
[2017] 77 taxmann.com 257 (Madras)/[2017] 392 ITR 633 (Madras)

IT : Where there is no exempt income in relevant year, there cannot be a disallowance of expenditure under section 14A in relation to any assumed income

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[2017] 77 taxmann.com 257 (Madras)

HIGH COURT OF MADRAS

Redington (India) Ltd.

v.

Additional Commissioner of Income-tax, Co. Range-V, Chennai*

NOOTY RAMAMOohana RAO AND DR. ANITA SUMANTH, JJ

T.C.A. NO. 520 OF 2016[†]

DECEMBER 23, 2016

Section [14A](#) of the Income-tax Act, 1961, read with rule [8D](#) of the Income-tax Rules, 1962 - Expenditure incurred in relation to income not includible in total income (Condition precedent) - Assessment year 2007-08 - Whether provision of section 14A is relatable to earning of actual income and not notional or anticipated income, hence, where there is no exempt income in a year, there cannot be a disallowance of expenditure in relation to an assumed income - Held, yes [Para 15] [In favour of assessee]

Circulars and Notifications: [Circular No. 5 of 2014, dated 11-2-2014](#)

FACTS

- The assessee had investments in companies to the tune of Rs. 177.56 crores that had not yielded any returns in the previous year relevant to the present assessment year.
- The Assessing Officer disallowed the expenditure under section 14A, read with rule 8D despite objections that the provisions of the abovesaid section would not be attracted in a case where no actual exempt income had been earned.
- On appeal, the Dispute Resolution Panel also confirmed the disallowance.
- On further appeal, the Tribunal also confirmed the disallowance.
- On appeal to the High Court:

HELD

- Section 14A was inserted providing that no deduction shall be allowable in respect of expenditure incurred in relation to the earning of income exempt from taxation. The Supreme Court in the judgment in the case of *CIT v. Walfort Share & Stock Brokers (P.) Ltd.* [\[2010\] 326 ITR 1/192 Taxman 211](#) has observed that section 14A desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail of the tax incentive by way of an exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. [Para 9]
- The provision thus is clearly relatable to the earning of actual income and not notional or anticipated

income. The computation of total income in terms of section 5 is on real income and there is no sanction in law for the assessment of admittedly notional income, particularly in the context of effecting a disallowance in connection therewith. [Para 10]

- The computation of disallowance in terms of rule 8D is by way of a determination involving direct as well as indirect attribution. Thus, accepting the submission of the revenue would result in the imposition of an artificial method of computation on notional and assumed income. [Para 11]
- Nothing much turns on the use of the word 'includable' and the phrase 'under the act' in section 14A and the emphasis laid or the interpretation of the same by the revenue cannot be accepted. An assessment in terms of the Income-tax Act is specific to an assessment year and the related previous year. [Para 14]
- The provisions of section 10 in Chapter III dealing with 'Incomes not included in total income' commences with the phrase 'In computing the total income of a previous year, any income falling within any of the following clauses shall not be included.....' [Para 14]
- The exemption extended to dividend income would relate only to the previous year when the income was earned and none other and consequently the expenditure incurred in connection therewith should also be dealt with in the same previous year. Thus, by application of the matching concept, in a year where there is no exempt income, there cannot be a disallowance of expenditure in relation to such assumed income. The language of section 14A(1) should be read in that context and such that it advances the scheme of the Act rather than distort it. [Para 15]
- In conclusion, the provisions of section 14A, read with rule 8D of the rules cannot be made applicable in a vacuum *i.e.* in the absence of exempt income. The question of law are answered in favour of the assessee and against the department and the appeal allowed. [Para 16]

CASE REVIEW

Redington (India) Ltd. v. Addl. CIT [2015] 61 taxmann.com 312 (Chennai - Trib) (para 16) reversed.

CIT v. Walfort Share & Stock Brokers (P.) Ltd. [2010] 326 ITR 1/192 Taxman 211 (SC) (para 9); *Beach Minerals Co. (P.) Ltd. v. Asstt. CIT* [TC Appeal No. 681 of 2013, dated 2-12-2013] (para 13) and *Madras Industrial Investment Corpn. Ltd. v. CIT* [1997] 225 ITR 802/91 Taxman 340 (SC) (para 15) followed.

South Indian Bank Ltd. v. CIT [2014] 363 ITR 111/226 Taxman 130/49 taxmann.com 100 (Ker.); *CIT v. Catholic Syrian Bank Ltd.* [2012] 208 Taxman 51 (Mag.)/22 taxmann.com 166 (Ker.) and *Dhanuka & Sons v. CIT* [2011] 339 ITR 319/201 Taxman 105/12 taxmann.com 227 (Cal.) (para 12) distinguished.

CASES REFERRED TO

Cheminvest Ltd. v. ITO [2009] 121 ITD 318 (Delhi) (SB) (para 2), *CIT v. Corrttech Energy (P.) Ltd.* [2015] 372 ITR 97/[2014] 223 Taxman 130/45 taxmann.com 116 (Guj.) (para 6), *Holcim India Ltd. v. CIT* [2015] 57 taxmann.com 28 (Delhi) (para 6), *CIT v. Shivam Motors (P.) Ltd.* [2015] 230 Taxman 63/55 taxmann.com 262 (All.) (para 6), *Pr. CIT v. Gujarat State Petronet Ltd.* [Tax Appeal No. 543 of 2016, dated 11-7-2016] (para 6), *CIT v. Lakhani Marketing Inc.* [2014] 226 Taxman 45 (Mag.)/49 taxmann.com 257 (Punj. & Har.) (para 6), *CIT v. Maharashtra Sugar Mills Ltd.* [1971] 82 ITR 452 (SC) (para 9), *Rajasthan State Warehousing Corpn. v. CIT* [2000] 242 ITR 450/109 Taxman 145 (SC) (para 9), *CIT v. Walfort Share & Stock Brokers (P.) Ltd.* [2010] 326 ITR 1/192 Taxman 211 (SC) (para 9), *South Indian Bank Ltd. v. CIT* [2014] 363 ITR 111/226 Taxman 130/49 taxmann.com 100 (Ker.) (para 12), *CIT v. Catholic Syrian Bank Ltd.* [2012] 208 Taxman 51 (Mag.)/22 taxmann.com 166 (Ker.) (para 12), *Dhanuka & Sons v. CIT* [2011] 339 ITR 319/201 Taxman 105/12 taxmann.com 227 (Cal.) (para 12), *Beach Minerals Co. (P.) Ltd. v. Asstt. CIT* [TC Appeal No. 681 of 2013, dated 2-12-2013] (para 13) and *Madras Industrial Investment Corpn. Ltd. v. CIT* [1997] 225 ITR 802/91 Taxman 340 (SC) (para 15).

Vijayaraghavan for the Appellant. **T. Ravikumar**, Sr. Standing Counsel for the Respondent.

JUDGMENT

Dr. Anita Sumanth, J. - This appeal comes to us at the instance of the assessee raising various substantial questions of law extracted below:—

- "1. Whether the Tribunal was right in law in holding that disallowance under Section 14A of the Act r/w. Rule 8D of the Income Tax Rules can be made in a year in which no exempt income has been earned or received by the Assessee ?
2. Whether the Tribunal was right in law in confirming the disallowance under Section 14A, without appreciating that Section 14A of the Act envisages that there should be an actual receipt of income, which is not includible in the total income, during the relevant previous year for the purpose of disallowing any expenditure incurred in relation to the said income ?
3. Whether the Tribunal erred in not appreciating that provisions of Rule 8D have to be interpreted within the frame work of Section 14A and any expenditure which cannot be established to have been incurred in relation to earning exempt income cannot be disallowed ?
4. Whether the Tribunal erred in not appreciating that the provisions of section 14A cannot be invoked in respect of investments made by the assessee in subsidiary/associated companies out of business expediency and not for the purpose of earning dividend?
5. Whether the Tribunal erred in not appreciating that the Rule 8D was inserted by Income Tax (fifth amendment) Rules, 2008 with effect from 24th March 2008 and accordingly can have prospective application ?"

Though several questions have been raised in the Appeal, only substantial questions 1 and 2 have been pursued at the time of hearing and consequently, answered by us.

2. The assessment year involved is 2007-2008. The assessee had investments in Indian Companies to the tune of Rs. 177.56 crores that had not yielded any returns in the previous year relevant to the present assessment year. An order of draft assessment in terms of s.143(3) r.w.s.144C of the Income Tax Act 1960 (hereinafter referred to as 'Act') was issued by the assessing officer, inter alia proposing a disallowance in terms of s. 14A of the Act read with Rule 8D of the Income Tax Rules of an amount of Rs. 1,88,245/-. The proposal was confirmed despite objections that the provisions of s.14A and Rule 8D would not be attracted in a case where no exempt income had, in fact, been earned. The matter was carried before the Dispute Resolution Panel, which confirmed the disallowance. In appeal before the Income tax Appellate tribunal, (in short 'Tribunal') the directions of the DRP were confirmed relying on a decision of the Special Bench of the Tribunal in the case of *Cheminvest Ltd. v. ITO* [\[2009\] 121 ITD 318 \(Delhi\)](#). The order of the Tribunal dated 26.6.2015 is assailed in appeal before us.

3. We have heard the submissions of Sri. Vijayaraghavan, learned counsel appearing for the assessee and Sri. T. Ravikumar, learned Senior Standing Counsel appearing for the Income Tax Department.

4. The admitted position is that no exempt income has been earned by the assessee in the financial year relevant to the assessment year in issue. The order of assessment records a finding of fact to that effect. The issue to be decided thus lies within the short compass of whether a disallowance in terms of s. 14A of the Act read with Rule 8D of the Rules can be contemplated even in a situation where no exempt income has admittedly been earned by the assessee in the relevant financial year.

5. The submissions on behalf of the assessee are as follows:

S.14A has been inserted by Finance Act, 2001 with retrospective effect from 1.4.1962 to provide that no deduction of expenditure shall be allowed in respect of income earned by an assessee not forming part of total income under the Act. Thus, any assessment where the computation of total income in respect of a relevant financial year does not include income falling under Chapter III of the Act, viz. incomes not forming part of total income, would stand excluded from the application of s. 14A of the Act.

6. Reliance was placed on the following decisions: *CIT v. Corrttech Energy (P.) Ltd.* [\[2015\] 372 ITR 97/\[2014\] 223 Taxman 130/45 taxmann.com 116 \(Guj.\)](#), *Holcim India Ltd. v. CIT* [\[2015\] 57 taxmann.com 28 \(Delhi\)](#), *CIT v. Shivam Motors (P.) Ltd.* [\[2015\] 230 Taxman 63/55 taxmann.com 262 \(All.\)](#), *Pr. CIT v. Gujarat State Petronet Ltd.* [Tax Appeal No. 543 of 2016, dated 11-7-2016], *CIT v. Lakhani Marketing Inc.* [\[2014\] 226 Taxman 45 \(Mag.\)/49 taxmann.com 257 \(Punj. & Har.\)](#), *Chem Investments Ltd. (supra)* (reversing the decision of the Special Bench of Income tax Appellate tribunal relied on by the assessing officer in this case).

7. Per contra, Sri. T. Ravikumar appearing on behalf of the revenue drew our attention to the marginal notes of s.14A pointing out that the provision would apply not only where exempted income is 'included' in the total income, but also where exempt income is 'includable' in total income.

8. He relied upon a Circular issued by the Central Board of Direct Taxes in [Circular No. 5 of 2014 dated 11.2.2014](#) to the effect that s. 14A was intended to cover even those situations whether there is a possibility of exempt income being earned in future. The Circular, at paragraph 4, states that it is not necessary for exempt income to have been included in the income of a particular year for the disallowance to be triggered. According to the Learned Standing Counsel, the provisions of s.14A are made applicable, in terms of sub-section (1) thereof to income 'under the act' and not 'of the year' and a disallowance under s.14A r.w. Rule 8D can thus be effected even in a situation where a tax payer has not earned any taxable income in a particular year.

9. We are unable to subscribe to the aforesaid view. The provisions of section 14A were inserted as a response to the judgments of the Supreme Court in *CIT v. Maharashtra Sugar Mills Ltd.* [\[1971\] 82 ITR 452](#) and *Rajasthan State Ware Housing Corpn. v. CIT* [\[2000\] 242 ITR 450/109 Taxman 145](#) in terms of which, expenditure incurred by an assessee carrying on a composite business giving rise to both taxable as well as non-taxable income, was allowable in entirety without apportionment. It was thus that s. 14A was inserted providing that no deduction shall be allowable in respect of expenditure incurred in relation to the earning of income exempt from taxation. As observed by the Supreme Court in the judgment in the case of *CIT v. Walfort Share & Stock Brokers (P.) Ltd.* [\[2010\] 326 ITR 1/192 Taxman 211](#).

' The mandate of s.14A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail of the tax incentive by way of an exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income.'

