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# ACCFINTAX



**DEPARTMENT OF ACCOUNTANCY**

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# Highlights of Union Budget 2017

CA. MAHESH S. SATHE.

Union Finance Minister Shri Arun Jaitley presented 2017 Union Budget in the Lok Sabha on 1<sup>st</sup> February, 2017. This year's budget has three distinctive features –

- It was presented on 1<sup>st</sup> February instead of 28<sup>th</sup> February,
- Railway Budget was merged with Union Budget and
- Distinction between Plan and Non-plan expenditure is abolished to have a holistic view of allocations for sectors and ministries.

The agenda of Government of India for 2017-18 is “**Transform, Energise and Clean India.**” Government wants to transform the quality of governance and quality of life of people, energise the youth and the vulnerable and clean the country from evils of corruption, black money and non-transparent political funding.

The Finance Minister has focused on following ten distinct themes to foster the broad agenda of the Government –

- **Farmers** – Coverage under Fasal Bima Yojana scheme is to be increased from 30% of cropped area in 2016-17 to 40% in 2017-18 and 50% in 2018-19 for which a budget provision of Rs.9000 crores is made. The target for agricultural credit for 2017-18 is fixed at a record level of Rs.10 lakh crores. The long-term irrigation fund set up in NABARD will be increased to Rs.40,000 crores. Dairy processing and Infrastructure Development Fund to be set up in NABARD with a corpus of Rs.2,000 crores. Government will set up mini-labs in Krishi Vigyan Kendras for soil sample testing.
- **Rural Population** – Over Rs.3 lakh crores will be spent in rural areas every year for rural poor. MNREGA allocation is at the highest ever at Rs.48000 crores in 2017-18 to double farmers' income. During 2017-18 five lakh farm ponds will be taken up. Government proposes to provide one crore houses to houseless by 2019. There is an increased allocation to Pradhan Mantri Awaas Yojana – Gramin of Rs.23,000 crores for 2017-18

from Rs.15000 crores in 2016-17. We are on the way to achieve 100% village electrification by 1<sup>st</sup> May, 2018. Sanitation coverage in rural India has gone up from 42% in 2014 to 60% in 2017. Government has allocated Rs.19000 crores for Pradhan Mantri Gram Sadak Yojana for 2017-18. Pace of construction of PMGSY roads is accelerated to 133 kms. roads per day in 2016-17 as against average of 73 kms. per day during 2011-2014.

- **Youth** – Government will introduce a system of measuring annual learning outcomes and come out with an innovation fund for secondary education with focus on 3479 educationally backward districts. Pradhan Mantri Kaushal Kendras are to be extended to more than 600 districts. Hundred India International Skill Centres will be established across the country. Colleges will be identified based on accreditation. Good quality higher education institutions will have greater administrative and academic autonomy. Government plans to create additional 5000 medical Post-Graduate seats every year.
- **The poor and the underprivileged** – Government has allocated Rs. 500 crores for Mahila Shakti Kendra which will be set up for empowering rural women. Rs.6,000 will be transferred directly to the bank accounts of pregnant women who undergo institutional delivery and vaccinate their children. Affordable housing is given “infrastructure” status. National Housing Bank will refinance individual housing loans of about Rs.20,000 crores in 2017-18. Elimination of tuberculosis by 2025 is targeted. Two All India Institutes of Medical Sciences will be set up in Jharkhand and Gujarat. Government has allocated Rs.52,393 crores for Scheduled Castes and Rs.31,920 crores for Scheduled Tribes.
- **Infrastructure and Railways** – Total allocation for railways is Rs.1,31,000 crores. By 2019 all trains will have bio-toilets. Railway lines of 3,500 kms. will be commissioned in 2017-18. It is proposed to make 500 railways stations differently abled friendly. A new Metro Rail Policy will be announced. Budget has allocated Rs.64,900 crores for highways. High speed internet is to be allocated to 1,50,000 gram panchayats under Bharat Net. It is proposed to set up two more strategic crude oil reserves

in Odisha and Rajasthan which will zoom India's crude oil storage facility to above 15 MT.

