



**When Disallowance is made u/s 14A, whether addition can be made to the book profits computed as per Sec 115 JB of the I.T. Act 1961?**

## Issue:

X Co. Ltd. is paying tax on book profit u/s. 115JB of the Act 1961. The AO has made addition in respect of direct & indirect expenditure holding that this expenditures are incurred for earning exempt income and hence, disallowed proportionate expenditure as per Rule 8D read with section 14A of the Income Tax Act 1961. He has also added this disallowed expenditure to the book profit as an adjustment as per section 115JB of the Income Tax Act 1961.

## Proposition

It is proposed that the term book profit has been defined as “the net profit” as per profit & loss account as adjusted in accordance with the statutory additions and deductions as provided. The A.O. cannot go beyond the net profit as shown in the profit and loss account thus while computing book profit u/s 115JB the A.O. cannot make disallowance u/s 14A as such disallowances are not covered by the exceptions as provided in the explanation to section 115JB.

## Extracts from Section

### Section 14A

Expenditure incurred in relation to income not includible in total income.—For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.

## Section 115JB

Where in case of a company, the income tax payable on the total income as computed under the income tax act in respect of any previous year is less than 18.5% of its BOOK PROFIT, then such book profit shall be deemed to be the total income of the assessee and the tax payable on such total income shall be the amount of income tax at the rate of 18.5%. This income tax is, further has to be enhance by surcharge (as applicable) and education cess (@3%).

In the simple words every company has to compute its income tax liability as per two sets of provisions. The set of provisions which results in higher income tax liability become the income tax payable. Followings are the two set of provisions:

- 1). Income tax computed as per normal provisions of Income Tax Act.
- 2). Income tax computed as per provision of section 115JB of Income Tax Act.

## View in against of the preposition

ITAT Mumbai held In the case of DCIT vs. Viraj Profiles Ltd. ITAT (Mumbai) Income Tax (Appeal) no. 4439 of 2013, date of judgment 21/01/215 that section 14A provides that it mandates disallowance of expenditure ‘in relation’ to the income which does not form part of the total income while clause (f) in Explanation 1 to Section 115JB (2) mandates disallowance of expenditure ‘relatable’ to the income to which Section 10 (other than Section 10(38)) or Section 11 or Section 12 applies. Further the dividend income is declared on the share investment which is exempt u/s 10(33) (not Section 10(38)). Accordingly, expenditure relatable to the exempt income to be disallowed provided the same is debited to Profit and Loss Account.

The assessee company is engaged in the business of manufacturing of S.S. Billets, Angles, Flat Bars, Channels, S.S. Wire Rods etc. During the year under consideration, the assessee company derived income of Rs.28,19,03,964/- from Business & Profession after claiming deduction of Rs.1,20,36,43,184/- u/s 10B and Rs.67,03,000/- u/s 80G.

During the course of the assessment proceedings, the assessing officer noticed that the assessee company has investments in equity shares of various companies totaling to Rs.51,03,59,701/- as on 31-03-2008. The assessee company was asked to explain as to why disallowance u/s 14A read with Rule 8D of Income Tax Rules, 1962 should not be invoked in respect of the exempt income. In response, the assessee company submitted that the assessee company has not earned any exempt income during the relevant assessment year and with prejudice to the above contentions, the assessee company submitted the working of disallowance u/s 14A. The AO rejected the contentions of the assessee company and held that since the assessee company has blocked its funds in investments not yielding any income or yielding exempt income, the invocation of Section 14A is proper.

The AO relied upon the decision of Special Bench, ITAT; Mumbai in ITA NO 8057/Mum/03 dated 20.10.2008 in the case of M/s Daga Capital Management Private Limited and held that both direct and indirect expenses are disallowable u/s 14A which have any relation with the income not chargeable to tax under Act. The AO also relied upon the decision of Hon'ble Bombay High Court in Godrej & Boyce Manufacturing Company Limited v. DCIT (ITA No. 626 of 2010 & WP no. 758 of 2010(Bom.)) and made disallowance of Rs.73,07,018/- u/s 14A read with Rule 8D(2)(ii) (Rs.58,87,196/-) and 8D(2)(iii)(Rs.14,19,892/-) of Income Tax Rules, 1962.

Recently the Bangalore Bench of ITAT in the case of DCIT v. Sobha Developers(ITA No.1410/Bang/

2013) (Bang) 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). The Mumbai Tribunal in the case of RBK Share Broking (P) Ltd and Dabur India Ltd. held that expenditure incurred to earn exempt income will be disallowed under Section 14A while computing MAT profits.

