

Issues relating to section 14A disallowance



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Background & legislative history

Background

- Position prior to section 14A:
 - In case of indivisible business (where some income is taxable and some income is exempt) - entire expenditure allowable
 - In case of divisible business - principle of apportionment applies

[based on *Indian Bank (1965)(56 ITR 77)(SC)*, *Maharashtra Sugar Mills Ltd (1971)(82 ITR 452)(SC)*, *Rajasthan State Warehousing Corporation (2000)(242 ITR 450)(SC)*]

- Introduction of section 14A of the Income-tax Act, 1961 (Act) in Chapter IV of the Act by the Finance Act, 2001, with retrospective effect from (w.r.e.f) 1 April 1962 to prevent misuse of the above rulings
- Memorandum explaining the introduction of section 14A:

*“..... tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the **expenses incurred to earn the exempt income against taxable income**. This is against the basic principles of taxation whereby only the net income, i.e., gross income minus the expenditure, is taxed.”*

Legislative history

Provision	Inserted vide	Applicable from
14A(1)	Finance Act, 2001	1 April 1962
Proviso to section 14A	Finance Act, 2002	11 May 2001
14A(2) and (3)*	Finance Act, 2006	1 April 2007
Existing Rule 8D*	Notification dated 24 March 2008	Assessment Year (AY) 2008-09*
Amended Rule 8D	Notification dated 2 June 2016	Date of publication in the Official Gazette
Clarification	Circular No. 5/2014 dated 11 February 2014	?

* *Godrej & Boyce Mfg. Co. Ltd. (2010)(328 ITR 81)(Bom HC)*

- Upheld constitutional validity of sub-sections (2) and (3) of section 14A and of Rule 8D
- Held that Rule 8D would apply from AY 2008-09 and onwards

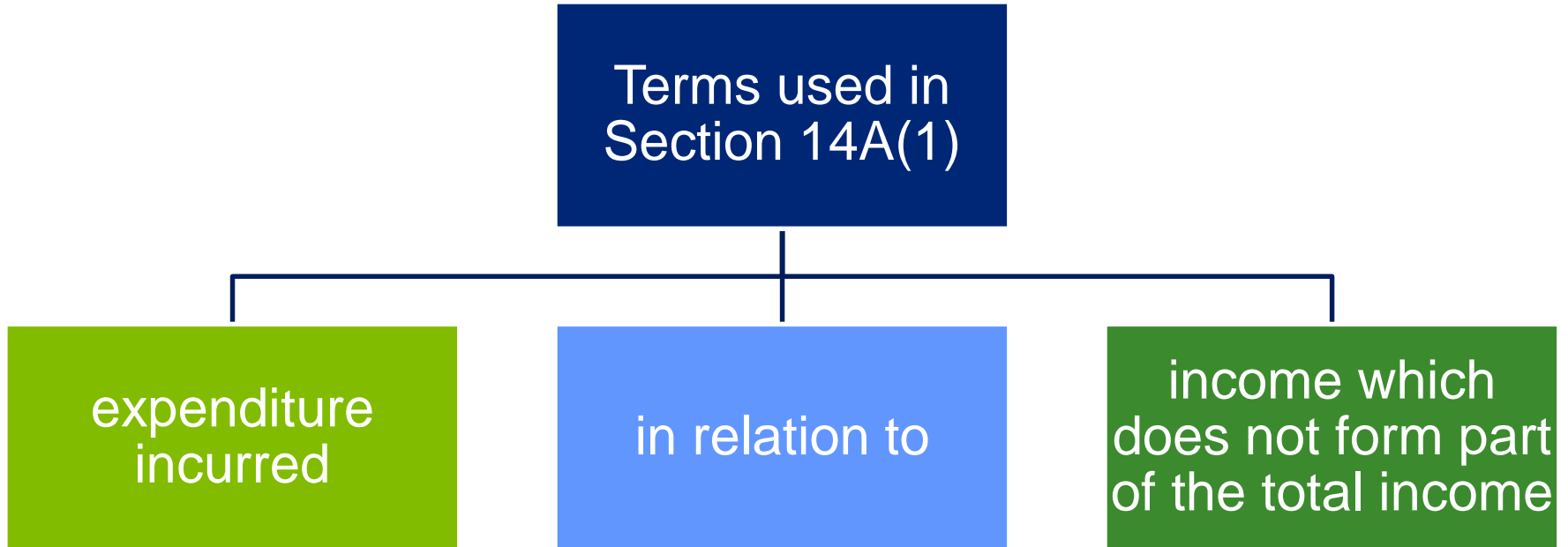
Section 14A - Provisions

Section 14A - provisions

- Sub-section (1) – introduced by the Finance Act, 2001 w.r.e.f 1 April 1962 - states 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** under the Act
- Sub-section (2) – inserted by the Finance Act, 2006 w.e.f 1 April 2007 - empowers the Assessing Officer (AO) to determine the amount of expenditure incurred in relation to such income which does not form part of total income, in accordance with Rule 8D of the Rules. Such power is to be exercised if the AO, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim made by the assessee
- Sub-section (3) – inserted by the Finance Act, 2006 w.e.f 1 April 2007 - provides that the provisions of sub-section (2) shall also apply where the assessee claims that no expenditure has been incurred in relation to income not forming part of total income under the Act
- Proviso to section 14A – inserted by the Finance Act, 2002, w.r.e.f 11 May 2001 – restricts the AO to either reassess under section 147, or to enhance the assessment, reduce refund already made or otherwise increase liability by passing an order under section 154, for any AY prior to AY 2001-02

