



**When no expenditure is incurred for earning dividend income, whether disallowance can be made u/s. 14A read with Rule 8D?**

**Issue:**

Mr. X has earned dividend income of Rs. 3 Lakhs on investments in shares. Mr. X claims that no expenditure is incurred for earning the dividend income except D-mat charges of Rs. 1,500/- Investments in shares is made out of internal accruals and not out of any borrowings. No administrative expenditure has been incurred by Mr. X. According to Mr. X no disallowance can be made u/s. 14A in his case except D-mat charges of Rs. 1,500/-.

According to AO, the general explanation of the assessee is not acceptable. Assessee has taken loan but assessee's claim that the loan has been utilized for the purpose of business only is not acceptable. Assessee has not submitted any proof or specific explanation other than the said general explanation. No day to day fund flow has been submitted. In absence of such fund flow the assessee's claim that no interest bearing funds were diverted for the investment in said shares/securities remains unsubstantiated.

**Proposition:**

It is submitted that when assessee has not incurred any expenditure other than the D-mat charges no disallowance is called for u/s. 14A of the Act read with Rule 8D. It is a duty of assessing officer to pin point any expenditure which the assessee has incurred for earning the exempt income. For earning exempt dividend income no expenditure is required to be incurred.

It is proposed that when no expenditure is incurred for earning exempt income no disallowance can be made u/s. 14A read with Rule 8D.

**View against the Proposition:**

It is well settled law that initial onus is on the person who claimed the deduction. It is for the assessee to prove that borrowed funds have been utilized for the purpose of business. The assessee cannot make a general claim that non-interest bearing funds have been utilized for the purpose of making investments in shares. It is for the assessee to prove precisely, by referring to the Bank and cash balance available on the date when interest free loan is given, and at best the benefit of doubt would be given to the assessee when in the common pool account there is sufficient balance which would cover the interest free loan.

Further, the Hon'ble Calcutta HC in the case of Dhandhuka & Sons vs. CIT reported in 339 ITR 319 has held as under:

“The object of section 14A of the Act is to disallow the direct and indirect expenditure incurred in relation to income which does not form part of the total income.

In the case before us, there is no dispute that part of the income of the assessee from its business is from dividend which is exempt from tax whereas the assessee was unable to produce any material before the authorities below showing the source from which such shares were acquired. Mr. Khaitan strenuously contended before us that for the last few years before the relevant previous year, no new share has been acquired and thus, the loan that was taken and for which the interest is payable by the assessee was not for acquisition of those old shares and therefore, the authorities below erred in law in giving benefit of proportionate deduction.

In our opinion, the mere fact that those shares were old ones and not acquired recently is immaterial. It

is for the assessee to show the source of acquisition of those shares by production of materials that those were acquired from the funds available in the hands of the assessee at the relevant point of time without taking benefit of any loan. If those shares were purchased from the amount taken in loan, even for instance, five or ten years ago, it is for the assessee to show by the production of documentary evidence that such loaned amount had already been paid back and for the relevant assessment year, no interest is payable by the assessee for acquiring those old shares. In the absence of any such material placed by the assessee, in our opinion, the authorities below rightly held that proportionate amount should be disallowed having regard to the total income and the income from the exempt source. In the absence of any material disclosing the source of acquisition of shares which is within the special knowledge of the assessee, the assessing authority took a most reasonable approach in assessment.

### **View in favour of Proposition:**

Law appears to be well settled that if no expenditure is incurred disallowance cannot be made u/s. 14A of the I.T. Act 1961. It is useful to refer to decision of P & H High Court in CIT Vs. Hero Cycles Ltd. 323 ITR 518. Where it has been held that unless there is evidence to show that interest bearing funds have been invested in the investments which have generated Tax Exempt Dividend Income, No disallowance can be made, revenue has to establish nexus in this regard. On the basis of mere presumption provisions of section 14A cannot be applied. Revenue is not permitted to presume that some administrative expenditure must have been incurred for the purpose of earning the exempt income.

