Judgment:

Order

K.C. Singhal (Vice-President).-The hon'ble President, Income-taxAppellate Tribunal, vide order dated July 4, 2007, has constituted theSpecial Bench in the case of M/s. Daga Capital Management Pvt. Ltd.,Mumbai to adjudicate upon the following issue :

"Whether, in the facts and in the circumstances of the case and inlaw, the provisions of section 14A of the Income-tax Act, 1961, areapplicable with respect to dividend income earned by the assesseeengaged in the business of dealing in shares and securities, on theshares held as stock-in-trade and when earning of such dividendincome is, therefore, incidental to trading in shares ?"as well as to dispose of the appeal on merits.

Subsequently, the hon'ble President vide order dated October 17, 2007,has directed the Bench to dispose of the following appeals also :

Sr.No.	I. T. A. No.	Appellant	Respondent	State
1.	ITA No. 183/Del/2005	M/s. Cheminvest Ltd., New Delhi	ITO, Ward 3(3), New Delhi	Delhi
2.	ITA No. 2048/Del/2005	M/s. Cheminvest Ltd., New Delhi	Deputy CIT, Circle 3(1), New Delhi	Delhi
3.	ITA No. 1372/Del/2005	M/s. Maxopp Invest-ment Ltd.	Asst. CIT, Circle 6(1), New Delhi	Delhi

The facts in the case of M/s. Daga Capital Management Pvt. Ltd. arehereby narrated. The assessee-company was engaged in the business ofdealing in shares in the year under consideration which declared loss ofRs. 12,87,780. It was noted by the Assessing Officer that the assessee hadclaimed expenditure by way of interest amounting to Rs. 9,58,325 onborrowed funds while computing the income as well as the losses incurredin dealing in shares and securities amounting to Rs. 2,86,240. It was alsonoted by him, that the assessee had received dividend income ofRs. 1,78,163 which was claimed as exempt from taxation under section10(33) of the Income-tax Act, 1961 ("the Act"). The assessee was thereforeasked to explain as to why the expenses incurred in relation to exempteddividend income should not be disallowed under section 14A. The expla-nation of the assessee in this behalf was-(i) that the business of the asses-see was to purchase and sell the shares and securities and not to make anyinvestments in shares on long-term basis, (ii) that the assessee wasengaged in the business of dealing in shares and securities. The purchaseand sale of shares were not shown separately in the profit and loss accountbut were shown under the head investments but on that account, no

adverse inference could be drawn since the entire sales had always beenoffered to tax as revenue receipts in the earlier years, (iii) the intention ofthe assessee has always been to hold the shares as stock-in-trade and divi-dend income was only the by-product of the trading activity and therefore,there was no relation between the expenditure by way of interest and theexempted income. The explanation of the assessee was rejected by theAssessing Officer by observing "the borrowed funds were mainly used formaking investments in shares and

securities of other companies with long-term perception in mind to earn lumpsum dividend without contributinganything to the exchequer on account of income-tax. During the year, theassessee has not done any business in shares and securities except for fewtransactions and only income earned during the year is dividend income."

In view of these observations, it was held by the Assessing Officer thatthe provisions of section 14A of the Act became applicable. Consequently,the deduction of Rs. 9,58,325 in respect of interest payment was disallowedby the Assessing Officer. It may also be mentioned that loss of Rs. 2,86,240in dealing of shares was however accepted by the Assessing Officer afterconsidering the necessary details filed by the assessee. As a result thereof,loss of Rs. 3,29,455 was determined vide order dated February 25, 2003.

The assessment made by the Assessing Officer was challenged beforethe learned Commissioner of Income-tax (Appeals) before whom it wascontended (i) that main object of the assessee was to deal in shares andsecurities as was apparent from the memorandum of association, (ii) noadverse inference could be drawn merely from the fact that investments inthe shares and securities was shown in the balance-sheet under the head"Investments", (iii) the Assessing Officer himself had accepted the loss inthe share dealing amounting to Rs. 2,86,240, (iv) the assessee had alwaysshown the business profit and never claimed as capital receipts either onlong-term or on short-term basis. In view of the same, it was claimed thatinterest payment was allowable under section 36(1)(iii) of the Act andconsequently no part of it can be disallowed under section 14A of the Act.

The learned Commissioner of Income-tax (Appeals) held that the asses-See was dealer in shares and securities considering (i) the object stated inmemorandum of association, (ii) the decision of the hon'ble SupremeCourt in the case of Kedarnath Jute Mfg. Co. Ltd. v. CIT reported in [1971]82 ITR 363 wherein it has been held that entries made in the books ofaccount is not determinative of the nature of the transaction, (iii) the factthat the Assessing Officer himself accepted the fact of share trading andthe loss arising therefrom. Accordingly, it was further held, that interestpaid on money borrowed was allowable deduction under section 36(1)(iii)

of the Act. However, on facts, it was found by him that total investment ofthe company in the share trading business was Rs. 99,24,061 out of whichRs. 27 lakhs had been invested in the unquoted shares. According to him,legal finding given by him was applicable only with reference to invest-ment in quoted shares as a trader and consequently, the unquoted sharesheld by the assessee could not be considered as stock-in-trade becausethere is no market for unquoted shares. Since, the borrowed funds and theassessee's own funds were mixed, the learned Commissioner of Income-tax (Appeals) sustained the disallowance of Rs. 2,61,361 on pro rata basisand the same was held to be disallowable in view of section 14A of the Act.Aggrieved by the same, the Revenue is in appeal before the Tribunal byraising the following grounds :

"1. On the facts and in the circumstances of the case and in law,the Commissioner of Income-tax (Appeals) erred in holding that theassessee-company is a dealer in shares and as such, interest paid onmoney borrowed for investment in quoted shares is to be consideredas allowable deduction under section 36(1)(iii) of the Income-tax Act.

2. On the facts and in the circumstances of the case and in law,

thelearned Commissioner of Income-tax (Appeals) erred in directing theAssessing Officer to restrict the disallowance under section 14A to theextent of Rs. 2,61,361 being proportionate interest attributable to theinvestment in the unquoted shares of Rs. 27 lakhs, out of disallow-ance of Rs. 9,58,325 made by the Assessing Officer, without appre-ciating that the borrowed funds to the tune of Rs. 99,24,061 has beenused for making investments in shares and securities and, therefore,the Assessing Officer rightly worked out the disallowance atRs. 9,58,325 on the total investment of Rs. 99,24,061."

However, it may be mentioned that the assessee has accepted the orderof the learned Commissioner of Income-tax (Appeals) by not filing anyappeal against the disallowance sustained by him.

When the appeal came up before the Division Bench, it was noticed thatthere was difference of opinion between the Benches on the issue involvedin the appeal. The Revenue had relied on the decision of the Tribunal datedSeptember 5, 2006, in the case of Ridge Investment Co. P. Ltd. v. Joint CIT[IT Appeal Nos. 4260-61 (Mum.) of 2003] as well as the decision of DelhiBench of the Tribunal in the case of Everplus Securities and Finance Ltd. v.Deputy CIT [2006] 285 ITR (AT) 112 (Delhi), wherein it was held that evenif the main activity of the company was to make investments in holdingcompany for retaining control over the group companies, the disallowanceunder section 14A can be made irrespective of the fact that dividend earn-

ings were only incidental in nature. On the other hand, the assessee hadrelied on the decision of the Delhi Bench of the Tribunal in the case ofVidyut Investments Ltd. v. ITO [2006] 10 SOT 284 wherein it was heldthat when shares are held as stock-in-trade with the object of trading inshares, and dividend income earning was only incidental in nature no partof the expenses could be disallowed under section 14A of the Act. In viewof such difference of opinion, the Bench recommended the constitution ofa Special Bench to decide the question mentioned in para 1 above. It is inthe above circumstances that the hon'ble President has constituted theSpecial Bench to decide the said question as well as to dispose of theappeal.

The facts relating to the appeals of M/s. Cheminvest Ltd., New Delhi,are these. The assessee is an investment company engaged in the businessof dealing in shares and securities as noted by the Assessing Officer at page1 of the assessment order. In the assessment year 2001-02, the assesseedeclared loss of Rs. 63,67,135. In the course of assessment proceedings, itwas found that the assessee had debited a sum of Rs. 2,64,169 as mana-gement/ administrative expenses and Rs. 1,32,54,058 on account of intereston borrowed capital for purchasing the equity shares. The assessee hadalso earned dividend income of Rs. 2,06,43,193 which was claimed to beexempt from taxation under section 10(33) of the Act. The only otherincome earned by the assessee was interest income of Rs. 71,24,595. TheAssessing Officer was of the view that the deduction in respect of interestpaid on borrowed capital could not be allowed in view of the provisions ofsection 14A of the Act since the related dividend income was exempt fromtax under section 10(33). The Assessing Officer determined the disallow-ance of interest at Rs. 1,00,49,752 on pro rata basis which resulted in thedetermination of total income at Rs. 36,82,620. In a similar manner he dis-allowed the sum of Rs. 59,95,717 in the assessment year 2002-03 as againstthe returned loss of Rs. 57,56,762 which resulted in total income ofRs. 2,38,955. Both the assessment orders were confirmed in appeal by thelearned Commissioner of Income-tax (Appeals). Aggrieved by the same,the assessee is in appeal before the Tribunal.

The facts relating to the appeal of M/s. Maxopp Investments Ltd., NewDelhi, are these. The assessee is an investment company primarily holdingshares in Max India Ltd. It declared profit of Rs. 1,28,81,291 as per theprofit and loss account which included dividend income of Rs. 49,90,860.The dividend income was declared as exempt from taxation under section10(33) of the Act. The perusal of the profit and loss account also showedthat the assessee had received interest of Rs. 1,94,70,181 while the interest

paid amounted to Rs. 1,16,21,168. It was also noted by the AssessingOfficer that the assessee had taken loans amounting to Rs. 8,33,40,000against which the loans given by the assessee amounted to Rs.14,62,85,000.The assessee was asked to show cause as to why the disallowance of inter-est could not be made under section 14A of the Act. The explanation of theassessee was that it had acquired the shares for selling it at a profit infuture and not for earning dividend. According to the assessee, the divi-dend income was only incidental to such acquisition of shares. Conse-quently, no disallowance could be made under section 14A of the Act.However, the Assessing Officer applied the provisions of section 14A of theAct and made disallowance of Rs. 67,74,175 on pro rata basis. Finally, thetotal income was determined at Rs. 1,41,69,420. On appeal, the learnedCommissioner of Income-tax (Appeals) upheld the action of the AssessingOfficer under section 14A of the Act. Aggrieved by the same, the assesseeis in appeal before the Tribunal.

The learned Departmental representative initially invited our attentionto the memorandum explaining the provisions in the Finance Bill, 2001, bywhich section 14A was proposed to be inserted in the Income-tax Act, 1961("the Act"), to indicate that the intention of the Legislature was to allowthe expenditure to the extent they are relatable to earning of taxableincome. Then it was submitted by him that the provisions of section 14Awas inserted in the Act by way of abundant caution in lieu of the lawalready existed. Thus, it was pleaded that purposive construction should beapplied which is also known as "mischief rule" as described in Heydon'scase [1584] 3 Co Rep 7a. Thus, four aspects should be taken into conside-ration while applying such principle, i.e., (i) what was the law before mak-ing of the Act ; (ii) what was the mischief or defect for which the law didnot provide ; (iii) what is the remedy that the Act has provided ; and (iv)what is the reason of remedy. Thus, the construction of statute should be insuch a manner which would suppress the mischief and advance theremedy. Consequently, the construction which defeat the intention of theLegislature should be avoided even though there may be some inexacti-tude in the language used.

According to him, Parliament in its wisdom had enacted section 14Awith retrospective effect from April 1, 1962, in order to clarify the alreadyexisting position that only those expenses could be claimed which wererelatable to the taxable income. In the past, it was seen that the assessee'swere pushing the expenses relating to exempt income which were not tax-able towards taxable income and thereby reducing the taxable incomewrongly. It was to curb this mischief that Parliament enacted section 14A

and also to overcome the decision of the hon'ble Supreme Court in thecase of Rajasthan State Warehousing Corporation v. CIT reported in[2000] 242 ITR 450, wherein it was held that if the exempted income andthe taxable income are earned from one and indivisible business then theapportionment of expenditure could not be sustained. According to him,the intention of the Legislature is clearly evident from the memorandumexplaining the provisions contained in the Finance Bill

wherein it wasexplained that only those expenses could be claimed as deduction whichare incurred in relation to earning the taxable income. It was further sub-mitted that the use of the expression "only to the extent" in the memo-randum is clear indicator that only that part of expenses can be allowed asdeduction which is related to the earning of taxable income. Accordingly, itwas contended that when the income is exempt and does not form part ofthe total income then, no expenditure whether direct or indirect in relationto that income could be claimed as deduction. To put it differently, theexpenses which are directly related to taxable income are to be allowed asdeduction.

Apart from the above, the learned senior Departmental representativemade various submissions which are being summarised below :

"(a) that section 14A being the special provision of law will over-ride the general provisions of law like section 36(1)(iii) or section 57,etc. Therefore, even though the expenditure may be allowable undersection 36(1)(iii) or section 57 of the Act, it would still be disallowableunder section 14A of the Act if it is found that expenditure related tothe income which does not form part of the total income.

(b) that expression 'in relation to' used by the Legislature in section14A is of the widest amplitude and is much wider and broader thanthe other expressions 'attributable to' and 'derived from'. The Legis-lature was aware of the other expressions and deliberately ignored thesame and used the wider expression 'in relation to'. Therefore, suchexpression neither can be interpreted in a narrower sense nor thesame can be read down since the power of reading down the statuteis available only to the High Courts and the Supreme Court of India.Since the expression 'in relation to' has been used in the widestsense, it must mean both the direct and indirect, related, associated,having some connection which is either proximate or distant but notremote and not the strict test of causa causans which means imme-diate and effective source. In support of this proposition, reliance hasbeen placed on the decision of the hon'ble Supreme Court in the caseof Doypack Systems Pvt. Ltd. v. Union of India [1989] 65 Comp Cas 1

for the proposition that the expression 'in relation to' is of widestamplitude and would include direct as well as indirect connectiondepending on the context.