- **Financial Sector** – Lending target under Pradhan Mantri Mudra Yojana is set at Rs.2.44 lakh crores where priority will be given to Dalits, Tribals, Backward classes and women. Foreign Investment Promotion Board will be abolished. More than 90% of FDI inflows are now automated. Shares of Railways PSE like IRCTC, IRFC and IRCON will be listed on Stock Exchanges. A new ETF with diversified CPSE stocks and other Government holdings will be launched in 2017-18. A Computer Emergency Response Team for financial sector (CERT – Fin) will be established.
- **Digital Economy** – Aadhar Pay, a merchant version of Aadhar Enabled Payment System will be launched. Nearly 125 lakh people have adopted BHIM app so far and government will launch Referral Bonus Scheme for individuals and a Cash back Scheme for merchants to promote usage of BHIM app.
- **Public Services** – Head post offices will be front offices for rendering passport services. A centralized Defence Travel System has been developed through which travel tickets can be booked online by our soldiers and officers.
- **Prudent Fiscal Management** – Allocation for capital expenditure is stepped up by 25.4% over last year. Fiscal deficit is targeted at 3.2% of GDP for 2017-18. Revenue deficit is pegged at 1.9% of GDP. Total resources to be transferred to State and Union Territories is Rs. 4.11 lakh crores as against Rs.3.60 lakh crores in 2016-17.
- **Tax Administration** – Existing rate of tax for individuals between Rs.2.5 lakh to Rs.5 lakh is reduced to 5% from 10%. All other categories of tax payers in subsequent brackets will get a benefit of Rs.12,500. There will be 10% surcharge on individual income above Rs. 50 lakh and upto Rs. 1 crore and surcharge of 15% will be on income above Rs.1 crore. Income tax on small companies with annual turnover up to Rs. 50 crore is reduced to 25% from 30%. In case of exemption of Long-term Capital Gain, holding period of asset other than shares and mutual funds is

reduced to two years from three years and for such assets held before 1.4.1981, Fair Market Value as on 1.4.2001 can be taken as cost instead of FMV as on 1.4.1981. Indexation will start from 1.4.2001. No transaction above Rs.3 lakh can be now made by cash. There will be 100% penalty for such transactions. Penalty is also introduced for late filing of income tax return. It is also proposed that people filing income-tax return for the first time will not come under government scrutiny. People with annual income up to Rs.5 lakh other than business income can file simple one page return. All political parties have to file income tax return now. This is a very bold decision. Political parties can take donations in cash up to Rs. 2,000 only. Donation above Rs.2,000 to political party can be made by cheque or by digital mode only.

As a push towards digital economy, excise duty on miniaturized card readers, Micro ATMs, fingerprint reader/scanner, Iris scanner has been exempted. Excise duty on tobacco products, gutkha and pan masala is increased. Goods and Service Tax (GST) is expected to be rolled out from 1<sup>st</sup> July, 2017.

Thus Union Budget 2017 provides impetus to agriculture and rural economy but the biggest challenge is to create jobs. Demonetisation has given India's growth a little setback for the time being but it can make a dramatic shift towards digital payments in India which in turn can boost India's GDP and India's growth drastically. Government needs to give huge emphasis on railways, roads and housing. This budget has balanced the needs of a dynamic economic environment and it has given a direction for progress in a digitalized and clean atmosphere.

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## SECTION 14A OF THE INCOME TAX, 1961 – AN OVERVIEW

**CA. Hrishikesh Wandrekar**

### **Introduction:**

Section 14A has been inserted in Chapter IV of the Income Tax Act by the Finance Act, 2001, with retrospective effect from 1-4-1962. This section provides for disallowance of expenditure incurred in relation to income which is not included in the total income of the assessee i.e. exempt income. The section reads as under:

*“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.”*

The Central Board of Direct Taxes further inserted Rule 8D providing guidelines for “Method for determining amount of expenditure in relation to income not includible in total income.”

The exempt incomes are those which are not includible while computing the total income of the assessee. ie. These incomes are exempt from income tax. An assessee may earn income from different sources. Some incomes will be subject to tax, others could be exempt from tax. Basic tenets of taxation and logic dictates that expenditure incurred against earning an income should be deducted from the gross income and only the net income should be subjected to income tax. As a corollary, it can be argued that only that expenditure which has been incurred for earning taxable income should be allowed as a deduction and expenditure incurred for earning exempt income should be disallowed as a deduction. There have been cases where deductions have been claimed in respect of such exempt income. This actually means that the expenditure incurred for earning tax free income is used to reduce the tax payable on the taxable income.