Terms used in section 14A(1) & their meanings

Terms used in section 14A(1)



Meaning - expenditure incurred

- Expenditure incurred refers to **actual expenditure** and not to some imagined expenditure. If no expenditure is incurred in relation to the exempt income, no disallowance can be made under section 14A of the Act:
 - *Maxopp Investment Ltd. (2012) (347 ITR 272)(Delhi HC)*
 - *Hero Cycles Ltd. (2010)(323 ITR 518)(P&H HC)*
 - *Yatish Trading Co. (P.) Ltd. (2011)(129 ITD 237)(Mum ITAT)*
 - *Justice Sam P. Bharucha (2012)(53 SOT 192)(Mum ITAT)*
- Entire expenditure is to be considered irrespective of whether it is fixed, variable, direct, indirect, administrative, managerial or financial:
 - *Kalpataru Construction Overseas (P.) Ltd.(2007)(13 SOT 194)(Mum ITAT)*
 - *Daga Capital Management Pvt. Ltd.(2009)(117 ITD 169)(Mum ITAT)(SB)*
- Section 14A will not apply to depreciation, which is an allowance and not an expenditure:
 - *Hoshang Nanavati (2012)(16 ITR(T) 614)(Mum ITAT)*
 - *Vishnu Anant Mahajan (2012)(16 ITR 621) (Ambd ITAT)(SB)*
- Section 14A will not apply to a payment deductible under Chapter VI-A, even if the same is made out of exempt income:
 - *Infosys Technologies Ltd.(2008)(19 SOT 7)(Bangalore ITAT)*
 - *Hoshang Nanavati (2012) (16 ITR(T) 614)(Mum ITAT)*

Meaning - in relation to

- There has to be a connection or a live nexus between the expense incurred and the exempt income i.e. there should be a proximate cause for disallowance:
 - *Walfort Share & Stock Brokers Pvt. Ltd. (2010)(326 ITR 1)(SC)*
 - *Hero Cycles Ltd. (2010)(323 ITR 518)(P&H HC)*
 - *Maxopp Investment Ltd. (2012) (347 ITR 272)(Delhi HC)*
 - *Hitachi Home and Life Solutions (I) Ltd (2014)(221 Taxman 109)(Guj HC)*
 - *Om Prakash Khaitan (2015)(376 ITR 390)(Delhi HC)*
 - *Patco Investment & Consultancy Services (P) Ltd.(2015)(372 ITR 195)(Madras HC)*
 - *Yatish Trading Co. (P.) Ltd. (2011)(129 ITD 237)(Mum ITAT)*
 - *Garware Wall Ropes Ltd. (2014)(65 SOT 86)(Mum ITAT)*

Meaning – income which does not form part of the total income

- Section 14A does not apply to income deductible under Chapter VI-A:
 - *Tamil Nadu Silk Producers Federation Ltd (2007)(105 ITD 623)(Chenn ITAT)*
 - *Kings Exports (2010)(318 ITR 100)(P&H HC)*
 - *Kribhco (2012)(349 ITR 618) (Delhi HC)*
 - *Meditap Specialities (P) Ltd (2012)(53 SOT 190)(Mum ITAT)*
 - *Osmanabad Janta Sah. Bank Ltd (2013) (152TTJ 1)(Pune ITAT)*
 - *Banaskantha Dist. Co. Op. Milk Producers' Union Ltd. (2014)(45 taxmann.com 152) (Guj HC)*

A contrary view has been expressed in the case of *Punjab State Co-operative Milk Producers Federation Ltd. (2011)(336 ITR 495)(P&H HC)*. The view has been reiterated recently in the same assessee's case reported at *(2016)(238 Taxman 207)(P&H HC)*.

- Section 14A does not apply to income covered under sections 10A/10AA/10B:
 - *Meditap Specialities (P.) Ltd.(2012)(53 SOT 190)(Mum ITAT)*
 - *Sandoz P. Ltd (2013)(145 ITD 551)(Mum ITAT)*

Rule 8D – Provisions:

Existing Rule

Amended Rule

A Comparison

Existing Rule 8D - Provisions (1/2)

- Rule 8D (inserted vide notification dated 24 March 2008) prescribes the method for computing expenditure incurred in relation to the income not forming part of total income
- Rule 8D(1) states that where having regard to the assessee's accounts, the AO is not satisfied with the correctness of the expenditure claimed by the assessee or with the assessee's claim that no expenditure has been incurred in relation to exempt income, he shall determine such expenditure in accordance with the method prescribed under Rule 8D(2)
- Rule 8D(2) provides that the expenditure in relation to exempt income, shall be the aggregate of the following three amounts:
 - i. the amount of expenditure **directly relating to income** which does not form part of total income;
 - ii. in a case where the assessee has incurred expenditure by way of **interest** during the previous year which is **not directly attributable** to any particular income or receipt, an amount computed in accordance with the following formula:

$$A * B / C$$

Existing Rule 8D - Provisions (2/2)

where A = amount of expenditure by way of **interest** other than the amount of interest included in clause (i) incurred during the previous year;

B = the **average of value of investment**, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

C = the **average of total assets** as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year

- iii. **an amount equal to one-half percent of the average of the value of investment**, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year
- Rule 8D(3) clarifies that “total assets” shall mean, total assets as appearing in the balance sheet excluding the increase on account of revaluation of assets but including the decrease on account of revaluation of assets

Amended Rule 8D – Background

- The Income-tax Simplification Committee headed by Justice Easwar that was appointed to look into the hardships faced by the taxpayers, made several recommendations (refer Slide 53) aimed at providing relief and reducing litigation around interpretation of section 14A and Rule 8D
- Based on some of these recommendations, the Finance Minister stated in his speech on the Budget 2016, as under:

“Another issue which has led to considerable number of disputes is quantification of disallowance of expenditure relatable to exempt income in terms of Section 14A of the Income Tax Act. I propose to rationalize the formula in Rule 8D governing such quantification. The said Rule is being amended to provide that disallowance will be limited to 1% of the average monthly value of investments yielding exempt income, but not exceeding the actual expenditure claimed.”