(c) that dividend income can be earned only after investments aremade. The investments having been made out of the borrowed capital,the interest payment made on such borrowings is clearly an amountwhich is required to be regarded as expenditure laid out wholly andexclusively for the purpose of earning dividend income. Therefore, suchexpenditure must be deducted from the gross dividend and it is the netdividend income which can be allowed as exempt under section 10(33)of the Act. In other words, such expenditure cannot be allowed whilecomputing the taxable income. Reliance is placed on the decision of thehon'ble Madras High Court in the case of CIT v. Chemical HoldingsLtd. reported in [2001] 249 ITR 540 for the proposition that even thededuction under section 80M in the case of dealer in shares is to beallowed with reference to the net dividend income. According to him, ifthe expenditure is not allowed against the dividend income, then itwould amount to double deduction which is not permissible in law inview of the decision of the hon'ble Supreme Court in the case ofEscorts Ltd. v. Union of India [1993] 199 ITR 43.

(d) that section 14A being a special piece of legislation will overridethe general provisions of law and consequently, the expenditureincurred in

relation to exempted income would be disallowable eventhough such expenditure would have been allowable either undersection 36(1)(iii) or under section 37 or under section 57 or under anyother section meant for computation of total income under either ofthe heads. Reliance is placed on the decisions of the Tribunal reportedas Insaallah Investments Ltd. v. ITO reported in [2008] 23 SOT 130(Delhi) and Maruti Udyog Ltd. v. Deputy CIT reported in [2005] 92ITD 119 (Delhi).

(e) that there can be no business in acquisition of shares for cont-rolling group companies and consequently, expenditure by way ofinterest on borrowed funds utilised for acquisition of shares cannot beallowed as deduction even under section 36(1)(iii) as held by theTribunal in the case of Everplus Securities reported in [2006] 285 ITR(AT) 112 (Delhi) as well as the other Tribunal decisions namely KanuMetals Pvt. Ltd. (I. T. A. No. 7211/Mum./03 order dated May 30,2008), Mohan T. Adwani Finance Pvt. Ltd. (I. T. A. No. 1060/Mum./2003) and Mechintosh Finance Estates P. Ltd. (I. T. A. No. 5615/Mum./2002).

(f) that the decision of the Tribunal in the case of S. G. Investmentsand Industries Ltd. reported in [2004] 89 ITD 44 (Kolkata) is anauthority for the proposition that the words used in section 14A arewider than the words used in section 57(iii) and consequently theexpenditure in relation to exempted income has to be disallowed eventhough such expenditure may be allowable in other sections. Refer-ence is also made to other decisions of the Tribunal namely, K.V.Trading Company [I. T. A. No. 924 of 2003 (Cal.)].

(g) that the provisions of sub-sections (2) and (3) of section 14A aremerely procedural and clarificatory in nature and therefore, wouldapply with retrospective effect. Reliance is placed on the various deci-sions of the Tribunal, namely, Mohananlal M. Shah v. Deputy CITreported in [2008] 303 ITR (AT) 221 (Mum), Asst. CIT v. CiticorpFinance (India) Ltd. [2008] 300 ITR (AT) 398 (Mum), Deputy CIT v.Seksaria Biswan Sugar Factory Ltd. reported in 14 SOT 66 (Mum),Deputy CIT v. Smita Conductors Ltd. reported in 16 SOT 251 (Mum)and ITO v. Rhino Bags P. Ltd. reported in [2007] 12 SOT 571 (Mum).The decision of the Special Bench in the case of Aquarius Travels P.Ltd. v. ITO [2008] 301 ITR (AT) 111 (Delhi) is cited in support of theproposition that the provision of section 14A can be invoked by theappellate authorities even though, the same was not applied by thelower authorities. Accordingly, in view of sub-sections (2) and (3) ofsection 14A, the theory of apportionment would apply and theexpenditure incurred by the assessee will have to be apportionedreasonably between taxable income and non-taxable income as heldby the Tribunal in the case of Marezban Bharucha v. Asst. CITreported in [2007] 12 SOT 133 (Mum). It was also pointed out by himthat theory of apportionment is based on the various Supreme Courtjudgments mentioned below :

(i) Anglo-French Textile Company Ltd. v. CIT [1954] 25 ITR 27(SC) ;

(ii) CIT v. Ahmedbhai Umarbhai and Co. [1950] 18 ITR 472 (SC) ;and

(iii) Continental Construction Co. v. Asst. CIT 106 TTJ 855(Mum) (sic).

(h) That entire provisions of section 14A should be read in a holis-tic manner and therefore sub-section (1) should not be read in iso-lation. Once the exempted income is earned by the assessee and theassessee claims that no expenditure is incurred in relation to suchincome than disallowance must be made in accordance with sub-

section (3) thereof. Similarly, if the Assessing Officer is not satisfiedwith

the correctness of the claim of the assessee then having regard tothe accounts of the assessee, disallowance can be made under sub-section (3) thereof.

(i) The following decisions were cited in support of the propositionthat all expenses which are direct/indirect, fixed or variable, mana-gerial or financial in relation to income not chargeable to tax are to bedisallowed under section 14A of the Act :

(i) Sunash Investment Co. v. Asst. CIT [2007] 106 TTJ (Mum) 855 ;

(ii) Kalpataru Construction Overseas P. Ltd. v. Deputy CIT[2007] 13 SOT 194 (Mum) ;

(iii) Conwood Agencies P. Ltd. v. ITO Wd. 9(1)(2) [2007] 15 SOT308 (Mum) ;

(iv) Narotamdas Bhau v. Asst. CIT [2007] 15 SOT 629 (Mum) ;

(v) D. J. Mehta v. ITO [2007] 290 ITR (AT) 238 (Mum) ;

(vi) Rhythm Exports P. Ltd. v. ITO (SMC) [2005] 97 TTJ 493(Mum) ;

(vii) Deputy CIT v. Tata Investment Corporation Ltd. [2007] 295ITR (AT) 330 (Mum).

(j) That the decisions of the hon'ble Supreme Court in the cases ofRajasthan State Warehousing Corporation v. CIT [2000] 242 ITR 450and in the case of CIT v. Rajendra Prasad Moody [1978] 115 ITR 519(SC) were rendered with reference to the language employed insections 36, 37, 56 and 57 which is quite different from the languageused in section 14A of the Act and therefore those decisions cannotbe considered in interpreting the provisions of section 14A. Reliancewas placed on the judgment of the hon'ble Supreme Court in the caseof Distributors (Baroda) P. Ltd. [1985] 155 ITR 120 wherein it wasobserved (headnote of 155 ITR) : "It is most unsafe to try to arrive atthe true meaning of a statutory provision by reference to an inter-pretation, which might have been placed on an earlier statutory pro-vision which is not only couched in different language but is alsostructurally different." In view of these observations, it has been sub-mitted that the judgment of the hon'ble Bombay High Court in thecase of Emrald Co. Ltd. [2006] 284 ITR 586 and the decision of theTribunal in the case of Claridges and Investments Finances Pvt. Ltd.[2007] 18 SOT 390 (Mum) would not help the case of the assessee."

Mr. Vipul Joshi, learned counsel for the assessee, has submitted beforeus that the question referred to the Special Bench is in a narrow compass

and method of apportionment of disallowance would apply only if thequestion is answered against the assessee. He has raised various submis-sions in support of the proposition that in the case of a dealer in shares andsecurities, the provisions of sub-section (1) of section 14A of the Act wouldnot apply since the profit arising from the sale of shares and securities ischargeable to tax and the dividend income, if any, is only incidentalcarrying on such business. He has not disputed the application of mischiefrule as contended by the learned Departmental representative. However, ithas been submitted by him that inquiry under section 14A starts withreference to the expenditure incurred and not with reference to the income.According to him, the expenditure incurred must relate to the tax freeincome if section 14A is to be invoked. If the expenditure incurred by theassessee produces the taxable income then

such expenditure is allowable asdeduction under section 36(1)(iii) and no disallowance can be made undersection 14A of the Act since such expenditure would not have any con-nection with the tax free income. Reliance is placed on the decisions of thehon'ble Supreme Court in the case of CIT v. Indian Bank Ltd. reported in[1965] 56 ITR 77 and in the case of CIT v. Maharashtra Sugar Mills Ltd.reported in [1971] 82 ITR 452 (SC). Accordingly, it has been pleaded thatonce the expenditure incurred produces taxable income, the inquiry muststop there itself. The intention is to be seen at the time when the expendi-ture is incurred. Proceeding further, it was also submitted that onus is onthe Department to prove that expenses were incurred in relation to the tax-free income since existence of such relation is a condition precedent forinvoking the provisions of section 14A. Coming to the scope of the expres-sion "in relation to" it was contended by him that remote connection isexcluded as per the definition given in Law Lexicon. He also referred to thejudgment of the Constitution Bench of eleven judges in the case of H. H.Maharajadhiraja Madhav Rao Jivaji Rao Scindia Bahadur of Gwalior v.Union of India [1971] 1 SCC 85 wherein their Lordships by majority opi-nion held that such expression means dominant and immediate connec-tion. In view of the same it is pleaded that any connection which is eitherincidental or ancillary or remote would be excluded from the scope of suchexpression. Accordingly, in the case of a dealer in shares and securities, theexpenditure incurred has a dominant and immediate connection with theprofits arising on the sale of such shares and securities and the connection,if any, with the dividend income is only incidental one. Consequently, nodisallowance can be made in such cases merely because the assessee hasearned some dividend income in a casual manner. He also relied on thedecisions of the hon'ble Bombay High Court in the case of Emrald Co. Ltd.

reported in [2006] 284 ITR 586 as well as in the case of General InsuranceCorporation of India (No.1) reported in [2002] 254 ITR 203 (Bom) whereinit has been held that in the case of dealer in shares the expenditure isincurred in relation to the profits on the sale of shares and not with refer-ence to the dividend income.

Learned counsel, Mr. K. C. Patel, has appeared on behalf of the inter-vener i.e., Mandalia Group. He took us through the circulars issued by theCentral Board of Direct Taxes to clarify the scope of section 14A. Then ithas been pointed out that the disallowance, if any, has to be made inaccordance with the prescribed manner. He drew our attention to rule 8Bwhich has been inserted by the Income-tax (Fifth Amendment) Rules,2008. According to him, a formula has been prescribed in sub-rule (2)(ii)i.e., the expenditure incurred by way of interest multiplied by value ofinvestment and divided by the value of all the assets. Emphasis was madeby him on the words "value of investment" to contend that the formula isapplicable only in the case of an investor and therefore it impliedly meansthat the rules are not applicable in the case of dealer in shares. Proceedingfurther it was submitted by him that once the deduction is allowable undersection 36(1)(iii) of the Act then there is no scope for applying the provi-sions of section 14A of the Act. Reliance has been placed on the followingdecisions :

1. CIT v. Emrald Co. Ltd. [2006] 284 ITR 586 (Bom) ;

2. Addl. CIT v. Laxmi Agents P. Ltd. [1980] 125 ITR 227 (Guj) ;

3. CIT v. Cotton Fabrics Ltd. [1981] 131 ITR 99 (Guj) ;

4. CIT v. Kanoria Investments P. Ltd. [1998] 232 ITR 7 (Cal) ;

5. Vidyut Investments Ltd. v. ITO [2006] 10 SOT 284 (Delhi) ;

6. Asst. CIT v. Claridges and Investments Finances Pvt. Ltd. [2007]18 SOT 390 (Mum) ;

7. Deputy CIT v. Core Health Care Ltd. [2008] 298 ITR 194 (SC)

Mr. Kunal Reshamwala, counsel for the intervener, M/s. Taj Investmentsand Finance Company Ltd., has submitted before us as under :

1. Section 14A as it stood during the relevant assessment year did notprovide for the method for calculation of disallowance under section 14A.

2. Method for computing disallowance under section 14A was firstsought to be provided only with effect from April 1, 2007.

3. Notification No. 45/2008, dated March 24, 2008 ([2008] 299 ITR(St.) 88), now provides the method for computing disallowance under section 14A with effect from the date on which it is published in the OfficialGazette.

4. Since no method for computing disallowance was provided prior toApril 1, 2007/March 24, 2008, as per the decision of the hon'ble SupremeCourt in the case of B.C. Srinivas Shetty [1981] 128 ITR 294 followed inCIT v. Infosys Technologies Ltd. [2008] 297 ITR 167 (SC) if the computa-Tional provisions fail no liability can be fastened on the assessee.

5. The above notification cannot be given retrospective effect as it isonly for the first time vide the notification that the Assessing Officer getsthe right to calculate the disallowance based upon the notification.

6. Without prejudice to above, even if it is assumed that the notifi-cation is to be applied retrospectively it does not cover a case where securities are held on trading account and not as an investment.

Mr. Ajay Vora, learned counsel for the assessee namely, M/s. Chem-Invest Ltd. and M/s. Maxopp Investments Ltd. has not disputed the legalcontention of the learned senior Departmental representative that theprovisions of section 14A of the Act has overriding effect over the othercomputational provisions relating to other heads. However, it has beensubmitted that on the facts of the case, no disallowance can be made in thecases of the above assessees. It has been submitted that both these asses-sees are promoters of Max India Ltd. engaged in diverse business activitieswhich are also listed in the stock exchange. It is further submitted that boththe assessees are engaged in the business of holding investments in sharesof listed companies, namely, Max India Ltd. and Gaylord Impex Ltd. aswell as other companies which are not listed. Our attention was drawn topage Nos. 140 to 142 to point out that investment in shares of Max IndiaLtd. and Gaylord Impex Ltd. are shown as investment in quoted shareswhile investments in the shares of other companies are shown as invest-ments in unquoted shares. It is further pointed out that quoted shares areheld as trading assets i.e., stock-in-trade while the unquoted shares areshown as capital assets. The investments in quoted shares have been madewith a view to have controlling interest in those companies and conse-quently, the same had been held as trading assets. It was further pointedout that whenever any of the quoted shares had been sold, the profits there-on was declared as business income and the Assessing Officer had alsoaccepted such profits as "business profits". In support of his

submissions,he drew our attention to page 26 of the paper book to point out that profitson sale of quoted shares amounting to Rs. 4,966 has been shown as busi-ness income pertaining to the assessment year 1998-99. He also drew ourattention to the assessment order relating to the assessment year 1998-99appearing at pages 31 and 32 of the paper book to point out that entireincome has been assessed as business income. It was also submitted by

him that the assessee itself had disallowed the interest expenditure relat-able to investment in unquoted shares and the dispute relates to the inter-est liability relatable to investment in the shares held as stock-in-trade. Onthe basis of these facts, it was contended by him that no disallowance canbe made under section 14A of the Act since expenditure was not incurredwith a view to earn dividend income but to earn the business income onthe sale of shares held as stock-in-trade.

