A GODREJ & BOYCE MANUFACTURING COMPANY LIMITED

v.

DY. COMMISSIONER OF INCOME-TAX & ANR.

(Civil Appeal No. 7020 of 2011)

B MAY 08, 2017

[RANJAN GOGOI AND ASHOK BHUSHAN, JJ.]

Income Tax Act, 1961 – s. 14A – Expenditure incurred in relation to income not includible in total income – Phrase "income C which does not form part of total income under this Act" in s.14A – Scope of – If includes dividend income on shares in respect of which tax is payable u/s. 115-O and income on units of mutual funds on which tax is payable u/s. 115-R – Held: s.14A would apply to dividend income on which tax is payable u/s. 115-O – Plain reading of s.14A shows that the income must not be includible in the total D income of the assessee – Once the said condition is satisfied, the expenditure incurred in earning the said income cannot be allowed to be deducted – Thus, s.14A would operate to disallow deduction of all expenditure incurred in earning the dividend income u/s. 115-O which is not includible in the total income of the assessee – On facts E and in the circumstances of the assessee's case, for the assessment year in question, the assessee is entitled to the benefit of claim of dividend income without any deduction – ss.115-O, 115-R.

Allowing the appeal, the Court

HELD: 1.1 The object behind the introduction of Section F 14A of the Income Tax Act, 1961 by the Finance Act of 2001 is clear and unambiguous. The legislature intended to check the claim of allowance of expenditure incurred towards earning exempted income in a situation where an assessee has both exempted and non-exempted income or includible or non-G includible income. While there can be no doubt that if the income in question is taxable and, therefore, includible in the total income, the deduction of expenses incurred in relation to such an income must be allowed, such deduction would not be permissible merely on the ground that the tax on the dividend received by the assessee has been paid by the dividend paying H company and not by the recipient assessee, when under Section

10(33) of the Act such income by way of dividend is not a part of the total income of the recipient assessee. A plain reading of Section 14A would go to show that the income must not be includible in the total income of the assessee. Once the said condition is satisfied, the expenditure incurred in earning the said income cannot be allowed to be deducted. The Section does not contemplate a situation where even though the income is taxable in the hands of the dividend paying company the same to be treated as not includible in the total income of the recipient assessee, yet, the expenditure incurred to earn that income must be allowed on the basis that no tax on such income has been paid by the assessee. Such a meaning, if ascribed to Section 14A, would be plainly beyond what the language of Section 14A can be understood to reasonably convey. [Para 24] [622-C-G]

1.2 The literal meaning of Section 14A, far from giving rise to any absurdity, appears to be wholly consistent with the scheme of the Act and the object/purpose of levy of tax on income. Therefore, the well entrenched principle of interpretation that where the words of the statute are clear and unambiguous recourse cannot be had to principles of interpretation other than the literal view would apply. [Para 27] [624-C-D]

1.3 While it is correct that Section 10(33) exempts only dividend income under Section 115-O of the Act and there are other species of dividend income on which tax is levied under the Act, it cannot be seen how the said position in law would assist the assessee in understanding the provisions of Section 14A in the manner indicated. What is required to be construed is the provisions of Section 10(33) read in the light of Section 115-O of the Act. So far as the species of dividend income on which tax is payable under Section 115-O of the Act is concerned, the earning of the said dividend is tax free in the hands of the assessee and not includible in the total income of the said assessee. If that is so, it cannot be seen how the operation of Section 14A of the Act to such dividend income can be foreclosed. The fact that Section 10(33) and Section 115-O of the Act were brought in together; deleted and reintroduced later in a composite manner, also, does not assist the assessee. Rather, the said facts would countenance a situation that so long as the dividend income is

A taxable in the hands of the dividend paying company, the same is not includible in the total income of the recipient assessee. At such point of time when the said position was reversed (by the Finance Act of 2002; reintroduced again by the Finance Act, 2003), it was the assessee who was liable to pay tax on such dividend
B income. In such a situation the assessee was entitled under Section 57 of the Act to claim the benefit of exemption of expenditure incurred to earn such income. Once Section 10(33) and 115-O was reintroduced the position was reversed. The above, actually fortify the situation that Section 14A of the Act would operate to disallow deduction of all expenditure incurred in
C earning the dividend income under Section 115-O which is not includible in the total income of the assessee.[Para 30][625-B-F]

1.4 Even if it is assumed that the additional income tax under Section 115-O is on the dividend and not on the distributed profits of the dividend paying company, no material difference to the
D applicability of Section 14A would arise. Sub-sections (4) and (5) of Section 115-O of the Act makes it very clear that the further benefit of such payments cannot be claimed either by the dividend paying company or by the recipient assessee. The provisions of Sections 194, 195, 196C and 199 of the Act, would further fortify the fact that the dividend income under Section 115-O of the Act
E is a special category of income which has been treated differently by the Act making the same non-includible in the total income of the recipient assessee as tax thereon had already been paid by the dividend distributing company. The other species of dividend income which attracts levy of income tax at the hands of the
F recipient assessee has been treated differently and made liable to tax under the said provisions of the Act. [Para 31] [625-G-H; 626-A-B]

1.5 The first question is answered against the assessee by holding that Section 14A would apply to dividend income on which
G tax is payable under Section 115-O. [Para 34] [627-B]