- Accordingly, Rule 8D has been amended vide Notification No. SO1949(E)[F.NO.370142/7/2016-TPL] dated 2 June 2016. The amended Rule shall come into force on the date of its publication in the Official Gazette

Amended Rule 8D – Provisions

- Amended Rule 8D(2) provides that the expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts:
 - (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 averages 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

- The amended Rule thus restricts the quantum of disallowance to the amount of total expenditure claimed deductible by the taxpayer

Amended Rule 8D – Applicability

- The notification dated 2 June 2016 states that the amended Rule shall come into force on the date of its publication in the Official Gazette
- Based on the ratio of the decision of the jurisdictional Bombay High Court in the case of *Godrej Boyce Mfg. Co. Ltd.(2010)(328 ITR 81)(Bom HC)*, it may be contended that the amended Rule would have prospective operation and will apply to assessment years commencing from AY 2017-18

However, taxpayers who may benefit as a result of the amended Rule could argue that the amendment was aimed at removing difficulties. In the context of beneficial legislation intended to remove difficulties, it is useful to make reference to the decision in the case of *Allied Motors (1997)(224 ITR 677)(SC)* wherein the Supreme Court has held that a proviso which is inserted to remedy unintended consequences and to make the provision workable requires to be treated as retrospective in operation

A Comparison

Existing Rule 8D	Amended Rule 8D	Impact
Expenditure directly incurred to earn exempt income [Rule 8D(2)(i)]	Expenditure directly incurred to earn exempt income [Rule 8D(2)(i)]	No change
Interest expense (in the proportion of average value of investments yielding exempt income, to average value of total asset) which is not directly attributable to any exempt income [Rule 8D(2)(ii)]	No such provision	The formula specified in relation to indirect interest expenditure has been deleted. Accordingly, indirect interest expenses will not be disallowed.
On presumptive basis, i.e. 0.5% of the annual average value of investments yielding exempt income [Rule 8D(2)(iii)]	On presumptive basis, i.e. 1% of the annual average of the monthly averages of value of investments yielding exempt income [Rule 8D(2)(ii)]	<ul style="list-style-type: none"> • Rate of presumptive expenditure has been increased to 1% from 0.5%. • The annual average of the monthly averages of value of investments to be considered instead of the annual average value of investment
No such provision	The disallowance as computed under Rule 8D shall not exceed total expenditure claimed by the taxpayer [Proviso to Rule 8D(2)]	The new Rule provides a cap on disallowance at total expenditure claimed by taxpayer

Expectations from the
AO – recording of
satisfaction, onus, etc.

Recording of satisfaction

- Memorandum to the Finance Act 2006 explaining introduction of sub-sections (2) and (3) in section 14A of the Act, states as under:

“However, the Assessing Officer shall be required to adopt the prescribed method if, 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 in relation to income which does not form part of the total income”

- The invocation of sections 14A(2)/(3) read with Rule 8D is thus made conditional upon the objective satisfaction of the AO about the correctness of the assessee's claim, having regard to the accounts of the assessee. The AO has to arrive at the decision in good faith and on relevant considerations. If the AO is not satisfied with the correctness of the assessee's claim, he must record the reasons for his conclusion. Resort cannot be had to the provisions of Rule 8D in the absence of such finding:
 - *Godrej & Boyce Mfg. Co. Ltd. (2010)(328 ITR 81)(Bom HC)*
 - *Maxopp Investment Ltd. (2012)(347 ITR 272)(Delhi HC)*
 - *Taikisha Engineering India Ltd (2015)(370 ITR 338)(Delhi HC)*
 - *Graviss Hospitality Ltd. (2015)(67 SOT 184) (Mum. ITAT)*
 - *Abhishek Industries Ltd (2016)(380 ITR 652)(P & H HC)*
 - *Damodar Valley Corporation (2016)(157 ITD 415)(Kol. ITAT)*
 - *Canara Bank (2016)(68 taxmann.com 128)(Bang. ITAT)*

However, in the case of *T and T Motors Ltd (2015)(154 ITD 306)(Del ITAT)*, the Delhi Tribunal has held that as the CIT(A)'s powers in disposal of appeal are co-terminus with those of the AO, the AO's deficiency in recording proper satisfaction, could be made good by the CIT(A)

Onus to prove incurrence of expenditure

- The onus to prove that interest bearing funds were used or expenditure was incurred, lies squarely on the shoulders of the revenue. Thus, if the AO is able to refer to relevant material while recording satisfaction that borrowed funds were used to earn interest- free income, he may legitimately disallow such a claim. The AO however cannot by recording general observations, particularly where the assessee has denied using interest- bearing funds, proceed to infer that interest-bearing funds may have been used to earn exempted income. Section 14A being in the nature of an exception, has to be construed strictly and only where the AO records satisfaction, on the basis of clear and cogent material, shall an order be passed under section 14A, disallowing such a claim
 - *Abhishek Industries Ltd (2016)(380 ITR 652)(P & H HC)*
 - *Maruti Udyog Ltd.(2005)(92 ITD 119)(Del ITAT)*
 - *Claridges Investments & Finances (P) Ltd (2007)(18 SOT 390)(Mum ITAT)*
 - *Allied Investments Housing P Ltd (2013)(ITA No305/Mds/2013)(Chen ITAT)*
- The following rulings however hold that the onus lies with the assessee:
 - *Deepak Mittal (2014)(361 ITR 131)(P&H HC)*
 - *Pavak Securities (P) Ltd (2014)(146 ITD 305)(Mum ITAT)*
 - *Alcon Developers (2015)(68 SOT 299)(Panaji ITAT)*

