

Mumbai ITAT rules no disallowance of expenditure u/s 14A , if shares held as stock-in-trade

Executive Summary

This tax alert summarises the recent ruling of Mumbai Income Tax Appellate Tribunal (ITAT) in the case of **India Advantage Securities Limited** (Taxpayer) on an issue : whether pursuant to section 14A of the Income Tax Act (ITA), expenditure incurred in relation to shares held as stock-in-trade which yields tax exempt dividend income, is not deductible?

The ITAT held that the expenditure is not liable to disallowance pursuant to the above section in view of Karnataka High Court ruling in the case of CCI Ltd¹

Background

Pursuant to Section 14A of the ITA, any expenditure incurred in relation to

income which is tax exempt, is not deductible in computation of income. In this context there was a controversy as to whether expenditure incurred in relation to shares held as stock-in-trade is liable to disallowance having regard to the position that a Taxpayer earns taxable business income on sale of shares and incidentally, also earns dividend income if it accrues or arise before the sale of shares.

Facts

The Taxpayer claimed exemption for dividend income in relation to shares held as stock-in-trade. He claimed deduction for the interest expenditure incurred in respect of the aforesaid shares which was disallowed by the Tax Authorities invoking section 14A of

the Act. On appeal, the first appellate authority deleted the disallowance.

The Revenue filed an appeal before the ITAT whose decision is discussed hereunder.

Taxpayer's contentions

- The interest expenditure incurred in respect of the shares held as stock-in-trade was deductible u/s 36(i)(iii) of the ITA
- No disallowance could be made u/s 14A in respect of tax exempt dividend income earned on shares held as trading stock as ruled by Karnataka High Court
- The same view as above has been expressed by Mumbai ITAT²

¹ CCI Limited (250 CTR 291)

² Yatish Trading Co (P) Ltd (129 ITD 237)

Tax Authority's contentions

- The provisions of section 14A are applicable even in relation to the dividend income received from shares held for trading as ruled by Special Bench of Tribunal³
- Mumbai ITAT in the case of American Express Bank⁴ confirmed the above view

ITAT Ruling

- The Karnataka High Court ruling in the case of CCI Ltd (supra), is a direct decision of the High Court affirming the position that no disallowance should be made in respect of interest expenditure incurred in relation to dividend received from trading shares
- The decision of the High Court referred to above should be preferred over the contrary decision of the Special Bench of Tribunal in the case of Daga Capital Management (P) Ltd (supra)

³ Daga Capital Management (P) Ltd (117 ITD 169)

⁴ ITA No.5904 & 6022/Mum/2000

- The decision of the co-ordinate Bench of the ITAT in the case of American Express Bank which was based on indirect inference derived from Kerala High Court ruling in the case of Leena Ramachandran⁵ stands overruled in view of the direct ruling of the Karnataka High Court in the case of CCI Ltd (supra)
- The expenditure incurred in respect of tax exempt income earned in relation to shares held as stock-in-trade is not liable to disallowance u/s 14A of the ITA

Our Comments

- This ruling of the ITAT would help achieve clarity on the tax position of disallowance u/s 14A of ITA in respect of expenditure incurred in relation to shares held as stock-in-trade where the primary purpose of the Taxpayer is to earn business income on sale of the shares and tax exempt dividend income is incidental

⁵ 339 ITR 296

to the unsold shares on the balance sheet date

- The said ruling having duly considered the previous unfavourable ruling of Mumbai ITAT will hold the field for taxpayers in Mumbai jurisdiction – unless any High Court rules against the Taxpayer hereafter

This space is intentionally left blank

Disclaimer

This alert has been prepared for general information to our clients; it may not deal with the subject comprehensively. The application of any law stated herein may need evaluation in specific cases under a professional advice. We accept no responsibility for any action taken or inaction, by recipient of this alert.

© **PHD** & Associates - 2012

At your Service

For any clarification or elucidation in respect of this alert, you may kindly connect to our Direct Tax Team.

We are reachable at:

PHD & Associates

Chartered Accountants

Radha Chambers, Level 3,

Telli Park Lane, Andheri East,

Mumbai - 400 069. India.

Tel : +91 22 26820083

Fax : +91 22 26830824

Web : www.phd-ca.com