The Assessing Officer cannot apply provisions of Section 14A of the Act read with Rule 8D of the Rules automatically or mechanically without rendering any opinion on the correctness of the claim of the assessee regarding incurring of any expenditure or non-incurring of any expenditure to earn exempt income. The Hon'ble Delhi High

Court in the case of Maxopp Investment Ltd. reported in 347 ITR 272 has held as under:

“The condition precedent for the Assessing Officer to himself determine the amount of expenditure is that he must record his dissatisfaction with the correctness of the claim of expenditure made by the assessee that no expenditure has been incurred. It is only when this condition precedent is satisfied, that the AO is required to determine the amount of expenditure in relation to income not includable in total income in the manner indicated in sub-rule (2) of Rule 8D.”

The Pune Tribunal in the case of ACIT Vs. Magarpatta Township Development & Construction Co. Ltd. in 46 taxmann.com 284, following the decisions of the Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd. Vs. DCIT 328 ITR 81 and the decision of Delhi High Court in the case of Maxopp Investment Ltd. 203 Taxmann 364, has held that where the AO has not recorded satisfaction as required by Section 14A(2) of the Act, disallowance u/s. 14A invoking Rule 8D is unjustified.

### **Summation:**

It is submitted that the onus is on the revenue to establish that assessee has incurred some expenditure for the purpose of earning the exempt income. However, AO as well as CIT(A) insist on negative onus so to say according to them assessee has to establish that no expenditure is incurred for the purpose of earning exempt income.

In view of the decision of ITAT Delhi Bench in DCM Ltd. Vs. DCIT the AO must give reasons before rejecting assessee's claim. He must establish nexus between the expenditure and the exempt income.

It is respectfully submitted that the case of Mr. X is squarely covered by the decision of the jurisdictional high court of Gujarat in the case of CIT Vs. Torrent Power Ltd. (Guj.) reported in 363 ITR 478. Their lordships of Gujarat High Court held as under:

“The Assessing Officer has not pin pointed any expenditure which the assessee had incurred for earning the exempt income. We also find support to our reasoning by the ratio laid down by the Hon. Delhi High court in case of Maxopp Investments Ltd. Vs. CIT (2012) 347 ITR 272 (Delhi).”

I further invite kind attention to another decision of Jurisdictional High Court of Gujarat in the case of CIT Vs. Gujarat State Fertilizer And Chemicals Ltd. (Guj.) 358 ITR 331. Their lordships of Gujarat High Court held as under:

“Had the revenue been successful in establishing that the assessee had incurred the expenses to earn the dividend income from the borrowed funds, the entire discussion of application of section 14A of the Act could be understood.”

I respectfully rely on the following judicial authorities to submit that when no expenditure is incurred for earning exempt income no disallowance can be made u/s. 14A of the I.T. Act 1961.

1. CIT Vs. Deepak Mittal (2014) 361 ITR 131 (P&H)

In this case their lordships of P & H High Court held that in a case where no expenditure has been incurred by the assessee in earning the exempt income. There cannot be any disallowance of expenditure u/s. 14A r.w.r. 8D of the I.T. Rules 1962.

2. Canara Bank Vs. ACIT (2014) 99 DTR 36 (Karn)

In this case, income was derived by way of dividends exempt u/s. 10(33), interest on tax-free bonds exempt u/s. 10(15)(h) and interest on long term finance to infrastructure companies exempt u/s. 10(23G) of the Act. The persons with whom the aforesaid investment

was made by the assessee were crediting the aforesaid income to the assessee’s account by way of a bank transfer.

It was held by the Hon. High Court that there was no human agency involved in collecting these dividends and interest for which the assessee had to incur any expenditure. This is the consequence of computerization, online transaction through NEFT, RTGS and also D-mat account. The AO should take note of these developments in deciding, whether any expenditure is incurred in earning the said income.

3. CIT Vs. Hero Cycles Ltd. 323 ITR 518 (P & H)

Unless there is evidence to show that such interest bearing funds have been invested in the investments which have generated the “tax exempt dividend income”. There is no nexus established by the Revenue in this regard and therefore, on a mere presumption, the provisions of Section 14A cannot be applied.

4. CCI Ltd. Vs. JCIT (2012) 206 taxmann 563 (Karn.) (HC)

When no expenditure is incurred by the assessee in earning the dividend income, no notional expenditure could be deducted from the said income.

In view of the above it is submitted that when no expenditure is incurred for earning exempt income disallowance u/s. 14A read with Rule 8D cannot be made.

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