Computation under
existing Rule 8D – some
issues

Existing Rule 8D – some issues (1/4)

Based on the assessee's facts and in case of apparent incongruity on mechanical application of Rule 8D, an amount lower than the computation as per Rule 8D can be disallowed:

- *Ramkumar Venugopal Investments Pvt. Ltd. (2014)(ITA No. 6324/Mum/2012)(Mum ITAT)*
- *Damani Estates & Finance Pvt Ltd (2013)(ITA No. 3029/Mum/2012)(Mum ITAT)*
- *Oriental Structural Engineers (P) Ltd (2013)(216 Taxman 92)(Del HC)* – the Delhi HC upheld the ITAT's decision restricting disallowance to 2% of the dividend income, in disregard of Rule 8D
- *Kodak India (P) Ltd (2013)(155 TTJ 697)(Mum ITAT)*

Interest directly relatable to taxable income is also to be excluded for the purpose of Rule 8D(2)(ii):

- *Godrej & Boyce Mfg. Co. Ltd. (2010)(328 ITR 81)(Bom HC)* – Revenue's stand
- *Bharti Overseas (P) Ltd (2016)(237 Taxman 417)(Del HC)*
- *Champion Commercial Co Ltd (2012)(139 ITD 108)(Kol ITAT)*
- *Best & Crompton Engg Ltd (2013)(60 SOT 53)(Chenn ITAT)*
- *Geojit Investment Services Ltd (2014)(50 taxmann.com 150)(Cochin ITAT)*

However, the said issue would be academic under the amended Rule 8D which does not prescribe apportionment of indirect interest expenditure

Existing Rule 8D – some issues (2/4)

Netting off of interest income against interest expenditure in applying Rule 8D(2)(ii):

- Netting off allowed:
 - *Aditya Medisales Ltd.(2016)(67 taxmann.com 270)(Ahd ITAT)*
 - *Morgan Stanley India Securities (P) Ltd(2011)(55 DTR 177)(Mum ITAT)*
 - *Trade Apartment Ltd (ITA No.1277/Kol/2011)(Kol ITAT)*
 - *Jamson Securities Pvt Ltd (ITA No.6015/M/2012)(Mum ITAT)*
 - *Karnavati Petrochem Pvt. Ltd.(ITA No.2228/Ahd/2012)(Ahd ITAT)*
- Netting off not allowed:
 - *Cranes Software International Ltd (2014)(152 ITD 737)(Bang ITAT)*
 - *Sitsons India (P) Ltd (2014)(63 SOT 37)(Mum ITAT)*

However, the said issue would be academic under the amended Rule 8D which does not prescribe apportionment of indirect interest expenditure

Existing Rule 8D – some issues (3/4)

Whether ‘total assets’ under Rule 8D(2)(ii) would include:

- *Deferred Revenue Expenditure:*
Distinction is required between a typical deferred revenue expenditure (where resource is defrayed but benefits are expected to last over more than one year) vis-a-vis prepaid expenses or payments where the payee is bound to provide benefit over multiple years. If an item represents a contractual right or an asset, it may be included in the total assets
- *Profit and Loss Account – Debit balance:*
It represents accumulated losses which do not have any of the attributes of an ‘asset’. Hence, the same may be excluded from the total assets
- *Deferred tax asset:*
It represents a resource since by paying higher current tax, the taxpayer gains a right to claim deduction in subsequent years on fulfilment of relevant conditions (eg. actual payment of liability disallowed under section 43B). It constitutes future tax savings and hence could be included in the value of total assets

Existing Rule 8D – some issues (4/4)

Whether ‘total assets’ under Rule 8D(2)(ii) would include:

- *MAT credit:*

As per ‘Guidance Note on Accounting for credit available in respect of Minimum Alternative Tax under The Income-tax Act, 1961’ issued by the ICAI, MAT credit can be considered as an asset. Hence the same would be includible in the total assets.

- *Current liabilities and provisions:*

In the generic sense from an accounting perspective, total assets would refer to the sum of Fixed assets and Current assets. Current liabilities would not be deducted from total assets. Further, in the absence of a specific provision for either ignoring or reducing the value of Current liabilities and provisions, from the ‘total assets as appearing in the balance sheet’, the generic sense may be considered. That is the total assets should include the gross Current assets without netting off the Current liabilities and provisions.