1.6 Section 14A as originally enacted by the Finance Act of 2001 with effect from 1.4.1962 is in the same form and language as currently appearing in sub-section (1) of Section 14A of the Act. Sections 14A (2) and (3) were introduced by the Finance Act
H of 2006 with effect from 1.4.2007. It cannot be denied is that the

requirement for attracting the provisions of Section 14A(1) is proof of the fact that the expenditure sought to be disallowed/ deducted had actually been incurred in earning the dividend income. Insofar as the appellant-assessee is concerned, the issues stand concluded in its favour in respect of the Assessment Years 1998-1999, 1999-2000 and 2001-2002. Earlier to the introduction of sub-sections (2) and (3) of Section 14A, such a determination was required to be made by the Assessing Officer in his best judgment. In all the said assessment years, it was held that the Revenue had failed to establish any nexus between the expenditure disallowed and the earning of the dividend income in question. In the appeals arising out of the assessments made for some of the assessment years the said question was specifically looked into from the standpoint of the requirements of the provisions of sub-sections (2) and (3) of Section 14A which had by then been brought into force. It is on such consideration that findings were recorded that the expenditure bore no relation to the earning of the dividend income and hence, assessee was entitled to the benefit of full exemption claimed on account of dividend income. [Para 36] [627-C-G]

1.7 It cannot be seen how in the said fact situation, a different view could have been taken for the Assessment Year 2002-2003. Sub-sections (2) and (3) of Section 14A of the Act read with Rule 8D of the Rules merely prescribe a formula for determination of expenditure incurred in relation to income which does not form part of the total income under the Act in a situation where the Assessing Officer is not satisfied with the claim of the assessee. Whether such determination is to be made on application of the formula prescribed under Rule 8D or in the best judgment of the Assessing Officer, what the law postulates is the requirement of a satisfaction in the Assessing Officer that having regard to the accounts of the assessee, as placed before him, it is not possible to generate the requisite satisfaction with regard to the correctness of the claim of the assessee. It is only thereafter that the provisions of Section 14A(2) and (3) read with Rule 8D or a best judgment determination, as earlier prevailing, would become applicable. [Para 37] [627-H; 628-A-C]

1.8 In the instant case, there is no mention of the reasons

A which had prevailed upon the Assessing Officer, while dealing with the Assessment Year 2002-2003, to hold that the claims of the Assessee that no expenditure was incurred to earn the dividend income cannot be accepted and why the orders of the tribunal for the earlier Assessment Years were not acceptable to the Assessing Officer, particularly, in the absence of any new fact B or change of circumstances. Neither any basis was disclosed establishing a reasonable nexus between the expenditure disallowed and the dividend income received. That any part of the borrowings of the assessee had been diverted to earn tax free income despite the availability of surplus or interest free C funds available remains unproved by any material whatsoever. While it is true that the principle of *res judicata* would not apply to assessment proceedings under the Act, the need for consistency and certainty and existence of strong and compelling reasons for a departure from a settled position has to be spelt D out which clearly is absent. [Para 38] [628-D-F]

1.9 The second question formulated is answered in favour of the assessee and for the Assessment Year 2002-2003, the assessee is entitled to the full benefit of the claim of dividend income without any deductions. [Para 39] [629-B-C]

E 1.10 The order of the High Court is set aside subject to the aforesaid conclusions. [Para 40] [629-C]

K.P. Varghese v. *Income-Tax Officer, Ernakulam and Anr.* (1981) 131 ITR 597 (SC); *C.I.T.* v. *Walfort Share & Stock Brokers P. Ltd.* (2010) 326 ITR 1 (SC); F *Commissioner of Income Tax-III* vs. *Calcutta Knitwears, Ludhiana* (2014) 6 SCC 444; *Commissioner of Income-Tax* vs. *Tara Agencies* (2007) 292 ITR 444 (SC); *Radhasoami Satsang* vs. *Commissioner of Income-Tax* (1992) 193 ITR (SC) 321 – referred to.

G *Cape Brandy Syndicate* vs. *IRC* [1921] 1 KB 64 – referred to.

Case Law Reference

(1981) 131 ITR 597 (SC)	referred to	Para 14
(2010) 326 ITR 1 (SC)	referred to	Para 19

H

(2014) 6 SCC 444	**referred to**	**Para 27**	A
(2007) 292 ITR 444 (SC)	**referred to**	**Para 28**	
(1992) 193 ITR (SC) 321	**referred to**	**Para 38**	

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 7020 of 2011. B

From the Judgment and Order dated 12.08.2010 of the High Court of Bombay in Income Tax Appeal No. 626 of 2010.

Sohrab E. Dastur, Percy J. Pardiwalla, Sr. Advs., Nitesh Joshi, Rustom B. Hathikhanawala, Advs. for the Appellant.

C

The Judgment of the Court was delivered by

RANJAN GOGOI, J. 1. The appellant Company, incorporated in the year 1932, is engaged in the business of manufacture of steel furniture, security equipments, typewriters, electrical equipments and a host of other related products. It is also a promoter of various other companies and invests its funds in such companies in order to maintain control of such concerns as sister concerns. D

2. The issue in the present appeal relates to the admissibility or otherwise of deduction of expenditure incurred in earning dividend income which is not includible in the total income of the Assessee by virtue of the provisions of Section 10(33) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") as in force during the relevant Assessment Year i.e. 2002-2003. E

3. For the Assessment Year 2002-2003, the appellant – Company filed its return declaring a total loss of Rs.45,90,39,210/-. In the said return, it had shown income by way of dividend from companies and income from units of mutual funds to the extent of Rs.34,34,78,686. Dividend income to the extent of 98% of the said amount was contributed by the Godrej group companies whereas only 0.05% thereof amounting to Rs.1,71,000/- came from non-Godrej group companies. A sum of Rs.66,79,000/-, constituting 1.95% of the aforesaid dividend income, came from mutual funds. Admittedly, a substantial part of the appellant's investment in the group companies was in the form of bonus shares which did not involve any fresh capital investment or outlay. F G

4. The other relevant facts which may be taken notice of is that on the first day of the previous year relevant to the Assessment Year H

A 2002-2003 i.e. 1st April, 2001, the investment in shares and mutual funds of the appellant company stood at Rs.127.19 crore whereas at the end of the previous year i.e. as on 31st March, 2002 the investment was Rs.125.54 crore. The above figures would go to show that there were no fresh investments made during the previous year relevant to the Assessment Year 2002-2003. In fact, the investments had come down B to the extent noticed above.

