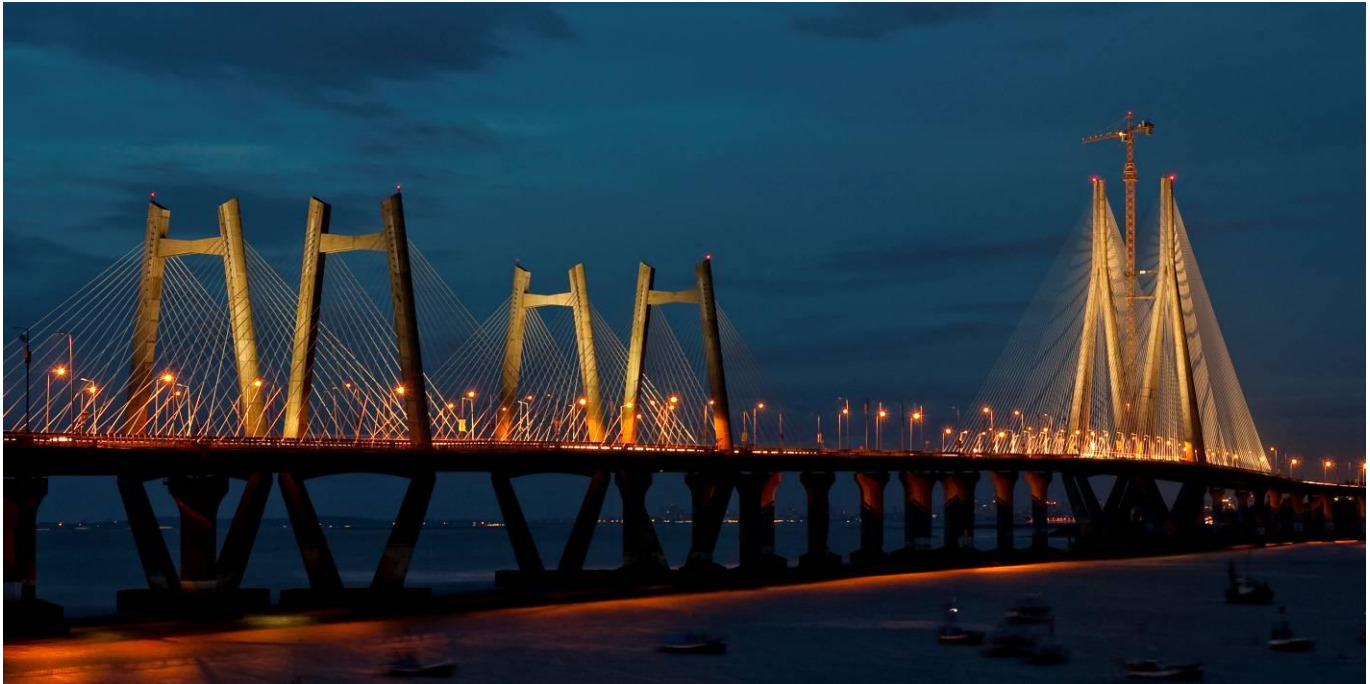


## Disallowance under Section 14A read with Rule 8D will apply while computing book profits under the provisions of Minimum Alternate Tax

17 February 2015



### Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Sobha Developers<sup>1</sup> (the taxpayer) held that disallowance under Section 14A read with Rule 8D of the Income-tax Rules, 1962 (the Rules) is applicable while computing book profits under Section 115JB of the Income-tax Act, 1961 (the Act).

### Facts of the case

- During the Assessment Year 2008-09, the taxpayer earned dividend income and a share of profit from its partnership firm which was exempt under Sections 10(35) and 10(2A) of the Act, respectively. The said income was included in the profit and loss account (P&L account) prepared in accordance with the provisions of the Companies Act, 1956.
- While calculating book profits under Section 115JB of the Act, the Assessing Officer (AO) disallowed expenditure amounting to INR2.46 million under Section 14A of the Act read with Rule 8D of the Rules. The said expenditure were relatable to

income to which provisions of Section 10(35) and 10(2A) of the Act are applicable. It was not in dispute that the direct expenditure were not attributable to earning of exempt income. Therefore, what was disallowed by the AO was only indirect interest expenditure and other expenditure invoking provisions of Rule 8D(2)(ii) and (iii) of the Rules.

- The Commissioner of Income-tax (Appeals) [CIT(A)] deleted the disallowance made by the AO.

### Tribunal's ruling

- The quantum of expenditure disallowed by the AO by invoking the provisions of Section 14A of the Act while computing total income under the normal provisions of the Act has not been challenged by the taxpayer and the said disallowance has been accepted by the taxpayer.