Proceeding further, it was submitted that section 14A can be appliedwhen it is established that-(i) the expenditure is incurred and (ii) suchexpenditure was incurred in relation to the income not liable to tax. There-fore, some inquiry must be made in this regard. Regarding the scope of theexpression "in relation to" appearing in section 14A of the Act, heendorsed the arguments made by Mr. Vipul Joshi and also relied on thedecision of the hon'ble Supreme Court in the case of Navin ChemicalsManufacturing and Trading Co. Ltd. v. Collector of Customs [1993] 4 SCC320 wherein the expression "in relation to" has been defined as a directand proximate relationship. Further reliance has been placed on the deci-sion of the Third Member of the Tribunal in the case of Wimco SeedlingsLtd. v. Deputy CIT (Asstt.) [2007] 293 ITR (AT) 216 (Delhi) wherein theTribunal was concerned regarding the scope of section 14A of the Act itself.In this case it was held that the expression "in relation to" would meandirect connection or association between the expenditure incurred and theincome which is not taxable. He also placed reliance on other decisions ofthe Tribunal namely, Asst. CIT v. Eicher Ltd. [2006] 101 TTJ (Delhi) 369and Maruti Udyog Ltd. v. Deputy CIT [2005] 92 ITD 119 (Delhi). How-ever, it was submitted that it is the intention/motive of the assessee at thetime when the expenditure is incurred which is relevant for establishing thedominant and immediate connection between the expenditure incurredand the income earned by the assessee. If the earning of tax free income ismerely incidental then it cannot be said that dominant and immediate con-nection existed between the expenditure incurred and the earning of taxfree dividend income. According to him, in the case of these assessees,there cannot be any motive/intention to earn the dividend income sincethe dominant motive/ intention is to earn the taxable income on the sale ofshares. Reliance has been placed on the decision of the hon'ble SupremeCourt in the case of CIT v. Sutlej Cotton Mills Supply Agency Ltd. [1975]100 ITR 706 and the decision of the hon'ble Bombay High Court in the caseof CIT v. Tata Chemicals Ltd. [2002] 256 ITR 395. Proceeding further it wasalso submitted that if the dividend arises or accrues to the assessee in thecourse of its business activities then the nature of dividend would continue

to be as business receipts even though the same might be assessable underdifferent heads i.e., "Income from other sources". Reliance was placed onthe decisions of the hon'ble Supreme Court in CIT v. Chugandas and Co.[1965] 55 ITR 17, CIT v. Cocanada Radhaswami Bank Ltd. [1965] 57 ITR306 (SC) and Western States Trading Co. P. Ltd. v. CIT [1971] 80 ITR 21.In view of these judgments, it was pleaded that if the intention of theassessee is to carry on the business then the expenditure incurred in rela-tion thereto must be allowed as deduction even though the dividendincome might have arisen or accrued to the assessee in the course of carry-ing on such business activity. He also

relied on various High Court judg-ments in support of his above proposition. Reference was made to thedecision of the Gujarat High Court in the case of Addl. CIT v. LaxmiAgents P. Ltd. [1980] 125 ITR 227 wherein it was held that interest onborrowed amount was allowable as deduction against his business incomeeven though the dividend was assessable under the separate head. Refer-ence was made to certain judgments of various High Courts i.e., CIT v.Rajeeva Lochan Kanoria [1994] 208 ITR 616 (Cal), CIT v. Jardine Hender-son Ltd. [1994] 210 ITR 981 (Cal), CIT v. Amritaben R. Shah [1999] 238 ITR777 (Bom) and the decision of the Tribunal in the case of A. T. E. Enter-prise Ltd. v. Joint CIT [2005] 286 ITR (AT) 101 ; [2006] 102 ITD 110 (Mum)wherein interest on borrowed capital was held to be deductible where theborrowed capital was utilised to purchase shares of different companies inorder to acquire controlling interest. Lastly, it was submitted by him thatdecisions relied upon by the learned Departmental representative weredistinguishable on facts.

Rival submissions of the parties have been considered carefully in thelight of material produced before us and case law referred to. This Bench isrequired to define the scope of the provisions of section 14A of the Actwhich reads as under :

"14A. (1) For the purposes of computing the total income underthis Chapter, no deduction shall be allowed in respect of expenditureincurred by the assessee in relation to income which does not formpart of the total income under this Act :

Provided that nothing contained in this section shall empower theAssessing Officer either to reassess under section 147 or pass an orderenhancing the assessment or reducing a refund already made orotherwise increasing the liability of the assessee under section 154, forany assessment year beginning on or before the 1st day of April, 2001.

(2) The Assessing Officer shall determine the amount of expendi-ture incurred in relation to such income which does not form part of

the total income under this Act in accordance with such method asmay be prescribed, if the Assessing Officer, having regard to theaccounts of the assessee, is not satisfied with the correctness of theclaim of the assessee in respect of such expenditure in relation toincome which does not form part of the total income under this Act :

(3) The provisions of sub-section (2) shall also apply in relation to acase where an assessee claims that no expenditure has been incurredby him in relation to income which does not form part of the totalincome under this Act."

The scheme of the Act shows that total income of the assessee is to becomputed under various heads of income specified in section 14. The pro-visions for computation of income under various heads are provided in sec-tions 15 to 57 of the Act. The Legislature in its wisdom thought thatexpenditure in relation to income exempted from taxation should not beallowed deduction while computing the income chargeable to tax. Accord-ingly, the Legislature, instead of making various provisions for disallow-ance under various heads, inserted section 14A at the inception i.e., prior tothe computational provisions under various heads. Thus, intention of theLegislature is clear to disallow all the expenditures incurred in relation toincome not forming part of total income. Contextual interpretation of sec-tion 14A clearly suggests that expenditure in relation to exempted incomehas to be disallowed even though such expenditure would have beenallowable under the computational

provisions relating to various heads ofincome. Hence, we are in agreement with the contention of the learnedsenior Departmental representative that section 14A has an overridingeffect over the computational provisions under various heads. We holdaccordingly. To hold otherwise would amount to rendering the provisionsof section 14A as otiose/redundant which is not permissible in law. Hence,we do not find force in the contention of Mr. Patel that no disallowancecan be made under section 14A if the deduction is permissible under sec-tion 36(1)(iii) of the Act. Consequently, in the case of an assessee carryingon a business activity, any expenditure incurred by him even though allow-able under section 36(1)(iii) or section 37 can be disallowed under section14A if such expenditure has been incurred in relation to the income notforming part of total income.

Coming to the scope of section 14A of the Act, the perusal of the saidsection reveals that any expenditure incurred in relation to income notforming part of total income has to be disallowed. Thus, the scope of thissection entirely depends upon the meaning of the expression "in relationto" used by the Legislature in this section. Such expression has not been

defined in the Act. However, we find that such expression has been judi-cially defined by the Constitution Bench of eleven judges of the hon'bleSupreme Court in the case of H. H. Maharajadhiraja Madhav Rao JivajiRao Scindia Bahadur of Gwalior v. Union of India [1971] 1 SCC 85. TheirLordships considered the scope of the expression "provisions of thisConstitution relating to" appearing in article 363 of the Constitution ofIndia. Their Lordships, in para 135 of the judgment, held that suchexpression means "provisions having a dominant and immediate con-nection with". It was also held that it does not mean merely having areference to.

It is the settled legal position that if a word or an expression has beenjudicially defined by the court then it should be presumed that the Legis-lature was well aware of such meaning while enacting an enactment andconsequently, such word or expression in the enactment should be under-stood in the same sense in which it was judicially defined. Reference can bemade to the decision of the hon'ble Supreme Court in the case of AhmedG.H. Ariff v. CWT [1970] 76 ITR 471 wherein it was observed as under(page 478 of 76 ITR) :

" . . . It is well-settled that where the Legislature uses a legal termwhich has received judicial interpretation, the courts must assumethat the term has been used in the sense in which it has been judi-cially interpreted."

Similar view was taken by the apex court in the case of Keshavji Ravjiand Co. v. CIT [1990] 183 ITR 1 by observing as under (headnote of 183ITR) :

"When words acquire a particular meaning or sense because oftheir authoritative construction by superior courts, they are presumedto have been used in the same sense when used in a subsequentlegislation in the same or similar context."

In view of the above legal position, it is held that the expression "in rela-tion to" in section 14A of the Act must be understood in the same sense inwhich their Lordships of the apex court understood in the case of H. H.Maharajadhiraja Madhav Rao Jivaji Rao Scindia Bahadur of Gwalior [1971]1 SCC 85. Accordingly, the expression "in relation to" would mean domi-nant and immediate connection. This means that disallowance of expen-diture under section 14A can be made only when there is dominant andimmediate connection between the expenditure

incurred and the incomenot forming part of the total income. As a necessary corollary, it wouldmean that disallowance cannot be made if the connection is not dominantand immediate but is merely incidental, ancillary or remote one. The

contention of the Revenue that the expression "in relation to" would meanany and every relation except remote is, therefore, rejected.

The decision of the hon'ble Supreme Court in the case of DoypackSystems P. Ltd. [1989] 65 Comp Cas 1 has been relied on by the Revenuefor the proposition that the expression "in relation to" would include directas well as indirect connection. A perusal of this decision shows that it wasrendered by Bench of two judges without considering the decision of theConstitution Bench of eleven judges in the case of H. H. MaharajadhirajaMadhav Rao Jivaji Rao Scindia Bahadur of Gwalior [1971] 1 SCC 85. It is asettled rule of precedence that in case of any conflict of opinion betweenthe views expressed by different Benches of a court then the view taken bythe Larger Bench would prevail since the Division Bench cannot enlargethe scope of the decision rendered by the larger Bench. Therefore, in ouropinion, the later decision cannot be applied to determine the scope of sec-tion 14A of the Act.

Having held as above, the next question is how to determine the natureof the connection between the expenditure incurred and the incomeearned by the assessee. In our opinion, the answer to this question woulddepend upon the intention/object with which the expenditure was incur-red. If the expenditure is incurred with a view to earn the taxable incomethen it can be said that dominant and immediate connection exists bet-ween the expenditure incurred and the taxable income and consequently,no disallowance under section 14A can be made even where some tax-freeincome is received incidentally. On the other hand, if the expenditure isincurred mainly with a view to earn the tax-free income then it can be said,that the dominant and immediate connection exists between the expen-diture incurred and in the tax-free income and consequently disallowanceunder section 14A can be made even though some taxable income mayarise incidentally.

However, there may also be cases where the expenditure may be incur-red with a view to earn tax-free as well as taxable income simultaneouslyfrom an indivisible activity. Reference can be made to the decision of thehon'ble Supreme Court in the case of Maharashtra Sugar Mills Ltd. [1971]82 ITR 452 where the assessee was carrying on the composite business ofgrowing sugar cane and manufacturing sugar therefrom. The assesseeclaimed deduction in respect of managing agency commission paid by itbut the Assessing Officer partly disallowed the same on the ground thatpart of such expenditure related to management of sugar cane cultivationincome which was exempt from tax. However, the Supreme Court heldthat there is no basis for the view that the only expenditure incurred in

respect of a business activity giving rise to taxable income can be allowedas deduction under section 10(2)(xv) and not otherwise. If the allowanceclaimed is permissible under the Act, then the same has to be deductedfrom the gross profit and if it is not permissible under the Act, it has to berejected. For the similar reasons, the apex court held in the case of Rajas-than State Warehousing Corporation [2000] 242 ITR 450 that where theassessee was carrying on one indivisible business then deduction in respectof an expenditure could not be disallowed merely because part of theincome from such business was exempt from tax. In both the cases, theexpenditure was incurred with a view to earn tax-free as well as taxableincome simultaneously and therefore it can be said that dominant andimmediate connection exists in such cases between

the expenditureincurred and the tax-free as well as taxable income earned by the assessee.Therefore, in such cases, in our opinion, the disallowance can be madeunder section 14A on proportionate basis in accordance with the provisionsof sub-sections (2) and (3) of section 14A of the Act. At this stage, it mayalso be pointed out that section 14A was inserted with a view to overcomethe effect of the decision of the Supreme Court in the case of RajasthanState Warehousing Corporation [2000] 242 ITR 450.

In view of the above legal position, the next question which arises forour consideration is whether any disallowance under section 14A can bemade in the case of a dealer in shares. Generally, in our opinion, a dealer inshares does not acquire shares and securities to earn dividend income. Thedominant and immediate object behind acquisition of shares is to earnprofit on the sale of shares at the earliest point of time which is chargeableto tax under the Act. Sometimes, such person by chance may also get thedividend on the shares held by him as "stock-in-trade". Since such divi-dend income is never intended at the time of purchase of shares, in ouropinion, the connection between the expenditure incurred and the divi-dend income can be said to be incidental only since the dominant andimmediate connection exists only between the expenditure incurred andprofit on sale of shares. Since the existence of dominant and immediateconnection is the condition precedent for invoking the provisions of section14A of the Act, in our opinion, the mere receipt of dividend income inci-dentally in the case of dealer in shares would not be sufficient for invokingthe provisions of section 14A of the Act.

