Deloitte.

India | Tax & Regulatory | For private circulation only | 23 March 2018

Global Business Tax Alert
Sharp Insights

In Maxopp Investment case, Supreme Court holds that expenditure incurred for acquiring strategic investments is subject to disallowance u/s 14A, even if earning dividend is only incidental

Issue no: GBTA/06/2018

In this issue:

Facts of the case

- Maxopp Investment Ltd. (the appellant or the company) is engaged in the business of finance, investment and dealing in shares and securities. The appellant holds shares in two portfolios- (a) as investment on "capital account" and (b) as "trading assets" for the purpose of acquiring and retaining control over investee group companies, particularly Max India Ltd.
- Profit/loss on sale of shares held as 'investment'; is returned as income under the head 'capital gains', whereas profit/loss on sale of shares/ securities held as trading assets, is offered to tax as business income under the head 'profits and gains of business or profession'.
- In the tax return filed for Assessment Year (AY) 2002-03, while the appellant claimed exemption in respect of dividend income earned from Max India Limited, it did not disallow apportioned interest expenses, relatable to such dividend incomes.
- The appellant's contention of not disallowing any expense under Section 14A of the Act was that the dominant purpose for purchasing the share was not to earn dividend income, but to gain control over the investee group company or for the purpose of trading in the shares and earning business income and the receipt of dividend was merely incidental.
- The Assessing Officer (AO), while passing the assessment order, disallowed certain portion of the interest income, by apportioning the total interest expenditure in the ratio of investment in shares of Max India Ltd (on which dividend was received) to the total amount of unsecured loan.
- The order passed by the AO was upheld by the first appellate authority of the CIT(A). Further, on appeal, the special bench of ITAT upheld the disallowance made under Section 14A of the Act by holding that there existed a dominant and immediate connection between interest paid on loan utilized for acquiring such shares and earning of dividend income.
- On appeal filed by the appellant before the Delhi High Court, the Hon'ble Delhi High Court held that provisions of section 14A shall apply where an income is claimed as exempt, regardless of the intention/ motive behind making the investment. The Hon'ble Court also relied on the memorandum explaining the provisions of Section 14A of the Act and the decision passed by the Hon'ble Supreme Court in the case of CIT v. Walfort Share and Stock Brokers P Ltd , wherein it was held that the basic principle of taxation was to tax the net income and hence disallowance of expenses apportioned to exempt income may be disallowed.
- Aggrieved by the order of the High Court, the taxpayer filed an appeal before the Supreme Court.

Issues under consideration

Applicability of provisions of Section 14A of the Act in relation to dividend income earned in the following scenarios:

- Where the main purpose of investing in shares was to gain control over investee company and not as investment to earn dividends.
- Where the shares of investee company were held by assessee as stock-in-trade (i.e. as a business activity) and not as investment to earn dividends.

Ruling of the Supreme Court

- In connection with the dominant purpose test, the Hon'ble Supreme Court relying on the decision rendered by itself in the case of CIT v. Walfort Share and Stock Brokers P Ltd held that the fact that the appellant had made investments to gain control over the investee company, is not a relevant factor to determine the applicability of Section 14A of the Act, since dividend income earned by the appellant is non-taxable.
- It has further been held that if any expenditure is incurred on earning the dividend income, that portion of expenditure attributable to dividend income, is to be disallowed and not be treated as business expenditure.
- In connection with the applicability of Section 14A of the Act in respect of dividend income earned from shares held by assessee as stock-in-trade, the Hon'ble Supreme Court has held that when the shares are held as stock-in-trade, certain dividend income is earned, which is exempt under Section 10(34) of the Act. The same also triggers applicability of Section 14A of the Act and the depending upon the facts of each case, expenses have to be apportioned between taxable and non-taxable income. [Reliance placed on CIT v. Walfort Share and Stock Brokers P Ltd].

Conclusion

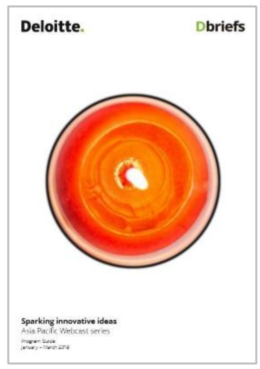
- The Supreme Court has laid down that the principle of apportionment of expenditure relating to non-taxable income did not apply prior to introduction of Section 14A. Prior to insertion of Section 14A, where an assessee had composite and indivisible business which had elements of both taxable and non-taxable income, the entire expenditure in respect of the said business was deductible. However, where the business was divisible, the principle of apportionment was applicable. The legislature inserted section 14A with retrospective effect to address this problem and to clarify the intent that no deduction shall be made in respect of any expenditure incurred, in relation to income which does not form part of the total income.

- The Supreme Court has clarified the intention of section 14A by holding that while determining the disallowance, the dominant purpose or the intention while making the purchase of such investment is not relevant. If an income is considered exempt, the expenses incurred for earning such dividend income have to appropriately apportioned and disallowed under Section 14A of the Act.
- Section 14A was to curb taxpayers taking double tax advantage by avoiding tax on exempt income and at the same time lowering taxable income by treating the expenditure relating to these exempt income as allowable deduction.
- The said ruling will increase the tax cost for all the holding companies who used to receive dividend income from subsidiaries and associates.

Do you know about Dbriefs?

Dbriefs are live webcasts that give valuable insights on important developments affecting your business. To register, visit the Dbriefs page

Download the report



Contacts

Ahmedabad
19th Floor, Shapath - V
SG Highway,
Ahmedabad – 380 015.
Tel: + 91 (079) 6682 7300
Fax: + 91 (079) 6682 7400

Bangalore
19th Floor, 46 - Prestige Trade Tower, Palace Road, High Grounds,
Bengaluru,
Karnataka – 560001.
Tel: + 91 (079) 6627 6000
Fax: +91 (080) 6627 6010

Chennai
No.52, Venkatanarayana Road,
7th Floor, ASV N Ramana Tower,
T-Nagar,
Chennai 600 017.
Tel: +91 (044) 6688 5000
Fax: +91 (044) 6688 5050

Coimbatore
Shanmugha Manram
41, Race Course,
Coimbatore
Tamil Nadu - 641018
Tel: + 91 (0422) 439 2801
Fax: +91 (0422) 222 3615

Delhi/Gurgaon
Building 10,
Tower B, 7th Floor,
DLF Cyber City,
Gurgaon 122 002
Tel : +91 (0124) 679 2000
Fax : + 91 (0124) 679 2012

Hyderabad
KRB Towers, Plot No. 1-4,
Survey No. 65 to 67,
1st -3rd Floor
Madhapur, Serilingampally(M),
RR District, Hyderabad.
Tel: +91 (040) 6603 2600
Fax:+91 (040) 6603 2714

Kolkata
13th and 14th Floor,
Building – Omega
Bengal Intelligent Park
Block – EP & GP
Sector V, Salt Lake City,
Kolkata – 700091
Tel : + 91 (033) 6612 1000
Fax : + 91 (033) 6612 1001

Mumbai
Indiabulls Finance Centre,
Tower 3, 28th Floor,
Elphinstone Mill Compound,
Senapati Bapat Marg, Elphinstone (W),
Mumbai – 400013
Tel: + 91 (022) 6185 4000
Fax: + 91 (022) 6185 4101

Pune
706, B-Wing, 7th Floor,
ICC Trade Tower,
Senapati Bapat Road,
Pune – 411 016.
Tel: + 91 (020) 6624 4600
Fax: +91 (020) 6624 4605

Deloitte makes an impact that matters