5. Furthermore, as against the investment of Rs.125.54 crore as on 31st March, 2002, on the said date the appellant had a total of Rs.280.64 crore by way of interest free funds in the form of share capital (Rs.6.55 crore) as well as Reserves and Surplus (Rs.274.09 crore). On the other C hand, as against the investment of Rs.127.19 crore on the first day of the previous year i.e. 1st April, 2001, the appellant had a total of Rs.270.51 crore by way of interest free funds in the form of share capital (Rs.6.55 crore) and Reserves and Surplus (Rs.263.96 crore). The above facts would show that the appellant had sufficient interest free funds available D for the purpose of making investments.

6. At this stage we may go back a little in time and start with the Assessment Year 1998-1999 wherein the appellant's dividend income was Rs.11,41,34,093/-. The Assessing Officer notionally allocated Rs.1,47,40,000/- out of the total interest expenditure of Rs.34,64,89,000/ E - as referable to the earning of the said dividend income and had disallowed such interest expenditure and consequently reduced the exemption available under Section 10(33) of the Act to the net dividend. In appeal, the Commissioner of Income Tax (Appeals) allowed exemption of the entire dividend income on the ground that the Assessing Officer had failed to show any nexus between the investments in shares and F units of mutual funds on the one hand and the borrowed funds on the other. The learned Income Tax Appellate Tribunal (hereinafter referred to as "Tribunal") which was moved by the Revenue confirmed the appellate order. The said order had attained finality.

7. For the Assessment Years 1999-2000 and 2001-2002 the issue G with regard to exemption under Section 10(33) of the Act was similarly held in favour of the assessee by the Commissioner of Income Tax (Appeals) and the learned Tribunal, once again. Initially, the Assessing Officer, in both the Assessment Years, had disallowed notionally computed interest expenditure as being relatable to the earning of dividend income. H The said appellate order(s) had also attained finality. For the intervening

Assessment Year 2000-2001 there was no scrutiny of the appellant's return of income. Consequently, the dividend income was allowed in full without disallowing any expenditure incurred in relation to earning such income. However, for the Assessment Year 2002-2003, the Assessing Officer did not allow interest expenditure to the extent of Rs.6,92,06,000/- holding the same to be attributable to earning the dividend income of Rs. 34,34,78,686/-. The said figure of interest expenditure disallowed was worked out from the total interest expenditure for the year on a notional basis in the ratio of the cost of the investments in shares and units of mutual funds to the cost of the total assets appearing in the balance sheet. Though the aforesaid order of the Assessing Officer was reversed by the Commissioner of Income Tax (Appeals) following the earlier orders pertaining to the previous Assessment Years, as noticed above, the learned Tribunal, in appeal, took a different view by its order dated 26th August, 2009. The learned Tribunal held that sub-sections (2) and (3) of Section 14A of the Act (inserted by the Finance Act, 2006 with effect from 1st April, 2007) were retrospectively applicable to the Assessment Year 2002-2003 and, therefore, the matter should be remanded to the Assessing Officer for recording his satisfaction/findings in the light of the said sub-sections of Section 14A of the Act. This was notwithstanding the fact that the only disallowance made by the Assessing Officer which was reversed in appeal by the Commissioner of Income Tax (Appeals) was in respect of interest expenditure what was worked out on a notional basis.

8. The High Court by the impugned judgment dated 12th August, 2010, *inter alia*, held that Section 14A of the Act has to be construed on a plain grammatical construction thereof and the said provision is attracted in respect of dividend income referred to in Section 115-O as such income is not includible in the total income of the shareholder. Sub-sections (2) and (3) of Section 14A of the Act and rule 8D of the Income-tax Rules, 1962 (hereinafter referred to as "the Rules") would, however, not apply to the AY 2002-03 as the said provisions do not have retrospective effect. Notwithstanding the above the High Court upheld the remand as made by the Tribunal to the AO though for a slightly different reason as will be noticed hereinafter. We may also notice that the High Court in its impugned judgment also held that the tax paid under section 115-O of the Act is an additional tax on that component of the profits of the dividend distributing company which is distributed by way of dividends and that the same is not a tax on dividend income of the assessee.

A 9. Aggrieved, the instant appeal has been filed raising two questions in the main which have been summarized by the appellant, and we may say accurately, as follows :

"(a) Irrespective of the factual position and findings in the case of the Appellant, whether the phrase "income which does not form part of total income under this Act" appearing in Section 14A includes within its scope dividend income on shares in respect of which tax is payable under Section 115-O of the Act and income on units of mutual funds on which tax is payable under Section 115-R.

B

C (b) Whatever be the view on the legal aspects, whether on the facts and in the circumstances of the Appellant's case and bearing in mind the unanimous findings of the lower authorities over a considerable period of time (which were accepted by the Revenue) there could at all be any question of the provisions of Section 14A in the appellant's case."

D

10. We have heard Shri Sohrab E. Dastur, learned Senior Counsel appearing for the appellant and Shri Ranjit Kumar, learned Solicitor General appearing for the Revenue.

11. At the very outset, the relevant provisions of the Act which will require a consideration are extracted below:

E

"2. In this Act, unless the context otherwise requires,—

(*22*) "dividend" includes—

(a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;

F

(b) xxx xxx xxx xxx xxx

(c) xxx xxx xxx xxx xxx

G

(d) xxx xxx xxx xxx xxx

(e) xxx xxx xxx xxx xxx

but "dividend" does not include— ....

xxx xxx xxx xxx xxx

H

A

(24) "income" includes—

(i) profits and gains ;

(ii) dividend ;

(iia) ...."

