

No disallowance under section 14A unless exempt income is earned during the year

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In brief

The Delhi High Court (HC) has recently held in the case of Holcim India Private Limited (the taxpayer), that there could be no disallowance of expenditure for earning of exempt income (section 14A of Income-tax Act, 1961 (the Act)) in case exempt income was not earned during the year.

In detail

Facts

- The taxpayer¹ was a holding company having investment in another cement company.
- During the relevant assessment year, the tax officer disallowed business expenditure of the taxpayer stating that it had not commenced business activity.
- The Commissioner of Income-tax (Appeals) held that although the business had commenced activity, the expenditure was disallowed [under section 14A of the Act] as it had been incurred for earning dividend income which was a tax-exempt income.
- As per the provisions of the Indian Tax Laws, expenditure incurred for earning tax exempt income

was disallowed under section 14A of the Act.

- However, the Income-tax Appellate Tribunal (Tribunal) ruled in favour of the taxpayer.

Issue

- Whether the expenditure incurred on investments in shares was disallowable considering income on these investments i.e. dividend was an exempt income?

Taxpayer's contention

- The taxpayer had not earned any dividend income during the year which was exempt and did not form part of the total income.
- In the absence of any clear finding or nexus between expenses incurred and exempt income, no *ad hoc* disallowance could be made.

Tax authorities contention

- The investments made by the taxpayer would earn dividend income which was exempt under the Act, and therefore expenditure incurred on these investments should have been disallowed.

High Court ruling

- The HC observed that even though long-term capital gains on which securities transaction tax was paid was exempt from tax, there was always a possibility of a private sale in an off-market transaction which was chargeable to tax.
- As regards dividends, HC observed that the declaration of a dividend was not the shareholders prerogative as they could not insist on it. Furthermore, on declaration, a dividend was subjected to dividend distribution tax.

¹ Commissioner of Income-tax-IV v. Holcim India Private Limited [TS-640-HC-2014(Delhi)]

- The HC also observed that the taxability of income to be earned in the subsequent year depended upon the nature of transaction entered into in the subsequent year. Also the income which at present was exempt under section 10 of the Act may become taxable in subsequent years.
- The HC referred to other judgments² wherein Courts had ruled that in the absence of any tax exempt income during the year, the corresponding expenditure could not be disallowed. Considering the above, the HC held that the expenditure could not be disallowed under section 14A of the Act in the absence of any exempt income during the year.

The takeaway

On this issue, Central Board of Direct Taxes has earlier issued a circular³ clarifying that expenditure can be disallowed even in cases where corresponding exempt income has not been earned during the year. However it appears that this circular was not brought to notice of the HC. The HC, referring to earlier judgments, ruled that the expenditure incurred in the course of the business of holding and protecting investments cannot be disallowed under section 14A of the Act in the absence of any exempt income during the year.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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² Commissioner of Income-tax v. M/s. Lakhani Marketing Incl. [2014] 226 Taxman 45 (Punjab & Haryana), and Commissioner of Income-tax-I v. Corrtch Energy Private Limited [2014] 223 Taxmann 130 (Gujarat), Commissioner of Income-tax v. M/s. Shivam Motors Private Limited [ITA No. 88 of 2014]

³ Circular No 5/ 2014 dated 11 February, 2014

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