

IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

INCOME TAX APPEAL No.66 of 2014 (O&M)

RESERVED ON : 03.03.2015

DATE OF DECISION: 18.03.2015

Sh. Subhash Chander Malik

....Appellant

versus

Deputy Commissioner of Income Tax Circle (I) Chandigarh

.....Respondent

**CORAM:- HON'BLE MR.JUSTICE S.J.VAZIFDAR, ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE G.S. SANDHAWALIA**

Present: Mr. Sandeep Goyal, Advocate for the appellant

Ms. Urvashi Dhugga, Advocate for the respondent

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S.J. VAZIFDAR, ACTING CHIEF JUSTICE:

This is an appeal against the orders of the Income Tax Appellate Tribunal dated 17.02.2012 and 21.06.2013 in ITA No.1107/CHD/2010 and MA No.61/CHD/2012, respectively, in respect of Assessment Year 2007-08. The Tribunal dismissed the appellant's appeal against the order of the CIT (Appeals) dated 17.06.2010. By the second order dated 21.06.2013, impugned in this appeal, the Tribunal dismissed a miscellaneous application taken out by the appellant on the ground that the revised grounds of appeal had not been considered.

2. The appellant has raised the following questions of law:-

"(i) Whether on the facts and circumstances of the case, the Id. ITAT was justified in upholding

the disallowance of Rs.16.00 lacs paid as commission to the persons covered under Section 40A(2)(b) ignoring the fact that the persons to whom commission had been paid are income tax assessee paying tax in the highest tax bracket?

- (ii) Whether on the facts and circumstances of the case, the Ld. ITAT was justified in upholding the order of the AO in disallowing the commission merely on the basis of surmises and conjectures even though the commission had been paid and the TDS had been deducted on such commission?
- (iii) Whether on the facts and circumstances of the case, the Ld. Tribunal was justified in upholding the disallowance of Rs.10,50,806/- on account of rent paid ignoring the fact that addition in space during the year in question and also the evidence produced with regard to the prevalent market rate of rent in the vicinity?
- (iv) Whether the Ld. AO was justified in disallowing the entire rent paid in excess of rent paid during the last year ignoring the addition of 2 floors which were used for the shop which would attract the rental income as per the market rate?
- (v) Whether on the facts and circumstances of the case, the Ld. AO was justified in disallowing the rent and the commission paid to the family members on the basis of Section 37 even though such expenses are specified under Section 36 and therefore provisions of Section 37 are not applicable in such a scenario."

The appeal is admitted on the first two questions being substantial questions of law.

Re: questions No.(i) and (ii)

3. During the relevant assessment year, the appellant had paid commission up to 5% aggregating to Rs.16 lacs to his son,

daughter and daughters-in-law. The recipients are persons referred to in Section 40A(2) (a) and (b). Section 40A in so far as it is relevant reads as under:-

"Expenses or payments not deductible in certain circumstances.

.....

(2)(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and the Assessing officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction:

Provided that no disallowance, on account of any expenditure being excessive or unreasonable having regard to the fair market value, shall be made in respect of a specified domestic transaction referred to in section 92BA, if such transaction is at arm's length price as defined in clause(ii) of section 92F.

(b) The persons referred to in clause (a) are the following, namely-

(i) Where the assessee is an individual	any relative of the assessee;
.....	"

The Assessing Officer called upon the assessee to explain the basis on which the commission was paid including the nature of services rendered by the persons in respect whereof the commission was paid.

4. These persons had also been paid salaries and rent during the relevant period. Further, the payments were made allegedly as commission on the last day of the accounting year in question, namely, 31.03.2009. In other words, the commission was not paid on a regular basis during the year. The salaries of

these persons had also increased during the relevant period which had also been paid on the last day of the financial year.

Admittedly, there was no agreement in writing between the appellant and the said persons regarding the payment of commission. The details of the services rendered by these persons were not furnished. There was no explanation for the payment of the commission only on the last day of the relevant year.

5. In view of these facts, the Assessing Officer's finding that the alleged commission was not an expenditure incurred by the appellant wholly and exclusively for the purposes of the business as per the provisions of Section 37 of the Act cannot be faulted. It is an inference which can reasonably and legitimately be drawn. The Assessing Officer accordingly justifiably disallowed the expenditure of Rs.16 lacs and added the same to the assessed income. He also initiated penalty proceedings under Section 271(1) (c) of the Act.

6. The CIT (Appeals) observed that the appellant had failed to establish the nature of the services provided by the said persons to whom the commission had been paid. He also held that the nature of the business of the appellant is not commensurate with such payments as in this line of business namely sale of jewellery, customers normally purchase the material as per their needs and demands.

7. The CIT (Appeals) observed that in a retail business of this nature, the need for paying commission is incomprehensible. This observation does appear to be too wide and general and not based on any material. However, the other observations cannot by any stretch of imagination be held to be perverse.

8. The Income Tax Appellate Tribunal confirmed the assessment order and the order of the CIT (Appeals) also for the following further reasons. The appellant had paid Rs. 4,80,000/- as salary to each of the persons who are his close relatives. The payment of commission was merely a device adopted to reduce the appellant's taxable income. The appellant had failed to discharge the burden cast on him to prove the genuineness of the expenditure claimed towards payment of commission. The appellant had failed to adduce cogent and credible evidence establishing the genuineness of the commission paid. The appellant had failed to adduce evidence regarding the technical qualification of such recipients to justify the payments made to them towards commission. The appellant had failed to file any explanation or submission justifying the payment of commission as genuine business expenses.

