

# **Seminar on section 14A & rule 8D of Income Tax Act' 1961**

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Gujarat**



## Section 14A of I.T. Act' 1961

Introduced by the Finance Act 2001  
**with retrospective effect** from 1 April  
1962,

to provide for disallowance of  
expenditure incurred/ deemed to  
have been incurred in relation to  
earning of income not chargeable to  
tax in India.

### **Logic for introduction of section 14A:**

If an income was not charged to tax,  
then the expenditure incurred to earn  
such tax free income should also not  
be allowed as deduction as the same  
would tantamount to double taxation.

It would be unjust to allow deduction  
of this expenditure against the other  
taxable income.



## Section 14A of I.T. Act' 1961

### [Expenditure incurred in relation to income not includible in total income

**14A.** [(1)] For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.]

[(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.

(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act :]

[**Provided** that nothing contained in this section shall empower the Assessing Officer either to reassess under [section 147](#) or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under [section 154](#), for any assessment year beginning on or before the 1st day of April, 2001.]



## Issues regarding section 14A

Sl. No.	Issue	Decision of Courts
1	Assessing Officer should not reject, <b>without reasoning</b> , the explanation or rationale of the assessee to offer particular amount as expenditure.	<p>(A) <i>Moonstar Securities Trading and Finance Co. (P.) Ltd</i> <a href="#">(2019) 105 taxmann.com 275 (SC)</a></p> <p>(B) <i>Hero Corporate Service Ltd</i> <a href="#">[2019] 103 taxmann.com 200 (SC)</a></p> <p><b>How to record reasons:</b></p> <p>(A) <i>Devarsons Industries (P.) Ltd</i> <a href="#">[2017] 84 taxmann.com 244 (Gujarat)</a> <a href="#">ITAT order, CIT(A) &amp; AO's order</a></p> <p>(B) <i>Kalpataru Power Transmission Ltd</i> <a href="#">(ITAT Ahd), ITA no. 1462 &amp; 1463/Ahd/2016 dated 10/05/2019</a> <b>(Where <u>AO's disallowance</u> deleted by Ld.CIT(A) but upheld by Hon'ble ITAT)</b></p>
2	<b>Purpose</b> of making investments ( <i>income from which is claimed exempt</i> ) is <b>not relevant</b> . E.g. investments for acquiring controlling stakes in other companies, shares held as stock-in-trade etc. are all liable for application of sec. 14A	<p><i>Maxopp Investment Ltd</i> <a href="#">[2018] 91 taxmann.com 154 (SC)</a></p>



## .....Issues regarding section 14A

Sl. No.	Issue	Decision of Courts
3	If <u>no exempt income</u> earned in an AY, then <u>no disallowance</u> u/s 14A can be made	<p>(A) <i>GVK Project and Technical Services Ltd</i> <a href="#">[2019] 106 taxmann.com 181 (SC)</a></p> <p>(B) <i>Oil Industry Development Board</i> <a href="#">[2019] 103 taxmann.com 326 (SC)</a></p> <p>(C) <i>Chettinad Logistics (P.) Ltd</i> <a href="#">[2018] 95 taxmann.com 250 (SC)</a></p> <p><i>In this case, Hon'ble Madras High Court had discussed CBDT Circular no. 5/2014 dated 11/02/2014 in <a href="#">[2017] 80 taxmann.com 221 (Madras)</a> &amp; one question of law before SC also was regarding Circular no. 5/2014. Review petition of Department also dismissed by Hon'ble SC vide decision dated 31/07/19 in <a href="#">SLP (C) no. 16194/2018</a>.</i></p> <p><i>However, none of above decisions explicitly held Circular no. 5/2014 as ultra-vires.</i></p>



## .....Issues regarding section 14A

Sl. No.	Issue	Decision of Courts
4	Disallowance under section 14A to be <u>restricted to amount of exempt income only</u>	<i>State Bank of Patiala</i> <a href="#">[2018] 99 taxmann.com 286 (SC)</a>
5	Whether disallowance u/s 14A to be added back to book profits u/s 115JA/115JB	<i>Yes. Assessee's SLP pending before Hon'ble Supreme Court vide <a href="#">SLP(C) No. 009191/2015</a> against Hon'ble Calcutta High Court decision in <i>M/s Jayshree Tea &amp; Industries Ltd</i> (High Court <a href="#">G.A. No. 1501/2014 &amp; ITAT 47/2014</a>, High Court decision dated 19/11/2014, ITAT order ITA no. 590/Kol/2012) has been dismissed as on 26/02/2020. <u>Other cases in favour of Deptt:</u> <i>Goetze (India) Ltd.</i> <a href="#">[2014] 44 taxmann.com 138 (Delhi)</a> <i>Viraj Profiles Ltd</i> <a href="#">(2015) 64 taxmann.com 52 (Mumbai - Trib.)</a></i>
6	When investments (from which exempt income is derived) are held in two portfolios- <b>stock-in-trade as well as capital assets</b> (e.g. in cases of banks, stock brokers/traders) whether disallowance u/s 14A can be made	<i><u>Yes, proportionate disallowance to be made.</u></i>  <i>Maxopp Investment Ltd</i> <a href="#">[2018] 91 taxmann.com 154 (SC)</a>



