CBDT notify amendments to Rule 8D of Income-tax Rules

Quantification of disallowance of expenditure under Section 14A of the Income-tax Act, 1961 (the Act) relatable to earning of exempt income has been one of the most litigious issues. The computation mechanism provided in Rule 8D of the Income-tax Rules, 1962 (the Rules) finds its application where the assessing officer is not satisfied with the correctness of the claim of expenditure made by the taxpayer or where the taxpayer claims that no expenditure has been incurred in relation to earning of exempt income. The Finance Minister in his Budget Speech of 2016 acknowledged the multiplicity of disputes over this issue and proposed to rationalise the quantification of disallowance contained in Rule 8D of the Rules.

The Central Board of Direct Taxes (CBDT) has notified amendments to Rule 8D of the Rules.

The erstwhile sub-rule (2) to Rule 8D provided for computing the expenditure in relation to earning of exempt income as an aggregate of the following:

- expenses directly incurred to earn exempt income;
- interest expenditure incurred by the taxpayer (not directly attributable to any particular income) computed as a proportion of the average value of investment earning exempt income to average total assets; and
- 0.5 per cent of the average value of investment income from which is exempt.

The CBDT has amended the formula for computing the expenditure relatable to earning of exempt income contained in Rule 8D. The amendment has done away with the inclusion of proportionate indirect expenses in computing the expenditure relatable to earning exempt income, as against the earlier formula. However, the new formula provides for aggregation of expenses directly identifiable to earning exempt income with a value computed at a presumptive rate of 1 per cent (as against earlier 0.5 per cent) to be applied to the annual average of monthly averages of the value of investments. The new rule further provides for an overall capping on the disallowance to the total expenditure claimed by the taxpayer.

This amendment has come into force on 2 June 2016.

Our comments

The efforts of the government in recent times have been more focused to bring in an environment of simplified tax regime coupled with minimised litigation to foster growth and clarity amongst taxpayers for doing business in India. The amendment to Rule 8D is yet another effort aimed to bring clarity and curb litigation.

Bringing in a capping on the disallowance is a welcome move. However, the impact of amended formula containing increased presumptive rate of 1 per cent (as against 0.5 per cent previously) applied to the average value of investments would be required to be seen based on facts of each case.

While the proviso seeks to limit the extent of disallowance to total expenditure claimed by the taxpayer, the interesting question may arise whether such limit is to be applied to each of the constituents of the formula or the aggregate amount derived. Also, whether the term 'total expenditure claimed by assessee' should be considered as relatable to only expenditure claimed by assessee in relation to earning exempt income or is to be considered as the total expenditure claimed under the Profit and Loss Account drawn for tax purposes. Though the notification states that the amended Rule 8D comes into force from 2 June 2016, the issue may emerge whether such amended rule will apply retrospectively to pending assessments. It seems these aspects need further clarification.

1 Notification No. 43/2016 [F.No. 370142/7/2016-TPL] dated 2 June 2016

2 The date of its publication in official gazette
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