



No disallowance under Section 14A when no expenditure has been incurred in relation to exempt income or in the absence of exempt income

Recently, the Madras High court in case of Celebrity Fashion Ltd.¹ (the taxpayer) dealt with the issue of disallowance under Section 14A of the Income-tax Act, 1961 (the Act). The High Court held that only expenditure, which is incurred in relation to earning of tax exempt income is disallowed under Section 14A. Provisions of Section 14A cannot be extended to disallow the expenditure, which is assumed to have been incurred for earning tax free income. Provisions of Section 14A read with Rule 8D of the Income-tax Rules, 1962 cannot be made applicable in the absence of exempt income.

Facts of the case

During the Assessment Year (AY) 2011-12, the taxpayer invested in SBI Magnum Insta Cash Fund and secured loans. The taxpayer incurred the finance cost out of which certain amount was pertaining to interest on term loan and working capital facilities. The taxpayer made investments in mutual funds, out of which, there was a possibility of earning dividend income. The taxpayer claimed that it had not incurred any expenditure for making such investment. In the absence of such expenditure, the question of disallowance does not arise. The Assessing Officer (AO) rejected the stand taken by the taxpayer and made disallowance under Section 14A.

The Commissioner of Income-tax (Appeals) [CIT(A)] observed that the investments were in growth funds and not dividend funds and therefore, did not constitute tax free income. The CIT(A) referred to various decisions² and set aside the findings of the AO.

The Tribunal relied on the decision of the Madras High Court in the case of Redington India Ltd.³ and dismissed the appeal filed by the tax department.

High Court's decision

The taxpayer invested in SBI Magnum Insta Cash Fund and it had not incurred any expenditure in making such investment. Further at the year end, the taxpayer did not earn tax free income from such investments. As per the provision of Section 14A, only expenditure, which is incurred in relation to earning of tax free income, could be disallowed and such provision could not be extended to disallow the expenditure, which were assumed to have been incurred for earning tax free income.

To apply the provisions of disallowance under Section 14A, the AO should have recorded a finding under Section 14A(1)⁴. In the absence of any such findings, the disallowance made by the AO was not justifiable. The AO straightaway proceeded to the second limb of Section 14A(2), which is not permissible.

The Tribunal correctly applied the ratio of the decision in the case of Redington India Ltd. where it was held that the provisions of Section 14A read with Rule 8D cannot apply in the absence of exempt income. `

Our comments

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

¹ CIT v. Celebrity Fashion Ltd (Tax Case Appeal No. 26 of 2018) (Mad) – Taxsutra - The High Court has dealt with the various issues in this decision. However, this flash news captures issue relating to disallowance under Section 14A.2

² Cheminvest Ltd. v. CIT [2015] 378 ITR 33 (Del), ACIT v. M. Baskaran [ITA.No.1717/Mds/2013]

³ Redington India Ltd. v. CIT [2017] 77 Taxmann.com 257 (Mad)

⁴ Section 14A(1) - For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.

The Delhi High Court in the case of Wimco Seedlings Ltd.⁵ observed that the expression 'expenditure incurred' refers to actual expenditure and not to some imagined expenditure. If no expenditure is incurred in relation to the exempt income, no disallowance can be made under Section 14A. Similarly, the Tribunal in the case of DLF Ltd⁶ held that the expenditure which is incurred in relation to earning of tax free income can be disallowed and section cannot be extended to disallow even expenditure which is assumed to have been incurred for earning tax free income. Subsequently, the Delhi High Court⁷ has affirmed this decision.

In 2014, CBDT issued a Circular⁸ clarifying that disallowance of expenditure for earning exempt income under Section 14A read with Rule 8D would be attracted even if the corresponding exempt income has not been earned during the financial year.

The High Court in the present case has held that no disallowance can be made under Section 14A when no expenditure has been incurred in relation to exempt income or in the absence of exempt income.



⁵ CIT v. Wimco Seedlings Ltd. [2012] 204 Taxman 97 (Del)

⁶ DLF Ltd. v. CIT [2009] 27 SOT 22 (Del)

⁷ [2013] 31 taxmann.com 158 (Del)

⁸ CBDT Circular No. 5/2014 dated 11 February 2014

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