## .....Issues regarding section 14A

Sl. No.	Issue	Decision of Courts
7	Whether reopening u/s 148 and/or revision u/s 263 is justified if assessee had not allocated any expenses towards exempt income?	<p><u>Yes.</u></p> <p><b>For section 148</b>, in such cases, it can be said that income had escaped assessment by reasons of failure on part of assessee to disclose fully and truly all material facts necessary for its assessment.</p> <p><i>Honda Siel Power Products Ltd</i> <a href="#">[2012] 20 taxmann.com 5 (SC)</a></p> <p><b>For section 263</b>, it can be said that order of AO was erroneous and prejudicial to interest of Revenue</p> <p><i>RKBK Fiscal Services (P.) Ltd</i> <a href="#">[2013] 32 taxmann.com 153 (Calcutta)</a> <i>Goetze (India) Ltd.</i> <a href="#">[2014] 44 taxmann.com 138 (Delhi)</a></p>
8	Whether Section 14A is applicable to exempt income derived from sources other than shares/mutual funds etc.?	<p><u>Yes.</u></p> <p><i>Vishnu Anant Mahajan</i> <a href="#">[2012] 22 taxmann.com 88 (Ahd.) (SB)</a></p>



## Rule 8D of I.T. Rules, 1962

Introduced by the Finance Act 2001 **with retrospective effect** from 1 April 1962

### **Logic for introduction of Rule 8D:**

To provide a reasonable basis to compute a deeming amount of deduction/expense which may be incurred on earning such exempt income.



# Rule 8D: Method for determining amount of expenditure in relation to income not includible in total income

*As amended by IT(Fourteenth Amendment Rules) 2016 w.e.f. 02/06/2016*

- (1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with—
- (a) the correctness of the claim of expenditure made by the assessee; or (b) the claim made by the assessee that no expenditure has been incurred, in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).
- [ (2) *The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely:—*
- (i) *the amount of expenditure directly relating to income which does not form part of total income; and*
- (ii) *an amount equal to one per cent of the annual average of the monthly average of the opening and closing balances of the value of investment, income from which does not or shall not form part of total income :*
- Provided that the amount referred to in clause (i) and clause (ii) shall not exceed the total expenditure claimed by the assessee.]**
- (3) [\*\*\*]

# *Rule 8D:*

## *Prior to IT(Fourteenth Amendment Rules) 2016*

(1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with-

1. the correctness of the claim of expenditure made by the assessee; or
2. the claim made by the assessee that no expenditure has been incurred,

in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

(2) The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely :-

1. the amount of expenditure directly relating to income which does not form part of total income;
2. in a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt, an amount computed in accordance with the following formula, namely:- A  
$$X B / C$$
Where:  
A = amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year;  
  
B = the average of value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year ;  
  
C = the average of total assets as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;
3. an amount equal to one-half per cent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year.

(3) For the purposes of this rule, the "total assets" shall mean, total assets as appearing in the balance sheet excluding the increase on account of revaluation of assets but including the decrease on account of revaluation of assets.

