



Global Business Tax Alert Sharp Insights

Supreme Court (in case of Essar Teleholdings) confirms Income Tax Rules 1962 (Rule 8D) are prospective in operation

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Background

- Section 14A of the Income Tax Act (the Act) provides for disallowance of expenditure related to earning of exempt income. Earlier there was no method prescribed for computing the amount of disallowance for expenses. However, the government, vide notification dated March 24, 2008, introduced Rule 8D to Section 14A, prescribing the method of computation of allocation of these costs. Ever since there has been a controversy around whether such rule can be applied for years prior to Assessment Year (AY) 2008-09 or such rule is prospective in application.

Facts of the case

- During the Financial Year (FY) 2002-03 (AY 2003-04), the taxpayer was in receipt of both taxable and non-taxable dividend income.
- The Assessing Officer in the assessment order, disallowed partial interest expenditure (approximately INR 26 crores) claimed by the taxpayer in the tax return as disallowance under Section 14A read with Rule 8D relating to investment income claimed as exempt by the taxpayer.
- On appeal, the Commissioner of Income Tax (Appeals) [CIT(A)] partly allowed the appeal. Aggrieved, the taxpayer filed an appeal before the Tribunal (ITAT).
- The Hon'ble ITAT, ruled that the provisions of Rule 8D cannot be invoked in years prior to AY 2008-09 and allowed the appeal in favour of the taxpayer. The ITAT restored the matter back to the files of the Assessing Officer for fresh adjudication without invoking the provisions of Rule 8D. [The Tribunal while passing the order, placed reliance on the judgment passed by the Hon'ble High Court in the case of Godrej and Boyce Manufacturing Company Limited [2010] (328 ITR 81 (Bom))]
- The High Court dismissed an appeal filed by Revenue.
- Aggrieved, the Revenue filed an appeal before the Supreme Court on the issue of retrospective application of Rule 8D.

Issues for consideration before the Supreme Court

Whether Rule 8D of Income Tax Rules is prospective in operation as held by the High Court or it is retrospective in operation and shall also be applicable in the assessment year in question as contended by learned counsel for the Revenue.

Ruling of the Supreme Court

- The Hon'ble Supreme Court has relied on the following to dismiss the appeal filed by the Revenue and has held that Rule 8D is prospective in operation and could not have been applied to any AY prior to AY 2008-09:
 - The principles of statutory interpretation for interpreting retrospectivity of a fiscal statute, which provides that fiscal legislation imposing liability is generally governed by the normal presumption that it is not retrospective and it is a cardinal principle of the tax law that the law to be applied is that in force in the assessment year unless otherwise provided expressly or by necessary implication
 - The Explanatory memorandum to Finance Act, 2006 and the CBDT Circular dated 28.12.2006, wherein it has been clearly mentioned that sub-section (2) and sub-section (3) of Section 14A of the Act shall be effective with effect from the assessment year 2007-08.
 - The fact that Rule 8D prescribing the method of calculation of deduction under Section 14A was inserted with effect from 24.03.2008 to implement sub section (2) and (3) of Section 14A of the Act.

Conclusion

The Supreme Court by applying the principles of statutory interpretation for interpreting retrospectivity of a fiscal statute, the nature and purpose of sub-section (2) and sub-section (3) of Section 14A of the Act, the purpose and intent of Rule 8D of the Rules coupled with the explanatory notes in the Finance Bill, 2006 and the departmental understanding as reflected by Circular dated 28 December, 2006, held that Rule 8D was intended to operate prospectively and cannot be applied for AYs prior to AY 2008-09.

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