However, the said issue would be academic under the amended Rule 8D which does not prescribe apportionment of indirect interest expenditure

Other issues

Partial taxation of dividends – new section 115BBDA inserted by the Finance Act 2016

- Finance Act 2016 has introduced section 115BBDA providing for an additional tax of 10% on the amount of dividend exceeding Rs. 10 lakhs. The provision would apply to dividends declared or distributed or paid from 1 April 2016
- Sub-section (1) provides that any income in aggregate exceeding Rs.10 lakhs, by way of dividend declared, distributed or paid by a domestic company, shall be chargeable to tax at the rate of 10% in the case of an individual, HUF or a firm who is a resident in India
- Sub-section (2) further provides that no deduction of any expenditure or allowance or set off of loss shall be allowed under any provision of the Act against the dividend in excess of Rs.10 lakhs i.e. dividend in excess of Rs.10 lakhs will be charged to an additional tax @ 10% on gross basis
- Given this partial taxation of dividends in excess of Rs.10 lakhs, it would be interesting to see the manner in which the provisions of section 14A and Rule 8D in particular, are applied in relation to the exempt portion of the dividends

Own funds versus Borrowed funds (1/2)

- If there are funds available – both own and borrowed, and if the own funds are sufficient to meet the amount of investment yielding the exempt income, then a presumption would arise that the investment was made out of the own funds available with the assessee:
 - *Reliance Utilities & Power Ltd (2009)(313 ITR 340)(Bom HC)*
 - *UTI Bank Ltd. (2013) (215 Taxman 8) (Mag.)(Guj. HC)*
 - *BNP Paribas (2013)(214 Taxman 548) (Bom. HC)*
 - *HDFC Bank Ltd. (2014)(366 ITR 505) (Bom HC)*
 - *Dhampur Sugar Mills Ltd.(2015) (370 ITR 187)(All HC)*
 - *SBI DHFL Ltd (2015)(376 ITR 296)(Bom HC)*
 - *India Gelatine and Chemicals Ltd (2015)(376 ITR 553)(Guj HC)*
 - *Karnataka State Industrial & Infrastructure Development Corpn Ltd (2016)(237 Taxman 240)(Kar HC)*
 - *Yes Bank Ltd. (2015)(68 SOT 291)(Mum ITAT)*
 - *Bandekar Brothers (P.) Ltd (2015)(155 ITD 1171)(Panji ITAT)*
 - *Yes Bank Ltd. (2015)(68 SOT 291) (Mum ITAT)*

Own funds versus Borrowed funds (2/2)

- The Mumbai Tribunal held in the case of *HDFC Bank Ltd.(2015)(155 ITD 765) (Mum ITAT)* that even if the assessee had utilized own funds for making investments which had resulted in exempt income, expenditure incurred in earning of that income would have to be disallowed under section 14A read with rule 8D. In arriving at this conclusion, the Tribunal sought to distinguish the binding decisions of the Bombay HC in the case of *Reliance Utilities & Power Ltd.* (supra) and also in the *taxpayer's own case (366 ITR 505)(supra)*

However, the above decision of the Mumbai Tribunal has been recently struck down by the Bombay HC in *HDFC Bank Ltd. (2016)(67 taxmann.com 42)(Bom HC)* on the basis that it was a clear case of judicial indiscipline. The Hon'ble HC held that the Tribunal could not circumvent a binding HC decision and has hence restored the matter for fresh adjudication

Disallowance in the absence of exempt income

- Disallowance under section 14A will not apply if no exempt income is received or receivable during the relevant year:
 - *Winsome Textile Industries Ltd. (2009)(319 ITR 204) (P&H HC)*
 - *Delite Enterprises (ITA No. 110/2009)(Bom HC)*
 - *Lakhani Marketing Inc (2014)(272 CTR 265)(P&H HC)*
 - *Corrtech Energy Pvt. Ltd.(2014)[(372 ITR 97)(Guj HC)*
 - *Shivam Motors (P) Ltd. (2015)(230 Taxman 63) (All. HC)*
 - *Holcim India P. Ltd. (2015)(57 taxmann.com 28)(Del HC)*
 - *Cheminvest Ltd (2015)(378 ITR 33)(Del. HC)* – Special Bench reversed
- Earlier, a contrary view was expressed by a Special Bench of the Delhi Tribunal in the case of *Cheminvest Ltd(2009)(121 ITD 318)(Del ITAT)(SB)*. However the Special Bench's decision has been reversed by the Delhi HC in the ruling supra.
- Further, CBDT Circular No. 5/2014 dated 11 February 2014 clarifies that for disallowance under section 14A, it is not material that exempt income should have been earned during the year under consideration. However, given that circulars which are not favourable to the assessee are not binding and in view of the HC decisions above, it can be strongly contended that section 14A will not apply in the absence of exempt income.

Disallowance in excess of exempt income

- Disallowance under section 14A should be restricted to the income claimed as exempt:
 - *Joint Investments Pvt. Ltd. (2015)(372 ITR 694)(Del. HC)*
 - *Sahara India Financial Corpn. Ltd.(2014)(148 ITD 336) (Del. ITAT)*
 - *Daga Global Chemicals P. Ltd. (2015)(ITA No. 5592/Mum/2012)(Mum ITAT)*
 - *Kumaran Systems (P.) Ltd (2016)(66 taxmann.com 75)(Chenn ITAT)*
- A contrary view has however been expressed in:
 - *Sanchayita Mercantile P. Ltd. [2008](25 SOT 57) (Mum. Trib.)*
- Reliance can also be placed on the favourable HC rulings holding that disallowance under section 14A will not apply if no exempt income is received or receivable during the year (discussed in the immediately preceding slide)

Disallowance in excess of expenditure claimed

- Disallowance under section 14A should be restricted to the expenditure claimed as deductible:
 - *Gillette Group India (P) Ltd (2012)(51 SOT 221)(Del ITAT)*
 - *Iqbal M. Chagala (2014)(67 SOT 123)(Mum ITAT)*
 - *Manugraph India Ltd (2015)(ITA No.4761/Mum/2013)(Mum. ITAT)*
- As discussed in Slide 18, the amended Rule 8D restricts the quantum of disallowance to the amount of total expenditure claimed deductible by the taxpayer.