# Issues regarding Rule 8D

Sl. No.	Issue	Decision of Courts
1	Whether Rule 8D is <u>retrospectively</u> applied? Can it be applied for assessment years prior to AY 2008-09?	<u>No. Rule 8D is prospectively applied for AY 2008-09 onwards.</u>  <i>Maxopp Investment Ltd</i> <a href="#">[2018] 91 taxmann.com 154 (SC)</a> <i>CIT v. Essar Teleholdings Ltd.</i> <a href="#">(2018) 90 taxmann.com 2 (SC)</a>
2	If Rule 8D is <u>prospectively</u> applied, then what is method of computation for AY 2007-08 & prior years?	<b><i>A disallowance on a reasoned basis can be made provided nexus is established by AO between exempt income &amp; expenses.</i></b>  <u><i>In favour of Deptt:</i></u> <i>Catholic Syrian Bank Ltd</i> <a href="#">[2011] 9 taxmann.com 148 (Kerala)</a> <i>Eih Associated Hotels Ltd</i> <a href="#">(2009) 126 TTJ 246 (Kolkata- Trib.)</a>
3	<b><i>Between AY 2008-09 to AY 2016-17</i></b>  Whether <u>netting</u> of interest ( <i>Interest PAID less Interest EARNED</i> ) in clause (ii) of Sub-Rule (2)(2) of Rule 8D to be allowed	<u><i>No netting to be allowed.</i></u>  <i>Department's SLP pending before Hon'ble Supreme Court vide</i> <a href="#">SLP (Civil) Diary no. 12855/2018</a> <i>against Hon'ble Gujarat High Court in TA no. 409 &amp; 514/2017 in Nirma Credit &amp; Capital (P.) Ltd</i> <a href="#">[2017] 85 taxmann.com 72 (Gujarat)</a>



## .....Issues regarding Rule 8D

Sl. No.	Issue	Decision of Courts
4	If assessee has interest-free funds that exceed the amount of investments income from which is exempt, whether disallowance u/s 14A read with Rule 8D to be made	<p><b><i>Against the Department:</i></b></p> <p><i>Sintex Industries Ltd <a href="#">[2018] 93 taxmann.com 24 (SC)</a> &amp; <a href="#">[2017] 82 taxmann.com 428 (Gujarat)</a></i></p> <p><i>However, in Sintex Industries (Supra) case, the investments were minor in comparison to interest-free funds.</i></p> <p><b><i><u>SLPs of Department pending before Hon'ble Supreme Court as on 30.09.2019 -</u></i></b></p> <ol style="list-style-type: none"><li><b><i>M/s. Jamnalal Sons Pvt. Ltd. <a href="#">(Civil Appeal No. 2793 of 2018)</a> against Bombay High Court order in <a href="#">[2018] 99 taxmann.com 350 (Bombay)</a> dated 01/08/2017</i></b></li><li><b><i>Reliance Industries Ltd, <a href="#">Diary No. 25116 of 2019</a> (Against Bombay High Court order in <a href="#">ITA No. 1550 of 2017 Dated 22/08/2017</a>)</i></b></li></ol>



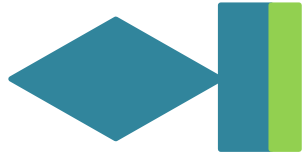
## .....Issues regarding Rule 8D

Sl. No.	Issue	Decision of Courts
5	When assessee claims/AO finds that investments are out of mixed funds (interest-bearing & interest-free)	<p><i>High Courts have almost consistently held against Department that in such cases, <b>presumption</b> would arise that investment would be out of interest free funds available with company &amp; once there was a presumption that interest free funds were utilized for making exempt investment, assessee would not be expected to establish same and it would be for revenue to establish to contrary.</i></p> <p><b><u>However, SLPs of Department pending before Hon'ble Supreme Court as on 30.09.2019 -</u></b></p> <ol style="list-style-type: none"><li><b><u>1. Reliance Industries Ltd, Diary No. 25116 of 2019 (Against Bombay High Court order in ITA No. 1550 of 2017 Dated 22/08/2017)</u></b></li><li><b><u>2. SICOM Ltd, SLP(C) No. 018516 of 2019, Diary no. 21880 of 2019 (Against Bombay High Court order in ITA 1374 of 2016 dated 22/01/2019)</u></b></li><li><b><u>3. Oriental Bank of Commerce, Diary No. 29948 of 2018 (Against Delhi High Court order in ITA No. 245 of 2018 Dated 26/02/2018)</u></b></li><li><b><u>4. Maruti Suzuki India Ltd (Formerly Maruti Udyog Ltd), Diary no. 32591 of 2018 (Against Delhi High Court order in ITA No. 250 of 2005 dated 07/12/2017)</u></b></li></ol>



## To sum up

1. AO should concentrate on **investments in the balance sheets** which would result in incomes not includible in taxable income; for e.g. **tax free bonds, equities held as investments, PPF, LIC investments, capital in partnership firm or agriculture assets, etc.**
2. AO to write detailed reasons, backed by facts, to disagree with explanation of assessee, before AO proceeds for making disallowance u/s 14A.



## .....**To sum up**

3. AO to call for fund-utilization/cash flow statement & independently call loan approval documents from banks/Financial Institution to arrive at/rule out one-to-one nexus of borrowed funds with investments income from which is claimed as exempt.
4. Always **check the current status of SLPs/Appeals** pending before Hon'ble Supreme Court or High courts.



*Thank  
You*