



Disallowance of expenditure under Section 14A read with Rule 8D in relation to exempt income is mandatory irrespective of whether expenditure is incurred or not

Background

Recently, the Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Mr. M. A. Alagappan¹ (the taxpayer) held that even in cases where no expenditure has been incurred, the tax authority has to apply Rule 8D of the Income-tax Rules, 1962 (the Rules) for the disallowance of expenditure under Section 14A of the Income-tax Act, 1962 (the Act). Section 14A(3) of the Act provides that even in a case where the taxpayer claims that no expenditure was incurred, the tax authority has to presume the incurring of such expenditure as provided under Section 14A(2) read with the Rule 8D of the Rules. When a deeming provision is made on the basis of statutory presumption, the requirement of factual evidence is replaced by statutory presumption and the Assessing Officer (AO) has to follow the consequences stated in the statute.

Facts of the case

- During the year under consideration, the taxpayer has not made any investment yielding exempt income and has also not incurred any expenditure to earn exempt income.
- During the year under consideration, the taxpayer had earned dividend income which was exempt from tax. Therefore, the Assessing Officer (AO) disallowed the dividend income under Section 14A by applying Rule 8D of the Rules.
- On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] remitted the issue relating to Rule 8D(2)(ii) of the Rules for fresh consideration. However, he confirmed the addition in respect of the disallowance made under Rule 8D(2)(iii) of the Rules.

- Against this, the taxpayer is filed an appeal before the Tribunal.

Tribunal's decision

- Section 14A(1) of the Act provides that the expenditure incurred by the taxpayer in relation to the income which does not form part of the total income under the Act shall not be allowed as a deduction in computing the taxable income of the taxpayer.
- Section 14A(2) of the Act provides for determining the quantum of such expenditure which shall not be allowed as a deduction. That is the machinery provision in so far as Section 14A of the Act is concerned. In that provision, it has been provided that if the AO is not satisfied with the correctness of the computations made by the taxpayer, he/she shall compute the quantum in accordance with the method that may be prescribed. For this matter, Rule 8D has already been prescribed.
- Section 14A(3) further provides that even in a case where the taxpayer claims that no expenditure was incurred, the tax authority has to presume the incurring of such expenditure as provided under Section 14A(2) read with Rule prescribed. Therefore, it becomes clear that even in a case where the taxpayer claims that no expenditure was so incurred, the statute has provided for a presumptive expenditure which has to be disallowed by the force of the statute.

¹ Mr. M. A. Alagappan v. ACIT (ITA No.3280/Mds./2016) – Taxsutra.com

- In a distant manner, literally speaking, it may even be considered for the purpose of convenience as a deeming provision. When such deeming provision is made on the basis of statutory presumption, the requirement of factual evidence is replaced by statutory presumption and the AO has to follow the consequences stated in the statute.
- Even in a case where no expenditure is stated to have been incurred, the tax authority has to apply Rule 8D of the Rules. As the statutory presumption substitutes the requirement of factual evidence, the question of an enquiry does not arise. Therefore, the Tribunal was unable to agree with the argument of the taxpayer. The decision of Mumbai Tribunal in the case of Justice Sam P. Bharucha² relied on by the taxpayer is distinguishable on the facts of the present case.

Our comments

Disallowance of expenditure incurred in relation to income which does not form part of total income has been a subject matter of debate before the Courts.

On one hand, some of the Courts/the Tribunal³ have held that Section 14A of the Act cannot be invoked where the taxpayer has not earned income not forming part of total income. On the other hand, some of the Courts/the Tribunal⁴ have held that disallowance under Section 14A of the Act could be made even in a year in which no exempt income was earned or received by the taxpayer.

The Central Board of Direct Taxes (CBDT) vide Circular No. 5/2014, dated 11 February 2014 has clarified that Rule 8D of the Rules read with Section 14A of the Act provides for disallowance of expenditure even where taxpayer has not earned any exempt income in a particular year. However, the CBDT Circular is binding on the tax officers and not on the Courts or even the taxpayer. The same has been upheld by the Supreme Court in the case of Hero Cycles Pvt. Ltd.⁵.

The Chennai Tribunal in the present case has held that Rule 8D of the Rules is mandatory irrespective of whether expenditure was incurred or not. Even in a case where no expenditure has been incurred, the tax authority has to apply Rule 8D of the Rules for disallowance of expenditure under Section 14A of the Act.



² Sam P. Bharucha v. ACIT [2012] 53 SOT 192 (Mum)

³ CIT v. Shivam Motors P. Ltd. [2015] 230 Taxman 63 (All), CIT v. Corrtch Energy (P.) Ltd [2014] 372 ITR 97 (Guj), CIT v. Lakhani Marketing Inc [2014] 226 Taxman 45 (P&H), Alliance Infrastructure Projects Pvt Ltd v. DCIT (Bangalore Tribunal, 12 September 2014)

⁴ Siva Industries & Holding Ltd [2012] 54 SOT 49 (Chen), Technopack Advisors P Ltd [2012] 50 SOT 31 (Del)(URO), Relaxo Footwear Ltd [2012] 50 SOT 102 (Del), India Infrastructure Developers Limited v. DCIT (ITA No. 5656/Mum/2011), Cheminvest Ltd. v. ITO [2009] 121 ITD 318 (Del)

⁵ CIT v. Hero Cycles (P) Ltd. [1997] 228 ITR 463 (SC)

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