



## Disallowance under Section 14A does not apply to computation of MAT

### Background

Recently, the Delhi Special Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Vireet Investment Pvt Ltd.<sup>1</sup> (the taxpayer) held that disallowance under Section 14A of the Income-tax Act, 1961 (the Act) shall not apply to Minimum Alternate Tax (MAT) computation. The Tribunal observed that literal meaning cannot always be followed logically because sometimes it tends to defeat the obvious intention of the legislature and results in producing a wholly unreasonable result. The total income as contemplated under normal provisions is inextricably linked to book profits under MAT provisions, and it is wrong to suggest that both operate on entirely different fields. The jurisdictional High Court<sup>2</sup> has taken a divergent view on this issue, however, if two reasonable constructions of a taxing provision are possible, the construction which favours the taxpayer must be followed. Therefore, following the decision of the Delhi High Court in the case of Bhushan Steel Ltd it has been held that the computation under the MAT provisions<sup>3</sup> is to be made without resorting to the computation as contemplated under Section 14A read with Rule 8D of the Income-tax Rules, 1962 (the Rules).

### Facts of the case

- The taxpayer was engaged in the business of finance and investment company making an investment in shares and securities. The taxpayer is also advancing money and borrowing money to/from industrial enterprises. During the Assessment Year (AY) 2008-09, the taxpayer had filed its return of income paying tax under Section 115JB of the Act.

- During the year under consideration, the taxpayer had earned income from operation of INR439.86 million which included an amount of INR75.46 million from income from speculation profit on F&O, interest income, short term gain on sale of investments and winning from race horses. The balance amount of INR364.40 million had been claimed as exempt income. This amount comprised of exempt dividend, tax-free interest income and long term capital gain.
- The taxpayer claimed total expenditure of INR34.09 million. Further, the taxpayer had worked out at 0.5 per cent of the average value of its investment on the basis of their value as at opening and closing of the relevant financial year and offered disallowance of INR3.40 million under Section 14A as per Rule 8D. This disallowance is in respect of exempt dividend income and in respect of long term capital gain, claimed exempt under Section 10(38) of the Act.
- The Assessing Officer (AO) did not accept the taxpayer's contention since the main source of taxpayer income was from dividend and other tax-free incomes. The AO computed the proportionate expenditure amounting to INR5.84 million under Section 14A of the Act. The proportionate expenditure for net disallowance under Section 14A in respect of earning of the taxpayer related to non-taxable income was amounting to INR28.25 million (INR34.09 million – INR5.84 million)
- The AO, while computing the book profits under Section 115JB of the Act, made the addition of INR 28.25 million on account of disallowance under Section 14A as per P&L Account.

<sup>1</sup> ACIT v. Vireet Investment Pvt Ltd. (ITA No. 502/Del/2012) – Taxsutra.com

<sup>2</sup> CIT v. Goetze (India) Limited [2014] 361 ITR 505 (Del), Pr.CIT v. Bhushan Steel Ltd (ITA No. 593/2015)

<sup>3</sup> Under clause (f) of Explanation 1 to Section 115JB(2) of the Act

- The Commissioner of Income-tax (Appeals) [CIT(A)] computed disallowance under Rule 8D(2)(iii), and no disallowance was made under Rule 8D(2)(i) of the Rules. Relying on the decision of Cheminvest Ltd.<sup>4</sup> it was held that while working disallowance, the value of the investment as per books is required to be taken. The CIT(A) observed that as per clause (f) of Explanation 1 to Section 115JB(2) of the Act, only the expenditure relating to income other than income assessable under Section 10(38) was to be added while calculating book profits under Section 115JB of the Act.

