IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved on: .12.2016

Pronounced on : 15.02.2017

Coram:

The Hon'ble Mr.Justice HULUVADI G. RAMESH

AND

The Hon'ble Dr. Justice ANITA SUMANTH

T.C.A. Nos.700, 701, 702 and 719 & 830 and 831 of 2004

Tax Case (Appeal) No.700 of 2004:

Commissioner of Income Tax

Cent. Cir.III, Chennai
Appellant

Vs

Smt. L. Parameswari,

178, Sathy Road,

Erode 638 003
Respondent

Tax Case (Appeal) No.701 of 2004

Commissioner of Income Tax

Cent. Cir.III, Chennai
Appellant

Vs

M/s.Kasi Chemicals,

172-A, Sathy Road,

Erode 638 003.
Respondent

Tax Case (Appeal) No.702 of 2004

Commissioner of Income Tax

Cent.Cir.III, Chennai
Appellant

Vs

Shri E.K.Lingamurthy

178 Sathy Road,

Erode 638 003.
Respondent

Tax Case (Appeal) No.719 of 2004:

Commissioner of Income Tax

Cent. Cir.III, Chennai.
Appellant

Vs

M/s.Swastik Dye Stuff Corporation

172 Sathy Road, Erode 638 003.
Respondent

Tax Case (Appeal) No.830 of 2004

Commissioner of Income Tax-II

Coimbatore
Appellant

Vs

M/s.Swasti Chem Pvt. Ltd.,

Erode.
Respondent

Tax Case (Appeal) No.831 of 2004

Commissioner of Income Tax-II

Coimbatore
Appellant

Vs

M/s.Swastic Corporation Ltd.,

Erode
Respondent

Prayer in TCA.No.700 of 2004: Tax Case Appeal filed under section 260-A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal C Bench, Chennai dated 15.09.2003 in ITA.No.1198/Mds/2001 for the assessment year 1997-98.

Prayer in TCA.No.701 of 2004: Tax Case Appeal filed under section 260-A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal C Bench, Chennai dated 15.09.2003 in ITA.No.1199/Mds/2001 for the assessment year 1997-98.

Prayer in TCA.No.702 of 2004: Tax Case Appeal filed under section 260-A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal C Bench, Chennai dated 15.09.2003 in ITA.No.1200/Mds/2001 for the assessment year 1997-98.

Prayer in TCA.No.719 of 2004: Tax Case Appeal filed under section 260-A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal C Bench, Chennai dated 15.09.2003 in ITA.No.1201/Mds/2001 for the assessment year 1997-98.

Prayer in TCA.No.830 of 2004: Tax Case Appeal filed under section 260-A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal C Bench, Chennai dated 15.09.2003 in ITA.No.1940(Mds)/2002 for the assessment year 1997-98.

Prayer in TCA.No.831 of 2004: Tax Case Appeal filed under section 260-A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal C Bench, Chennai dated 15.09.2003 in ITA.No.1202/Mds/2002 for the assessment year 1997-98.

For Appellant in all appeals .. Mr.M. Swaminathan

For Mr.K.Sureshkumar

For Respondent in all appeals .. Mr.S. Sridhar

COMMON JUDGMENT

(Judgment of this Court was delivered by ANITA SUMANTH, J.)

The above Tax Case (Appeals) have been filed by the Revenue challenging an order of the Tribunal dated 15.09.2003.

2. Substantial Questions of Law in T.C.A.No.700 of 2004 admitted for consideration are extracted below and are representative of the questions raised in TC(A) Nos.701, 702 and 719 of 2004.

> *1. Whether in the facts and circumstances of the case, the Tribunal had enough material to hold and was right in holding that the commission paid to Swastic Corporation Ltd., is a deductible expenditure?*

2. *Whether in the facts and circumstances of the case, the Tribunal was right in holding that the additional price paid to sister concerns with respect to goods already purchased during the year, without any prior commitment to the same*, could be treated *as revenue expenditure and deducted?"*

3. The questions admitted in TCA.No.830 of 2004, wherein the assessee is M/s.Swastic Chem (P) Limited, are couched differently though the issues are identical. We extract the same below:

> '*1. Whether on the facts and in the circumstances of the case the Income Tax Appellate Tribunal was right in holding that the disallowance of the claim of commission payment of Rs.67,48,500/- by the assessee to its loss making sister concern M/s.Swastic Corporation could not be considered as a sham transaction?*
>
> *2.Whether on the facts and in the circumstances of the case that the Income Tax Appellate Tribunal was right in not considering the relevant material and considering irrelevant material to hold that the commission payment was justified and, therefore, allowable as deduction?'*

4. The substantial questions of law that arise for consideration in TCA.No.831of 2004 (Swastic Corporation Limited) are as follows;

> "1. *Whether on the facts and in the circumstances of the case the Income Tax Appellate Tribunal was right in holding that the price difference paid by the assessee company to the sister concern M/s.United Bleachers Limited arose from genuine*

commercial transactions and could not be disallowed?

2. Whether on the facts and in the circumstances of the case that the Income Tax Appellate Tribunal was right in holding that the price difference borne by the assessee company in respect of the transaction with M/s.United Bleachers Limited, a sister concern, could not be disallowed alternatively, u/s.40A(2), ignoring the reasons given in support of the addition by the Assessing Officer.?"

