

ITAT: Disallowance u/Sec.14A cannot exceed exempt income, partly allows Assessee's appeal

Aug 10, 2024

Morgan Stanley India Company Ltd [TS-579-ITAT-2024(Mum)]

Conclusion

Mumbai ITAT partly allows Assessee's appeal, holds that the disallowance under Section 14A read with Rule 8D can never exceed the exempted income earned by the Assessee; Disregarding Assessee's voluntary disallowance under Section 14A without citing the reason, Revenue invoked Rule 8D and computed disallowance by applying 0.5% of the total investment; ITAT relies on coordinate bench ruling in Assessee's own case for AY 2011-12 and observes that Revenue can make disallowance under Section 14A to the extent of exempt income; On the issue of disallowance on account of erred trade losses, ITAT notes that the error trade loss for the relevant AY is also very small and the nature of such loss claimed by the Assessee are similar to the loss claimed in the preceding AY; Thus, relies on coordinate bench ruling in Assessee's own case for AY 2014-15 wherein it was noted that Assessee being a broker is entitled to claim deduction on erred trade losses under Section 37 being incidental to the main business, thus, holds that error trade loss is incidental to the business of the Assessee and allowable as expenditure. ITAT Mum

Decision Summary

The ruling was delivered by the Division Bench of Mumbai ITAT comprising Smt. MS Padmavathy, Accountant Member and Shri Rahul Chaudhary, Judicial Member.

Advocate Dr. Sunil Lala appeared for the Assessee while Revenue was represented by Mr. Nayanjyoti Nath, Sr.DR.

Assessee, engaged in the business of providing financial services filed return of income for AY 2012-13 declaring total income of Rs. 327 Cr; During assessment, Revenue made disallowance of Rs. 17.79 Lac claimed as loss on account of error trade on the premise that the said loss was not incurred during the relevant AY and disallowance of Rs. 2.25 Cr under Section 14A read with Rule 8D by applying 0.5% of total investment; CIT(A) dismissed Assessee's appeal;

Before ITAT, Assessee relied on coordinate bench ruling in its own case for AY 2011-12 and contended that disallowance under Section 14A cannot be made beyond the exempt income i.e., Rs. 6.59 Lac; Also relied on coordinate bench ruling in own case for AY 2014-15 and held that the erred trade losses were very small and the nature of such losses were similar to the losses claimed in preceding wherein it was allowed by the coordinate bench;

ITAT notes that Assessee received the dividend income of Rs. 6.59 Lac against which suo moto disallowance of Rs. 3.94 Lac was made, however, Revenue invoked Rule 8D and disallowed 0.5% of total investment i.e., Rs. 2.25 Cr; Relies on coordinate bench ruling in Assessee's own case for AY 2011-12 and observes that Revenue can make disallowance under Section 14A to the extent of exempt income i.e., Rs. 6.59 Lac; Thus, partly allows Assessee's appeal.

**IN THE INCOME TAX APPELLATE TRIBUNAL
“D” BENCH, MUMBAI**

**BEFORE MS PADMAVATHY S, AM &
SHRI RAHUL CHAUDHARY, JM**

**I.T.A. No. 2448/Mum/2024
(Assessment Year: 2012-13)**

Morgan Stanley India Company Ltd. 18F, Tower 2, One World Center, 841, Senapati Bapat Marg, Mumbai-400013. PAN : AAACJ4998F	Vs.	ACIT-4(3)(2) Aayakar Bhavan, M.K. Road, Mumbai-400020.
Assessee)	:	Respondent)

Assessee/Appellant by : Shri Sunil Lala, CA
Revenue/Respondent by : Shri Nayanjyoti Nath, Sr. DR

Date of Hearing : 22.07.2024
Date of Pronouncement : 30.07.2024

ORDER

Per Padmavathy S, AM:

This appeal by the assessee is against the order of the Commissioner of Income Tax (Appeals) / National Faceless Appeal Centre, Delhi [for short 'the CIT(A)] dated 19.03.2024 for the AY 2012-13. The assessee raised grounds with regard to the following issues:

- (i) *Disallowance of loss on account of error trading transaction - (Ground No.1)*
- (ii) *Disallowance under section 14A of the Act – (Ground No.2)*
- (iii) *Addition of interest income already offered in subsequent year – (Ground No.3)*
- (iv) *Initiation of penalty under section 271(1)(c) of the Act – (Ground No.4)*

2. The assessee is a company engaged in the business of providing financial services including providing institutional equity sales and trading services to both domestic and overseas institutional clients. For the Assessment Year (AY) 2012-13 the assessee filed a return of income on 16.11.2012 declaring a total income of Rs. 327,52,69,310/- under regular provisions of the Act and a book profit earned at section 115JB of the Act at Rs. 306,26,14,293/-. The case was selected for scrutiny and the Assessing Officer (AO) made a disallowance towards error trade loss, interest income and disallowance under section 14A. The CIT(A) on further appeal confirmed the disallowance/additions made by the AO.