#### **View in favor of Proposition**

It is submitted that no disallowance u/s 14A for computing book profit u/s 115JB of the Act, is permissible. It appears to me that as per decision of Delhi Bench of Tribunal in Goetze (India) Ltd (32 SOT 101) (Del) and the decision of Mumbai Bench of the Tribunal in M/s Bengal Finance and Investment P. Ltd. in ITA No.5620/Mum/2010, dated 31.7.2012 while computing book profit u/s 115JB of the Act, provisions of section 14A cannot be imported. Therefore, amount disallowed u/s 14A of the Act cannot be considered while computing book profit u/s 115JB of the Act. Accordingly, the issue was decided in favour of the assessee.

With Respect to re-computation of book profits u/s 115JB of the act it is submitted that as observed in Apollo Tyres Limited v. CIT 255 ITR 273 (SC) by Apex Court that where Profit & Loss Account has been prepared in accordance with Part II and III of Schedule VI to the Companies Act, 1956 and which has been scrutinized and certified by the statutory auditors and relevant authorities, the AO has no power to scrutinize the net profit and loss account except to the extent provide in the explanation of Section 115JB. Held that the same view has been reiterated by Hon'ble Bombay High Court in Kinetic Motor Co. Ltd v. DCIT wherein it has been held that there is no scope for the AO to make adjustment to Book Profits beyond what was authorized by the definition in Explanation 1 to Section 115 JB.

Hence, in regard to disallowance u/s 14A for computing book profit u/s 115JB of the Act, following the decision of Delhi Bench of Tribunal

in Geotze (India) Ltd (32 SOT 101) (Del) and the decision of Mumbai Bench of the Tribunal in M/s Bengal Finance and Investment P. Ltd in ITA No.5620/Mum/2010, dated 31.7.2012 while computing book profit u/s 115 JB of the Act, provisions of section 14A cannot be imported. Therefore, amount disallowed u/s 14A of the Act cannot be considered while computing book profit u/s 115JB of the Act.

### **Summation**

It is submitted that views against the proposition advanced following arguments

- 1) The Provisions of Section 115 JB of the Act read with Explanation provides that the amount of expenditure relatable to income, to which section 10 applies, should be added to the profit as per P&L account.
- 2) 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 tax payer 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.
- 3) Accordingly, the disallowance under Section 14A will be applicable while arriving at the book profits under Section 115 JB(2) of the Act read with Explanation 1(f) thereto.

However, I am in respectful disagreement of the above arguments. It is submitted that the disallowance made u/s 14A cannot be added to the Book Profits because the same does not amount to actual expenditure debited to Profit & Loss Account for earning the exempt income.

The Delhi Tribunal in the case of Quippo Telecom Infrastructure Ltd. has held that disallowance under Section 14A of the Act cannot be made while computing the book profit under Section 115 JB 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 Geotze (India) Ltd. 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.

Further, Delhi Tribunal in the case of Minda Sai Ltd. V. ITO (2015) 167 TTJ 689 (Delhi) (Trib.), it was decided as under “fact that assessee may have accepted 14A disallowance affects that disallowance only and nothing more than that, it does not clothe such an adjustment in computation of book profit u/s. 115JB with legality.

Recently Ahmedabad Tribunal in the case of DCIT vs. Alembic Ltd in ITA No.1928/Ahd/2010 and CO No.204/Ahd/2010, dated 27/03/2014 for A.Y.2007-08, relying on the order of the Mumbai Tribunal in the case of M/s Essar Teleholdings Ltd. vs. DCIT in ITA No.3850/Mum/2010 for A.Y., held that provisions of Sub-Sections 2&3 of Section 14B cannot be imported into Clause (F) of the Explanation to Section 115 JB of the Act.

Following Authorities have also taken the same view:

- ACIT vs. Spray Engineering Devises Ltd. 53 SOT 70 (Chan.) (AY 08-09)
- Reliance Petroproducts Pvt. Ltd vs. ACIT in ITA No.2324/Ahd/2009, dated 13/07/2012.
- Atul Ltd. vs. ACIT in ITA No.8/Ahd/2013, dated 11/10/2013.

Finally, it is submitted that the Applicability of provisions of Section 14A read with Rule 8D of the Rules and clause (f) of explanation to section 115JA of the Act while computing adjusted book profit is highly debatable issue and can be settled only after the Apex Court gives the final decision.

\*\*\*