However, on facts, there may be instances where even a dealer in sharesmay choose to acquire shares with the main object of earning dividendincome. In various cases, it has been seen that the shares/ securities arepurchased only with a view to earn dividend income despite knowing well

in advance that there would be loss on the sale of such shares/securities,for example, Unit Trust of India usually notifies a date for declaration ofdividend, in such cases, market price of units rises abnormally before thenotified date and falls also abnormally after the notified date. Even in suchsituation, the assessee buys units at a high price before the notified date,receives the tax free dividend and then sells the units shortly thereafter at aloss. Reference can be made to the case of Wallfort Shares and Stock Bro-kers Ltd. [2005] 96 ITD 1 (Mum) [SB] where such facts existed. The divi-dend income earned is exempt from tax while the loss is the business losswhich gets adjusted against other business profits. In such cases, it cannotbe said that dominant and immediate object is to earn profit on sale ofsecurities. On the other hand, the dominant and immediate object of theassessee is self evident i.e., to earn dividend income which is exempt fromtax under section 10(33) of the Act. Therefore, in our considered opinionthe disallowance under section 14A can be made in such cases in respect ofexpenditure incurred. However, onus would be heavy on the Revenue toestablish such connection because the settled legal proposition is that onusof proof lies on the person who invokes a particular provision or allegesthat a fact exists. If the Assessing Officer wants to invoke the provisions ofsection 14A then onus would be on him to establish that there exists domi-nant and immediate connection between the expenditure incurred and theincome not forming part of total income. On the other hand, where theassessee claims deduction under section 36(1)(iii) or section 37, the onuswould be on the assessee to prove that the expenditure was for the purposeof the business. Once this onus is discharged, it would shift to the Asses-sing Officer to establish that there exists dominant and immediate connec-tion between expenditure

incurred and income exempt from tax if section14A is to be invoked by him. We hold accordingly.

Coming to the scope of sub-sections (2) and (3) of section 14A, we findthat these are the procedural provisions for determining the disallowanceof the expenditure in relation to income not forming part of the totalincome. These sub-sections provide the procedure for making disallowanceunder section 14A. The hon'ble Supreme Court, in the case of CWT v.Sharvan Kumar Swarup and Sons [1994] 210 ITR 886, has held that pro-cedural law, generally speaking, is applicable to all pending cases since noperson has a vested right in the procedure. In view of this legal position,we are in agreement with the contention of the learned senior Depart-mental representative that such provisions would be applicable to all pend-ing matters. Therefore, the contention of Mr. Kunal Reshamwala, thatprovisions of sub-sections (2) and (3) of section 14A cannot be applied to

earlier years cannot be accepted. However, we are unable to agree with hiscontention that disallowance under sub-sections (2) and (3) can be madeeven if sub-section (1) does not apply, in our opinion, sub-sections (2) and(3) being procedural provisions cannot control the substantive provisions ofsub-section (1) of section 14A. Sub-sections (2) and (3) would apply onlywhen sub-section (1) applies to the facts of the case. If the AssessingOfficer finds that there is dominant and immediate connection betweenthe expenditure incurred and the income not forming part of the totalincome then only the provisions of sub-sections (2) and (3) would comeinto play and not otherwise. We hold accordingly.

In view of the above discussion, it is held that in the case of dealer inshares no disallowance under section 14A of the Act can be made merelybecause some dividend is received incidentally unless it is established thatthere was dominant and immediate connection between the acquisition ofshares and the earning of dividend income. Consequently, the referredquestion is answered in the negative and in favour of the assessee.

Coming to the merits of the appeal in the case of Daga Capital Mana-gement Pvt. Ltd., we find that the assessee was engaged in the business ofpurchase and sale of shares and securities which is also apparent from thefact that the Assessing Officer himself has accepted the loss of Rs. 2,86,240incurred in dealing of shares and securities. There is nothing on record tosuggest that there was any dominant and immediate connection betweenthe borrowed funds for acquisition of funds and the dividend earned by theassessee. The onus which lies on the Assessing Officer to prove suchconnection has not been discharged and consequently, we do not find anyinfirmity in the order of the learned Commissioner of Income-tax(Appeals) deleting the disallowance made by the Assessing Officer.

Now we take up the appeals of Cheminvest Limited and MaxoppInvestments Limited. Rival submissions of the parties, already referred toearlier, have been considered carefully in the light of the material placedbefore us. The material placed before us reveals that investment was madein acquisition of quoted shares as well as unquoted shares. The assesseecompanies are also admittedly one of the promoters of Max India Ltd. andGaylord Impex Ltd. whose shares are listed at stock exchange. However,investment in shares of these companies has been shown in the balance-sheet, as trading assets while the investment in shares of all other compa-nies has been shown as investments in unquoted shares. Further, interestrelatable to unquoted shares has not been claimed as deduction in com-putting its

income. Only the interest on borrowings relatable to acquisitionof shares of Max India Ltd. and Gaylord Impex Ltd. has been claimed as

deduction under section 36(1)(iii) of the Act. Further, the assessee had soldsome insignificant quantity of shares of Max India Ltd. in the assessmentyear 1998-99 and the resultant profit on the sale of such shares had beenshown as business receipt and the Assessing Officer had also accepted thesame as business receipt chargeable to tax under section 28 of the Act. Onthese facts, undisputedly, the assessees were allowed deduction undersection 36(1)(iii) of the Act in respect of interest on borrowed capital uti-lised for acquiring shares of Max India Ltd. and Gaylord Impex Ltd. in theearlier years which is apparent from the assessment orders passed by theAssessing Officer. Therefore, it could not be contended by the learnedDepartmental representative that investment by the assessee was on capi-tal account. We, therefore, proceed on the footing that the assessee wasalso engaged in the business of holding investment in shares of two com-panies apart from making investments in unquoted shares on capitalaccount.

Learned counsel for the assessee, Mr. Ajay Vora, has raised a plea thatinvestment in shares of Max India Ltd. and Gaylord Impex Ltd. was madewith a view to have controlling interest in these two companies. Such pleawas never raised either before the Assessing Officer or the learned Com-missioner of Income-tax (Appeals). The only explanation before the lowerauthorities was that the assessee was an investment company engaged inthe business of dealing in shares and securities. We have also gone throughthe memorandum of association of M/s. Cheminvest Ltd. The object clausepermits the assessee to carry on the business of an investment companyand to buy, underwrite, invest in, acquire, hold and deal in shares, stocks,debentures, etc. This also suggests that the assessee was authorised tocarry on the business as an investment company. The mere fact that theassessee was one of the promoters of the above two companies, would notlead to the conclusion that the only purpose for acquiring the shares was tohave controlling interest. There is nothing on record to hold that invest-ment in shares of these two companies was made with a view to have con-trolling interest. It was merely a case of making investment by an invest-ment company in pursuance of its objects. Acquisition of controllinginterest normally is on capital account. It is also not the business of theassessees to take over the other companies by acquiring the controllinginterest. Accordingly, the plea raised by the assessee cannot be accepted.Consequently, the case law relied upon by learned counsel for the assesseein this regard would have no relevance in adjudicating the issue before us.

Now the question arises whether on the facts stated above disallowancecan be made under section 14A of the Act. Learned counsel for the asses-

see also has not disputed the legal position that section 14A can be appliedeven if deduction is allowable under section 36(1)(iii). His only contentionis that on the facts of the case, there is no direct connection between theexpenditure incurred and the dividend income and the connection, if any,is merely incidental to the main business activity of holding investment inshares. After giving our due consideration to the facts of the case, we areunable to accept the contention of learned counsel for the assessee for thereasons given hereafter. We have already held that disallowance undersection 14A can be made only when there is dominant and immediate con-nection between the expenditure incurred and the tax free income and nototherwise. The factual details regarding holding of shares of Max India Ltd.by M/s. Cheminvest Ltd. is given below:

Assessment year	Opening balance	Purchase of shares		Bonus shares	Sale of shares
1997-98	4,75,865	Nil	Nil	Nil	1998-99
4,75,715	28,850	Nil	7501999-2000	5,03,815	1,74,211
Nil	Nil	2000-01	6,78,026	17,550	Nil
8,67,345	Nil	2001-02	6,95,576	2,16,884	Nil
Nil	2002-03	17,79,805	Nil	Nil	Nil
Nil	2003-04	17,79,805	10,000	Nil	

Note : The assessee had purchased 36,650 shares of Gaylord ImpexLtd. prior to April 1, 1996, and thereafter no transaction was made by theassessee in respect of such shares.

Details of dividend received

Assessment year	Dividend received		
Rs.	1997-98	16,65,528	1998-99
17,65,845	1999-00	6,57,47,136	2000-01
29,42,767	2001-02	2,06,16,696	2002-03
61,80,206	2003-04	Nil	

Note : The factual position in the case of Maxopp Investments Ltd. isalmost similar to the case of Cheminvest Ltd.

On the basis of the above factual details, it is clear that motive/ intentionof the assessee was to acquire and hold the shares on long-term basis as aninvestment company. So the dominant intention is not to sell the shares on

regular basis. Since the intention of the assessee is not to sell the shares ofthese companies in the near future, in our opinion, it cannot be said thatthere is any dominant and immediate connection between the interest paidand the taxable profits on the sale of shares. The chart given above revealsthat only one transaction of insignificant quantity of shares was made. Onthe other hand, the enormous dividend income has been accrued andreceived by the assessee every year. In the case of investment companies,the main purpose of investment is to earn the maximum dividend income.There is no other motive or intention in case of investment companies.Therefore, we are of the view that there did not exist any dominant andimmediate connection between the interest paid and the taxable income.In fact, such connection existed between interest paid and the dividendincome since the only motive/object was to earn the dividend income as isapparent from the amount of dividend received. Therefore, in our view, thedisallowance under section 14A was justified. The orders of the learnedCommissioner of Income-tax (Appeals) in both the cases are thereforeupheld.

In the result, the appeal of the Revenue in the case of M/s. Daga CapitalManagement (P.) Ltd. and the appeals of M/s. Maxopp Investments Ltd.and M/s. Cheminvest Ltd. are dismissed.

G. C. Gupta (Judicial Member) and R. S. Syal (Accountant Member).- We have meticulously gone through the order proposed by the hon'bleVice President. Despite rounds of discussion, there could not be any con-Sensus ad idem on certain issues. We are, therefore, constrained to writeseparate order.

The factual matrix of the case, along with the submissions made by therival parties have been aptly recorded by the hon'ble Vice President in hisproposed order through paras 1 to 16. We adopt the same and proceed togive our decision on the issues raised in these appeals.

The core of controversy raised before us is to interpret section 14A of

theIncome-tax Act, 1961 (hereinafter called "the Act") for determining as towhether or not any disallowance of expenses is warranted under this sec-tion when the assessee is dealing in shares by way of purchase and saleand any dividend income, which is exempt under section 10(33), is earnedon the shares or other securities held by it as stock-in-trade. However,there is no controversy about the rightness in making the disallowance ofexpenses under section 14A when the shares and other securities are heldas investment and not as stock-in-trade. The case of the Revenue is thatthe disallowance is necessary under section 14A even when the shares areheld as stock-in-trade. On the other hand, the view point of the assessee is

that the main purpose of making investment in shares and securities is tohold them as stock-in-trade and earning profit on their trading, whichincome is otherwise taxable under the head "Profits and gains of businessor profession" (hereinafter called the "Business income"). Since suchincome from trading is taxable and not exempt and hence on that analogythe dividend income resulting from such holding, though exempt underthe provisions of the Act, is only incidental to the holding of shares andaccordingly no disallowance be made under section 14A. In order to appre-ciate the rival submissions qua the instant controversy, it is relevant toextract section 14A, which is as under :

"14A. (1) For the purposes of computing the total income underthis Chapter, no deduction shall be allowed in respect of expenditureincurred by the assessee in relation to income which does not formpart of the total income under this Act.

(2) The Assessing Officer shall determine the amount of expendi-ture incurred in relation to such income which does not form part ofthe total income under this Act in accordance with such method asmay be prescribed, if the Assessing Officer, having regard to theaccounts of the assessee, is not satisfied with the correctness of theclaim of the assessee in respect of such expenditure in relation toincome which does not form part of the total income under this Act.

(3) The provisions of sub-section (2) shall also apply in relation to acase where an assessee claims that no expenditure has been incurredby him in relation to income which does not form part of the totalincome under this Act.

Provided that nothing contained in this section shall empower theAssessing Officer either to reassess under section 147 or pass an orderenhancing the assessment or reducing a refund already made orotherwise increasing the liability of the assessee under section 154, forany assessment year beginning on or before April 1, 2001."

This section has been inserted by the Finance Act, 2001, with retrospec-tive effect from April 1, 1962. At the time of insertion there were no sub-sections. It is only by the Finance Act, 2006 that sub-sections (2) and (3)have been inserted with effect from April 1, 2007, and that the earlier partof section 14A has been renumbered as sub-section (1).

Before we analyze this section and test the facts of our cases on thetouchstone of its prescription, it would be beneficial to note down thebackground which led to the insertion of this section.

The hon'ble Supreme Court in the case of CIT v. Indian Bank Ltd.[1965] 56 ITR 77 was confronted with a situation in which the Indian BankLimited carried on the business of banking and in the normal course of itsbusiness it received deposits from constituents and paid

interest to them. Itinvested a large sum in securities both of the Central and State Govern-ments. The interest on State Government securities was exempt fromincome-tax and super tax under the provisions of a notification issuedunder section 60 of the Indian Income-tax Act, 1922. It bought and sold thesecurities and the profits and losses on the purchase and sale of such secu-rities were duly taken into account in computing the income under thehead "Business". It claimed deduction as interest paid to various depositorsfor a sum of Rs. 25.91 lakhs. The Income-tax Officer disallowed interest ofRs. 2.80 lakhs by calculating the proportionate amount which would bepayable on the money borrowed for purchase of the State Governmentsecurities. The Tribunal upheld the Income-tax Officer's stand on theground that the assessee was not entitled to double benefit, being theexemption from the tax in respect of certain securities and also allowanceof interest against the regular business income. Eventually the hon'bleSupreme Court held that the interest paid by the bank on the moneyborrowed from its various depositors had to be allowed in its entirety andthere is no scope for making any disallowance of the proportionate part ofthe interest referable to the monies borrowed for the purchase of securitieswhose interest was tax free.