Disallowance of loss on account of error trading transaction - (Ground No.1)

3. During the course of assessment, the AO notice that the assessee has claimed loss of Rs. 17,79,806/- on account error trade. The AO called on the assessee to furnish the nature of loss and to justify the claim with evidence. The assessee submitted that during the course of regular business of rendering broking services to client due to various reasons such error in the name of the script, etc. the clients do not take delivery and the said transaction is booked in the name of the assessee only. When these transactions are subsequently squared off the same may result in either loss or gains which are accounted as arising out of error trade. The assessee submitted that the said loss is incurred in the regular course of business and therefore, the same should be allowed as deduction. The AO did not accept the submissions of the assessee and held that the error trade loss is not incurred on behalf of the clients and therefore, they cannot be claimed as business loss. On further appeal the CIT(A) confirmed the disallowance on the same ground.

4. We heard the parties and perused the material on record. The ld. AR brought to our attention that the similar issue arose in assessee's own case for AY 2014-15 and the co-ordinate bench in a combined order dated 30.11.2023 for AYs 2014-15 to 2018-19 (ITA No. 340 & 7550/Mum/2019, ITA No. 1009/Mum/2021 and ITA No. 594 & 2435/Mum/2022) has held that the error trade losses are allowable. The relevant observations of the Tribunal in this regard are extracted below:

“24. Heard both the sides and perused the material on record. During the course of assessment in support of its claim of net loss of Rs.28,09,603/- on account of error trades, the assessee had submitted the details like client name, reason for error trades, date of transactions, script name internal e-mail etc. The assessee also explained that error trades are the clerical & other errors of the assessee in execution of the transactions for the clients. The error trades are basically trades generated by the clients, however, due to error inter alia in punching of the trade, etc. these trades are not executed as per the trading order of the clients. The error could be in the name of wrong punching of quantity, rate, security, system error and error in punching the type of order etc. During the course of appellate proceedings before us the assessee has also placed reliance on the decision of ITAT, Mumbai in the case of CLSA India Pvt. Ltd. vs. ACIT (Range-4(1) vide ITA No. 4824/Mum/2015 A.Y. 2003-04 dated 14.12.2020. In the aforesaid decision the ITAT observed that certain client for whom the assessee was working as a broker had not owned up certain share transactions then the assessee had no other alternative but to accept those transactions as its own transactions because of its relation with the clients from whom it was accepting good earnings. After considering the volume of transactions undertaken by the assessee company as broker for various clients we observe that such marginal error in share trading is incidental to the business of the assessee, therefore, we don't find any reason to that assessee has wrongly claimed such loss, therefore, AO is directed to allow the claim of the assessee.”

5. We notice that the error trade loss for the year under consideration also is very small and the nature of error trade loss claimed by the assessee are similar to the loss claimed in the above AY. Therefore respectfully following the above decision of the co-ordinate bench, we hold that the error trade loss is incidental to the business of the assessee and therefore the assessee should be allowed to claim

such loss. Accordingly, the AO is directed to delete the disallowance made in this regard. This ground of the assessee is allowed.

Disallowance under section 14A of the Act – (Ground No.2)

6. During the year under consideration, the assessee has received dividend of Rs. 6,59,736/- and claimed the same as exempt. In the computation of income, the assessee has made a suo-moto disallowance of Rs. 3,94,498/- under section 14A of the Act. The AO did not accept the submissions made by the assessee with regard to further disallowance proposed by the AO under section 14A r.w.r. 8D. Accordingly, the AO proceeded to make a disallowance under section 14A r.w.r. 8D(2)(iii) by applying 0.5% of the total investments amounting to Rs. 2,25,45,450/-. The CIT(A) confirmed the said disallowance.

7. The Id. AR submitted that the assessee has earned dividend income of only Rs. 6,59,736/- and that the disallowance under section 14A r.w.r. 8D cannot exceed the amount claimed as exempt. The Id. AR in this regard placed reliance on assessee's own case for AY 2011-12 (ITA No. 1715/Mum/2015 and C.O. 145/Mum/2016 dated 15.12.2022) where it has been held that

“On careful consideration, respectfully following the decision of ITAT in assessee’s own case for A.Y. 2010-11, we direct the learned Assessing Officer to restrict the disallowance under Section 14A of the Act to the extent of exempt income only. Accordingly, the ground no.1 of the appeal is partly allowed.”

8. Respectfully following the above decision of the Co-ordinate bench, we direct the AO to restrict the disallowance under section 14A to the extent of income claimed as exempt i.e Rs. 6,59,736/-. This ground of the assessee is partly allowed.

9. During the course of hearing, the ld. Authorized Representative (AR) did not press for Gound No.3 and therefore, the same is dismissed as not pressed. Ground No.4 pertaining to penalty is premature and does not warrant any adjudication.

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

Order pronounced in the open court on 30-07-2024.

Sd/-
(RAHUL CHAUDHARY)
Judicial Member

**SK, Sr. PS*

Sd/-
(PADMAVATHY S)
Accountant Member

Copy of the Order forwarded to :

1. The Assessee
2. The Respondent
3. DR, ITAT, Mumbai
4. Guard File
5. CIT

BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai