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TAX FLASH NEWS

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Disallowance under Section 14A of the Income-tax Act is applicable to shares held as stock-in-trade

Background

Recently, the Kolkata Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Kalyani Barter (P) Ltd.[1] (the taxpayer) held that disallowance under Section 14A of the Income-tax Act, 1961 (the Act) is applicable to shares held as stock-in-trade. However, the disallowance is restricted with respect to those shares, which have yielded dividend income in the year under consideration.

Facts of the case

- The taxpayer, a private limited company, is engaged in the business of trading in shares and securities.

- The Assessing Officer (AO) while completing assessment under Section 143(3) of the Act noticed that the taxpayer had earned dividend income in the year under consideration which was offered to tax under the head of business income in its computation of income.

- The taxpayer neither showed dividend income as income from other sources nor claimed any exemption on such income under Section 10(34) of the Act. However the AO was of the view that the taxpayer should have claimed exemption on such income and accordingly should have disallowed the expenses in pursuance to the provisions of Section 14A of the Act.

- The AO invoked the provisions of Rule 8D of the Income-tax Rules, 1962 (the Rules) read with section 14A of the Act and disallowed INR42.29 lakh.

Tribunal's ruling

- There is no dispute that the taxpayer has earned exempt income and therefore the expenses incurred in relation to such income have to be disallowed.

- The taxpayer has not disallowed any expenses on the grounds that it has not claimed any exemption of dividend income under Section 10(34) of the Act rather the dividend income was offered to tax. Therefore, the taxpayer contended that no disallowance under Section 14A of the Act is warranted. However, the intention of the legislature is to collect tax on the income which is chargeable to tax.

- The revenue is not authorised to collect the tax on those activities which are not chargeable to tax under the Act. It is the duty of the tax department to exclude those items of income from the taxable income which are not chargeable to tax in spite of the fact that the taxpayer has offered the same to tax.

[1] Kalyani Barter (P) Ltd. v. ITO (ITA No. 681/Kol/2015) – Taxsutra.com

- The controversy whether the disallowance is to be made under section 14A of the Act in relation to those shares which are held as stock-in-trade has been settled by the High Court in the case of Dhanuka & Sons[2]. In view of the Calcutta High Court's decision, the provisions of Section 14A of the Act are attracted on those investments which are held as stock in trade.

- However, the taxpayer has raised an alternative contention that even if Section 14A read with Rule 8D is held to be applicable in the case of the taxpayer, the AO may be directed to compute the disallowance as per Rule 8D by taking into consideration only those shares which have yielded dividend income in the year under consideration.

- The alternative contention of the taxpayer is squarely in its favour in line with the decision of the Mumbai Tribunal in the case of REI Agro Ltd.[3]. Accordingly, the Tribunal directed the AO to compute the disallowance as per Rule 8D by taking into consideration only those shares that have yielded dividend income in the year under consideration.

Our comments

The issue with respect to disallowance of expenditure under Section 14A of the Act has been a subject matter of debate before the Courts/Tribunal.

In the cases where shares and securities are held as stock-in-trade, the taxpayers have been contending that the intention is not to earn dividend income and therefore no disallowance should be made under Section 14A of the Act. This aspect has been considered by the Courts in various decisions. The Karnataka High Court in the case of CCI Ltd.[4] held that since the expenditure incurred on purchase of shares was for normal course of business and the said expenditure was not incurred to earn dividend income, no expenditure is disallowed under Section 14A of the Act. However, the Delhi High Court in the case of Maxopp Ltd.[5] held that even if the interest expenditure has been incurred not to earn dividend income but to acquire a controlling stake in the course of normal business, the same would be subject to disallowance under Section 14A of the Act.

Relying on the decision in the case of CCI Ltd., the Punjab and Haryana High Court in the case of State Bank of Patiala[6] and the Calcutta High Court in the case of G K K Capital Markets (P) Limited[7] have held that where securities are held as stock-in-trade, disallowance under Section 14A cannot be made. In the case of G K K Capital Markets (P) Limited, the Calcutta High Court distinguished its decision in the case of Dhanuka & Sons. However, the Kolkata Tribunal in the instant case relying on the decision in the case of Dhanuka & Sons held that disallowance under Section 14A of the Act is applicable to shares held as stock-in-trade.

[2] Dhanuka & Sons v. CIT [2011] 339 ITR 319 (Cal)
[3] REI Agro Ltd. v. DCIT [2013] 144 ITD 141 (Kol)
[4] CCI Ltd. v. JCIT [2012] 250 CTR 291 (Kar)
[5] Maxopp Investment Ltd. v. CIT [2012] 247 CTR 162 (Del)

[6] Pr. CIT v. State Bank of Patiala [2017] 391 ITR 218 (P&H)
[7] CIT v. G K K Capital Markets [2017] 78 taxmann.com 341 (Cal)

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