Overlap with expenses disallowed under other provisions, say section 36(1)(iii)

- Section 36(1)(iii) allows deduction of the interest expense (of a revenue nature) incurred for business purpose, whereas section 14A disallows interest expenditure incurred in respect of exempt income
- A scenario may arise wherein interest which has not been allowed as deductible under section 36(1)(iii), may also be considered for disallowance under section 14A

Under such circumstances, it can be argued that as the interest has not been allowed as deduction under section 36(1)(iii), the same should not be considered for section 14A disallowance as it would result into double disallowance

A similar proposition has been accepted by the Kolkata Tribunal in the case of *Snowtex Investment Ltd (2015)(174 TTJ 875)(Kol ITAT)*

Can the claim for exemption be foregone (1/2)

- An exemption granted under the Act is a matter of privilege or advantage. It may be argued that the exemption provision may be considered as onerous in nature and hence a taxpayer is at a privilege to read the law by excluding the exemption provision

In the case of *Mahendra Mills (2000)(243 ITR 56)(SC)*, the Supreme Court in the context of depreciation under section 32, prior to insertion of Explanation 5, held that if a taxpayer does not wish to avail a particular benefit, such benefit cannot be thrust upon him by the Department

- Section 14A will apply only in respect of expense relating to income which does not form part of total income. If the claim for exemption of income is foregone, the income would form part of the total income and hence section 14A will not apply
- In the case of *Winsome Textile Industries Ltd (2009)(319 ITR 204)(P&H HC)*, it was held that disallowance under section 14A will not apply as 'no claim for exemption' was made by the assessee. However the facts of the case are not clear on whether the assessee did not earn tax-free income during the year, or earned such income, but merely did not claim exemption

Can the claim for exemption be foregone (2/2)

- As discussed in the previous slides, there are several rulings which have held that disallowance under section 14A will not apply in the absence of exempt income. However, these rulings are distinguishable on the fact that in all those cases, the assessee did not earn any exempt income during the relevant year, and it was not that they earned exempt income, but waived the claim for exemption of income

Once the benefit of these rulings is not available due to the above difference in facts, then owing to Circular No. 5/2014 dated 11 February 2014, which states that disallowance would apply even if there is no tax-free income, it may not help in any way to give up the claim for exemption of income as the assessee would not only lose the benefit of exemption of income, but could also be made to suffer a disallowance of the expense

- In any case, even if it is argued that such option to forego the exemption of income is available, the same would have to be followed consistently and not on a pick-and-choose basis from year to year

Applicability to investments capable of yielding taxable income

- Investments which are capable of yielding taxable income (eg: a share of an unquoted company is capable of yielding tax-free dividend, as well as taxable capital gains) are to be excluded for the purpose of disallowance under section 14A:
 - *Avshesh Mercantile Private Limited (2012)(54 SOT 19)(Mum ITAT)*
 - *Sundaram Asset Management Co. Ltd.(2013)(145 ITD 17)(Chenn ITAT)*

Applicability to computation of book profit under section 115JB

- Expenditure disallowed under section 14A will have to be added back while computing book profit under section 115JA/ 115JB:
 - *Viraj Profiles Ltd (2016)(156 ITD 72) (Mum ITAT)*
 - *Sobha Developers (2015)(58 taxmann.com 107)(Bang. ITAT)*
 - *Microlabs Ltd (2015)(70 SOT 774) (Bang. ITAT)*
 - *Ferani Hotels (P.) Ltd (2015)(58 taxmann.com 42)(Mum ITAT)*
 - *Goetze (India) Ltd. (2014)(361 ITR 505)(Delhi HC) – overruled Del ITAT*
 - *Dabur India Ltd. (2014)(159 TTJ 563) (Mum ITAT)*
 - *RBK Share Broking (P) Ltd (2013)(60 SOT 61)(Mum ITAT)*
- Contrary view:
 - *Goetze (India) Ltd. (2009)(32 SOT 101) (Del. ITAT) – overruled by Del HC*
 - *Beach Minerals Company (P.) Ltd (2015)(ITA Nos. 2110,2188 of 2014)(Chen. ITAT)*
 - *Ovira Logistics Ltd. (ITA Nos. 3230 & 2439 of 2012)(Mum ITAT)*
 - *Bengal Finance & Investments (P.) Ltd. (ITA No. 5937 of 2010)(Mum ITAT)*
 - *Essar Teleholdings Ltd. (ITA No. 3850 of 2010)(Mum ITAT)*

Applicability to shares held as stock-in-trade (1/2)

- When the assessee has not retained shares with the intention of earning dividend income and the dividend is only incidental to its share trading business, the expenditure relatable to the dividend income cannot be disallowed under section 14A:
 - *CCI Ltd.(2012)(250 CTR 291) (Kar HC)*
 - *Smt. Leena Ramachandran (2011)(339 ITR 296) (Ker HC) (obiter dicta)*
 - *Yatish Trading Co. (P.) Ltd. (2011)(129 ITD 237)(Mum. ITAT)*
 - *Oasis Securities Ltd. (2013)(59 SOT 302) (Mum. ITAT)*
 - *Zaveri Virjibhai Mandalia (2013)(152 TTJ 20(UO)) (Ahd. ITAT)*
 - *India Advantage Securities Ltd (2014)(ITA No. 1131 of 2013)(Bom HC)*
 - *Baljit Securities (P.) Ltd (2015)(68 SOT 82)(Kol. ITAT)*
 - *Canara Bank (2016)(68 taxmann.com 128) (Bang Trib.)*
 - Provisions of Rules 8D(2)(ii) and (iii) refer to ‘investments’ and would hence not apply to shares held as stock-in-trade:
 - *Gulshan Investment Co. Ltd. (2013)(142 ITD 89)(Kol ITAT)*
 - *Baljit Securities (P) Ltd. (2015)(68 SOT 82)(Kol ITAT)*
- Argument not accepted in:
- *Daga Capital Management Pvt. Ltd.(2009)(117 ITD 169)(Mum. ITAT)(SB)*

