



## The Bombay High Court's decision on Section 14A of the Income-tax Act and the binding precedent

### Background

Recently, the Bombay High Court, in the case of HDFC Bank Ltd.<sup>1</sup> (the taxpayer) dealt with the issue of disallowance under Section 14A of the Income-tax Act, 1961 (the Act) of interest paid on borrowed funds in respect of investments made in tax-free securities when the taxpayer had owned funds in excess of investments. The High Court referred to the taxpayer's case of earlier years and observed that the presumption with regard to investment in tax-free securities coming out of the taxpayer's own funds, in case the same are in excess of the investments made in the securities, applies to Section 14A of the Act.

The High Court observed that the Mumbai Tribunal is bound to follow the jurisdictional High Court decision on the issue which was concluded in the taxpayer's own case for earlier years. The decision in the case of Godrej and Boyce Manufacturing Co. Ltd.<sup>2</sup> is not a precedent for the issue in the instant case and could not be relied upon to disregard the binding decision in the case of the taxpayer's own case for the earlier year. The decision of the High Court is binding upon all authorities and Tribunals functioning within the state.

<sup>1</sup> HDFC Bank Ltd. Mumbai v. DCIT [Writ Petition no. 1753 of 2016] (Bom)

<sup>2</sup> Godrej and Boyce Manufacturing Co. Ltd. v. DCIT [2010] 328 ITR 81 (Bom)

### Facts of the case

- The taxpayer filed its return of income for the Assessment Year (AY) 2008-09, *inter alia*, declaring a tax-exempt income from investments in securities. These investments were treated by the taxpayer as stock-in-trade.
- During the relevant year, the taxpayer paid interest on borrowed funds and claimed the same as expenditure. However, the taxpayer did not disallow any expenditure on the income earned on tax-free securities, on the ground that such investments were made out of its own funds.
- The Assessing Officer (AO) held that the taxpayer was not able to provide evidence that the investments made in tax-free securities came out of its interest-free funds and invoked Section 14A of the Act read with Rule 8D of the Income-tax Rules, 1962 (the Rules) to disallow an amount on account of interest and other expenditure.
- The Commissioner of Income Tax (Appeals) [CIT(A)] upheld the order of the AO.
- The Tribunal did not accept the taxpayer's appeal. It disregarded the binding decision of the Bombay High Court in the case of HDFC Bank Ltd. (taxpayer's own case) and held that an earlier decision of the court in the case of

Godrej and Boyce Manufacturing Co. Ltd. was not brought to notice. The Tribunal observed that the decision of Godrej and Boyce Manufacturing Ltd. would not hold the field.

- The taxpayer relied on the decision of India Advantage Securities Ltd.<sup>3</sup> and contended that no disallowance under Section 14A of the Act shall be made as investment was held as stock in trade. The Tribunal observed that since the Bombay High Court did not entertain the appeal against the said decision, the same could not apply.
- The taxpayer filed a writ petition under Articles 226 and 227 of the Constitution of India.

## High Court's ruling

### ***Binding precedent***

- The theory of precedent ensures that what has been done earlier would be done subsequently on identical facts. Thus, the doctrine of precedent ensures certainty of law, uniformity of law and fairness meeting some of the essentials ingredients of the rule of law.
- The Bombay High Court referred to the decisions of the Supreme Court in the case of Raghuvir Singh<sup>4</sup> and Dunlop India Ltd.<sup>5</sup> and observed that the principle of doctrine precedent would equally apply to the decisions of the High Court within the state over which it exercises jurisdiction. Thus, the law declared by the decisions of the High Court will be binding upon all authorities and Tribunal functioning within the state.
- A decision would be considered as a binding precedent only if it deals with/decides an issue, which is a subject matter of consideration/decision before a co-ordinate or a subordinate court. It is axiomatic that a

decision cannot be relied upon in support of the proposition that it did not decide<sup>6</sup>. Therefore, it is only the ratio decidendi, i.e. the principle of law that decides the dispute, which can be relied upon as a precedent and not any obiter dictum or casual observations<sup>7</sup>.

- The Tribunal disregarded the binding decision of this court in the taxpayer's own case. The Tribunal after recording that it is conscious that the decision of the Bombay High Court is binding upon it, proceeds on the basis that it had to decide, which of the two decisions rendered, i.e. in Godrej and Boyce and HDFC Bank Ltd. is to be followed. Thereby implying and proceeding on the basis that there is a conflict between these two decisions.
- In the instant case, the issue before the Tribunal was that where interest-free funds are available with a taxpayer, which are more than the investments made in tax-free securities, then a presumption arises that the investments were made from its interest-free funds. However, examination of the decision of this court in the case of Godrej and Boyce Manufacturing Co. Ltd. indicates that that this issue was not decided therein, and no view even as an 'obiter dictum' on the issue was expressed.
- Merely because a decision has been cited before the court, and a reference to that has been made in the order of the court, such as in the case of Godrej and Boyce Manufacturing Co. Ltd., a reference made to Reliance Utilities and Power Ltd.<sup>8</sup>, by itself would not lead to the conclusion that the latter case has been considered, and the opinion on the same has been rendered.
- The test to decide whether or not two decisions are in conflict with each other is first to determine the ratio of both the cases and if the ratio in both the cases is in conflict with each other, then alone, it can be said that the two decisions are in conflict.