Provisions of Section 14A state that any expenditure incurred for earning income exempt from tax, should be disallowed. The deduction of expenses is allowed only to the extent they are relatable to the earning of taxable income. Hence the assessee has to identify the expenditure incurred for earning the exempt income. This expenditure may comprise not only expenditure directly related to the exempt income, but also any proportionate indirect expenditure. The identification and measurability of this indirect expenditure is a matter of debate. Rule 8D was introduced to address this debate. Rule 8D lays down a method to identify and quantify the amount of expenditure that can be apportioned as having being incurred for earning exempt income. The underlying provision of this Rule states that Rule 8 can be applied in case the AO (Assessing Officer) is not satisfied with the disallowance made by the assessee u/s 14A. Hence this rule lays down guidelines for the AO to compute the disallowance u/s 14A, in case he is not satisfied with the disallowance made by the assessee. However, this Rule is treated as a deeming provision determining the expenditure to be disallowed by applying a particular method, as against considering the actual expenditure. However, various controversies are created by the deeming provisions.

While actually implementing the provisions, the Income-tax Department has been taking a view that all items of incomes exempt from tax as per the provisions of the Income Tax Act are governed by Section 14A. Rule 8D lays down a method for computing the disallowance of expenditure incurred for earning this exempt income. As Section 14A and Rule 8D are relatively new provisions, the underlying principles of the law are still evolving. Hence there are numerous controversies arising as a result of these new provisions, which have far reaching consequences for all assessees. Various courts have given conflicting decisions and have interpreted the law differently. This has added to the uncertainty and confusion in the application of these provisions.

While implementing the provisions of Section 14A, the Income-Tax department has been taking a view that all items of income including dividend on shares and units of mutual funds on which dividend distribution tax is paid, stated in Section 10 of the Income Tax Act are governed by section 14A. The main intention of this legislation was to disallow only direct expenses incurred for earning exempt income. But in almost all cases, even indirect expenses are also being disallowed on proportionate basis. Rule 8D provides a formula for calculating the expenditure in relation to income which does not form part of the total income which is very complicated. According to this formula, interest cost on borrowings made for making investment, on which exempt income is earned, should be disallowed. However, this formula also considers for disallowance, interest cost which has not been directly incurred for earning exempt income. Hence, expenditure which is not connected with earning the exempt income is also disallowed by applying this formula. In certain cases, the amount of disallowance made is more than the exempt income earned.

### **Critical analysis of the provisions on the basis of various cases**

#### **For expenditure to be disallowed should there be an intention to earn exempt income?**

Is the intention of the assessee in earning exempt income relevant to be considered for making an disallowance?

In the case of *CCI Ltd. [TS-226-HC-2012]*, the *Karnataka HC* held that the disallowance u/s 14A was not applicable on shares held as stock in trade. HC held that the dividend income was incidental to the business of share trading and the expenditure was not incurred with an intention to earn dividend. Since dividend was earned on unsold portion of shares, no expenditure could be disallowed u/ 14A.

In the case of *Yogesh J Shah [(2010) (46 SOT 183 )]*, *Mumbai ITAT* held that it was not necessary that dividend should be earned out of intended activity so as to apply disallowance u/s 14A. When the assessee had incurred expenditure for an activity which had resulted into an exempt income, the disallowance u/s 14A was applicable.

The two decisions are conflicting in nature. In the first decision, it is held that there should be an intention to earn exempt income for Sec 14A to be applicable. The second decision holds a contrary view that any exempt income earned is subject to Sec 14A, irrespective of the intention of the assessee. These decisions raise a question as to whether the intention of making investment (which will earn exempt income) has to be considered while computing disallowance. In certain cases, investments are made to comply with laws

or regulations (eg. Investment by banks to comply with SLR). In other cases, making an investment is obligatory (eg. Purchase of shares of Co-operative Bank while opening an account or taking a loan). In these cases, there is no intention to earn dividend income. The dividend earned is incidental in nature.

**Applicability of Sec. 14A when no exempt income earned during relevant year:**

In the case of *Cheminvest Ltd [121 ITD 318 2009]*, *Delhi ITAT Special Bench* held that Sec. 14A disallowance had to be made in respect of interest on loans, which were utilized for investment in shares, even though no dividend income was earned on those shares during the relevant year.