Applicability to shares held as stock-in-trade (2/2)

- Once an investment is made in shares, disallowance under section 14A has to be computed even if the shares constitute stock-in-trade:
 - *Daga Capital Management Pvt. Ltd.(2009)(117 ITD 169)(Mum. ITAT)(SB)*
 - *Dhanuka & Sons (2011)(339 ITR 319) (Kol HC)*
 - *D. H. Securities (2014)(146 ITD 1)(Mum. ITAT)(TM)*
 - *Damani Estates and Finance P. Ltd. (2013)(25 ITR 683) (Mum ITAT)*
 - *Doubledot Finance Ltd. (2014)(65 SOT 324)(Mum ITAT)*
 - *Chona Financial Services Ltd. (2015)(153 ITD 119)(Chenn ITAT)*

Applicability to investments in group companies/ strategic investments

- The provisions of section 14A will not apply as these investments are made for strategic purpose or to acquire controlling interest and not for earning dividend income:
 - *Interglobe Enterprises Ltd.(2014)(ITA Nos.1362, 1032/Del/2013)(Del ITAT)*
 - *Garware Wall Ropes Ltd. (2014)(65 SOT 86)(Mum. ITAT)*
 - *Selvel Advertising (P.) Ltd (2015)(37 ITR(T) 611)(Kol ITAT)*
 - *Oriental Structural Engineers (P) Ltd.(2013)(216 Taxman 92)(Del HC)*
 - *L & T Infrastructure Development Projects Ltd.(2015)(37 ITR(T) 10)(Chennai ITAT)*
 - *EIH Ltd.(2015)(63 taxmann.com 291) (Kol. ITAT)*
 - *U.P. Electronics Corporation Ltd (2015)(ITA No. 538/LKW/2012)(Luck. ITAT)*
- Contra view - investment in shares of operating companies for acquiring and retaining a controlling interest therein is hit by the provisions of section 14A:
 - *Maxopp Investment Ltd. (2012)(347 ITR 272)(Delhi HC)*

Applicability to investments due to commercial expediency

- Disallowance under section 14A will not apply as dividend income is purely incidental and hence the expenses cannot be termed as expenses for earning exempt income:
 - *L & T Infrastructure Development Projects Ltd.(2015)(37ITR(T)10)(Chenn ITAT)*
 - *EIH Associated Hotels Ltd.(2013)(ITA No.1503/Mds/2012)(Chenn ITAT)*
 - *Igarashi Motors India Ltd (2016)(68 taxmann.com 333)(Chenn ITAT)*
 - *Oriental Structural Engineers (P) Ltd.(2013)(216 Taxman 92)(Del HC)*
- Disallowance will apply to investments made in compliance with the RBI Guidelines related to the Statutory Liquidity Ratio as the object or purpose of investment does not affect operation of section 14A:
 - *Punjab National Bank (2006)(103 TTJ 908)(Del. ITAT)*
 - *State Bank of Travancore (2011)(203 Taxman 639)(Ker HC)*
 - *Sahara India Financial Corpn Ltd (2014)(148 ITD 336)(Del Trib)*

Applicability to share application money

- Share application money with no known date on which shares are to be allotted, cannot be equated with an investment made for the purpose of earning income. Pending allotment of shares, it is not capable of yielding dividend income. Hence the question of applying section 14A does not arise:
 - *Aban Investments P Ltd. (2012)(22 taxmann.com 44) (Chenn ITAT)*
 - *Rainy Investments P. Ltd. (2013)(56 SOT 61) (Mum ITAT)*
 - *MSA Securities Services P. Ltd. (2013)(58 SOT 44)(Chenn ITAT)*
 - *LGW Ltd (2015)(ITA No. 267 of 2013)(Kol ITAT)*

Applicability to shares received pursuant to amalgamation/ merger

- In the case of *Greaves Leasing Finance Ltd. (2012)(54 SOT 22)(Mum. ITAT)*, the Mumbai Tribunal held that the AO is not justified in making disallowance under section 14A where the assessee had not incurred any expenditure to earn dividend income on shares which were acquired by way of amalgamation.
- In the case of *Cellice Developers (P) Ltd (2015)(231 Taxman 255)(Cal HC)*, the Calcutta HC observed that no substantial expenditure was incurred by the assessee in relation to shares acquired by virtue of a merger.

Disallowance in the hands of partner and partnership firm

- Disallowance under section 14A will apply in relation to partner's share of profit from the partnership firm:
 - *Sudhir Dattaram Patil (2005)(2 SOT 678)(Mum ITAT)*
 - *A.H. Baldota (2006)(10 SOT 757)(Mum ITAT)*
 - *Marezban Bharucha (2007)(12 SOT 133)(Mum ITAT)*
 - *Popular Vehicles & Services Ltd (2010)(325 ITR 523) (Ker HC)*
 - *Vishnu Anant Mahajan(2012)(137 ITD 189)(Ahd. ITAT)(SB)*
 - *Hoshang Nanavati (2012)(25 taxmann.com 141)(Mum ITAT)*
- Interest paid on partner's capital would be disallowable under section 14A in the firm's hands, where the same is attributable to earning of exempt dividend income:
 - *Shankar Chemicals Works (2011)(47 SOT 121)(Ahd ITAT)*
 - *Pahilajrai Jaikishan (2016)(157 ITD 1187)(Mum ITAT)*