## Tribunal's decision

### **Applicability of Section 14A disallowance on MAT computation**

- Section 115JB is a complete code in itself. Chapter XII-B provides an alternate scheme for computing tax liability of certain companies, whose total income under normal provisions is below the threshold book profit as prescribed under Chapter XII-B.
- The intention of the legislature once is manifested in a particular section of the statute then said intention cannot be given a different meaning, if a similar provision has been incorporated in a different section of the statute. The intention of the legislature must be found out by reading the statute as a whole.
- When the question arises as to the applicability of similar provisions in different parts of the statute, then it is not only legitimate but proper to read both the provisions in their context. If the context is same, different meaning cannot be assigned, it is to be found that what mischief was intended to be remedied by inserting a particular section.
- Literal meaning cannot always be followed logically because sometimes it tends to defeat the obvious intention of the legislature and results in producing a wholly unreasonable result. To achieve the obvious intention and to produce a reasonable result. The Tribunal relied on various decisions<sup>5</sup>.
- The Supreme Court in the case of K.P. Varghese<sup>6</sup>, while examining the true meaning of Section 52(2), observed that wherever the declared value for transfer of property was less by 15 per cent or more compared to the fair market value, it is refused to accept the strict literal meaning. It would be absurd and unreasonable to apply Section 52(2) according to its strict literal construction. A fair and reasonable construction would be that the tax department must show not only that the fair market value of the capital asset exceeds the declared value by 15 per cent or more and also that it is not a bona fide declaration and the taxpayer has actually received underhand payment apart from what has been actually declared by him.
- Chapter XII-B has been inserted by the Finance Act, 1987 with effect from 1 April 1988. Under this Chapter, specific items have been prescribed for computation of book profit. The same has to be followed, and the computation as contemplated under Chapter IV of the Act for computation of business income cannot be imported in the whole sum per se under this Chapter.
- In the case of Canada Sugar Refinery Co.<sup>7</sup> it was observed that every clause of a statute is to be construed with reference to the context and other clauses of the Act as far as possible to make a consistent enactment of the whole statute or series of statutes. The mode of computation with the same purpose cannot be made differently merely because Section 115JB creates a deeming section. The object of deeming provisions is to substitute the total income computed under normal provisions by that computed under MAT provisions.
- Under the provisions of Section 14A, both direct and indirect expenditure in relation to earning of exempt income are to be reduced. Therefore, different meaning cannot be ascribed in clause (f) and, therefore, the submission of the taxpayer that only directly relatable expenditure is to be reduced, cannot be accepted.
- There cannot be any dispute with the proposition that clause (f) of Explanation 1 to Section 115JB(2) is in conformity to matching principles of accounting. As per the provisions of Section 115JB(1), a comparison of the total income computed under the normal provisions of the Act is to be made with the book profits as computed under Section 115JB of the Act. This makes it clear that total income as contemplated under normal provisions is inextricably linked to book profits under MAT provisions and it is wrong to suggest that both operate on entirely different fields. This

<sup>4</sup> Cheminvest Ltd. v. ITO [2009] 121 ITD 318 (Del) (SB)

<sup>5</sup> N.B. Sanjana v. Elphinstone Spinning & Weaving Mills Ltd. (AIR 1971 SC 2039), Central Excise v. National Tobacco Company Ltd. (AIR 1972 SC 2563), K.P. Varghese v. ITO (AIR 1981 SC 1922)

<sup>6</sup> K.P. Varghese v. ITO (AIR 1981 SC 1922)

<sup>7</sup> Canada Sugar Refinery Co. v. R (1898) AC 735

interpretation overlooks the very object of insertion of MAT provisions. When we resort to a comparison between computation under normal provisions of the Act and MAT provisions, the comparison will not be on the same footing.

- The Tribunal agreed with the contention of the tax department that the decision in the case of Goetze (India) Limited cannot be said to be by way of concession more particularly when a substantial question of law and not a question of fact was under consideration of the High Court. Thus, it cannot be said that the Delhi High Court has not considered this issue and merely allowed the tax department's appeal. The substantial question of law framed by the Delhi High Court clearly indicates that the specific issue was whether disallowance under Section 14A was required to be made while computing book profit under Section 115JA/115JB of the Act. The Delhi High Court has not only recorded taxpayer's plea of merely not contesting the issue in view of specific provisions but has recorded that the counsel fairly conceded. The expression 'fairly' implies that the High Court was also of the view that the provisions of Section 14A of the Act were applicable with full force to the corresponding provisions of Section 115J of the Act.
- In every case, it is not necessary that at long drawn reasoning should be given before arriving at any conclusion more particularly when both the parties are agreed on the certain provision of law. Therefore, the taxpayer's contention that the decision of High Court in the case of Goetze (India) Ltd. does not constitute a binding precedent is to be rejected.
- The Tribunal pitted against two decisions<sup>8</sup> of jurisdictional High Court taking divergent views and, under such circumstances, the Tribunal has to decide which decision to follow. It has been observed that from the decisions relied on by the taxpayer more particularly in the case of Bhika Ram<sup>9</sup> that later pronouncement by a bench of co-equal strength should be followed even if the earlier decision was not considered. The Tribunal did not agree with the contention of the taxpayer that Tribunal can decide which decision state the law more elaborately and accurately.