B

xxx xxx xxx xxx xxx

10. Incomes not included in total income.- In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included-

xxx xxx xxx xxx xxx

C

(33) any income by way of-

(i) dividends referred to in section 115-O; or

(ii) income received in respect of units from the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963); or

D

(iii) income received in respect of the units of a mutual fund specified under clause (23D)

Provided that this clause shall not apply to any income arising from transfer of units of the Unit Trust of India or of a mutual fund, as the case may be"

E

xxx xxx xxx xxx xxx

14A. Expenditure incurred in relation to income not includible in total income.-

F

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

G

(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed , if the Assessing Officer, having regard to the accounts of the assessee, is

H

A not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income 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 a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act:

B

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

C

Rule 8D.- (introduced by CBDT Notification No.45/2002 dated 24.03.2008.

D

"Method for determining amount of expenditure in relation to income not includible in total income.

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

E

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

(b) the claim made by the assessee that no expenditure has been incurred, in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

F

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

G

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

(ii) in a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly

H

attributable to any particular income or receipt, an amount computed in accordance with the following formula, namely:- A

$$A \times \frac{B}{C}$$

Where A = amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year; B

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

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

D

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

E

(3) For the purposes of this rule, the 'total assets' shall mean, total assets as appearing in the balance sheet excluding the increase on account of revaluation of assets but including the decrease on account of revaluation of assets."

115-O. Tax on distributed profits of domestic companies.- F

(1) Notwithstanding anything contained in any other provision of this Act and subject to the provisions of this section, in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year, any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise) on or after the 1st day of April, 2003, whether out of current or accumulated profits shall be charged to additional income-tax (hereafter referred to as tax on distributed profits) at the rate of fifteen per cent. G

H

A

(1A) xxx xxx xxx xxx xxx

(1B) xxx xxx xxx xxx xxx

(2) Notwithstanding that no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of this Act, the tax on distributed profits under sub-section (1) shall be payable by such company.

B

(3) The principal officer of the domestic company and the company shall be liable to pay the tax on distributed profits to the credit of the Central Government within fourteen days from the date of—

C

(*a*) declaration of any dividend; or

(*b*) distribution of any dividend; or

(*c*) payment of any dividend,

D

whichever is earliest.

(4) The tax on distributed profits so paid by the company shall be treated as the final payment of tax in respect of the amount declared, distributed or paid as dividends and no further credit therefor shall be claimed by the company or by any other person in respect of the amount of tax so paid.

E

(5) No deduction under any other provision of this Act shall be allowed to the company or a shareholder in respect of the amount which has been charged to tax under sub-section (1) or the tax thereon.

F

(6) xxx xxx xxx xxx xxx

(7) xxx xxx xxx xxx xxx

(8) xxx xxx xxx xxx xxx"

xxx xxx xxx xxx xxx xxx

G

"115R. Tax on distributed income to unit holders.- (1) Notwithstanding anything contained in any other provisions of this Act and section 32 of the Unit Trust of India Act, 1963 (52 of 1963), any amount of income distributed on or before the 31st day of March, 2002 by the Unit Trust of India to its unit holders

H

shall be chargeable to tax and the Unit Trust of India shall be liable to pay additional income-tax on such distributed income at the rate of ten per cent: A

Provided that nothing contained in this sub-section shall apply in respect of any income distributed to a unit holder of open-ended equity oriented funds in respect of any distribution made from such fund for a period of three years commencing from the 1st day of April, 1999. B

(2) Notwithstanding anything contained in any other provision of this Act, any amount of income distributed by the specified company or a Mutual Fund to its unit holders shall be chargeable to tax and such specified company or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the rate of— C

(*i*) xxx xxx xxx xxx xxx

(*ii*) xxx xxx xxx xxx xxx D

(*iii*) xxx xxx xxx xxx xxx

xxx xxx xxx xxx xxx xxx xxx

12. Shri Sohrab E. Dastur, learned Senior Counsel appearing for the appellant has argued that Section 14A of the Act pertains to disallowance of expenditure relatable to an item of income on which tax has not been paid. According to the learned counsel, Section 14A applies only in situations where income is tax free; non-taxable and there is no incidence of tax *per se*. Dividend on shares is subjected to tax under Section 115-O of the Act whereas returns of units or mutual funds is subjected to tax under Section 115R. The fact that the tax on such dividend is paid by the dividend paying company and not by the recipient of the dividends, according to the learned counsel, is of no consequence. Proceeding further, Shri Dastur has argued that under Section 10(33) of the Act, income by way of dividend referred to in Section 115-O of the Act or income received in respect of units from the UTI or of mutual funds alone is exempted. It is only one specie of dividend income which is exempted under Section 10(33) of the Act whereas other species of such (dividend) income, say for example, dividend from foreign companies is still liable to tax. As tax has already been paid on such dividend, though by the dividend paying company, Section 14A will not apply to E F G H

A exclude expenditure incurred to earn such dividend income as the said income, really, is not tax-free.

13. Shri Dastur has further argued that there is a discernible correlation between Section 10(33) and Section 115-O of the Act inasmuch as both the Sections were inserted in the Act by the Finance B Act, 1997. When the earlier status was restored by the Finance Act, 2002 shareholders once again became liable for tax on dividends which position continued until the provisions of Section 10(33) of the Act [engrafted as Section 10(34)] and Section 115-O were reintroduced by the Finance Act, 2003 with effect from 1st April, 2003. It is, therefore, C argued that both the Sections 10(33) and Section 115-O of the Act constitute a composite scheme for taxation of dividend income wherein the legislative policy is clear that dividend, though to be taxed in the hands of the company distributing the same, is not to be included in the total income of the recipient Assessee. The mere fact that the amount is not to be included in the total income of the recipient Assessee, would D not attract the provisions of Section 14A of the Act, inasmuch as the cardinal test is whether the dividend income is tax-free or not. The person paying the tax, according to the learned counsel, is not relevant for the aforesaid purpose.