<sup>3</sup> CIT v. India Advantages Securities Ltd. (ITA 1131/13) (Mum)

<sup>4</sup> Union of India v. Raghuvir Singh 1989 (2) SCC 754

<sup>5</sup> Collector of Central Excise v. Dunlop India Ltd. [1985] 154 ITR 172 (SC)

<sup>6</sup> Mittal Engineering v. Collector of Central Excise [1997 (1) SCC 203]

<sup>7</sup> Girnar Tea v. State of Maharashtra [2007(7) SCC 555], Shin Estu Chemical Co. Ltd v. Aksh opticfibre Ltd [2005 (7) SCC 234]

<sup>8</sup> CIT v. Reliance Utilities and Power Ltd. [2009] 313 ITR 340 (Bom)

- If such an exercise was done in the present case, the Tribunal would have noted that this court in Godrej and Boyce Manufacturing Co. Ltd. has not decided the issue of applicability of Reliance Utilities and Power Ltd. in as much as it has restored the entire issue to the AO after upholding the constitutional validity of Section 14A of the Act.
- Thus, it cannot be approved that there is conflict in the decisions of this court in the case of Godrej and Boyce Manufacturing Co. Ltd. and HDFC Bank Ltd. The decision in the case of Godrej and Boyce Manufacturing Co. Ltd. is not a precedent for the issue arising before the Tribunal and could not be relied upon in the impugned order of the Tribunal to disregard the binding decision in HDFC Bank Ltd.
- The action of the Tribunal is not within the bounds of its authority, based on the materials placed before it leading to the impugned order, since it failed to follow the binding precedent in the taxpayer's own case.

### ***Disallowance under Section 14A of the Act***

- In the case of Reliance Utilities and Power Ltd, it was concluded that where both interest-free funds and interest bearing funds are available, and the interest-free funds are more than the investments made, the presumption is that the investment in tax-free securities would have been made out of interest-free funds available with the taxpayer. Though, the said decision was rendered in the context of Section 36(1)(iii) of the Act, and it was consciously applied by the High Court while interpreting Section 14A of the Act, in the taxpayer's own case.
- Once the issue is settled by this court in the decision of HDFC Bank Ltd., there is now no need for the taxpayer to establish with evidence that the amounts, which have been invested in tax-free securities, have come out of interest-free funds available with it. This is because once the taxpayer is possessed of interest-free funds sufficient to make an investment in tax-free securities; it is presumed that it has been paid for out of the interest-free funds.

### ***Investment held as stock in trade***

- On the issue of investment held as stock in trade, the taxpayer has relied on the decision of India Advantage Securities Ltd. Since the Bombay High Court did not entertain the appeal against the said order, the tax department argued that the said decision does not lay down any binding proposition of law. The High Court held that when an appeal is not entertained, then the order of the Tribunal holds the field, and the co-ordinate benches of the Tribunal are obliged to follow the same unless there is some difference in the facts or law applicable and the difference in fact and/or law should be reflected in its order taking a different view.

### ***Acceptance of the writ petition***

- The powers under Article 227 of the Constitution of India are exercised, in view of the manner in which the Tribunal order has chosen to disregard and/or circumvent the binding decision of this High Court in respect of the same taxpayer for an earlier assessment year.

This is a case of judicial indiscipline and creating confusion in respect of issues, which stand settled by the decision of this court. Accordingly, the impugned order is set aside in its entirety, and the issue is restored to the Tribunal to decide upon it afresh on its own merits and in accordance with the law. However, the Tribunal would scrupulously follow the decisions rendered by the High Court wherein a view has been taken on identical issues arising before it.

### ***Our comments***

The Bombay High Court in the instant case observed that the presumption that investment in tax-free securities is made from the taxpayer's own funds if the funds are in excess of the securities, applies to Section 14A of the Act. Such a presumption would apply, notwithstanding the fact that the taxpayer concerned may also have taken some funds on interest.

The Tribunal relied on the decision in the case of Godrej & Boyce Manufacturing Co. Ltd. and disallowed the interest expenditure under Section 14A of the Act. The High Court observed that on examination of the decision of Godrej and Boyce Manufacturing Co. Ltd, it indicated that that the issue of the present case was not decided therein, and no view even as an 'obiter dictum' on the issue was expressed. The decision in the case of Godrej and Boyce Manufacturing Co. Ltd. is not a precedent for the issue in the instant case and could not be relied upon to disregard the binding decision in the case of the taxpayer's own case for the earlier year.

The Bombay High Court in this decision dealt with an important principle of 'doctrine of precedent'. The High Court observed that once there is a binding decision of the High Court, the same continues to be binding on all authorities and Tribunal within the state. The binding nature continues until it has stayed and/or set aside by the Supreme Court, or the same High Court takes a different view on an identical factual matrix or a larger bench of this court takes a view different from the one already taken.

The High Court accepted the writ petition and observed that it is not open to the Tribunal to disregard a binding decision of this court in the taxpayer's own case, since the decision in the case of Reliance Utilities and Power Ltd. has been consciously applied by this court while rendering a decision in the context of Section 14A of the Act.

In the case of Suzlon Energy Ltd.<sup>9</sup>, the Gujrat High Court held that where a taxpayer owned interest-free funds and there was no direct nexus between the interest bearing borrowed funds and the investments, no disallowance of interest expenditure could be made under Section 14A of the Act. The Bombay High Court in the case of SBI DHFL Ltd.<sup>10</sup> held that no disallowance under Section 14A of the Act shall be made where investment in tax-free bonds has been made from a common pool of owned and borrowed funds.

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<sup>9</sup> CIT v. Suzlon Energy Ltd. [2013] 354 ITR 630 (Guj)

<sup>10</sup> CIT v. SBI DHFL Ltd. [2015] 376 ITR 296 (Bom)



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