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TAX FLASH NEWS

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Dividend earned from strategic investment is business income and brought forward business loss can be set-off against such income

The Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Tamil Nadu Industrial Development Corporation[1] (the taxpayer) dealt with the issue of set-off of brought forward business loss against dividend income earned from an investment to acquire controlling interest in undertakings. The Tribunal held that dividend earned from such investment is business income and brought forward business loss can be set-off against such income.

Facts

The taxpayer is engaged in the promotion of industries in Tamil Nadu by making investment in various companies as well as having joint venture thereon. The taxpayer earned dividend income from such investment. The taxpayer claimed that the said dividend income would partake the character of business receipt and not ‘income from other source’ and hence it was entitled for set-off of brought forward business loss against such dividend income. The Assessing Officer (AO) agreed with the taxpayer and adjusted the brought forward business loss[2] against the dividend income. However, the Commissioner of Income-tax (CIT) revised[3] the order of the AO and observed that brought forward business loss could be set-off only against business income of the taxpayer. The dividend income earned by the taxpayer cannot be treated as business income of the taxpayer. Therefore, the order passed by the AO was erroneous and prejudicial to the interest of the revenue.

Tribunal’s decision

It was incumbent on the part of the taxpayer to promote industries in the state and undertake to participate in the day to day affairs in the management of those undertakings by participating in crucial decision-making process. The taxpayer had to maintain its 24 per cent equity stake in those undertakings at every point in time, so that it should not lose controlling interest over the respective undertakings. The taxpayer was all along getting returns only in the form of dividend and had never participated in any profit sharing with those public sector undertakings right from the inception.

The CIT observed that in the Balance Sheet, the taxpayer had shown ‘investments other than subsidiaries’ and had shown market value of investments thereon. However, the Tribunal observed that this disclosure requirement was made in accordance with Schedule VII of the Companies Act, 1956, which has no relevance for the purpose of Income-tax Act, 1961 (the Act).

The decisions[4] relied upon by the taxpayer and the decision of the Jurisdictional High Court[5] in the taxpayer’s own case for the earlier years would apply to the facts of the present case. Therefore, the taxpayer would be entitled for set-off of brought forward loss against the dividend income.

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[1] Tamilnadu Industrial Development Corporation v. ACIT (ITA No. 1181/Chny/2008, AY 2003-04)- Taxsutra.com
[2] Assessment Year 1998-99
[3] Revision proceedings under Section 263 of the Act

[4] DCIT v. Tamilnadu Industrial Development Corporation Ltd [2010] 124 ITD 117 (Chen) (TM), Taxpayer’s own case for the assessment years 1976-77, 1979-80, 1980-81 and 1981-82 in ITA Nos.2153 to 2156/Mds/1987, dated 19 March 1991
[5] CIT v. Tamilnadu Industrial Development Corporation Ltd [2014] 368 ITR 545 (Mad)

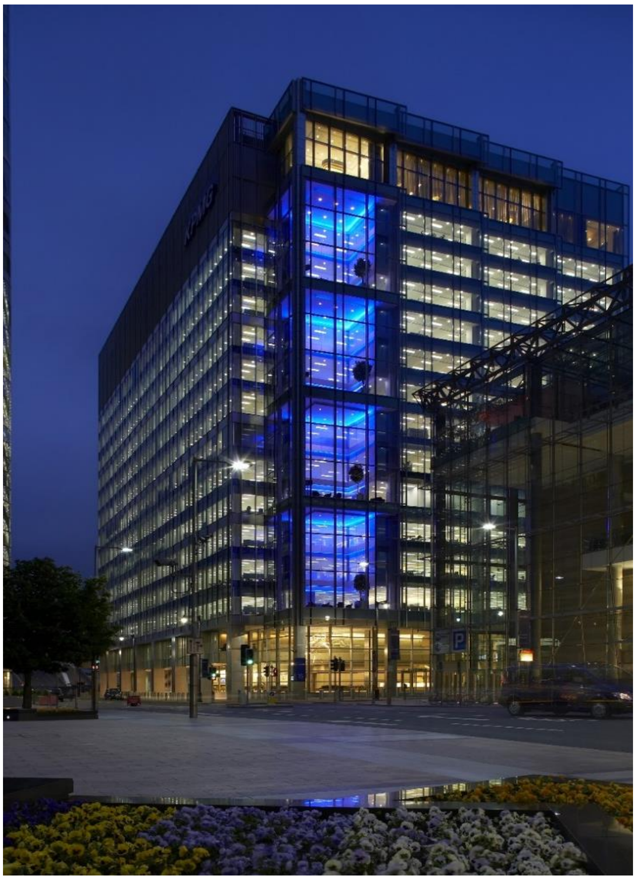
Our comments

The issue with respect to treatment of dividend income earned from a strategic investment as business income or income from other source and further set-off of brought forward business loss against such dividend income has been a subject matter of litigation.

In some of the cases, the Courts/Tribunal[6] have held that although dividend income was assessable separately under the head 'Income from other sources', since the taxpayer was a dealer in shares, the dividend income should be treated as 'business income' for the purpose of set-off of earlier years' business losses.

The Tribunal in the present case held that dividend income is taxable as business income and therefore, the taxpayer was entitled to set-off of brought forward loss against the dividend income.

The Finance Bill, 2020 abolished the Dividend Distribution Tax with effect from FY 2020-21. The dividend will now be taxable in the hands of shareholders. Further the recipients are not eligible for any expenses except interest expense to the extent of 20 per cent of such dividend under Section 57 of the Act. However, if the income is treated as business income, the restriction on expenditure allowability may not apply to taxpayers.



[6] Western States Trading Co. (P.) Ltd.'s, v. v. CIT [1971] 80 ITR 21 (SC), Brook Bond & Co. Ltd. v. CIT [1986] 162 ITR 373 (SC), Aakrosh Investment & Leasing (P.) Ltd [2004] 90 ITD 287 (Mum.), CIT v. Excellent Commercial Enterprises & Investments Ltd. [2006] 282 ITR 423 (Del), Himalaya Co. Ltd. v. ITO [1989] 30 ITD 139 (Cal)

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