Almost a similar issue was raised before the hon'ble apex court in thecase of CIT v. Maharashtra Sugar Mills Ltd. [1971] 82 ITR 452 in whichthe assessee-company owned extensive lands on which it grew sugar caneand used the sugarcane for the manufacture of sugar in its factory. Theassessee-company was managed by managing agents who were paidremuneration in accordance with the agreement entered into between theassessee-company and the managing agents. The managing agents wereentitled to commission at Rs. 4.86 lakhs which was claimed as deduction.The Income-tax Officer disallowed a sum of Rs. 1.26 lakhs on the groundthat the same related to the commission of the managing agents formanaging the sugar cane cultivation part of the business. The Tribunal aswell as High Court deleted the addition by observing that it was one singleindivisible business. The hon'ble Supreme Court observed that the entiremanaging agency commission was expended for the purpose of thebusiness carried on by the assessee and was allowable in entirety notwith-standing the fact that the income form a part of that business was notexigible to tax.

Similar facts came up for consideration before the hon'ble SupremeCourt in the case of Rajasthan State Warehousing Corporation v. CIT[2000] 242 ITR 450. In this case the assessee was a State GovernmentCorporation who derived its income from interest, letting out of warehouseand administration charges for procurement of foodgrains. It claimeddeduction of expenditure amounting to Rs. 38.13 lakhs under section 37 ofthe Act. The Income-tax Officer allowed only so much of the expenditureas could be allocated to the taxable income and disallowed the rest of itwhich was referable to the non-taxable income, being exempt under sec-tion 10(29) of the Act. When the matter finally came up before the hon'bleSupreme Court, it allowed deduction as claimed by the assessee followingthe above discussed two judgments and also laid down the following prin-ciples for allowing or denying deduction in respect of expenses vis-a-vistaxable or exempt income (page 455 of 242 ITR) :

"(i) if income of an assessee is derived from various heads ofincome, he is entitled to claim deduction permissible under therespective head, whether or not computation under each head resultsin taxable income ;

(ii) if income of an assessee arises under any of the heads ofincome but from different items, e.g., different house properties ordifferent securities, etc., and income from one or more items alone istaxable

whereas income from the other item is exempt under the Act,the entire permissible expenditure in earning the income from thathead is deductible ; and

(iii) in computing 'profits and gains of business or profession'when an assessee is carrying on business in various ventures andsome among them yield taxable income and the others do not, thequestion of allowability of the expenditure under section 37 of theAct, will depend on :

(a) fulfilment of requirements of that provision noted above and(b) on the facts whether all the ventures carried on by him constitutedone indivisible business or not ; if they do the entire expenditure willbe a permissible deductible but if they do not, the principle of appor-tionment of the expenditure will apply, because there will be nonexus between the expenditure attributable to the venture not form-ing an integral part of the business and the expenditure sought to bededucted as the business expenditure of the assessee."

On going through the above referred three judgments of the hon'bleapex court along with several other judgments laying down the similarproposition, it transpires that the opinion of the judiciary was that the

deductibility of the expenditure was to be viewed with reference to therelevant provisions of the Act allowing such deduction, notwithstandingthe fact that the resultant income so produced is taxable or exempt. It wasfurther elaborated in Rajasthan State Warehousing Corporation [2000] 242ITR 450 (SC) that if the two businesses producing taxable and exemptincome can be bifurcated and do not constitute one indivisible business,then the apportionment of expenditure is permissible, but if the entirebusiness was composite and indivisible, then no disallowance of theexpenditure relatable to the exempt business could be made.

It was pursuant to the judgment in Rajasthan State Warehousing Corporation [2000] 242 ITR 450 (SC) rendered on February 23, 2000, and otherjudgments laying down the same ratio decidendi that the Legislatureinserted section 14A by the Finance Act, 2001, with retrospective effectfrom April 1, 1962. At this juncture it would be appropriate to note downthe intention behind the insertion of this section which is coming up fromthe Memorandum Explaining the Provision in the Finance Bill, 2001 ([2001]248 ITR (St.) 162), as under (page 195) :

"No deduction for expenditure incurred in respect of exemptincome against taxable income.-

Certain incomes are not includible while computing the totalincome as these are exempt under various provisions of the Act.There have been cases where deductions have been claimed inrespect of such exempt income. This in effect means that the taxincentive given by way of exemptions to certain categories of incomeis being used to reduce also the tax payable on the non-exemptincome by debiting the expenses incurred to earn the exempt incomeagainst taxable income. This is against the basic principles of taxationwhereby only the net income, i.e., gross income minus the expendi-ture, is taxed. On the same analogy, the exemption is also in respectof the net income. Expenses incurred can be allowed only to theextent they are relatable to the earning of taxable income.

It is proposed to insert a new section 14A so as to clarify theintention of the Legislature since the inception of the Income-tax Act,1961, that no

deduction shall be made in respect of any expenditureincurred by the assessee in relation to income which does not formpart of the total income under the Income-tax Act.

The proposed amendment will take effect retrospectively fromApril 1, 1962, and will accordingly, apply in relation to the assessmentyear 1962-63 and subsequent assessment years."

After the Finance Bill getting approval of Parliament and the Presidentof India, Circular No. 14 was issued relating to the provisions of theFinance Act, 2001 reported in [2001] 252 ITR (St.) 65, the relevant part ofwhich is as under (page 86)

"25. No deduction for expenditure incurred in respect of exemptincome against taxable income.-

25.1 Certain incomes are not includible while computing the totalincome, as these are exempt under various provisions of the Act.There have been cases where deductions have been claimed inrespect of such exempt income. This in effect means that the taxincentive given by way of exemptions to certain categories of income,is being used to reduce also the tax payable on the non-exemptincome by debiting the expenses incurred to earn the exempt incomeagainst taxable income. This is against the basic principles of taxationwhereby only the net income, i.e., gross income minus the expendi-ture, is taxed. On the same analogy, the exemption is also in respectof the net income. Expenses incurred can be allowed only to theextent they are relatable to the earning of taxable income.

25.2 Through Finance Act, 2001, a new section 14A has beeninserted so as to clarify the intention of the Legislature since theinception of the Income-tax Act, 1961, that no deduction shall bemade in respect of any expenditure incurred by the assessee in rela-tion to income which does not form part of the total income underthe Income-tax Act.

25.3 It is also being clarified that the assessments where theproceedings have become final before April 1, 2001, should not bereopened under section 147 of the Act to disallow expenditure relat-able to the exempt income by applying the provisions of section 14Aof the Act.

25.4 This amendment takes effect retrospectively from April 1,1962, and accordingly, applies in relation to the assessment year1962-63 and subsequent assessment years."

On a cursory look at the memorandum explaining the provision in theFinance Bill as well as the aforenoted circular, it becomes abundantly clearthat the Legislature clarified its intention that no deduction is allowable inrespect of any expenditure incurred by the assessee in relation to incomewhich does not form part of the total income under the Income-tax Act. Ithas further been made clear that the purpose of insertion of section 14A isnot to make any disallowance of expenditure in relation to the exemptincome for the first time, but it was always the intention of the Act for not

allowing such deductions and this insertion was made only to clarify theintention of the Legislature as it was since inception. Thus the judgmentsgranted deductions for expenses in relation to the exempt income againstthe taxable income, were considered as not laying down the correct law inconsonance with the intention of the Legislature. Such a view was, there-fore, sought to be invalidated with the insertion of the new section.

At this stage, it would not be out of place to consider the Heydon's Rulealso known as the "mischief rule" which deals with ascertaining the correctintention of the Legislature by looking into the mischief that was sought tobe remedied by the legislation. This rule basically comprises four things tobe considered.

(a) what was the common law before the making of the Act ;

(b) what was the mischief or defect for which the common law didnot provide ;

(c) what remedy Parliament has appointed to cure the defect ; and

(d) the true reasons of the remedy.

This rule contemplates in considering the position prevailing anterior to theamendment, which was intended to be rectified by way of amendment orinsertion of a section and then considering the amendment as overruling thehitherto legal position. If a particular provision is enacted for getting rid of theexisting law, as it is or as interpreted by the courts, the new amendment wouldbe construed as superseding the earlier prevalent view which was consideredby the Legislature as mischievous. The mischief rule has been repeatedlyapproved by several courts in the country including the hon'ble apex court inthe case of CIT v. Shahzada Nand and Sons [1966] 60 ITR 392.

Coming back to our case and applying the mischief rule, we observe thatsection 14A has been inserted so as to clarify the intention of the Legis-lature that no deduction is allowable, against the income from taxable busi-ness, in respect of any expenditure incurred by the assessee in relation toincome which does not form part of the total income. The contrary viewexpressed by the hon'ble courts on this issue is, therefore, to be regarded asno more relevant and binding and that too since the commencement of theAct, as has been clarified by the circular.

With this background in mind, we will take up certain issues, one by onethat have been raised before us for decision.

A. Whether section 14A has overriding effect over all other sectionsallowing deductions

Learned counsel for the assessee contended that section 14A wouldhave no application to income chargeable under the head "Business

income". He submitted that the disallowance of interest has been wronglymade by considering the applicability of section 14A, whereas the correctsection allowing deduction is 36(1)(iii) as per which the amount of interestpaid in respect of capital borrowed for the purposes of business or pro-fession is to be allowed as deduction. The learned authorised representa-tive further submitted that though the dividend income falls under thehead "Income from other sources", but in view of the fact that the shareswere held as stock-in-trade, such income would also be considered as"business income" and not "income from other sources". He relied on thejudgment of the hon'ble Delhi High Court in the case of CIT v. ExcellentCommercial Enterprises and Investments Ltd. [2006] 282 ITR 423, which inturn has followed the judgment of the hon'ble Supreme Court in the caseof CIT v. Cocanada Radhaswami Bank Ltd. [1965] 57 ITR 306 for contend-ing that the dividend earned by

an assessee from shares held as stock-in-trade is to be treated as business income. Once the dividend income is heldto be falling under the head "Business income", the learned authorisedrepresentative put forth that interest on borrowed capital would becomedeductible as it is so allowable under section 36(1)(iii). He relied on thejudgment of the hon'ble Supreme Court in the case of Deputy CIT v. CoreHealth Care Ltd. [2008] 298 ITR 194 in support of his proposition.

Per contra, the learned Departmental representative submitted that sec-Tion 14A is fully applicable to all the heads in respect of which income iscomputed under the Act and it is not borne out from the section that itwould have no application in respect of business income.

There is no squabble over the fact that when the assessee is engaged inthe business of purchase and sale of shares, then the dividend income isassessable as business income and not as income from other sources. Thisview has been taken by the hon'ble Supreme Court in the abovenotedcelebrated case of Cocanada Radhaswami Bank Ltd. [1965] 57 ITR 306 andmost of several other High Courts. Unfortunately the arguments havedeparted from the real controversy before us which is not to determine thehead under which dividend income would fall, but whether under section14A applies to "business income" or not. There is no denial of the fact thatthe dividend earned by the assessee from the shares held as stock-in-trade,prior to insertion of section 10(33) exempting it from the taxation underthis Act, was taxable under the head "Business income". But in this batchof appeals we are concerned in deciding as to whether section 14A wouldhave any application when expenditure is otherwise deductible under anyof sections enshrined under the head "Business income".

In order to appreciate this controversy it is of utmost importance toconsider the placement of section 14A under Chapter IV of the Act. ThisChapter comprises of seven sub-chapters. The first sub-chapter has beentitled as "Heads of income" containing two sections viz., 14 and 14A.Section 14 specifies that all income shall be classified under the heads"Salaries", "Income from house property", "Profits and gains of businessor profession", "Capital gains" and "Income from other sources" except asotherwise provided. The head of income "Interest on securities" has beenomitted by the Finance Act, 1988 with effect from April 1, 1989. The onlyother section in the first sub-chapter is 14A, which starts with the words"for the purpose of computing the total income under this Chapter". It,therefore, emerges that section 14A has been inserted to have applicabilityover all the heads of income. The residence of this section in the first sub-chapter, viz., "Heads of income", clearly demonstrates that it has beenmade applicable to all the head of income. If the intention of the Legis-lature had been to restrict its application to the expenditure under theheads other than "business income", then it would have been placed underthe relevant sub-chapter instead of the first sub-chapter, which, in turn,refers to all the heads of income. We, therefore, hold that the expensesdeductible under the head "Business income" are not immune from sec-tion 14A and this section has full application over all the heads of income.In other words if any expenditure is found to have been claimed as deduc-tion under any of the heads of income in relation to income which does notform part of the total income under this Act, that will fall in the con-sideration zone of section 14A for disallowance.

he learned authorised representative has argued that section 36(1)(iii)is a complete code in itself and the amount of interest paid in respect ofcapital borrowed for the purposes of the business or profession has to beallowed as deduction. It has, therefore, been claimed that since the capitalwas borrowed for the purpose of business, that is investing in

shares heldas stock-in-trade, the interest cannot be disallowed under section 14A.Reliance was placed on the judgment of the hon'ble Supreme Court in thecase of Core Health Care Ltd. [2008] 298 ITR 194 in which it has been heldthat in order to claim deduction under section 36(1)(iii), the assesseeshould have borrowed capital and the purpose of the borrowing be forbusiness which is carried on by the assessee. It has also been held in thiscase that the deduction cannot be denied if the borrowed capital is utilizedfor capital purposes. We observe that the assessment years involved in thiscase are between 1992-93 to 1997-98. It has further been made clear in thisjudgment that the proviso to section 36(1)(iii), by which any interest paid in

respect of capital borrowed for acquisition of an asset for any period begin-ning from the date on which the capital was borrowed for acquisition ofthe asset till the date first put to use shall not be allowed as deduction,would have only retrospective effect from the assessment year 2004-05 andwould not hold good for the assessment years in question. We respectfullybow before the verdict of the hon'ble Supreme Court by which interest onborrowed capital has been held to be deductible irrespective of its user forrevenue or capital purposes. The question before us is not the deductibilityof interest under section 36(1)(iii), but the applicability of section 14A. Thisjudgment was rendered for determination of the question : "Whetherinterest paid in respect of borrowings on capital asset not put to use in theconcerned financial year can be permitted as allowable deduction undersection 36(1)(iii) of the Income-tax Act, 1961?" It is patent from the ques-tion raised before the hon'ble Supreme Court that their Lordships were todecide the deductibility of interest under section 36(1)(iii) and no issue quathe applicability of section 14A was ever raised before it. As against that weare concerned in the present appeals about the applicability of section 14Ato the deductions otherwise available under the provisions of the Act.

