

TAX FLASH NEWS

26 September 2020



Administrative expenditure apportioned towards managing investments in group companies and disallowed under Section 14A of the Income-tax Act

Recently, Mumbai Bench of Income-tax Appellate Tribunal (the Tribunal) in the case of Future Retail Ltd.¹ (the taxpayer) dealt with the issue of disallowance of certain administrative expenses under Section 14A of the Income-tax Act, 1961 (the Act). The taxpayer contended that such expenses were not incurred to manage investments in group companies. However, the Tribunal rejected the taxpayer's claim and held that the investment does require constant monitoring even though it is made within the group concern. The Tribunal directed the Assessing Officer (AO) to determine the disallowance by applying two methods i.e. the Apportionment method and the method prescribed under Rule 8D(2)(iii)². Further, in order to apply provision of Section 14A, the AO should consider the lesser of the two amounts calculated under the above two methods.

Facts of the case

The taxpayer is engaged in the business of manufacturing and retailing in readymade garments and other products. During the Assessment Year (AY) 2012-13, the taxpayer had made investment in group concern. The taxpayer also incurred certain administrative expenditure. The taxpayer claimed that disallowance of such administrative expenditure under Section 14A is not applicable since the company has sufficient own funds to manage these investments. Therefore, apportionment under Rule 8D(2) is also not warranted. The taxpayer claimed that investments made in associates/subsidiaries for strategic business purposes cannot be considered for the purpose of disallowance under Section 14A read with Rule 8D.

Further the taxpayer contended that he had not incurred any expenditure for earning exempt income since the entire dividend was received through ECS and hence no disallowance can be made for administrative expenditure. However, the AO invoked disallowance under Section 14A read with Rule 8D.

Tribunal decision

The taxpayer contended that it has incurred administrative expenses purely for administration of its affairs. The Tribunal did not agree with the contention the taxpayer that it had not incurred any expenditure. The investment does require constant monitoring even though it is made within the group concern. Sometimes, the method applied as per Rule 8D(2)(iii) gives absurd result, like the disallowance is more than the actual administrative expenses. Therefore, the Tribunal directed the AO to determine the total administrative expenses and also determine the total income earned by the taxpayer including taxable and exempt income, apply the ratio of income to determine the administrative expenses and apportioned to exempt income.

Further the Tribunal directed the AO to also calculate 0.5 per cent of the investment as per Rule 8D(2)(iii) and in applying the rules, he should consider only those investments which have actually earned dividend/exempt income.

The Tribunal also asked AO to compare the both these methods of calculation. Further, in order to apply provision of Section 14A, the AO should consider the lesser amount from the amount calculated under the above two methods.

¹ Future Retail Ltd. v. ACIT (ITA No. 5959/Mum/2016, AY 2012-13) - Taxsutra.com

² Amount equal to one-half per cent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the taxpayer, on the first day and the last day of the previous year

Our comments

The issue with respect to the disallowance of expenditure related to exempt income under Section 14A has been a matter of debate since the introduction of Section 14A in the Act. While dealing with the issues of disallowance under Section 14A vis-à-vis strategic investment/stock-in-trade, the Courts³ have held that the intention behind purchase of shares/stock was not to earn dividend. The intention was either to hold investment for strategic purpose to control the business in the company in which shares were invested or for business purpose to earn gain from increase in the value of shares. Therefore, disallowance under Section 14A is not warranted.

The Supreme Court in the Maxopp Investment Ltd⁴ dealt with this issue and the relevant judicial precedents and concluded the matter in favour of the tax department. The Supreme Court interpreted Section 14A in a strict manner to held that dominant or main object would not be a relevant consideration for disallowance under Section 14A. If expenditure is incurred on earning the dividend income, then such expenditure which is attributable to the dividend income has to be disallowed.

The Mumbai Tribunal in the present case has held that investment does require constant monitoring even though it is made within the group concern and directed the AO to determine the disallowance under Section 14A by applying the lesser of the above-referred two methods.



³ PCIT v. State Bank of Patiala [2017] 391 ITR 218 (P&H), CCI Ltd v. JCIT [2012] 250 CTR 291 (Kar), DCIT v. M/s Development Consultant Pvt. Ltd. (ITA No. 213/Kol/2016)

⁴ Maxopp Investment Ltd v. CIT (Civil Appeal Nos 104-109 of 2015) (SC)

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