9. The finding of Tribunal that the mere payment of TDS by the appellant in respect of the said payments is irrelevant is correct. The payment itself is not denied. The question is whether the appellant was entitled to deduct the same from his income.

10. The findings of fact and the appreciation of evidence by the Assessing Officer, C.I.T. (Appeals) and the Tribunal cannot be faulted on any ground. They are by no means perverse or unreasonable. The relevant facts were taken into consideration and analysed. In the appreciation of facts no question of law arises.

11. It was, however, contended that the finding of the Tribunal that the payments were a device adopted to reduce the appellant's taxable income is perverse as each of the persons to whom the commission was paid was taxable in the highest bracket. The revenue, therefore, suffered no loss. In view thereof, the appellant in the facts of this case ought to have been allowed the deduction in respect of the amounts paid as commission.

12. The submission is not well founded. Section 36(1)(ii) reads as under:-

"36(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28-

xx	xx	xx
xx	xx	xx
xx	xx	xx

(ii) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission;"

Section 36(1)(ii) of the Act entitles an assessee to deduction in respect of the commission paid provided the payment is genuine and justified. If the payment is justified, the appellant is entitled to the deduction irrespective of the tax

bracket that the recipient falls in. Conversely if the payment of commission is not justified, the assessee is not entitled to deduction irrespective of the tax bracket that the recipients fall in.

13. In the present case, it has been held that the appellant had not established that the payments by him to the said persons were by way of commission. The appellant's case in this regard has been disbelieved. As we mentioned earlier, this was purely an issue of fact and raised no question of law.

14. The fortuitous circumstance in the present case that the said persons belong to the highest tax bracket and the revenue, therefore, had not suffered any loss is irrelevant to the interpretation of Section 36(1)(ii) of the Act.

If the ingredients of Section 36(1)(ii) are satisfied, the assessee is entitled to the deduction provided therein. If not he is not entitled to the same. The interpretation of Section 36(1)(ii) does not depend upon whether in the ultimate analysis the revenue suffered a loss or not. Such an approach or interpretation would render the entire tax machinery unworkable. When a person's income is assessed, the Assessing Officer is not concerned with or even aware of the possible financial consequences to the revenue. Indeed while making the payment, he cannot possibly be aware, except possibly in a rare case, of the financial implications on the revenue. The assessment in respect of the recipients of the alleged commission may not have attained

finality when the assessment of the person making the payment is made. The recipient may not accept the assessment order and the challenge thereto may remain pending. Even if the assessment order in respect of the recipient has attained finality, the recipient in a given case may fail to or even be unable to meet the tax demand. Entitlement of deduction of Section 36(ii) cannot possibly depend upon whether the recipients meet or are capable of meeting the demand for tax or not. A view to the contrary would render the assessment orders pending for any length of time. Indeed it would then not be possible for an Assessing Officer to complete the assessment and pass an assessment order within the requisite time. The grant of deduction cannot be decided on the basis of conjectures and speculations regarding the recipients assessment or their ability to meet the demand for tax. It would be impossible for an Assessing Officer to determine such questions. The determination of such questions is not expected of the Assessing Officer.

15. In the circumstances, the fact that the recipients of the alleged commission in the present case had paid tax at the highest level is irrelevant to the question whether the appellant was entitled to deduct the amounts paid to them as commission.

16. Questions (i) and (ii) are, therefore, answered in the affirmative in favour of the Revenue.

17. Question (v) does not arise as the appellant has failed to establish that the payments to the said persons were by way of commission.

QUESTION NOS. (iii) and (iv)

18. The appellant claimed a deduction of a sum of Rs. 10,50,806/- as rent paid to three persons who also fall within the ambit of Section 40A(2) (b) of the Act. The Assessing Officer disallowed the same. The Assessing Officer observed that no explanation was furnished by the assessee to justify the payment. No rent agreement was furnished. Indeed the appellant stated that there was no rent agreement at all.

The Assessing Officer's inference that there was no plausible explanation regarding the high rent during the relevant year cannot be said to be perverse.

19. The C.I.T. (Appeals) upheld the disallowance of deduction for the same reasons, namely, that there was no evidence to support/justify the deduction. The view that the payment of TDS on the said amount is irrelevant is correct.

20. The Tribunal observed that the appellant had paid Rs. 14,40,000/- towards rent which was approximately 370% more than the rent paid in the preceding year namely Rs. 3,89,194/-. This is purely a question of appreciation of facts which in the facts of this case cannot be held to be perverse. No question of law arises in respect thereof.

21. It was then contended that the increase in the rent was on account of the increase in the area of the property. The appellant, however, failed to establish the facts necessary for the apportionment in respect thereof.

22. The appeal is, therefore, dismissed.

**(S.J. VAZIFDAR)
ACTING CHIEF JUSTICE**

18.03.2015
parkash/ravinder*

**(G.S. SANDHAWALIA)
JUDGE**

✓ Whether reportable: YES/NO
