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# Global Business Tax Alert
Sharp Insights

## The Apex Court of India in the case of Godrej & Boyce Manufacturing Company Ltd. ('the taxpayer')[1] held that disallowance under [2]Section 14A of the Income-tax Act, 1961 ('the Act') shall be applicable on dividend income liable to dividend distribution tax under the Act.

**Issue no:** GBTA/42/2017

**In this issue:**



[1] Godrej & Boyce Manufacturing Company Ltd. v. DCIT [2017] 81 taxmann.com 111 (SC)

[2] Section 14A provides for disallowance of expenditure incurred in relation to income which does not form part of total income of the taxpayer.

## Background/ Facts

- In the tax return filed by the taxpayer (‘Godrej & Boyce Manufacturing Company Ltd.’) for tax year 2001-02, dividend income for INR 343 million approx. was shown towards dividend income from shares and units of mutual funds.
- The Assessing officer (‘AO’) disallowed partial interest expenditure (for approx INR 69.2 million) claimed by the taxpayer in the tax return on a notional basis in the ratio of the cost of the investments in shares and units of mutual funds to the cost of the total assets appearing in the balance sheet.
- Commissioner of Income Tax (Appeals) [‘CIT(A)’] allowed the exemption of the entire dividend income following the earlier Tribunal order. Earlier, the issue was decided in the favor of the taxpayer on the grounds that the AO had failed to show any nexus between the investments in shares and units of mutual funds on the one hand and borrowed funds on the other.
- Following Revenue’s appeal, the Tribunal remanded the matter to the AO for a fresh adjudication to record his non-satisfaction with the correctness of the claim of the taxpayer, before quantifying the disallowance as per Rule 8D.
- On further appeal to the high court, the court upheld the remand made by the Tribunal to the AO.

## Issue for consideration before Apex Court

**Issue 1**

Whether the phrase “income which does not form part of total income under this Act” appearing in Section 14A, includes within its scope dividend income on shares in respect of which dividend distribution tax is payable.

**Issue 2**

Whether, findings of lower authorities that there is no nexus between the expenditure disallowed and earning of the dividend income (which were also accepted by the Revenue in the past), there could be any question of applicability of Section 14A in the taxpayer’s case, at all.

## Ruling of the Apex Court

**Issue 1**

- The object behind the introduction of Section 14A is to check the claim of allowance of expenditure incurred towards earning exempt income in a situation where an assessee has both exempt and non-exempt income.

- Expenses incurred only in respect of earning taxable income can be allowed. Therefore Section 14A clearly disallows expenses incurred in connection with earning exempt income.
- The literal meaning of Section 14A appears to be wholly consistent with the scheme of the Act and the object/purpose of levy of tax on income. Therefore, the well-entrenched principle of interpretation where the words of the statute are clear and unambiguous, recourse cannot be had to principles of interpretation other than the literal view will apply.
- Therefore, the provisions of Section 14A would apply to dividend income on which dividend distribution tax is payable.

**Issue 2**

- Section 14A postulates the requirement of satisfying the AO regarding correctness of the claim of the taxpayer. It is only thereafter that provisions of Section 14A(2)and 14A(3), read with Rule 8D of the Rules or a best judgement determination, as earlier prevailing, would become applicable.
- The Apex Court noted that
  - In the past, the Revenue could not prove that expenditure has been incurred to earn dividend income,
  - In the current year also, there is no new fact or change of circumstances,
  - The taxpayer had sufficient interest-free funds available for the purpose of making investments
  - No nexus has been established by the Revenue between expenditure disallowed and the dividend income earned by the taxpayer.
- The Court concluded that though the principle of *res judicata* would not apply to assessment proceedings under the Act, however the need for consistency and certainty and existence of strong and compelling reasons for a departure from a settled position, has to be spelt out which is conspicuously absent in the present case[3].
- Thus in the absence of any material on record, the Court upheld that the taxpayer is entitled to full benefit of the claim of exemption of dividend income without any disallowance.

[3] Referred its earlier ruling in Radhasoami Satsang v. Commissioner of Income-Tax' [1992] 193 ITR (SC) 321

## Conclusion

A key takeaway from this decision as confirmed by the Apex Court is that in order to trigger disallowance under Section 14A, the nexus between investment - which results in tax free dividend income - and borrowed funds needs to be proved. Further through this decision, the Court has emphasised the importance of the principle of consistency which requires that unless there is any change in the facts and circumstances, the tax position followed in the past should ordinarily allowed to be followed in the subsequent years.

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