

Note – No disallowance under section 14A relating to expenditure attributable to dividend and tax-free interest, etc.

As regards disallowance under section 14A of the Income-Tax Act, 1961 (the Act), it is well-known that in respect of correct interpretation of the same, divergent views have been expressed by various judicial fora. In this context, please refer to the Article authored by me under the title “*Disallowance under section 14A, in the light of the case of Deepak Mittal*”, which has been published in *361 ITR (Journ.) P.1 (Part.1)*

The aforesaid Article is mainly based on the recent judgement of Punjab and Haryana High Court in the case of *CIT Vs Deepak Mittal [2014] 361 ITR 131 (P&H)*. In the aforesaid judgement, the Hon. High Court has relied upon its earlier judgement in the case of *CIT Vs Hero Cycles Ltd. [2010] 323 ITR 518 (P&H)*.

As per the aforesaid judgement, in the case of *Deepak Mittal*, the High Court has held that in a case where no expenditure has been incurred by the assessee in earning the exempt income, there can not be any disallowance of expenditure under section 14A, r.w.r. 8D of the Income-Tax Rules, 1962 (the Rules). It was further held by the High Court that when consistent case / version of the assessee, despite notice given by the Assessing Officer (AO) to give details of the expenditure incurred on earning exempt income in the nature of dividend, was that he had not incurred any expenditure on earning such income, the AO, in terms of section 14A(2) of the Act, was to proceed further to collect such material or evidence to determine expenditure, if any, incurred by the assessee. The AO, however, relying on rule 8D of the Rules, applied as a formula applicable to an assessee, who had incurred expenditure by way of interest, which is not directly attributable to any particular income or receipt. Such was not the case in the case of the present assessee and therefore, there was clearly a wrong application of rule 8D, as a substitute for section 14A(2) of the Act, which is not permissible in law.

In regard to the issue of disallowance under section 14A of the Act, there is another very important judgement recently rendered by the Karnataka High Court in the case of *Canara Bank Vs ACIT [2014] 99 DTR 36 (Karn)*. In this case, income was derived by way of dividends exempt under section 10(33), interest on tax-free bonds exempt under section 10(15)(h) and interest on long-term finance to infrastructure companies exempt under section 10(23G) of the Act. The persons with whom the aforesaid investment was made by the assessee were crediting the aforesaid income to the assessee’s account by way of a bank transfer.

It was held by the Hon. High Court that there was no human agency involved in collecting these dividends and interest for which the assessee had to incur any expenditure. This is the consequence of

computerization, online transaction through NEFT, RTGS and also demat accounts. The AO should take note of these developments in deciding, whether any expenditure is incurred in earning the said income. The discussion by the AO clearly demonstrated that these aspects had not been considered and notional expenditure was calculated on the basis of pre-modernization scenario. Therefore, when the assessee had not incurred any expenditure for realizing the income, the disallowance of two per cent of gross total income, as an expenditure under section 14A, was not sustainable in law.

In the present context, paragraph (12) of the judgement on page 48 of the Report is relevant, which is reproduced as follows :

12. In the instant case, facts set out above demonstrate the income is derived by the dividends under s.10(33) of the Act and interest on tax free bonds under s.10(15)(h) of the Act and interest on long-term finance to infrastructure companies under s.10(23G) of the Act, In other words, the persons with whom the amounts are invested by the assessee are crediting the aforesaid amount to the assessee's account by way of a bank transfer. Therefore, no human agency is involved in collecting these dividends and interest for which the assessee has to incur any expenditure. This is the consequence of computerization, online transaction through NEFT (National Electronic Fund Transfer). RTGS (Real Time Gross Settlement) and also demat accounts. The assessing authority should take note of these developments in deciding whether any expenditure is incurred in earning the said income. The discussion by the assessing authority clearly demonstrates these aspects have not been taken note of and the notional expenditure is calculated pre-modernization. Therefore, in the light of the aforesaid judgement, when the assessee has not incurred any expenditure for realizing this income, the question of holding that 2 per cent of the gross total income is an expenditure and that has to be added back to the income is unsustainable in law. Accordingly, the substantial question of law is answered in favour of the assessee and against the Revenue.

It may be stated here that in most of the cases where exempt income forms part of total income, such exempt income is of the nature of dividend, tax-free interest, etc. Therefore, as laid down by the Karnataka High Court, the aforesaid income will be credited to the account of the assessee by bank transfer, for which no human agency will be involved.

It is, therefore, clearly established that in view of the aforesaid judgements of Punjab and Haryana High Court and the Karnataka High Court, no disallowance under section 14A of the Act will be permissible if the exempt income is of the nature of dividend and tax-free interest, etc.

It is, accordingly, advised that if the issue of disallowance under section 14A is involved, then, in the light of the aforesaid judgements, a claim should be made that no expenditure has been incurred in relation to the exempt income and therefore, no disallowance is called for under section 14A of the Act.

Place : Pune

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