14. Shri Dastur has also urged that the above position has been E accepted by the Revenue in its counter affidavit wherein it has been admitted that the exemption granted under Section 10(33) is consequent upon collection of tax on dividend income from the dividend distributing company under Section 115-O of the Act. It is, therefore, argued by Shri Dastur that a literal interpretation of Section 14A must be avoided. Reference in this regard is made to the case of _K.P. Varghese_ vs. F _Income-Tax Officer, Ernakulam and Anr._[1]. It is specifically contended by Shri Dastur that tax on the dividend paid is not a tax on profits out of which dividend is distributed inasmuch as under Section 115-O of the Act dividend can be paid either from accumulated profits or current profits. In-fact, Section 205 of the Companies Act permits payment of G dividend out of accumulated profits in the year though the company may have incurred losses. Furthermore, it is contended that the dividend paying company would be charged to tax under Section 115-O of the Act even in a case where no tax is payable under the regular provisions of the Act because its entire income, say, is otherwise eligible for

H [1] (1981) 131 ITR 597 (SC)

deductions. In other words, tax under Section 115-O of the Act is payable by the dividend paying company even when no tax is payable on the income of such company under the regular provisions of the Act. A

15. On the other hand, the learned Solicitor General of India, who has argued the case on behalf of the Revenue has laid before the Court the position of law prior to insertion of Section 14A of the Act by the Finance Act of 2001. According to the learned Solicitor General, the insertion of Section 14A in the Act was to offset several judicial pronouncements holding that in case of an assessee earning income which is both includible and non-includible in the total income, the entire expenses would be permissible as deduction, including, expenses pertaining to income not includible in the total income. The learned Solicitor General has drawn the attention of the Court to the Memorandum explaining the provisions of the Finance Bill, 2001 which is to the following effect. B C

> "Certain incomes which are not includible while computing the total income as these are exempt under various provisions of the Act. There have been cases where deductions have been claimed in respect of such exempt income. This in effect means that the tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income. This is against the basic principles of taxation whereby only the net income, that is, gross income minus the expenditure, is taxed. On the same analogy, the exemption is also in respect of the net income. Expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income. Therefore, it is proposed to insert a new section 14A so as to clarify the intention of the Legislature since the inception of the Income-tax Act, 1961, that no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income under the Income-tax Act." D E F G

16. The position is made clear by Circular No. 14 issued by the C.B.D.T. explaining the said purpose of the Finance Act, 2001. The said Circular has also been placed before the Court by the learned Solicitor General. H

A 17. The learned Solicitor General has also traced the history of the Amendments to Section 14A of the Act and, in particular, to the insertion of sub-sections (2) and (3) thereof by the Finance Act of 2006. The purpose of insertion of sub-sections (2) and (3), as explained in the Memorandum explaining the provisions of the Finance Bill 2006, has also been relied upon by the learned Solicitor General, who contends B that from the said Memorandum it is clear that sub-sections (2) and (3) had been introduced as the existing provisions of Section 14A did not provide any method of computation of expenditure incurred to earn an income which does not form a part of the total income. It is, therefore, urged by the learned Solicitor General that the legislative intent behind C enactment of Section 14A and sub-sections (2) and (3) thereof was to combat situations where tax incentives given by way of non-inclusion of different categories of income under the head "Income which do not form part of the total Income" was actually used to reduce the tax payable on the total income.

D 18. The Scheme of the Income Tax Act, 1961 has been sought to be explained by the learned Solicitor General to contend that Section 14 of the Act provides for five heads of income i.e. 'Income from Salaries'; 'Income from House Property'; 'Income from Profits & Gains of Business or Profession'; 'Income from Capital Gains'; and 'Income from Other Sources'. It is contended that even though Income from E dividend falls under the head "Income from Other Sources" specifically provided for under Section 56 of the Act, dividend income referred to in Section 115-O of the Act is excluded from the provisions of deductions contained in Section 57 inasmuch as such income does not form a part of the total income in view of Section 10(33) of the Act. The learned F Solicitor General has argued that Section 14A reiterates a fundamental principle enshrined by the Act that expenses are allowable only to the extent that they have a nexus to the earning of taxable income or income which forms a part of the total income.

19. Reliance in this regard is placed on the decision of this Court G in _C.I.T._ vs. _Walfort Share & Stock Brokers P. Ltd._[2] which decision, according to the learned Solicitor General, virtually decides the issues arising in the present case.

20. Referring to Section 115-O of the Act, the learned Solicitor General had submitted that the said section levies an additional income

H [2] (2010) 326 ITR 1 (SC)

tax on the profits of a company which has been declared and distributed to its shareholders in the form of dividend. No credit of such additional income tax paid by the company is available either to the company or the shareholders [Section 115-O(4)]. Such additional income tax paid by the company does not also enure to the benefit of the shareholders receiving the amount of dividend distributed by such company. The amount of such dividend does not form part of tax paid dividend in the hands of the shareholders. In fact, pointing to the provisions of Section 115-O(5) it is argued that under the said provisions a shareholder cannot claim deduction in respect of the dividend received by it/him from a dividend paying company on which tax has been paid by the said company under Section 115-O(1) of the Act. This, according to the learned Solicitor General, makes the intent of Section 14 crystal clear. The liability to pay tax under Section 115-O in respect of the dividend is on the dividend paying company and the shareholder/assessee has no connection with the same. Such an assessee is not required to include the dividend amount in his/its total income for the purposes of charge to tax. In such a situation, the expenditure incurred for earning the said income cannot be allowed.

21. There is a supplemental argument made by the learned Solicitor General based on the provisions of Sections 194, 195, 196C and 199 contained in Chapter XVII of the Act which deals with "Collection and Recovery of Tax" including tax on dividend income received by a shareholder. It may be convenient, to appreciate what has been argued, to notice what the aforesaid provisions of the Act actually say.

