

TAX FLASH NEWS

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Amendment to Section 14A relating to disallowance of expenditure when there is no exempt income is not retrospective in nature

Executive Summary

Section 14A of the Income-tax Act, 1961 (the Act) provides that no deduction shall be allowed in respect of expenditure incurred by the taxpayer in relation to income which is exempt from tax. There has been a considerable litigation with respect to disallowance of expenditure under Section 14A. Some of the Courts have held that when there is no exempt income in a particular year, no disallowance is warranted.

The Finance Act, 2022 amended Section 14A and inserted an Explanation which provides that for the removal of doubts, it is clarified that¹ the provisions of Section 14A shall apply and shall be deemed to have always applied even where there was no exempt income. The Memorandum to the Finance Bill, 2022 (the Memorandum) specifically states that this amendment comes into effect from 1 April 2022. However, since the explanation starts with the phrase 'for the removal of doubts', a controversy emerged that whether this amendment is retrospective in nature.

Recently, the Delhi High Court in the case of Era Infrastructure (India) Ltd.² dealt with this controversy and held that the amendment to Section 14A is not retrospective in nature. The amendment comes into effect from 1 April 2022 and it is applicable in relation to Assessment Year (AY) 2022-23 and subsequent AYs.

Facts of the case

- The Assessing Officer (AO) disallowed expenditure under Section 14A even though there was no exempt income.
- The Tribunal deleted the disallowance made by the AO relying on the decision of IL & FS Energy Development Company Ltd.³ In that decision, it was held that no disallowance under Section 14A could be made if the taxpayer had not earned any exempt income.

Tax department's arguments

- Reliance on the decision of IL & FS Energy Development Company Ltd. was not correct. The tax department has not accepted the said decision and has preferred Special Leave Petition (SLP) against the same.
- The amendment made by the Finance Act, 2022 to Section 14A has changed the law. Consequently, the decisions relied upon to delete the disallowance were no longer a good law.

High Court's decision

- Based on the Memorandum, the High Court observed that the amendment to Section 14A has come into effect from 1 April 2022. Therefore, it is applicable in relation to AY 2022-23 and subsequent AYs.

¹ Notwithstanding anything to the contrary contained in this Act
² PCIT v. Era Infrastructure (India) Ltd. (ITA No. 204 Of 2022) (Del) – Taxsutra.com

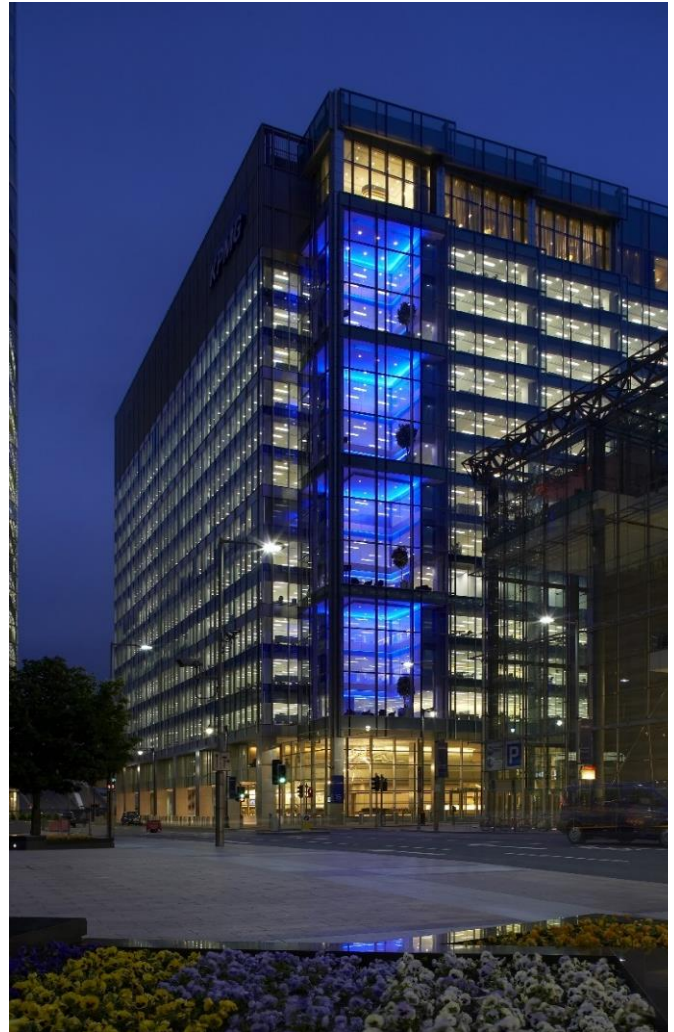
³ PCIT vs. IL & FS Energy Development Company Ltd. 2017 SCC Online Del 9893

- The High Court relied on the decision of the Supreme Court in the case of Sedco Forex International Drill Inc.⁴. The Supreme Court had held that a retrospective provision which is ‘for the removal of doubts’ cannot be presumed to be retrospective, even where such language is used, if it alters or changes the law as it earlier stood. The same principle has been reiterated in the case of M.M Aqua Technologies Ltd⁵.
- Thus, the amendment to Section 14A cannot be presumed to be retrospective.
- The High Court clarified that the order passed in the present case shall abide by the final decision of the Supreme Court in the case of IL & FS Energy Development Company Ltd.

Our comments

The Finance Minister in his 2014 budget speech had promised that the Government will not ordinarily bring about any change retrospectively which creates a fresh liability. However, there have been instances where amendments have been introduced to overcome judicial decisions in form of clarifications. While these amendments are introduced prospectively, having regard to the language used, revenue authorities and counsels are seeking to apply them to the past years as well. This approach goes contrary to the government’s commitment to provide a stable and predictable taxation regime that would be investor friendly.

Recently, tax tribunal benches have taken divergent view on retrospectivity of the amendment to Section 14A on disallowance of expense when there is no exempt income in the relevant financial year. This decision by a High Court would help bring some clarity on the retrospective application. However, as also noted by the High Court, this issue on the merits is pending before the Supreme Court in the case of IL & FS Energy Development Company Ltd. Thus, one needs to watch out for the Supreme Court’s verdict to get certainty on this dispute.



⁴ Sedco Forex International Drill Inc. v. CIT [2005] 279 ITR 310 (SC)

⁵ M.M Aqua Technologies Ltd. v. CIT [2021] 436 ITR 582 (SC)

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