Here we are reminded of the maxim generalia specialibus non derogantwhich means that the general things do not derogate from special. In otherwords, it implies that the special provisions override the general provision.If there are two conflicting provisions in the same section or clause, thespecial provision will prevail as the same is excluded from the general pro-vision. To put it still differently, if a specific provision is made on a certainsubject-matter, that matter is excluded from the general provision. Thehon'ble jurisdictional High Court in the case of Forbes Forbes Campbell andCo. Ltd. v. CIT [1994] 206 ITR 495 (Bom) has quoted this maxim withapproval. This maxim has also been applied by the hon'ble Madras HighCourt in the case of CIT v. Copes Vulcan Inc. [1987] 167 ITR 884, in whichcase it was held that section 9(1)(i) is general in nature and section 9(1)(vii)refers to a particular type of income and is a special provision dealing withfees for technical services rendered by the foreign company. After con-sidering the arguments from both sides it was held that section 9(1)(vii)would apply. Turning to the facts of our case, we observe that the deducti-bility of interest is covered by the general provision of section 36(1)(iii). Onthe other hand, section 14A is a special provision which deals with dis-allowing expenditure incurred by the assessee in relation to income whichdoes not form part of the total income under this Act. The expenses fallingunder any head or section which are otherwise deductible as businessexpenditure or under other respective heads, would call for disallowance in

view of the specific provision of section 14A to the extent these have beenincurred in relation to the income exempt from tax. Recently the hon'bleSupreme Court in the case of Britannia Industries Ltd. v. CIT [2005] 278ITR 546 had an occasion to deal with the disallowance of

general expensessuch as rent, repairs, maintenance and depreciation of premises used forthe purposes of guest house under section 37(4). It was claimed on behalfof the assessee that these expenses such as rent, repairs, maintenance,depreciation, etc., are allowable under the respective sections and section37(4) dealing with disallowances in respect of guest house cannot have anyapplication. The hon'ble Supreme Court, jettisoning such a contention,held that if the Legislature had intended that deduction would be allow-able in respect of all types of buildings/accommodations used for the pur-poses of business or profession, then the Legislature would not have feltthe need to amend the provisions of section 37 so as to make a definite dis-tinction with regard to buildings used as guest houses as defined in section37. Finally it was held that any expenditure towards rent, repairs, maintenance of the guest house used in connection with the business was to bedisallowed under section 37(4).

In view of the foregoing discussion, we are of the considered opinionthat the contention raised on behalf of the assessee that section 36(1)(iii)allows deduction on account of interest and hence no disallowance out ofinterest is warranted under section 14A, is bereft of any force and deservesthe fate of dismissal. Since the provisions of section 14A are special innature and deal with the disallowance of expenditure in relation to exemptincome, all such expenses cannot be allowed as deduction if these relate tothe exempt income notwithstanding the fact that there are separate pro-visions for allowing such deduction.

B. Sub-sections (2) and (3) of section 14A-Whether retrospective orprospective

We have reproduced sub-sections (2) and (3) of section 14A in an earlierpart of this order, which were inserted by the Finance Act, 2006 with effectfrom April 1, 2007. The issue of their prospective or retrospective applica-bility has been hotly argued before us. Whereas the assessee is claimingthat these sub-sections were inserted with effect from April 1, 2007 andhence will not be applicable to the assessment year in question, the learnedDepartmental representative has opposed the assessee's contention bysubmitting that these sub-sections are merely clarificatory in nature andprovide the procedure for computing the disallowance of the expenditureand hence should be considered as retrospectively inserted.

In order to properly appreciate the present controversy, it would berelevant to consider the intention behind the insertion of these sub-sec-tions, coming out from Memorandum Explaining the Provisions in theFinance Bill, 2006, as under :

"Method for allocating expenditure in relation to exempt income-Under the existing provisions of section 14A, it has been providedthat for the purposes of computing the total income, no deductionshall be allowed in respect of expenditure incurred by the assessee inrelation to income which does not form part of the total incomeunder the Income-tax Act. However, the existing provisions of section14A do not provide the method of computing the expenditureincurred in relation to income which does not form part of the totalincome. Consequently, there is considerable dispute between the tax-payers and the Department on the method of determining suchexpenditure.

In view of the above, it is proposed to insert a new sub-section (2)in section 14A so as to provide that it would be mandatory for theAssessing Officer to determine the amount of expenditure incurred inrelation to such income which does not form part of the total incomein

accordance with such method as may be prescribed. However, theAssessing Officer shall be required to adopt the prescribed method ifhaving regard to the accounts of the assessee, he is not satisfied withthe correctness of the claim of the assessee in respect of expenditurein relation to income which does not form part of the total income. Itis also proposed to provide that provisions of sub-section (2) shallalso apply in relation to a case where an assessee claims that noexpenditure has been incurred by him in relation to income whichdoes not form part of the total income.

This amendment will take effect from April 1, 2007, and will,accordingly, apply in relation to the assessment year 2007-08 andsubsequent years." [[2006] 281 ITR (St.) 190]

The normal rule is that any statutory provision is to be treated asprospective unless expressly stated otherwise or is inferred by necessaryimplication. Only the procedural provisions are regarded as being appli-cable to the pending proceedings, even though such proceedings may havecommenced at a point of time anterior to their introduction. However,when a substantive provision is incorporated for the first time, it cannot beconsidered as retrospective so as to unsettle the position already settled.Thus, it is only in a case where the amendment is clarificatory, proceduralor declaratory that such provision is applied in respect of matters relating

to periods prior to the date of introduction of the provision, even in theabsence of express language to that effect. This principle of interpretationof statutes is fairly settled by several judgments including the case ofS. Subash v. CIT [2001] 248 ITR 512 (Mad). From the enunciation of law inthis case, it is clearly borne out that a procedural, clarificatory or declaratoryprovision is always considered as retrospective and presumed to be appli-cable to the period anterior as well as posterior to the amendment. Thisview has been taken by the hon'ble Supreme Court in several judgmentsincluding H. H. Sir Rama Varma v. CIT [1994] 205 ITR 433 and CIT v.Podar Cement Pvt. Ltd. [1997] 226 ITR 625 (SC). Similar view has beenreiterated in CIT v. Shelly Products [2003] 261 ITR 367 (SC) in which it hasbeen held that the clarificatory provision inserted to clarify the law so as toremove the doubt, is retrospective even if it is stated to be applicable froma particular assessment year.

Learned counsel for the assessee has strongly relied on the judgment ofthe hon'ble Supreme Court in the case of Virtual Soft Systems Ltd. v. CIT[2007] 289 ITR 83 in which it was held that Explanation 4 to section271(1)(c) has been substituted by the Finance Act, 2002 with effect fromApril 1, 2003, so as to impose penalty under the section even if the amountof income in respect of which particulars have been concealed or inaccurateparticulars have been furnished has the effect of reducing the loss declaredin the return or converting that loss into income and hence this Explana-tion will apply only from the assessment year 2003-04. Gaining strengthfrom this judgment, it was contended by the learned authorised repre-sentative that since sub-sections (2) and (3) have been inserted with effectfrom the assessment year 2007-08 and the date of their applicability hasbeen specified, these cannot have any retrospective effect. We observe thatthis judgment in the case of Virtual Soft Systems Ltd. [2007] 289 ITR 83came up for consideration before the hon'ble Supreme Court in the latercase of CIT v. Raman Lal C Hathi [2008] 217 CTR 105, in which case againthe question for consideration was the applicability of Explanation 4 tosection 271(1)(c) from retrospective or prospective date. After consideringthe decision in the case of Virtual Soft Systems Ltd. [2007] 289 ITR 83 itwas felt that the matter needed reconsideration. Hence it was placed forthe

appropriate direction before the hon'ble Chief Justice of India. We further note that in pursuance of that, the hon'ble Supreme Court recently ina larger Bench considered this aspect in CIT v. Gold Coin Health Food P.Ltd. [2008] 304 ITR 308. After taking note of the various judgments on theissue of retrospective or prospective applicability of any provision, theearlier judgment in Virtual Soft Systems Ltd.'s [2007] 289 ITR 83 has been

overruled by holding that Explanation 4 to section 271(1)(c)(iii) of theIncome-tax Act, 1961, regarding imposition of penalty even if the returnedincome is loss, is clarificatory and not substantive. It was further held thatthe Finance Act, 2002 only intended to make the position explicit whichotherwise was implied. Accordingly it has been held to apply even to theassessment years prior to April 1, 2003, being the date from which it wasstated to be applicable from.

Explanation 2 to section 40(b) was added by the Taxation Laws(Amendment) Act, 1984, with effect from April 1, 1985, which providedthat where an individual is a partner in a firm on behalf, or for the benefitof any other person any interest paid by the firm to such individualotherwise than partner in a clause. When the applicability of Explanation 2was taken to the courts, the hon'ble Supreme Court in the case of BrijMohan Das Laxman Das v. CIT [1997] 223 ITR 825, came to the conclusionthat Explanation 2 to section 40(b) is declaratory in nature and is availablefor the period anterior to April 1, 1985. Similar view was reiterated by thehon'ble apex court in the case of Suwalal Anandilal Jain v. CIT [1997] 224ITR 753. However certain contrary observations were made in the case ofRashik Lal and Co. v. CIT [1998] 229 ITR 458 (SC) as to the operation ofExplanation 2. Again the matter was considered by the hon'ble SupremeCourt in CIT v. Kanji Shivji and Co. [2000] 242 ITR 124 in which all theearlier three judgments were considered. It was finally held that Explana-tion 2 to section 40(b) is declaratory and hence retrospective in operation.The observations in the case of Rashik Lal and Co. [1998] 229 ITR 458 (SC)appearing to be not in consonance with the view taken in the case of BrijMohan Das Laxman Das [1997] 223 ITR 825 (SC), were held to be obiter.

From the above discussion, it is amply clear that the general rule is thata provision is normally prospective unless it is given retrospective opera-tion expressly or can be so inferred by necessary implication. This rule istrue in case of substantive provisions. But when the clarificatory or expla-natory or procedural provision is under consideration, the date of insertionloses its significance. It takes retrospective effect from the date when thesubstantive provision was inserted. So the relevant consideration foraddressing this issue is to understand the true nature of the amendment. Ifthe new insertion or the amendment has the effect of imposing a newliability then it is substantive in nature and ordinarily applies prospectively.If, however it is either procedural or clarificatory in nature, then it would beretrospective notwithstanding the fact that a particular date has beenmentioned from which it would be applicable to. Such clarificatory orprocedural amendment would be fully applicable in the time anterior to the

date from which it has been said to be applicable. So the ultimate test forconsidering the retrospective or prospective operation of an amendment isto consider its nature rather than going by the date from which it has beenstated to be applicable from.

As can be seen that section 14A was inserted with a view to clarify theintention of making disallowance in respect of "expenditure incurred bythe assessee in relation to income which does not form part of the

totalincome under this Act". It can be viewed from the memorandum explain-ing the provisions, as extracted above, that this section declared the inten-tion of the Act "since inception". Sub-section (2) provides the procedurefrom determining the "amount of expenditure incurred by the assessee inrelation to such income which does not form part of the total income underthis Act", if the Assessing Officer is not satisfied with the correctness of theclaim of the assessee in respect of such expenditure. Sub-section (3) furtherprovides that the provisions of sub-section (2) shall apply in relation to acase where an assessee claims that no expenditure has been incurred byhim in relation to the exempt income. Thus the procedure for determiningthe expenditure incurred by the assessee in relation to exempt income shallapply in both the situations, that is, where the assessee makes a claim thata particular expenditure is incurred in relation to exempt income withwhich the Assessing Officer is not satisfied and also where the assesseeclaims that no expenditure has been incurred by him in relation to theexempt income. The procedure for determining the amount of expenditureincurred in relation to the exempt income is to be worked out "in accord-ance with such method as may be prescribed". The method for such com-putation has been, in turn, prescribed in rule 8D. On going through thesetwo sub-sections, it is clearly noticed that the purpose of these two sub- sections is to determine the amount of expenditure incurred in relation tothe exempt income. We are unable to find out any substantive liabilityimposed by the Legislature through these sub-sections (2) and (3). Thesesub-sections simply lay down the procedure and mechanism for workingout the expenditure in relation to income which is exempt from tax. Rule8D has been enshrined in the Income-tax Rules, 1962 which prescribes themethod by which the Assessing Officer has to determine the disallowableexpenditure as relatable to the exempt income in terms of sub-sections (2)and (3). Further when sub-section (1) itself is clarificatory and thenresultantly retrospective, it is beyond our comprehension as to how sub-sections (2) and (3), providing the mechanism to do what is provided insub-section (1), can be construed as substantive and hence prospective. Atthe same time, it is significant to mention that a proviso has also been

inserted to section 14A for reducing its rigor, which stipulates that noreassessment under section 147 or rectification under section 154 shall becarried out by the Assessing Officer so as to give effect to the newlyinserted provision. This has been done so as not to disturb the proceedingswhich have already attained the finality in the period prior to this insertion.However, the assessments which are pending at any stage, may be beforethe Assessing Officer or the Commissioner (Appeals) or the Tribunal or thehigher courts, would be governed by the mandate of this section as it isretroactive. The Special Bench of the Tribunal in Aquarius Travels P. Ltd.v. ITO [2008] 301 ITR (AT) 111 (Delhi) has also held that the proviso tosection 14A merely restrains the Assessing Officer from invoking the pro-visions of sections 147 and 154 only in relation to completed assessmentsfor assessment year 2001-02 and the earlier years ; the proviso does nottalk of restricting the power of the Commissioner of Income-tax (Appeals)or the Tribunal and, therefore, the Commissioner of Income-tax (Appeals)and the Tribunal are empowered to apply the provisions of section 14A inthe appeals pending before them for the assessment year 2001-02 andearlier years even if section 14A had not been invoked by the AssessingOfficer or the said provision was not available at the time of assessment.From the above discussion, it is vivid that sub-sections (2) and (3) areprocedural in nature and hence retrospective. We hold accordingly.