> 194. Dividends. The principal officer of an Indian company or a company which has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India, shall, before making any payment in cash or before issuing any cheque or warrant in respect of any dividend or before making any distribution or payment to a shareholder, who is resident in India, of any dividend within the meaning of sub-clause (*a*) or sub-clause (*b*) or sub-clause (*c*) or sub-clause (*d*) or sub-clause (*e*) of clause (*22*) of section 2, deduct from the amount of such dividend, income-tax at the rates in force :
>
> Provided that no such deduction shall be made in the case of a shareholder, being an individual, if—

A

(*a*) xxx xxx xxx xxx xxx

(*b*) xxx xxx xxx xxx xxx

Provided further that the provisions of this section shall not apply to such income credited or paid to—

B

(*a*) xxx xxx xxx xxx xxx

(*b*) xxx xxx xxx xxx xxx

(*c*) xxx xxx xxx xxx xxx

Provided also that no such deduction shall be made in respect of any dividends referred to in Section 115-O."

C

xxx xxx xxx xxx xxx xxx

195.Other sums.- (1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force :

D

E

Provided that ....

Provided further that no such deduction shall be made in respect of any dividends referred to in section 115-O.

F

xxx xxx xxx xxx xxx xxx

196C. Income from foreign currency bonds or shares of Indian company.-

Where any income by way of interest or dividends in respect of bonds or Global Depository Receipts referred to in section 115AC or by way of long-term capital gains arising from the transfer of such bonds or Global Depository Receipts is payable to a non-resident, the person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other

G

H

mode, whichever is earlier, deduct income-tax thereon at the rate of ten per cent : A

Provided that no such deduction shall be made in respect of any dividends referred to in section 115-O."

199. Credit for tax deducted.- (1) Any deduction made in accordance with the foregoing provisions of this Chapter and paid to the Central Government shall be treated as a payment of tax on behalf of the person from whose income the deduction was made, or of the owner of the security, or of the depositor or of the owner of property or of the unit-holder, or of the shareholder, as the case may be. B C

(2) Any sum referred to in sub-section (1A) of section 192 and paid to the Central Government shall be treated as the tax paid on behalf of the person in respect of whose income such payment of tax has been made.

(3) The Board may, for the purposes of giving credit in respect of tax deducted or tax paid in terms of the provisions of this Chapter, make such rules as may be necessary, including the rules for the purposes of giving credit to a person other than those referred to in sub-section (1) and sub-section (2) and also the assessment year for which such credit may be given. D E

22. All the said provisions, noticeably, exclude dividend received under Section 115-O. As the provisions of the aforesaid Sections of the Act contemplate deduction of tax payable by the shareholder on the dividend income, however, to the exception of dividend income under Section 115-O, it is submitted by the learned Solicitor General that it is crystal clear that the additional income tax paid under Section 115-O by the dividend paying company cannot assume the character of tax paid on dividend income by the assessee shareholder. The position, according to the learned Solicitor General, is further fortified by the provisions of Section 115-O(4), reference to which has already been made earlier. Specific reference is made to Section 199 of the Act which provides for credit to be given for the tax deducted at source on dividend paid. If the tax paid on dividend under Section 115-O is on income earned by the shareholder, Section 199 would have also provided for deduction of tax at source in respect of the dividends paid under Section 115-O of the Act to the assessee, it is contended. F G

H

A 23. Insofar as the second issue arising in the case is concerned, namely, the appellate orders of the learned Tribunal for the Assessment Years 1998-1999, 1999-2000 and 2001-2002 granting the benefit of full deduction on interest expenditure, it is submitted by the learned Solicitor General that each assessment year has to be reckoned separately; there is no estoppel and, furthermore, sub-sections (2) and (3) of Section 14A B having been introduced by the Finance Act of 2006, the Tribunal and the High Court was fully justified in remanding the matter to the Assessing Officer for a *de novo* consideration in the light of the provisions contained in sub-sections (2) and (3) of Section 14A of the Act.

24. The object behind the introduction of Section 14A of the Act C by the Finance Act of 2001 is clear and unambiguous. The legislature intended to check the claim of allowance of expenditure incurred towards earning exempted income in a situation where an assessee has both exempted and non-exempted income or includible or non-includible income. While there can be no scintilla of doubt that if the income in D question is taxable and, therefore, includible in the total income, the deduction of expenses incurred in relation to such an income must be allowed, such deduction would not be permissible merely on the ground that the tax on the dividend received by the assessee has been paid by the dividend paying company and not by the recipient assessee, when under Section 10(33) of the Act such income by way of dividend is not E a part of the total income of the recipient assessee. A plain reading of Section 14A would go to show that the income must not be includible in the total income of the assessee. Once the said condition is satisfied, the expenditure incurred in earning the said income cannot be allowed to be deducted. The section does not contemplate a situation where even though F the income is taxable in the hands of the dividend paying company the same to be treated as not includible in the total income of the recipient assessee, yet, the expenditure incurred to earn that income must be allowed on the basis that no tax on such income has been paid by the assessee. Such a meaning, if ascribed to Section 14A, would be plainly beyond what the language of Section 14A can be understood to G reasonably convey.

25. The reliance placed by the Assessee on K.P. Varghese (supra) may now be considered. In K.P. Varghese (supra) the interpretation of sub-section (2) of Section 52 of the Income Tax Act, 1961 (as it then in force), which is in the following terms, came up for consideration before H this Court.

"Consideration for transfer in cases of under-statement. A

52 (1) Where the person who acquires a capital asset from an assessee is directly or indirectly connected with the assessee and the Income-tax Officer has reason to believe that the transfer was effected with the object of avoidance or reduction of the liability of the assessee under Section 45, the full value of the B consideration for the transfer shall, with the previous approval of the Inspecting Assistant Commissioner, be taken to be the fair market value of the capital asset on the date of the transfer.