10. The provision thus is clearly relatable to the earning of actual income and not notional or anticipated income. The submission of the Department to the effect that s.14A would be attracted even to exempt income 'includable' in total income would entail the assessment of notional income, assumed to be exempt in the future, in the present assessment year. The computation of total income in terms of s.5 of the Act is on real income and there is no sanction in law for the assessment of admittedly notional income, particularly in the context of effecting a disallowance in connection therewith.

11. The computation of disallowance in terms of Rule 8D is by way of a determination involving direct as well as indirect attribution. Thus, accepting the submission of the Revenue would result in the imposition of an artificial method of computation on notional and assumed income. We believe this would be carrying the artifice too far.

12. The learned Standing Counsel relies on the decisions of the Division Bench of the Kerala High Court in *South Indian Bank Ltd. v. CIT* [\[2014\] 363 ITR 111/226 Taxman 130/49 taxmann.com 100](#) and *CIT v. Catholic Syrian Bank Ltd.* [\[2012\] 208 Taxman 51 \(Mag.\)/22 taxmann.com 166](#) as well as the decision of the Division Bench of the Calcutta High Court in *Dhanuka & Sons v. CIT* [\[2011\] 339 ITR 319/201 Taxman 105/12 taxmann.com 227](#) in all of which the assessee did, as a matter of fact, earn dividend income. The aforesaid decisions are thus factually distinguishable and do not advance this proposition of the revenue.

13. Reliance is also placed on a decision of the jurisdictional High Court in the case of *Beach Minerals Co. (P.) Ltd. v. Asstt. CIT* [TC Appeal No. 681 of 2013, dated 2-12-2013]. In that case, payments of interest by the assessee were sought to be disallowed invoking the provisions of s.14A on the premise that the same related to borrowings that had been invested and would yield exempt returns. The assessee contested the

disallowance u/s 14A on multiple grounds. It was contended that there were sufficient reserves and surpluses available for the purpose of investments, and borrowed funds, for which the payment of interest had been incurred, had not been invested. The assessee sought to draw a nexus between the borrowed funds and the interest payments, highlighting the position that the quantum of available free funds was far in excess of the investments made. The Bench, in the light of the above submissions, remanded the issue to the file of the assessing officer to be considered de novo and after conducting a proper enquiry. Inter alia a direction was issued to the assessee to tender a proper explanation for the interest payments. The open remand was made in the facts and circumstances of that case and no conclusion was drawn by the Bench on the position of law involved. In fact, the substantial question of law raised in that case for the consideration of the Court was couched in general terms as follows:

"Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in confirming the disallowance under Section 14A of the Income Tax Act, of an amount of Rs. 55,00,000/- in relation to assessment year 2007 - 2008 ?"

14. Nothing much turns on the use of the word '*includable*' and the phrase '*under the act*' in s. 14A and we are not persuaded to accept the emphasis laid or the interpretation of the same by the Revenue. An assessment in terms of the Income tax Act is specific to an assessment year and the related previous year. S.4 of the Act, which imposes the charge to tax reads thus:

"Charge of income-tax

4. (1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person:

Provided that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income tax shall be charged accordingly."

Thus, where the statute indented that income shall be recognized for taxation in respect of any previous other than that immediately preceding the relevant assessment year, the provision shall expressly state so. The provisions of s.10 in Chapter III of the Act dealing with 'Incomes not included in total income' commences with the phrase 'In computing the total income of a previous year, any income falling within any of the following clauses shall not be included'

15. The exemption extended to dividend income would relate only to the previous year when the income was earned and none other and consequently the expenditure incurred in connection therewith should also be dealt with in the same previous year. Thus, by application of the matching concept, in a year where there is no exempt income, there cannot be a disallowance of expenditure in relation to such assumed income. *Madras Industrial Investment Corpn. Ltd. v. CIT* [1997] 225 ITR 802/91 Taxman 340 (SC). The language of s.14A (1) should be read in that context and such that it advances the scheme of the Act rather than distort it.

16. In conclusion, we are of the view that the provisions of s. 14A read with Rule 8D of the Rules cannot be made applicable in a vacuum i.e. in the absence of exempt income. The questions of law are answered in favour of the assessee and against the department and the appeal allowed. No costs.

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*In favour of assessee.

†Arising out of *Redington (India) Ltd. v. Addl. CIT* [2015] 61 taxmann.com 312 (Chennai - Trib).