C. Expenditure incurred in relation to exempt income

Learned counsel for the assessee contended that the Assessing

Officererred in disallowing proportionate interest by holding it as relatable to theexempt dividend income. It was stated that the shares were held by theassessee as stock-in-trade and the main object of the assessee was to tradein shares and earning profit on its trading and not for earning any dividendincome. Such dividend income incidentally arose out of the shareholdingby the assessee as stock-in-trade. Since the main purpose of the assesseein acquiring the shares was to earn profit by its trading which was taxableunder the Act, the incidental income resulting by way of dividend fromsuch shareholding could not be considered for making any disallowance ofthe expenditure under section 14A. It was asserted that what is relevant toconsider is the object of incurring the expenditure. If such object is forearning exempt income then the disallowance is rightly called for undersection 14A. If however it is for earning taxable income then no disallow-ance can be made, even if the assessee had incidentally earned someincome which is exempt from tax. The learned authorised representativerelied on the judgment of the hon'ble Supreme Court in the case of H. H.Maharajadhiraja Madhav Rao Jivaji Rao Scindia Bahadur of Gwalior v.

Union of India [1971] 1 SCC 85 for contending that the expression "in rela-tion to" as used in section 14A should be considered to mean having "adominant and immediate connection with the subject and any indirectconnection was ruled out." In the light of this judgment it was stated thatsection 14A contemplated the making of disallowance of only suchexpenditure, the dominant object of whose spending was, to earn exemptincome. If the dominant and immediate object of the expenditure is not toearn the exempt income, the learned authorised representative submittedthat the same would go out of the purview of section 14A. It was furthercontended that even where the exempt income earned by the assessee wasthe main source and not incidental, in those cases also the AssessingAuthority is not obliged to make any disallowance of any indirect expendi-ture as relatable to the exempt income. In his opinion only the directexpenditure calls for disallowance. Still further the onus was stated to be onthe Assessing Officer to establish the nexus of such expenditure with theexempt income. If the Assessing Officer fails to conclusively prove nexusbetween the direct expenditure and the exempt income, the learnedauthorised representative submitted, the provisions of section 14A will failand no disallowance will be warranted.

In the opposition, the learned Departmental representative contendedthat the expression "in relation to" is wide in its scope and amplitude. Inhis opinion any expenditure having direct or indirect relation with theexempt income would call for disallowance under this section. He relied onthe judgment of the hon'ble Supreme Court in the case of Doypack Sys-tems Pvt. Ltd. v. Union of India [1989] 65 Comp Cas 1 (SC) ; [1988] 2 SCC299 (SC).

From the above submissions made by the erudite authorised represen-tative, it is noted that he has put across essentially the following threepoints for our consideration under this segment of the issue :

I. Section 14A talks of the relation between the expenditure and theexempt income.

II. Unless there is a direct and proximate connection between theexempt income and the expenditure, section 14A will not apply.

III. Section 14A has no application on the incidental exempt income.

We will deal with these points individually.

I. Section 14A talks of the relation between the expenditure and the exemptIncome

The contention is that we have to view the items of expenditure first. Ifthese have resulted in exempt income, only then the disallowance is to be

considered. In other words, the starting point for applying section 14A is toconsider the amount of expenditure and then moving forward forexamining if it has resulted in the exempt income or not. We are not con-vinced with the view point of the learned authorised representative thatsection 14A speaks about making disallowance of expenditure which hasresulted into exempt income. The language of sub-section (1) of section14A clearly provides that no deduction shall be allowed "in respect ofexpenditure incurred by the assessee in relation to income which does notform part of the total income under this Act". On going through the simpleand plain language, it is abundantly clear that the relation has to be seenbetween the exempt income and the expenditure incurred in relation to itand not vice versa. What is relevant is to work out the expenditure in rela-tion to the exempt income and not to examine whether the expenditureincurred by the assessee has resulted in exempt income or taxable income.If the view point of the learned authorised representative is accepted thenit would mean putting the cart in front of the horse and redrafting sub-sec-tion (1) of section 14A. On going through sub-section (1), it can be clearlynoticed that the exercise of making disallowance starts with firstly tracingout the exempt income and then initiating the process of working out theexpenditure incurred in relation to such exempt income. It is clearly borneout from rule 8D as has been discussed infra that it has three clauses ofsub-rule (2), being the expenditure directly relating to the exempt incomeas per clause (i) ; expenditure by way of interest which is not directly attri-butable to particular income as per clause (ii) and ; an amount equal to onehalf per cent of the average of the value of investment as per clause (iii).The sum total of these three amounts is the amount disallowable undersection 14A. From here it clearly emerges that stipulation of section is tocompute the amount of expenditure which is not allowable under section14A as is relatable to the exempt income and not in considering all theexpenses one by one for ascertaining if either of them have resulted inexempt income and thereafter considering such amount as disallowableunder section 14A. If this way of interpretation of section 14A as suggestedby the learned authorised representative is accepted, then the method ofcomputing the expenditure as relatable to the exempt income as providedin rule 8D, would become meaningless and the words "in accordance withsuch method as may be prescribed" in sub-section (2) for determining theamount disallowable would require obliteration, which in our consideredopinion is not possible. We, therefore, reject this contention raised onbehalf of the assessee.

II. Unless there is a direct and proximate connection between the exemptincome and the expenditure, section 14A will not apply

The next point urged on behalf of the assessee is that unless there is adirect and proximate connection between the expenditure and the exemptincome, there cannot be any disallowance of the expenditure under thissection. This view point is based on the meaning given by the learnedauthorised representative to the expression "in relation to" used in sectionas having only direct and proximate connection between the expenditureand exempt income. On the contrary, the learned Departmental repre-sentative proposed that this expression is very wide to encompass both thedirect and indirect expenditure.

It would be relevant to consider the two apex court judgments

whichhave been strongly relied upon by the rival parties for bringing home thepoint that section 14A embraces only the direct expenditure or both directand indirect expenditure. In the case of H. H. Maharajadhiraja MadhavRao Jivaji Rao Scindia Bahadur of Gwalior v. Union of India [1971] 1 SCC85 a petition was filed under article 32 of the Constitution by Madhav RaoScindia claiming a declaration under the Presidential order dated Septem-ber 6, 1970, derecognizing the rulers as unconstitutional. The Union ofIndia contended, inter alia, that articles 291 and 362 of the Constitution didnot invest the petitioner and the other rulers with any enforceable right asthe recognition of the rulers under article 366(22) was a matter of StatePolicy and the President was competent to pass the order. Thus, the ques-tion before the hon'ble Supreme Court was to examine if it had the juris-diction in examining the aforenoted three articles viz., 291, 362 and366(22). In that context the expression "relating to" came up for con-sideration when the Union of India contended that the jurisdiction of thecourt was barred as the dispute relating to enforcement interpretation orapproach of any treaty etc., was barred from the court's jurisdiction. Afterexamining the issue in detail, the hon'ble Supreme Court, by the majorityjudgment, came to conclusion that the expression "relating to" shouldmean a direct and immediate connection with the subject-matter. It was,therefore, held that the court had jurisdiction to examine articles 291, 362and 366(22) in so far as the dispute in question was concerned.

The facts in the case of Doypack Systems Pvt. Ltd. v. Union of India[1989] 65 Comp Cas 1 (SC) ; [1988] 2 SCC 299 (SC), relied upon by thelearned Departmental representative are that the Swadeshi Cotton MillsCompany Limited (Acquisition and Transfer of Undertakings) Act, 1986,was enacted with a view to effect acquisition and transfer of certain textileundertakings of the Swadeshi Cotton Mills Co. Ltd. and securing of such

maintenance undertakings so as to subserve the interest of the generalpublic by ensuring the continued manufacture, production and distributionof different varieties of cloth and yarn. As per section 3 of this Act everytextile undertakings and the right, title and interest of the company in rela-tion to every such textile undertaking shall, virtue of this Act, vest in theCentral Government, section 4 provides that "the textile undertakingreferred to in section 3 shall be deemed to include all assets, rights, lease-holds, power, authorities and privileges and all property movable andimmovable including lands, buildings, workshops, stores, instruments,machinery and . . . ". Section 7 provides that the shares were to be issuedby the National Textile Corporation for the value of the assets transferredto it by the Central Government. Swadeshi Cotton Mills had 10 lakhsshares in Swadeshi Polytex Limited and 17,18,344 shares in SwadeshiMining and Manufacturing Co. Ltd. It was claimed on behalf of these com-panies that such type of assets would not vest with the Government foracquisition. The hon'ble Supreme Court noted that section 3 employsexpression "in relation to". Interpreting this expression, the hon'ble courtheld that it was a very broad expression which presupposes anothersubject-matter as these are words of comprehensiveness which might haveboth a direct significance as well as an indirect significance depending onthe context. Assuming that the investments in shares and in lands do notform part of the undertakings but are different subject-matters, the hon'blecourt held that even then these would be brought within the purview ofthe vesting by reason of the aforenoted expression. Resultantly, it was heldthat the disputed properties vested in NTC.

Here we would like to mention that the meaning of a word or a phrasehas to be adopted by considering the context in which such word or phrasehas been used. It is equally important to note that the meaning

given to aparticular expression in one enactment cannot be bodily lifted and fittedinto an another altogether different enactment. The hon'ble SupremeCourt in the case of CIT v. Venkateswara Hatcheries P. Ltd. [1999] 237 ITR174 has held that "the meaning assigned to a particular word in a particularstatute cannot be imported to a word used in a different statute . . . Thesame word, if read in the context of one provision of the Act, may mean orconvey one meaning and another in a different context." From the aboveenunciation of the law by the hon'ble apex court, it is patent that whilegiving meaning to a particular word in one section, there is no authority forimporting and adopting the meaning of that word in some other parts ofthe same Act or in a different enactment.

With this background in mind, we go to the case of Madhavrao Scindia[1971] 1 SCC 85 relied upon by the learned authorised representative forcanvassing his point that the expression "in relation to" as used in section14A should be used in a narrow sense. From the narration of the facts ofthis case, it is observed that the expression "relating to" discussed in thiscase has been used by the hon'ble Supreme Court in the context ofexamining whether it had jurisdiction in a dispute in respect of any rightaccruing under or any liability or obligation arising out of any of the pro-visions of this Constitution relating to any such treaty, etc. It was only inthis context that the hon'ble Supreme Court held that the jurisdiction vestsin it because the expression "relating to" necessarily means that thereshould be direct and proximate connection. Thus, it is clear that the contextin which the expression "relating to" was interpreted by the hon'bleSupreme Court did not have any relation, worth the name, insofar provi-sions like section 14A concerning with the disallowance of expenditurerelatable to the exempt income, are concerned. What to talk of that Act ashomogeneous to the Income-tax Act, it has no matching shades at all.Moreover, in this judgment the hon'ble Supreme Court was dealing withthe scope of the expression "relating to". However, in the case of DoypackSystems Pvt. Ltd. [1989] 65 Comp Cas 1 (SC) ; [1988] 2 SCC 299 (SC) thequestion for consideration was to determine whether the shares etc. heldby the Swadeshi Cotton Mills would vest in the Central Government ornot. The hon'ble Supreme Court observed that in section 3 of the SwadeshiCotton Mills Co. Ltd. (Acquisition and Transfer of Undertakings) Act, 1986,the phrase used was "in relation to". Giving meaning to this expression, itwas held as under (page 27 of 65 Comp Cas) :

"The expression 'in relation to' (so 'also pertaining to'), is a verybroad expression which presupposes another subject-matter. Theseare words of comprehensiveness which might have both a directsignificance as well as an indirect significance depending on the con-text . . . Assuming that the investments in shares and in lands do notform part of the undertakings but are different subject-matters, eventhen these would be brought within the purview of the vesting byreason of the above expression."

Before we proceed to evaluate and examine the contentions raised onthis issue, it would be important to have a look at different expressionsused in the Income-tax Act, 1961 that spell out the scope of the respectiveprovision in the light of such expression. For example, section 72AB(3)(1)uses the phrase "directly relatable to" while dealing with the set-off of theaccumulated losses and unabsorbed depreciation allowable to the resulting

co-operative bank. In the like manner the phrase "attributable to" has beenemployed in various sections including Explanation 6 to section 43(6), sec-tion 44AC prior to its omission and section 10(23B). The

expression "inrelation to" has also been used in various sections apart from section 14A,such as sections 36(1)(ix), 35(2AB). The phrase "relating to" has been usedagain in several sections including 36(1)(vii), 28(ii)(c). The phrase "whollyand exclusively for the purposes of has been used in sections 37 and 57(iii).On going through the use of the above and other similar expressions indifferent parts of the Act, it is clearly borne out that these are not usedinterchangeably. The Legislature is fully conscious of employment ofappropriate expression depending upon its intent of expanding orcontracting the scope of the section. Wherever it intends to give a widermeaning, it uses the phrase like "in relation to" or "attributable to" etc.However, where the scope is to be restricted, it uses the suitable phrasesuch as "directly relatable to" or "wholly and exclusively for the purposesof, which narrows its ambit. We have noted above that the meaning of aword or phrase can be viewed only in reference to the context in which it isused. There is no need to wander here and there in search of the meaningof the expression "in relation to" as used in sub-section (1) because thesame has been explained in sub-section (2) itself. Whereas sub-sectionstates that no deduction shall be allowed in respect of "expenditureincurred by the assessee 'in relation to' income which does not form part ofthe total income", sub-section (2) provides the meaning of the sameexpression that is "expenditure incurred 'in relation to' such income whichdoes not form part of the total income" to mean the amount as determinedby the Assessing Officer "in accordance with such method as may beprescribed". The method has been prescribed in rule 8D to mean bothdirect and indirect expenditure as discussed elsewhere in this order. Sincethe Legislature opted to field the expression "in relation to" in preferenceover "directly relatable to" or "wholly and exclusively" for the purposes of,it clarified its intention of giving wider meaning and bringing into sweepnot only the direct but also the indirect expenditure in relation to theexempt income for the purposes of disallowance under section 14A. Theposition becomes more clear when we look into the direction of rule 8D,which has been brought in pursuance of sub-section (2) of section 14A.Here it would be interesting to jot down rule 8D, which runs as under :

"8D. Method for determining amount of expenditure in relation toincome not includible in total income.-(1) Where the AssessingOfficer, having regard to the accounts of the assessee of the previousyear, is not satisfied with-

(a) the correctness of the claim of expenditure made by the asses-see ; or

(b) the claim made by the assessee that no expenditure has beenincurred,

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

(2) The expenditure in relation to income which does not form partof the total income shall be the aggregate of following amounts,namely :-

(i) the amount of expenditure directly relating to income whichdoes not form part of total income ;

(ii) in a case where the assessee has incurred expenditure by wayof interest during the previous year which is not directly attributableto any particular income or receipt, an amount computed in accord-ance with the following formula, namely :-

A X B C

Where A = amount of expenditure by way of interest other thanthe amount of interest included in clause (i) incurred during the pre-vious year ;

B = the average of value of investment, income from which doesnot or shall not form part of the total income, as appearing in thebalance sheet of the assessee, on the first day and the last day of theprevious year ;

C = the average of total assets as appearing in the balance-sheet ofthe assessee, on the first day and the last day of the previous year ;

(iii) an amount equal to one half per cent. of the average of thevalue of investment, income from which does not or shall not formpart of the total income, as appearing in the balance-sheet of theassessee, on the first day and the last day of the previous year.