(2) without prejudice to the provisions of Sub-section (1), if in the opinion of the Income-tax Officer the fair market value of a C capital asset transferred by an assessee as on the date of the transfer exceeds the full value of the consideration declared by the assessee in respect of the transfer of such capital assets by an amount of not less than fifteen per cent of the value declared, the full value of the consideration for such capital asset shall, with the previous approval of the Inspecting Assistant D Commissioner, be taken to be its fair market value on the date of its transfer.

Provided that....."

26. On behalf of the Assessee, it was contended that a literal E construction of Section 52(2) of the Act, as quoted above, could lead to a manifestly unreasonable and absurd consequence. Such consequence as urged by the Assessee was appreciated by the Court by taking the illustration of the price in a sale agreement of immovable property as on the date of the agreement and the market price thereof as on the date of the sale which could be at a later point of time. If Section 52(2) were to F be interpreted literally, the Assessee would be required to pay tax on capital gains which had not occurred to him. It was, therefore, held:

"It is difficult to conceive of any rational reason why the Legislature should have thought it fit to impose liability to tax on an assessee who is bound by law to carry out his contractual G obligation to sell the property at the agreed price and honestly carries out such contractual obligation. It would indeed be strange if obedience to the law should attract the levy of tax on income which has neither arisen to the assessee nor has been received by him." H

A Accordingly, it was held that:

> "where the plain literal interpretation of a statutory provision produces a manifestly absurd and unjust result which could never have been intended by the Legislature, the court may modify the language used by the Legislature or even "do some violence" to it, so as to achieve the obvious intention of the Legislature and produce a rational construction: Vide Luke v. IRC [1963] AC 557; [1964] 54 ITR 692.

B

27. We do not see how the aforesaid principle of law in K.P. Varghese (supra) can assist the Assessee in the present case. The literal meaning of Section 14A, far from giving rise to any absurdity, appears to be wholly consistent with the scheme of the Act and the object/purpose of levy of tax on income. Therefore, the well entrenched principle of interpretation that where the words of the statute are clear and unambiguous recourse cannot be had to principles of interpretation other than the literal view will apply. In this regard, the view expressed by this Court in Commissioner of Income Tax-III vs. Calcutta Knitwears, Ludhiana[3] may be usefully noticed below:

C

D

> "the language of a taxing statute should ordinarily be read and understood in the sense in which it is harmonious with the object of the statute to effectuate the legislative animation. A taxing statute should be strictly construed; common sense approach, equity, logic, ethics and morality have no role to play. Nothing is to be read in, nothing is to be implied; one can only look fairly at the language used and nothing more and nothing less.

E

28. A similar view is to be found in Commissioner of Income-Tax vs. Tara Agencies[4] wherein this Court had concluded that:

F

> "Therefore, the legal position seems to be clear and consistent that it is the bounden duty and obligation of the court to interpret the statute as it is. It is contrary to all rules of construction to read words into a statute which the legislature in its wisdom has deliberately not incorporated." (para 69)

G

29. The off-quoted observations of Rowlatt,J. in the case of Cape Brandy Syndicate vs. IRC[5] may also be noticed at this juncture. On the question arising the learned Judge had observed (page 71) that:

[3] (2014) 6 SCC 444 (para 31)

[4] (2007) 292 ITR 444(SC) [At Page 464]

H [5] [1921] 1 KB 64

> "...in a taxing statute one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly on the language used."

30. While it is correct that Section 10(33) exempts only dividend income under Section 115-O of the Act and there are other species of dividend income on which tax is levied under the Act, we do not see how the said position in law would assist the assessee in understanding the provisions of Section 14A in the manner indicated. What is required to be construed is the provisions of Section 10(33) read in the light of Section 115-O of the Act. So far as the species of dividend income on which tax is payable under Section 115-O of the Act is concerned, the earning of the said dividend is tax free in the hands of the assessee and not includible in the total income of the said assessee. If that is so, we do not see how the operation of Section 14A of the Act to such dividend income can be foreclosed. The fact that Section 10(33) and Section 115-O of the Act were brought in together; deleted and reintroduced later in a composite manner, also, does not assist the assessee. Rather, the aforesaid facts would countenance a situation that so long as the dividend income is taxable in the hands of the dividend paying company, the same is not includible in the total income of the recipient assessee. At such point of time when the said position was reversed (by the Finance Act of 2002; reintroduced again by the Finance Act, 2003), it was the assessee who was liable to pay tax on such dividend income. In such a situation the assessee was entitled under Section 57 of the Act to claim the benefit of exemption of expenditure incurred to earn such income. Once Section 10(33) and 115-O was reintroduced the position was reversed. The above, actually fortifies the situation that Section 14A of the Act would operate to disallow deduction of all expenditure incurred in earning the dividend income under Section 115-O which is not includible in the total income of the assessee.

31. So far as the provisions of Section 115-O of the Act are concerned, even if it is assumed that the additional income tax under the aforesaid provision is on the dividend and not on the distributed profits of the dividend paying company, no material difference to the applicability of Section 14A would arise. Sub-sections (4) and (5) of Section 115-O of the Act makes it very clear that the further benefit of such payments

A cannot be claimed either by the dividend paying company or by the recipient assessee. The provisions of Sections 194, 195, 196C and 199 of the Act, quoted above, would further fortify the fact that the dividend income under Section 115-O of the Act is a special category of income which has been treated differently by the Act making the same non-includible in the total income of the recipient assessee as tax thereon B had already been paid by the dividend distributing company. The other species of dividend income which attracts levy of income tax at the hands of the recipient assessee has been treated differently and made liable to tax under the aforesaid provisions of the Act. In fact, if the argument is that tax paid by the dividend paying company under Section C 115-O is to be understood to be on behalf of the recipient assessee, the provisions of Section 57 should enable the assessee to claim deduction of expenditure incurred to earn the income on which such tax is paid. Such a position in law would be wholly incongruous in view of Section 10(33) of the Act.

