



**Trail of Judicial views on s. 14A
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Right from the day when s. 14A was introduced it has been the subject matter of litigation between the Tax Payers and the tax Collectors. Over a period the issue has remained not only in complex but also controversial.

S. 14A was introduced by Finance Act, 2001 w.e.f. 01.04.1962. This section, as originally enacted, provides that in computing the total income, no deduction shall be allowed in respect of expenditure incurred in relation to income which does not part of total income.

Subsequently, sub-sec. (2) and (3) inserted by Finance Act 2006, w.e.f. 01.04.2007 empowering AO to determine the said expenditure incurred in relation to exempt income.

Subsequently, Rule 8D was also introduced w.e.f. 24.03.2008, prescribing the method of computing the expenditure. The original enactment and the subsequent amendments have made provisions complex and litigative.

The first remarkable decision on the issue was that of ITO v. Daga Capital Mngt. Pvt. Ltd. [17

ITD 169 (Mum.)(SB)].In this case, controversy that arose was whether the expenditure by way of interest on borrowed capital in case of share trading business can be disallowed u/s. 14A. In the process of deciding the said issue, number of other issues connected with s. 14A were decided. It was held in the case as follows:

(a) The disallowance would be justified even if the expenditure is allowable u/s. 36(1)(iii).

(b) Sub-sec. (2) and (3) introduced by Finance Act, 2006 have retrospective application.

(c) The exempt income should be first traced and then disallowance u/ s. 14A should be resorted to.

(d) There should be direct nexus between the expenditure incurred and the exempt income. The onus therefore was on the AO to establish the direct nexus of the expenditure with the income.

Subsequent to the above decision, the controversy still remained unresolved was whether s.14A can be applied even if no income is earned by the assessee during the year. The Spl. Bench in Cheminvest Ltd v. ITO [124 TTJ 557 (Del)(SB)] held that s. 14A would be applicable even if no dividend income is actually earned during the year.

Inspite of the 2 Special Bench decisions elaborately discussing the



issues arising from s. 14A, the question still remained whether what is to be disallowed is actually expenditure or the expenditure computed on estimated basis. The Hon'ble Bombay High Court in the case of Wallfort Shares & Stocks Brokers Pvt. Ltd. v. ITO [310 ITR 42] observed that what is contemplated u/s. 14A is the expenditure actually incurred and not an assumed expenditure. The above view of the Hon'ble Bom. HC was upheld by the Hon'ble SC.

The issues earlier decided by the Spl. Bench in Daga Capital were subject matter of review before the Hon'ble Bombay High

Curt in case of Godrej Boyce Mfg. Co. Ltd. v. DCIT [234 CTR 1]. In this case, the Court decided number of issues as follows:

- (1) s. 14A and Rule 8D are constitutional validity.
- (2) Sub-sec. (2) and (3) as well as Rule 8D are applicable only w.e.f. A.Y. 2008-09.
- (3) There should be a proximate cost for disallowance based on the relationship of the Expenditure with exempt Income.
- (4) In respect of years prior to A.Y. 08-09, a reasonable disallowance may be made after considering the relevant

facts and circumstances of the case.

Even Punjab & Haryana High Court had dealt with an identical issue in the case of CIT v. Hero Cycles [323 ITR 158] wherein it was held that if no expenditure is found to have been incurred, disallowance cannot be made.

In relation to power of the Tribunal to invoke s 14A, Hon'ble Bombay HC in the case of Topstar Mercantile Pvt. Ltd. v. ACIT [225 CTR 351] held that if the AO has not raised any adverse findings, disallowance u/s. 14A cannot be made by the Tribunal.

While issues relating to s. 14A had almost reached finality, the

question that still arose was the nature of expenses that could be disallowed. In the case of CIT v. Catholic Syrian Bank Ltd., Kerala High Court observed that no assumption can be made in respect of investment out of the borrowed funds. Further, it was held that considering the facts that there is no precise formula for proportionate disallowance, no disallowance can be made for administrative cost attributable to tax free income until Rule 8D came into force.

On the above principles, several decisions have been rendered, the most recently reported being Reliance Consolidated Enterprises [2011-



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TIOL-44] wherein it was held that when there is evidence that investment to earn tax exempt income was made much prior to the borrowing of interest-bearing funds, AO is right in making ad hoc disallowance of some administrative expenditure.

Similarly, Delhi Tribunal held that no disallowance can be made if AO does not show the nexus between the borrowed funds and the tax free investment in the case of DCIT v. Maharashtra Seamless Ltd. [2011 TIOL 53 (Del)] In the case of DCIT v. Jindal Photos Ltd, it has been held that onus to show the nexus is on the AO.

In an interesting case of Pawan Kumar Parameshwarlal, the Tribunal accepted the submissions of the assessee that no expenditure was incurred by the assessee to earn tax free income as the shares were in demat account for longer time and the dividend was automatically credited to the bank account.

The long drawn controversy of s. 14A itself shows that the litigation does not end here and there is still scope for getting some relief from the clutches of s. 14A. In short, "Pictures Abhi Baki hai Mere Dost"

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