3. For the purposes of this rule, the 'total assets' shall mean, totalassets as appearing in the balance-sheet excluding the increase onaccount of revaluation of assets but including the decrease on accountof revaluation of assets."

On going through the contents of rule 8D, it becomes amply clear thatnot only the expenditure directly relating to exempt income [Sub-rule 2(i)

of rule 8D] but also the indirect expenditure like interest which is notdirectly attributable to any particular income or receipt [Sub-rule 2(ii)] andthen further one half per cent. of the value of investment to cover upincidental indirect expenses [Sub-rule 2(iii)] have been categorized asexpenditure incurred in relation to exempt income. We do not have evenan iota of doubt in our mind that the intention behind using the expression"in relation to" in section 14A is to encompass not only the direct but alsothe indirect expenditure which has any relation to the exempt income. We,therefore, hold that all the direct and indirect expenses are disallowableunder section 14A, which have any relation with the income not charge-able to tax under the Act.

Be that as it may, we would also deal with the contention that thereshould be a dominant and immediate connection between the expenditureincurred and the exempt income so as to make disallowance under section14A. A great deal of emphasis has been laid on the establishing ofdominant and immediate connection between the expenditure incurredand the exempt income. According to the learned authorised representa-tive the expenditure of interest on investment in shares has direct andproximate link with the profit or loss from trading of shares and an indirectlink with the dividend income which was earned incidentally and hence nodisallowance is warranted. In our opinion there is a basis fallacy in thisargument. Dominant and immediate connection refers to the first degree ofrelation between the two things. However, it would cease to be dominant ifthe degree of relationship slips from first to second. It is noticed that thereis a dominant and immediate connection between the expenditure incurredby the assessee in the shape of interest on borrowings for purchase ofshares and the dividend income. It is only due to the investment in theshares that the dividend income has resulted. Such investment results intwo incomes, viz., the profit on its sale and the dividend. Both theseincomes fall on the same platform and are the direct result of investment. Ifa person invests in the

shares from which dividend income is earned andthereafter such dividend is deposited in the bank from where the interestincome results, in such a situation the relation between the interest paid bythe assessee on the borrowed funds for the purchase of shares with thedividend income is dominant and immediate, being that of the first degreebut the relation of such interest paid with the interest income earned onthe amount invested in the bank, would be of the second degree, beingindirect and non-immediate. We, therefore, do not find any force in thissubmission.

Learned counsel for the assessee while inviting our attention to rule8D(2)(ii) contended that it refers to the "value of investment". On thisanalogy it was urged that section 14A along with this rule cannot have anyapplication where the shares are held as stock-in-trade. The sum and sub-stance of his submissions was that this section would apply only when theshares are held as "investment". We are not impressed with this submis-sion raised on behalf of the assessee for the out-and-out reason that thereference in this rule is to the "value of investment" and not the assets"held as investment". A person may make investment in shares and theshares so purchased may be held either as "stock-in-trade" or "invest-ment". The word "investment" in this rule refers to the making of purchaseof shares and not holding it as investment.

The learned authorised representative has relied on certain judgmentsincluding that of the hon'ble jurisdictional High Court in the case of CIT v.Emrald Co. Ltd. [2006] 284 ITR 586 (Bom), in which it was held that theinterest on borrowing and other expenditure incurred in the course ofshare trading activity are allowable as deduction while computing the busi-ness income and hence these cannot again be deducted from the dividendincome for the purposes of computing deduction under section 80M. Basedon this judgment, the learned authorised representative bolstered his pointof view that no disallowance is permissible in respect of interest and otherexpenditure under section 14A. We are not in agreement with the con-tention raised on behalf of the assessee primarily for the reason that thejudgment of the hon'ble Bombay High Court has been rendered in thecontext of computation of deduction under section 80M. The question waswhether gross or net dividend should be considered for computing deduc-tion under this section. Nowhere section 14A was the subject-matter ofconsideration. Whereas section 80M talks of granting deduction from thegross total income, section 14A, which operates in an entirely differentfield, concerns itself with making disallowance of the expenditure incurredin relation to the exempt "income". In this view of the matter, we are of theconsidered opinion that the judgments rendered in the context of section80M cannot be applied when the question is of making disallowance undersection 14A.

We further do not approve the view canvassed by the learned authorisedrepresentative that the onus would be on the Assessing Officer to establishthat there exists dominant and immediate connection between theexpenditure incurred and the income not forming part of total incomebefore he intends to invoke section 14A. Diagonally opposite opinionshave been expressed by different Benches, which have been relied on by

the rival parties. We note that there is a direct and solitary judgment,brought to our notice during the course of hearing, rendered by the hon'blePunjab & Haryana High Court in Haryana Land Reclamation and Deve-Lopment Corporation v. CIT [2008] 302 ITR 218 in which it has been held asunder (headnote of ITR) :

"Held, dismissing the appeal, that once the assessee had not beenable to substantiate before the authorities that the assets were notused for agricultural operations and that in fact they were being usedfor business purposes, there was no question of grant of depreciationthereon. Similarly, on account of gratuity, bonus, etc., the Tribunalalso held that the assessee could not bring any evidence on record toshow that the staff was engaged in its business operations and not inits agricultural operations. The Tribunal was correct in holding thatsection 14A would apply since substantial income was generated outof agricultural activity from the farm."

On going through the above judgment two things are noticeable viz.,first the onus to prove that the expenditure was incurred in the taxablebusiness operations and not the exempt income is upon the assessee andsecondly, the apportionment of the expenses is permissible for making dis-allowance under section 14A. No contrary judgment of any other HighCourt on this point has been pointed out. In the light of the fact that thereis a cleavage of opinion amongst the Benches of the Tribunal and there isno other judgment either of the hon'ble Supreme Court or of any otherHigh Court, this judgment of the hon'ble Punjab and Haryana High Courtappeals to us. Be that as it may, in our considered opinion, the discussionabout the apportionment of direct or indirect expenditure towards taxableand exempt income has become academic in view of rule 8D whichprescribes mechanism for working out the disallowance under section 14A.In this scenario, the further question as raised by the parties about the onuson the Assessing Officer or the assessee for bringing a particular amount ofexpenditure in the purview of section 14A and the manner of computationof disallowance has ceased to be of any relevance since the AssessingOfficer is bound to adopt rule 8D for making disallowance under section14A, where he is not satisfied with the correctness of the claim of theassessee in respect of such expenditure.

III. Section 14A has no application on the incidental exempt income

Now we turn to examine the main plank of the submissions made onbehalf of the assessee with a lot of vehemence that it is of paramountimportance to see the intention with which the expenditure was incurredand if it is incurred with a view to earn a taxable income then no

disallowance under section 14A is possible even in respect of the exemptincome resulting incidentally. The reason for this proposition is advancedto be the presence of the dominant or immediate connection between theexpenditure incurred and taxable income. To put it simply it was submittedthat if the dominant object of the expenditure is to earn taxable income,being the profit on sale of shares in the present case, then no disallowancewould be made with reference to the incidental income in the shape ofdividend from the holding of shares as stock-in-trade. We are not con-vinced with this argument for the obvious reason that the line of distinc-tion sought to be drawn on behalf of the assessee between the main andincidental income is, unfortunately, missing in the section. Sub-section (1)spells out in unambiguous terms that the expenditure incurred by theassessee in relation to income which does not form part of the total incomeunder this Act is to be disallowed under section 14A. The reference is to the"income which does not form part of the total income" without makingany further distinction between the main or incidental exempt income. Thestatus of income is not enhanced or lowered if it is earned from the mainbusiness activity or incidentally. There may be a difference in classificationof such income under one head or the other. But no special treatment isenvisaged for the main or incidental income under the Act. There is noprovision in the Act, which

exempts a particular income from taxationsimply on the ground that it is an incidental income. What is material toconsider is the nature of income and not it being major or subsidiary.Moreover dividend is exempt irrespective of whether it is earned by theassessee from the shares held as investment or as stock-in-trade. Theinstruction of sub-section (1) is unexceptional in the sense that if there isany exempt income, the disallowance of the expenditure under section 14Ain relation to such income has to automatically follow. There is absolutelyno indication much less the reference in the language of section that couldeven remotely suggest that the disallowance is not contemplated in respectof incidental income, which is otherwise exempt from tax in the samemanner as is the main income. We have already repelled the contentionraised on behalf of the assessee that the object of the expenditure is to beviewed as a determinative factor for making any disallowance under thissection. It is simple and plain that the disallowable expenditure is to beworked out which has relation with the exempt income and not otherwise.We are, therefore, not inclined to accept the assessee's version that if theexempt income is incidental to the main business whose income is taxable,then the provisions of section 14A will be defeated.

It was further argued on behalf of the assessee that the interpretationsought to be given by the learned Departmental representative to section14A, if accepted would be very harsh and unequitable as it will result indisallowance of expenditure which is indirectly related to the exemptincome. We are again at loss to appreciate this contention for the simplereason that the duty of the Tribunal is to interpret the provision as it existsin the Act. The Tribunal cannot usurp the legislative power to tone downthe rigor of any provision. It is settled legal position that equity or hardshipis hardly any relevant ground for the interpretation of tax law. Our view issupported by the judgment of the hon'ble Supreme Court in the case ofKaramchari Union v. Union of India [2000] 243 ITR 143 in which it waspleaded that the receipts on account of CCA, HRA and DA be not chargedunder the head "Salaries". It was also submitted that it would be ofimmense hardship if CCA is put to tax. Rejecting this contention, thehon'ble Supreme Court held that the receipt on account of CCA, HRA andDA are in the nature of income and are chargeable to tax as profits in lieuof salary. It was further laid down that equity is no consideration whileinterpreting the taxation laws. Similar opinion has been expressed again bythe hon'ble Supreme Court in the case of Hemalatha Gargya v. CIT [2003]259 ITR 1 in which it was held as under (page 8 of 259 ITR) :

"In none of the decisions of the High Courts which have held thatthe time prescribed under section 67(1) was not rigid has any legalbasis been relied on. The decision to extend the time appears to havebeen arrived at on considerations of equity. This approach, in ouropinion, was incorrect as the court had no power to act beyond theterms of the statutory scheme under which benefits had been grantedto the assessee."

From the above discussion, it boils down that the Tribunal is restricted ininterpreting the provision as it exists, whether it is hard or soft. Turning tothe language of section 14A, we observe that the disallowance is contem-plated in respect of expenditure incurred by the assessee in relation to theincome which does not form part of the total income under this Act. Whenthe language of section is clear and does not admit of any doubt what-soever, we are bound to interpret it literally. It is trite law that so long asthere is no ambiguity in the statutory language, resort to in interpretiveprocess to unfold the legislative intent becomes impermissible. Taxingstatute has to be strictly construed and nothing can be read in it as hasbeen held by the hon'ble Supreme Court in

several cases including theFederation of Andhra Pradesh Chambers of Commerce and Industry v.State of Andhra Pradesh [2001] 247 ITR 36. In Padmasundra Rao (Decd.) v.

of Tamil Nadu [2002] 255 ITR 147 also it was held that while interpreting a statute legislative intention must be found in the words used bythe Legislature itself ; legislative casus omissus cannot be supplied inter-pretative process except in case of clear necessity and when reason for it isfound in the four corners of the statute itself. Coming back to our case, wenote that sub-section (1) of section 14A provides in unequivocal terms fornot allowing deduction in respect of expenditure incurred by the assesseein relation to exempt income and sub-section (2) lays down the mechanismfor determining such amount of expenditure incurred in relation to theexempt income in accordance with the method as prescribed under rule8D. There is hardly anything to infer, that the Legislature intended toimmune the expenditure in relation to incidental exempt income from theoperation of section 14A. There is no exception for not considering anyincome which is exempt from tax, be it the main or incidental. We, there-fore, jettison this argument.

In view of the foregoing discussion we hold that the provisions of section 14A of the Act are applicable with respect to dividend income earnedby the assessee engaged in the business of dealing with shares and secu-rities, on the shares held as stock-in-trade when earning of such dividendincome is incidental to the trading in shares. We, therefore, answer thequestion posed to us in the affirmative. As we have held that sub-sections(2) and (3) of section 14A are retrospective in nature and the resultant rule8D would also fall on the same line, then the disallowance under section14A is required to be computed with reference to the mandate of theseprovisions. We, therefore, set aside the impugned orders in all the casesbefore us and remit the matter to the file of the Assessing Officers for com-putting the disallowance in terms of section 14A read with rule 8D.

We want to make it clear that all the cases relied on by both the sideshave been duly taken into consideration while deciding the matter. Thereference to some of the cases in the order is avoided either due to theirirrelevance or to relieve the order from the burden of the repetitive ratiodecidendi laid down in such decisions. Before parting with these appeals,we place on record our appreciation for the illuminating arguments putforth by the learned senior Departmental representative and the authorisedrepresentatives, which has assisted us in the disposal of the issue raised inthese appeals.

In the result, all the appeals are allowed for statistical purposes, bymajority view.