A similar view has been taken by ITAT Chennai in *Siva Industries & Holding Ltd [TS-438-ITAT-2011(CHNY)]* where it was held that disallowance u/s 14A was applicable, even though the assessee did not earn any exempt income.

The above decisions are not in spirit of the intention behind Section 14A. Sec 14A deals with disallowance of expenditure incurred in relation to earning exempt income. This raises an issue whether can disallowance of expenditure be made if no exempt income has accrued during the year? Can it be deemed that this 'disallowed expenditure' be attributed to income that could have been (but is not actually) earned? In other words, it raises a question whether Sec 14A applies to actual expenditure in relation to exempt income, or does it create a deeming fiction.

**Disallowance of interest cost incurred?**

Rule 8D states the method for computing disallowance u/s 14A. This rule assumes that amount invested for earning exempt income, is out of borrowed funds. Hence it assumes that the interest cost incurred on the borrowed funds has a direct nexus to the exempt income earned on investments. Hence Rule 8D computes disallowance based on the interest cost directly incurred for earning exempt income as well as interest cost not directly incurred for earning that income.

It can be argued that the investment has been made out of owned funds and hence no interest cost has been incurred in making the investment and earning the income. Hence provisions of Rule 8D may not be applicable.

However the courts have expressed contrary views in the subject. In the case of *CIT v Winsome Textile Industries Limited 204 ITR 319*, the court decided that when shares were acquired by way of own fund and no interest incurred as there was no borrowed fund, then there cannot be any disallowance under section 14A of the Income Tax Act, 1961.

*ITAT Delhi again the case of Dy. CIT vs. Maharashtra Seamless Ltd.* decided that no disallowance can be made under section 14A of interest on borrowed funds where in case of mixed funds, it is not possible to ascertain whether the investment in tax free bonds is out of the assessee's own funds, the source of investment in the tax free bonds is identified, and the Assessing Officer failed to establish any nexus between the borrowed funds and the investments in the tax free bonds.

*In Dhanuka & Sons [TS-173-HC-2011*, the Kolkata High Court decided that the assessee carried on indivisible business giving rise to taxable as well as exempt income. Since the assessee failed to prove that shares were acquired out of borrowed funds, the disallowance u/s 14A for interest expenditure was upheld.

### **Is Rule 8D automatic and mandatory?**

Rule 8D reads as under:

**8D.** (1) *Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with—*

*(a) the correctness of the claim of expenditure made by the assessee; or*

*(b) the claim made by the assessee that no expenditure has been incurred,*

*in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).*

The plain reading of the Rule suggests that it can be applied only when the Assessing Officer is not satisfied with the deduction u/s 14A made suo moto by the assessee. Hence computation of disallowance as per Rule 8D cannot be applied to all cases. This Rule only lays down guidelines for Assessing Officers for computing disallowance. This position has been endorsed by some courts as under:

Punjab & Haryana HC in *Metalman Auto(P)Ltd [(2011)336 ITR 434* held that disallowance u/s 14A cannot be made in the absence of actual expenditure. In other words, disallowance u/s 14A cannot be made on presumptive expenditure basis.

However there are decisions which seem to imply that Rule 14D is mandatory and not a guideline for Assessing Officers for computation of disallowance as is observed in *Lakshmi Ring Travelers [TS-210-ITAT-2012(Chennai ITAT)*, which upheld disallowance on a presumptive basis u/s 14A(3). ITAT observed that that even in a case where an assessee claims that no expenditure was incurred, the assessing authority has to presume the incurring of such expenditure as provided under sub-section (2) of Sec 14A read with Rule 8D, and make disallowance.

### **Findings & Conclusion**

From the above discussion, it is clear that there is still a lot of ambiguity in the application of the provisions of Section 14A and Rule 8D of the Income Tax Act, 1961. The fact that there are contrary decisions abound suggests that there is a long way to go till the law on the matter becomes clear. There is a fine line between applying provisions of the law in an equitable manner and being high handed. There are situations Rule 8D defies logic, as well as situations where the Rule fails to address the situation. Practical cases have shown that the disallowance computed as per this Rule exceeds the income, which is against the basic tenets of taxation law. It is imperative that the Government should have dialogue with the stakeholders and come out with clear guidelines or amendments to make the application of Section 14A equitable and justifiable.