D 32. A brief reference to the decision of this Court in Commissioner of Income-Tax vs. Walfort Share and Stock Brokers P. Ltd. (supra) may now be made, if only, to make the discussion complete. In Walfort Share and Stock Brokers P. Ltd.(supra) the issue involved was: "*whether in a dividend stripping transaction the loss on sale of units could be considered as expenditure in relation to earning of* E *dividend income exempt under Section 10(33), disallowable under Section 14A of the Act?*"

33. While answering the said question this Court considered the object of insertion of Section 14A in the Income Tax Act by Finance Act, 2001, details of which have already been noticed. Noticing the F objects and reasons behind introduction of Section 14A of the Act this Court held that:

> "Expenses allowed can only be in respect of earning of taxable income."

In paragraph 17, this Court went on to observe that:

G

> "Therefore, one needs to read the words "expenditure incurred" in section 14A in the context of the scheme of the Act and, if so read, it is clear that it disallows certain expenditure incurred to earn exempt income from being deducted from other income which is includible in the "total income" for the purpose of chargeability to tax."

H

The views expressed in _Walfort Share and Stock Brokers P. Ltd._ (supra), in our considered opinion, yet again militate against the plea urged on behalf of the Assessee. A

34. For the aforesaid reasons, the first question formulated in the appeal has to be answered against the appellant-assessee by holding that Section 14A of the Act would apply to dividend income on which tax is payable under Section 115-O of the Act. B

35. We may now deal with the second question arising in the case.

36. Section 14A as originally enacted by the Finance Act of 2001 with effect from 1.4.1962 is in the same form and language as currently appearing in sub-section (1) of Section 14A of the Act. Sections 14A(2) and (3) of the Act were introduced by the Finance Act of 2006 with effect from 1.4.2007. The finding of the Bombay High Court in the impugned order that sub-sections (2) and (3) of Section 14A is retrospective has been challenged by the Revenue in another appeal which is presently pending before this Court. The said question, therefore, need not and cannot be gone into. Nevertheless, irrespective of the aforesaid question, what cannot be denied is that the requirement for attracting the provisions of Section 14A(1) of the Act is proof of the fact that the expenditure sought to be disallowed/deducted had actually been incurred in earning the dividend income. Insofar as the appellant-assessee is concerned, the issues stand concluded in its favour in respect of the Assessment Years 1998-1999, 1999-2000 and 2001-2002. Earlier to the introduction of sub-sections (2) and (3) of Section 14A of the Act, such a determination was required to be made by the Assessing Officer in his best judgment. In all the aforesaid assessment years referred to above it was held that the Revenue had failed to establish any nexus between the expenditure disallowed and the earning of the dividend income in question. In the appeals arising out of the assessments made for some of the assessment years the aforesaid question was specifically looked into from the standpoint of the requirements of the provisions of sub-sections (2) and (3) of Section 14A of the Act which had by then been brought into force. It is on such consideration that findings have been recorded that the expenditure in question bore no relation to the earning of the dividend income and hence the assessee was entitled to the benefit of full exemption claimed on account of dividend income. C D E F G

37. We do not see how in the aforesaid fact situation a different view could have been taken for the Assessment Year 2002-2003. H

A Sub-sections (2) and (3) of Section 14A of the Act read with Rule 8D of the Rules merely prescribe a formula for determination of expenditure incurred in relation to income which does not form part of the total income under the Act in a situation where the Assessing Officer is not satisfied with the claim of the assessee. Whether such determination is to be made on application of the formula prescribed under Rule 8D or in the B best judgment of the Assessing Officer, what the law postulates is the requirement of a satisfaction in the Assessing Officer that having regard to the accounts of the assessee, as placed before him, it is not possible to generate the requisite satisfaction with regard to the correctness of the claim of the assessee. It is only thereafter that the provisions of Section C 14A(2) and (3) read with Rule 8D of the Rules or a best judgment determination, as earlier prevailing, would become applicable.

38. In the present case. we do not find any mention of the reasons which had prevailed upon the Assessing Officer, while dealing with the Assessment Year 2002-2003, to hold that the claims of the Assessee D that no expenditure was incurred to earn the dividend income cannot be accepted and why the orders of the Tribunal for the earlier Assessment Years were not acceptable to the Assessing Officer, particularly, in the absence of any new fact or change of circumstances. Neither any basis has been disclosed establishing a reasonable nexus between the expenditure disallowed and the dividend income received. That any E part of the borrowings of the assessee had been diverted to earn tax free income despite the availability of surplus or interest free funds available (Rs. 270.51 crores as on 1.4.2001 and Rs. 280.64 crores as on 31.3.2002) remains unproved by any material whatsoever. While it is true that the principle of *res judicata* would not apply to assessment F proceedings under the Act, the need for consistency and certainty and existence of strong and compelling reasons for a departure from a settled position has to be spelt out which conspicuously is absent in the present case. In this regard we may remind ourselves of what has been observed by this Court in Radhasoami Satsang vs. Commissioner of Income-Tax[6].

G

> "We are aware of the fact that strictly speaking res judicata does not apply to income tax proceedings. Again, each assessment year being a unit, what is decided in one year may not apply in the following year but where a fundamental aspect permeating

H [6] (1992) 193 ITR (SC) 321 [At Page 329]

through the different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be at all appropriate to allow the position to be changed in a subsequent year." A

39. In the above circumstances, we are of the view that the second question formulated must go in favour of the assessee and it must be held that for the Assessment Year in question i.e. 2002-2003, the assessee is entitled to the full benefit of the claim of dividend income without any deductions. B

40. Consequently, the appeal is allowed and the order of the High Court is set aside subject to our conclusions, as above, on the applicability of Section 14A with regard to dividend income on which tax is paid under Section 115-O of the Act. C

Nidhi Jain Appeal allowed.