,100/-. AO is directed accordingly.

6.2. Respectfully following the principles laid down in various judgments of the Hon'ble High Courts and the decisions of the Co-ordinate Benches, we are of the opinion that the disallowance under Rule 8D cannot exceed the dividend income earned and claimed as exempt. Therefore, the disallowance worked out under Rule 8D(iii) being administrative expenditure is restricted to the amount of dividend earned. AO is directed to modify accordingly. Ground is partly allowed.”

As the issue under consideration is materially identical to the said decision, following the conclusions drawn therein, we direct the AO to

delete the disallowance made u/s 14A r.w.r. 8D(2)(iii) as the disallowance u/s 14A cannot exceed the exempt income. Ground No. 2 is allowed.

11. As regards ground No. 3 with regard to disallowance of Rs. 1,76,564/- u/s 43B, during the course of assessment proceedings, on verification of information furnished by the assessee, AO noticed that statutory payments of Rs. 11,05,393/- were not paid. When AO asked the assessee as to why the said payments shall not be disallowed u/s 43B, the AR of the assessee submitted that out of such unpaid statutory liabilities the following amounts represents interest paid either to a bank or on late payment of service tax, excise duty and employees state insurance contribution, the details of which are as under:

1. Hire Purchase interest paid to HDFC Bank Ltd.	15,692
2. Interest paid on service tax	44,929
3. Interest paid on excise duty	91,731
4. Interest paid on ESI delay payments	<u>24,212</u>
Total	<u>1,76,564</u>
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It was therefore, argued that disallowance of the said amount out of Rs. 11,05,393/- was not justified as the provisions of section 43B are not applicable to the above payments of Rs. 1,76,564/-. However, the AO disallowed the same u/s 43B. CIT(A) relying on various decisions, upheld the disallowance.

12. Before us, the Id. AR reiterated the submissions as made before the revenue authorities, while, the Id. DR relied on the orders of revenue authorities.

13. Considered the rival submissions and perused the material on record. Provisions of section 43B read as under:

43B. Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of—

(a) any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or]

(b) any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees,

c) any sum referred to in clause (ii) of sub-section (1) of section 36,

(d) any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation], in accordance with the terms and conditions of the agreement governing such loan or borrowing

(e) any sum payable by the assessee as interest on any 29[loan or advances] from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan 30[or advances

(f) any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee,]

shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which such sum is actually paid by him”:

The Hon'ble Supreme Court in various decisions held that levy of interest on breach of the respective Act is compensatory in nature. The interest which is in the nature of breach of Act alone can be disallowed and in compensatory nature cannot be disallowed. Ld. CIT(A) has relied on case laws on sales tax. In those cases, it was held that sales tax is a statutory obligation. But, in the present case, the interest is levied on service tax, excise duty and ESI. In our view, these are compensatory in nature unlike sales tax Act. Therefore, the provisions of section 43B are not attracted. With regard to interest paid to HDFC Bank, in our view, HDFC Bank is not public financial institution. It is only private sector Bank. Interest paid to HDFC is outside the purview of section 43B. Therefore, the amounts paid towards interest under the aforementioned heads, do not come under the provisions of section 43B, hence, the disallowance is hereby deleted. Accordingly ground No. 3 is allowed.

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

Pronounced in the open Court on 31st July, 2018.

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Sd/--
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER

Hyderabad, Dated: 31st July, 2018

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Copy to:-

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- 3) *CIT(A) – 5, Hyderabad.*
- 4) *Pr. CIT - 5, Hyd.*
- 5) *The Departmental Representative, I.T.A.T., Hyderabad.*
- 6) *Guard File*