Applicability to certain businesses

- **Insurance business:**

Provisions of section 14A will not apply in view of the special provisions applicable to insurance companies for computation of profits:

- *Birla Sunlife Insurance Co. Ltd (2010)(TS-23-ITAT-2010) (Mum. ITAT)*
- *Oriental Insurance Co. Ltd. (2010)(130 TTJ 388) (Del. ITAT)*
- *Bajaj Allianz General Insurance Co. Ltd. (2010)(130 TTJ 398) (Pune ITAT)*

- **Shipping business qualifying for Tonnage Tax Scheme:**

Provisions of section 14A will not apply in view of the special provisions of the Tonnage Tax Scheme for computation of profits:

- *Varun Shipping Company Ltd. (2012)(144 TTJ 286)(Mum. ITAT)*
- *Four M Maritime (P.) Ltd. (2013)(152 ITD 557) (Chennai ITAT)*
- *Raj Shipping Agencies Ltd. (2013)(24 ITR 249) (Mum ITAT)*
- *TAG Offshore Ltd.(2015)(153 ITD 525)(Mum. ITAT)*

Applicability to Growth Funds

- **Growth Funds:**

- *Manugraph India Ltd (ITA No. 4761 of 2013)(Mum. ITAT)*
- *Everest Kanto Cylinders Ltd (167 TTJ 204)(Mum ITAT)*

Reopening of assessments for disallowance under section 14A

- Reopening of assessments for the purpose of disallowance under section 14A was not valid, where such reopening was based on change of opinion and/or there was no failure on the assessee's part to disclose facts material to the computation of income:
 - *Sun Pharmaceutical Industries Ltd (2016)(381 ITR 387)(Del HC)*
 - *Munjal Showa Ltd (2016)(67 taxmann.com 359)(Del HC)*
 - *P.G. Foils Ltd. (2013)(356 ITR 594)(Guj. HC)*
 - *Reckitt Benckiser Healthcare India Ltd. (2009)(216 Taxman 209)(Guj.HC)*
 - *Sterling Infotech Ltd. (2013)(59 SOT 19) (Chenn ITAT)*
- Reassessments of AY prior to AY 2001-02:
 - Reopening upheld despite the bar provided in proviso to section 14A
Honda Siel Power Products Ltd.(2012)(340 ITR 64)(SC)
 - Proviso not applicable when the initial proceedings were completed under section 143(1)
Tube Investments of India Ltd. (2011)(133 ITD 79)(Chennai ITAT)(TM)
 - Matters pending before appellate authorities
Aquarius Travels Pvt. Ltd.(2008)(111 ITD 53) (Delhi ITAT)(SB)

Revision under section 263 for disallowance under section 14A

- Revision under section 263 struck down on the basis that it was not justified simply because the AO after plausible enquiry, held a separate view:
 - *Deep Industries Ltd (2016)(238 Taxman 198) (Guj. HC)*
 - *Hotz Industries Ltd. (2014)(49 taxmann.com 267)(Delhi HC)*
 - *Galileo India (P) Ltd. (2014)(220 Taxman 115) (Mag.)(Delhi HC)*
 - *DLF Ltd. (2013)(350 ITR 555)(Delhi HC)*
 - *L&T Infrastructure Development Projects Ltd(2013)(357 ITR 763) (Mad HC)*
 - *Shri Paul John, Delicious Cashew Co (2011)(200 Taxman 154)(Ker HC)*
- Revision under section 263 was upheld:
 - *NIIT (2015)(60 taxmann.com 313) (Del. ITAT)*
 - *RKBK Fiscal Services P Ltd (2013)(358 ITR 228)(Cal. HC)*
 - *Goetze (India) Ltd. (2014)(361 ITR 505)(Delhi HC)*
 - *Jammu & Kashmir Bank Ltd. (2009)(118 ITD 146)(Amr. ITAT)*
 - *Mahesh G. Shetty (2012)(344 ITR 18)(Kar HC)*

Penalty under section 271(1)(c) on account of disallowance under section 14A

- So long as the assessee had disclosed all facts material to the computation of its income and had offered bonafide explanation for its claims, mere making of an incorrect claim or confirmation of the disallowance at the appellate level, would not entail penalty:
 - *Reliance Petroproducts (P) Ltd (2010)(322 ITR 158) (SC)*
 - *Aarge Drugs (P.) Ltd (2015)(61 taxmann.com 254)(Chand ITAT)*
 - *Nalwa Investments Ltd (2011)(ITA No. 3805/Del/2010)(Del ITAT)*
 - *Blue Niles Holdings Ltd (2011)(ITA No. 2904/Mum/2010)(Mum ITAT)*
 - *Mimosa Investment Co. (P) Ltd (2009)(28 SOT 470) (Mum ITAT)*
 - *Sunash Investment Co. Ltd. (2007)(14 SOT 80) (Mum ITAT)*
 - *Liquid Investment and Trading Co. (ITA 240/2009) dated 5/10/2010 (Del HC)*

Recommendations of Easwar Committee

Amendments to section 14A to provide that:

- (i) Dividend received after suffering dividend-distribution tax and share income from firm suffering tax in the firm's hands will not be treated as exempt income and no expenditure will be disallowed as relatable to them
- (ii) Expenditure disallowed shall not exceed the amount claimed
- (iii) Recommendation for issue of executive instructions that no interest be disallowed if source of investment is directly relatable to taxable income

Thank You