Book profit under section 115JB should be computed without considering the provisions of section 14A read with Rule 8D; For the purpose of computing disallowance under section 14A read with Rule 8D, only those investments to be considered for computing average value of investments that yield exempt income during the year

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In brief

In a recent judgement, the Special Bench of the Delhi Income-tax Appellate Tribunal (Tribunal) has held that the computation of book profit under section 115JB (MAT provisions) of the Income-tax Act, 1961 (the Act) was to be made without considering the disallowance under section 14A read with Rule 8D of the Income-tax Rules, 1962 (the Rules) and; for the purpose of computing disallowance under section 14A read with Rule 8D, only those investments were to be considered for computing the average value of investments that yielded exempt income during the year.

In detail

Facts

- The taxpayer[1], in the return of income filed for assessment year 2008-09, had claimed certain income as exempt which comprised of exempt dividends/ interest income (comprising of 24.94% of total exempt income) and long-term capital gains (comprising balance 75.06% of the exempt income). In the computation prepared under normal provisions of the Act, the taxpayer itself had made disallowance in respect of section 14A being 0.5% of average value of investments yielding tax exempt income.
- The Tax Officer (TO), computed the disallowance under section 14A by applying the ratio of total expenses to the exempt income/ taxable income

[1] ITA No 502/ Del/ 2012 and CO No. 68/ Del/ 2014

and made additions under the normal provisions as well as in computing book profit under section 115JB of the Act.

- On appeal by the taxpayer, the first appellate authority held that the disallowance under section 14A was restricted to 0.5% of average value of total investments, thereby negating the taxpayer's contention that only those investments that yielded tax-free income during the year should be considered. For computation of book profit, the addition was restricted to 24.94% of the amount derived as above.
- Both the Revenue and the taxpayer aggrieved with the order of the first appellate authority filed appeals/ cross objections before the Tribunal. The President had constituted a Special Bench to adjudicate the issue arising from the appeals.

Issues before the Tribunal

(i) Whether computation provisions prescribed for computation of total income under normal provisions with reference to section 14A read with Rule 8D could be taken into consideration while computing book profits under MAT provisions?

(ii) For computing disallowance under section 14A read with Rule 8D of the Rules, whether total investments as appearing in the balance sheet needs to be considered or only those investments that yielded exempt income during the year.

Taxpayer's contention

- The taxpayer contended that section 14A of the Act could not be read in section 115JB, as section 115JB is a complete code in itself and overrides all other provisions of the Act. Tax liability under section 115JB of the Act was to be worked out only on the basis of adjusted book profit and not on the basis of income computed under normal provisions of the Act.
- The TO cannot go beyond audited financial statements of the taxpayer while computing book profits under section 115JB.
- Based on the matching principle of accountancy, only expenses debited to the profit and loss account that had direct and proximate nexus with the exempt income credited to the profit and loss account should have been added back while computing book profit under MAT provisions.
- Applicability of section 14A is confined to computation of tax liability under the five heads of income under normal provisions contained in Chapter IV of the Act. Section 14A could not be extended and read into section 115JB, falling under Chapter XII-B of the Act.
- The taxpayer relied on the decision of the jurisdictional Delhi High Court (HC) in the case of Bhushan Steel Ltd. wherein it was held that disallowance under section 14A read with Rule 8D made by the TO cannot be added while computing book profit under MAT provisions.
- On the second issue, the taxpayer contended that while considering the average value of investment, only those investments were to be considered that have yielded exempt income and not those investments that did not yield any exempt income during the year.
- The taxpayer relied on catena of decisions, including the decision of the jurisdictional HC in the case of Holcim India, wherein it has been held that unless and until the taxpayer has actually earned income during the relevant year and that does not form part of the total income, section 14A of the Act would have no application.

Revenue's contention

- On the first issue, the Revenue contended that it could not be denied that legislative intent in disallowance of expenditure relating to earning of exempt income was the same, whether under normal provisions or under MAT provisions. Therefore, it could not be said that section 14A had no applicability to MAT provisions, which existed when section 14A was introduced for the first time.
- Section 14A is applicable for all kinds of incomes, which are claimed as exempt by the taxpayer under the Act.
- Relying on the decision of the jurisdictional Delhi HC in the case of Goetze India Ltd., it was contended that the TO is empowered to adopt the disallowance under section 14A read with Rule 8D while making addition under the MAT provisions.
- With regard to the subsequent decision of the jurisdictional Delhi HC in the case of Bhushan Steel Ltd., which has been relied upon by the taxpayer, it was submitted that the said decision was rendered without considering the binding decision of co-ordinate bench of equal strength, and therefore, cannot hold the field.
- On the second issue, the Revenue contended that irrespective of a particular investment capable of earning

exempt income, actually fetched income during the year or not, the same was to be considered for calculating average investments under Rule 8D of the Rules.

- The principles laid down by the Supreme Court in the case of Rajendra Prasad Moody[2], needs to be followed wherein it was held that an expenditure to be allowable need not be profitable, meaning that merely because there was no exempt income, expenditure in relation to this unearned exempt income could not be disallowed.

Tribunal's ruling

- The Special Bench noted that the Jurisdictional Delhi HC, in two different cases, had taken a contrary view on the issue of applicability of provisions of section 14A read with Rule 8D in the computation of book profit under the MAT provisions.
- The Supreme Court in the case of Vegetable Products Limited[3] had held that if two reasonable constructions of a taxing provision were possible, the construction that favours the taxpayer must be adopted.
- Under the circumstances, the Special Bench, followed the later decision of the Delhi HC in the case of Bhushan Steel Limited[4] wherein it was held that computation under MAT provisions was to be made without resorting to the computation as contemplated under section 14A read with Rule 8D and decided the matter in favour of the taxpayer.
- On the second issue, whether total investments as appearing in the balance sheet needs to be considered or only those investments that yielded exempt income during the year, the Special Bench held that the decision of the jurisdictional HC was directly on the point in dispute, whereas the decision of the Supreme Court in the case of Rajendra Prasad Moody relied upon by the Revenue had been rendered in the context of section 57(iii), the applicability of which had been ruled out by the Delhi HC in the case of Cheminvest Limited[5].
- While computing disallowance under section 14A read with Rule 8D, only those investments should have been considered for computing average value of investments that yielded exempt income during the year.

The takeaways

- This is a welcome decision by the Special Bench wherein it has addressed the following issues:
  - (i) The disallowance made by the TO under section 14A read with Rule 8D under normal provisions should not be added in the computation of book profit under MAT provisions.
  - (ii) While computing disallowance under section 14A read with Rule 8D, only those investments should be considered for computing average value of investments that yield exempt income during the year.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

[2] CIT *v.* Rajendra Prasad Moody [115 ITR 519 (SC)]
[3] CIT *v.* Vegetable Products Ltd. [88 ITR 192 (SC)]
[4] Pr. CIT v. Bhushan Steel Ltd. [ITA No. 593 & 594/ 2015 (Delhi)]
[5] Cheminvest Ltd. *v.* CIT [378 ITR 33 (Delhi)]

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