<sup>8</sup> CIT v. Goetze (India) Limited [2014] 361 ITR 505 (Del), Pr.CIT v. Bhushan Steel Ltd (ITA No. 593/2015)

<sup>9</sup> Bhika Ram v. UOI [1999] 238 ITR 113 (Del)

- The Supreme Court in the case of Vegetable Products Ltd.<sup>10</sup> observed that if two reasonable constructions of a taxing provision are possible, that construction which favours the taxpayer must be adopted. This is a well-accepted rule of construction recognised by this court in several of its decisions.
- Accordingly, following the decision of the Delhi High Court in the case of Bhushan Steel it has been held that the computation under clause (f) of Explanation 1 to Section 115JB(2) of the Act, is to be made without resorting to the computation as contemplated under Section 14A read with Rule 8D of the Income-tax Rules, 1962 (the Rules).

#### ***Mode of computation under Rule 8D(2)(iii) of the Rules***

- In both the decisions<sup>11</sup> viz. in the case of Cheminvest Ltd., and in the case of Rajendra Prasad Moody, the issue was related to the allowability of expenditure which had a direct nexus with the earning of income. The borrowing in both the cases has not been disputed being for acquiring shares. The Delhi High Court has specifically held that the decision of the Supreme Court in the case of Rajendra Prasad Moody was rendered in the context of allowability of deduction under Section 57(iii) of the Act, where the expression used is 'for the purpose of making or earning such income'. Section 14A of the Act on the other hand contains the expression 'in relation to income which does not form part of the total income'. The decision in Rajendra Prasad Moody cannot be used in reverse to contend that even if no income has been received, the expenditure incurred can be disallowed under Section 14A of the Act.
- Now the position of law as stands is that the decision of Jurisdiction High Court is directly on the point in dispute whereas the decision of the Supreme Court in the case of Rajendra Prasad Moody has been rendered in the context of Section 57(iii), the applicability of which has been ruled out by Delhi High Court in the case of Cheminvest.
- Under Article 227 of the Constitution of India, the courts function under the Supervisory jurisdiction of High Court. The decisions rendered by the High Court are binding on all subordinate courts working within its jurisdiction. Accordingly, it has been held that only those investments are to be considered for computing average value of an investment which yielded exempt income during the year.

<sup>10</sup> CIT v. Vegetable Products Ltd. [1973] 88 ITR 192 (SC)

<sup>11</sup> Cheminvest Ltd. v. CIT [2015] 378 ITR 33 (Del), CIT v. Rajendra Prasad Moody [1978] 115 ITR 519 (SC)



## Our comments

The applicability of the provisions of Section 14A read with Rule 8D of the Rules to the computation of MAT has been a matter of debate before the Courts.

On one hand, there are cases<sup>12</sup> where it has been held that disallowance under Section 14A of the Act cannot be made while computing the book profit under Section 115JB of the Act since no actual expenditure was debited in the profit and loss account relating to the earning of exempt income. The clause (f) of Explanation to Section 115JB refers to the amount debited to the profit and loss account which can be added back to the book profit while computing book profit under Section 115JB of the Act. On the other hand in some of the cases<sup>13</sup> it has been held that expenditure incurred to earn exempt income will be disallowed under Section 14A while computing MAT profits.

The Tribunal in the present case has held that disallowance under Section 14A of the Act read with Rule 8D of the Rules shall not apply to MAT computation. The computation under clause (f) of Explanation 1 to Section 115JB(2) of the Act, is to be made without resorting to the computation as contemplated under Section 14A read with Rule 8D of the Rules.

The Special Bench also dealt with an issue whether to include investments which yield exempt income while computing the average value of investment for the purpose of disallowance under Section 14A of the Act.

The Special Bench has held that disallowance under Rule 8D(2)(iii) of the Rules shall be computed only on those investments which yielded exempt income during the year. The Special Bench in the case of Cheminvest Ltd<sup>14</sup> expressed a contrary view, however, the same has been superseded in this decision. The current Special Bench decision is also against the view given in the CBDT Circular No. 21/2015, dated 10 December 2015.

<sup>12</sup> Quippo Telecom Infrastructure Ltd. v. ACIT (ITA No.4931/Del/2010 – Assessment Year 2007-08), DCIT v. Sobha Developers [2015] 58 taxmann.com 107 (Bang)

<sup>13</sup> ITO v. RBK Share Broking (P.) Ltd. [2013] 159 TTJ 16 (Mum), Dabur India Ltd. v. ACIT [2013] 145 ITD 175 (Mum)

<sup>14</sup> Cheminvest Ltd. v. ITO [2009] 121 ITD 318 (Del) (SB)



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