<sup>1</sup> DCIT v. Sobha Developers (ITA No. 1410/Bang/2013) (Bang)– Taxsutra.com

- The provisions of Section 115JB of the Act read with Explanation 1(f)<sup>2</sup> provides that the amount of expenditure relatable to income, to which Section 10 applies, should be added to the profit as per the P&L account.
- Section 14A of the Act read with Rule 8D of the Rules is a reasonable method of calculating the amount of expenditure, in a case where the taxpayer has not been able to satisfy the AO regarding the quantum of expenditure incurred in earning income which does not form part of the total income under the Act.
- If the taxpayer satisfies the AO regarding the quantum of expenditure incurred in earning income which does not form part of the total income under the Act, then that can be adopted for the purpose of addition under clause (f) of Explanation 1 below Section 115JB(2) of the Act.
- Rule 8D of the Rules come into play only when there is no other basis for arriving at the quantum of expenditure incurred in earning exempt income.
- There is no prohibition to adopt the disallowance made by the AO under Section 14A of the Act read with Rule 8D of the Rules, while computing total income under the normal provisions of the Act. The argument of the taxpayer that Section 14A of the Act is very specific and is applicable only for the purpose of computing total income under Chapter IV of the Act cannot be accepted.
- The argument of the taxpayer that Section 115JB appears in Chapter XIIB of the Act dealing with specific provisions relating to certain companies and therefore the provisions of Section 14A read with Rule 8D of the Rules cannot be applied while making an addition to the net profit under Section 115JB of the Act cannot be accepted.
- The argument of the taxpayer that only direct expenditure attributable to earning of income which does not form part of the total income under the Act can be added under clause(f) of Explanation 1 below Section 115JB(2) of the Act, cannot be accepted.

- There is no difference between the expression 'expenditure relatable' and the expression 'expenditure incurred by the assessee in relation to'.<sup>3</sup> Both the expressions mean that whatever expenditures are incurred to earn income which does not form part of the total income under the Act, both direct and indirect expenditure, have to be disallowed.
- There is no basis for the argument under Section 115JB of the Act that it is only direct expenses that are contemplated as capable of being added to the profits as per the profit and loss account under clause (f) to Explanation 1 to Section 115JB(2) of the Act.
- Accordingly, the disallowance under Section 14A will be applicable while arriving at the book profits under Section 115JB(2) of the Act read with Explanation 1(f) thereto.

## Our comments

The applicability of the provisions of Section 14A read with Rule 8D of the Rules to clause (f) of Explanation to Section 115JA of the Act while computing adjusted book profit has been a matter of debate.

The Delhi Tribunal in the case of Quippo Telecom Infrastructure Ltd.<sup>4</sup> has held that disallowance under Section 14A of the Act cannot be made while computing the book profit under Section 115JB of the Act since no actual expenditure was debited in the profit and loss account relating to the earning of exempt income. The clause (f) of Explanation to Section 115JB refers to the amount debited to the profit and loss account which can be added back to the book profit while computing book profit under Section 115JB of the Act.

Further, the Delhi Tribunal in the case of Goetze (India) Ltd.<sup>5</sup> has held that provisions of sub-section (2) and sub-section (3) of Section 14A cannot be imported into clause (f) of Explanation to Section 115JA while computing adjusted book profit.

<sup>3</sup> As per Explanation 1(f) to Section 115JB of the Act book profit means net profit as shown in the profit and loss account for the relevant previous year which shall be increased by the amount or amounts of expenditure relatable to any income to which Section 10 (other than the provisions contained in Section 10(38) thereof) or Section 11 or Section 12 apply.

<sup>4</sup> Quippo Telecom Infrastructure Ltd. v. ACIT (ITA No.4931/Del/2010 – Assessment Year 2007-08)

<sup>5</sup> Goetze (India) Ltd. v. CIT [2009] 32 SOT 101 (Del)

<sup>2</sup> As per Explanation 1(f) to Section 115JB of the Act book profit means net profit as shown in the profit and loss account for the relevant previous year which shall be increased by the amount or amounts of expenditure relatable to any income to which [Section 10 (other than the provisions contained in Section 10(38) thereof) or Section 11 or Section 12 apply].

However, the Mumbai Tribunal in the case of RBK Share Broking (P.) Ltd.<sup>6</sup> and Dabur India Ltd.<sup>7</sup> held that expenditure incurred to earn exempt income will be disallowed under Section 14A while computing MAT profits.

The Tribunal in the present has held that the disallowance under Section 14A will be applicable while arriving at the book profits under Section 115JB(2) of the Act.



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<sup>6</sup> ITO v. RBK Share Broking (P.) Ltd. [2013] 159 TTTJ 16 (Mum)

<sup>7</sup> Dabur India Ltd. v. ACIT [2013] 145 ITD 175 (Mum)

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