

15 March 2016

## Importance of 'binding nature of judicial precedents' emphasised by High Courts in case of disallowance of interest u/s 14A

### Background

The Bombay High Court, in a recent case of HDFC Bank Ltd.<sup>1</sup> ("the taxpayer"), has taken strict note of the actions of the Tribunal in not following the decision of the Jurisdictional High Court and giving a judgement is strict contrast with the same. The Bombay High Court has in stern language emphasised its authority over the lower courts and held that the decisions of a higher court are binding upon all authorities in the state and it is not open for the Tribunal or any other authority in the state to disregard the same.

### Facts of the case

- The taxpayer, a bank, had earned tax-free income from investment made in certain tax free securities.
- The income tax act requires that expenditures which can be apportioned to earning such tax-free income should be disallowed.
- The Assessing Officer has applied calculated interest expenses that could be appropriated for earning such tax-free income and has disallowed the same.
- The taxpayer had *suo-moto* not disallowed any interest on the presumption that the interest free funds available with the taxpayer were more than the investments made in such tax-

free securities. Hence, it must be assumed that such investments were made out of interest-free funds and not borrowed funds.

- The above argument of the taxpayer had been upheld by the Bombay High Court in the taxpayer's own case<sup>2</sup> for a previous year.
- The Tribunal chose not to follow the principles laid down by the High Court in the taxpayer's own case and upheld the disallowance of interest expenditure by relying on the decision of the High Court in a case of another assessee<sup>3</sup> by holding that there was a conflict between the two decisions of the High Court.

### Taxpayer's contentions

- The taxpayer filed a petition under Article 226 and Article 227 of the Constitution of India contending that the Tribunal has exceeded its authority by disregarding the binding decision of the High Court.
- The taxpayer contended that there was no conflict between the decisions of the High Court and the decision in the taxpayer's own case ought to be followed.

### Department's contentions

- The department contended that the taxpayer had a remedy to approach the High Court under the provisions of the Income Tax Act,

<sup>1</sup> HDFC Bank Ltd. vs DCIT (Writ Petition No 1753 of 2016)

<sup>2</sup> CIT vs HDFC Bank Ltd. (366 ITR 505) (Bom)

<sup>3</sup> Godrej and Boyce Manufacturing Co. Ltd. vs DCIT (328 ITR 81)

1961 and hence the High Court should not exercise extraordinary jurisdiction under the said petition.

- Further, on merits, the department contended that the taxpayer had not proved this contention before the Assessing Officer and the First Appellate Authority i.e. Commissioner of Income Tax (Appeals) and hence the decision of the High Court in the taxpayer's own case cannot be said to be applicable.

### High Court's ruling

- At the outset, the High Court relied on several judgements to emphasise that the 'theory of precedents' and the 'hierarchical system' are inherent parts of our judicial system.
- Further, the High Court held that the decision in the case of the Godrej and Boyce had not discussed the specific issue which was raised in the present case.
- The test of presumption that the tax-free securities have been made from available interest-free funds has been decided by the High Court for the first time in the case of the taxpayer.
- The High Court has taking strict note of the judicial indiscipline on part of the Tribunal commented that the 'doctrine of precedents' must be strictly followed and such judicial indiscipline will lead to complete chaos and anarchy in the administrative law.

### Our comments

- There have been several judgements in the past which have emphasised the importance of maintaining the 'hierarchy of courts' and the law of 'judicial precedents' provided in the Constitution of India. Hence, the present case of judicial indiscipline was a matter of grave concern as the decision of the Tribunal was

made in complete understanding of available judicial precedents and their binding nature.

- Further, even on the Tribunal's argument that there were conflicting decisions of the High Court in the said matter, there are several judicial precedents available to emphasise that in case there are two possible views on a subject, the view favourable to the taxpayer must be adopted.
- Also, this decision lays to rest all debate on the merits of the case i.e. whether the presumption can be made that the tax-free securities are made from interest-free funds in cases where the source of investment in these securities cannot be perfectly substantiated.
- The understanding that the tax-free securities should be presumed to be made from interest-free funds is a practical understanding of the issue by the High Court as businessmen would in normal circumstances not make investments out of borrowed funds if they have sufficient .