5. We first take up the appeals in TC(A) Nos. 700, 701, 702, 719 and 830/2004 for decision. The assesses are engaged in the trading of dyes and chemicals. Pursuant to search operations in the business and residential premises of one E.K. Lingamurthy (assesee in TCA.No.702 of 2004) on 11.10.1996, assessments were made on E.K.Lingamurthy, L.Parameswari (assessee in TCA.No.700 of 2004), Kasi Chemicals, (assessee in TC(A).No.701 of 2004) Swastic Dye Stuff Corporation (assessee in TC(A) No.719 of 2004) and Swastic Chem (P) Ltd (assessee in TC(A) No.830 of 2004) which are related concerns controlled by the same group of assessees. The issues as well as persons/entities being inter-related, we propose to deal with all appeals by way of a common order. The financials of M/s Swastic Corporation Limited (assessee in TC(A) 831/2004) for the year ending 31.3.1998 revealed a credit of an amount of Rs.1,37,46,000/- representing commission paid to it by Kasi Chemicals, Swastic Dye Stuff Corporation, Swastic Corporation Limited, E.K.Lingamurthy and L.Parameswari

Prop.Swastic Corporation (Erode).

6. The assessing officer was of the view that no services had been rendered by Swastic Corporation Limited and that the payment of commission was a colourable exercise. The claim of expenditure by the five assesses was thus proposed to be disallowed. The assessees, it appears, sought to explain the nature of services rendered by Swastic Corporation Limited. It was submitted that with effect from April 1996 the operations of all the entities owned and managed by the family of E.K. Lingamurthy had been streamlined and Swastic Corporation Limited earmarked as the sole selling agent for the group. To this effect, several communications were placed on record to establish that customers had placed orders on Swastic Corporation Limited as sales agent of the assessees. The assessees further produced an agreement dated 1.8.1996 between each assessee and the sales agent wherein the services to be rendered by the agent as well as other terms were agreed upon.

7. Notwithstanding the objections raised by the assessees, the assessing officer disallowed the payments being of the view that the same were non-genuine. According to the officer, the relationship between the parties militated against the claim being bonafide, particularly in the absence of proof of rendition of service by the sales agent.

8. In appeal before the Commissioner of Income Tax (Appeals), the disallowance was reversed with the officer taking the view that the

disallowance had been based entirely on conjectures without any positive material being brought on record by the assessing officer to justify the same. The Commissioner notes that Swastic Corporation Limited had been appointed as sales agent for the sake of maintaining uniformity in sale prices and to avoid unnecessary and uneconomical competition between the sister concerns. A decision thus came to be taken by the entities that a bifurcation of duty was called for and one concern identified to act as the selling agent for the entire group. The transaction thus found favour with the Commissioner as being bonafide and genuine.

9. The orders of the Commissioner of Income Tax (Appeals) were confirmed by the Income Tax Appellate Tribunal vide a common order dated 15.9.2003. The tribunal discussed the matter in detail from paragraph 17.3 onwards. The concurrent findings of fact by the first as well as the second appellate authorities is that the *modus operandi* adopted by the assessees was not contrary to commercial principles and has, in fact been put in place to render the commercial operations more economical and profitable. The tribunal also approves the findings of the Commissioner of Income Tax (Appeals) to the effect that the disallowance arises only from a suspicion in the mind of the assessing officer primarily from the fact that all entities are related and the payment was made on the last day of the accounting year.

10. The assessing officer also appears to have been swayed by the fact that the assessees approached the settlement commission after the

search with a large disclosure. The agreement produced by the assessee was disregarded by the assessing officer on the ground that it had not been located or noted in the course of search proceedings in the business and residential premises of A.K.Lingamurthy on 11.10.1996 and was thus an afterthought. While these facts can, at best, lead to a suspicion, it cannot lead to a disallowance that requires the support of positive material. A conclusion of colourability has to be based on hard facts and not on assumptions and presumptions. The fact that the document was not noticed at the time of search cannot be conclusive in leading to an adverse inference against the assessee as the possibility that it escaped the attention of the investigating authorities cannot be ruled out. Then again, the mere fact that the settlement commission had been approached cannot mean that every act of the assessee has to be dubious or colourable, except if supported by collaborative material. In the present case, a plausible explanation has been offered that has found favour with the appellate authorities.

11. There is no prohibition that related parties cannot engage in business transactions. Such an interpretation would render the provisions of Section 40A (2) of the Act redundant. Section 40A(2) empowers the assessing officer to effect a disallowance of payments that are, '*in his opinion'* excessive or unreasonable giving regard to 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 him or

accruing to him. Such '*opinion'* has to be based on tangible material and not assumptions and suspicions.

12. The provisions of section 40A(2) are not automatic and can be called into play only if the assessing officer establishes that the expenditure incurred is, in fact, in excess of fair market value. This had not been done in the present case. The quantum of commission paid is thus at arms length. The decision to streamline business activities and establish a division of labour or hierarchy of operations is within the domain of the entities and cannot be trespassed upon by the assessing officer except where the officer establishes that such design or method is a ruse to circumvent legitimate payment of tax .

13. The Supreme Court in the case of *Vodafone International Vodafone International Holdings BV. Vs. Union of India and another (341 ITR 1)* points out the difference between 'looking through' a transaction and 'looking at' a transaction settling the position that a conclusion of colourable /sham can be arrived at by viewing the transaction in a commercially realistic and wholistic perspective, not adopting a truncated and dissecting approach. In the present case, there is a consistent finding of fact that the transaction was bonafide and acceptable. Nothing is placed before us to indicate that the findings are perverse. We are thus not inclined to interfere with the concurrent findings of the authorities. Substantial question of Law No.1 is answered against the revenue and in favour of the

assessee.

14. Substantial question of law No.2 in TC (A) Nos.700, 701, 702 and 719 of 2004 deals with additional price paid to sister concerns with respect to purchases. The conclusion of the tribunal at para 17.12 is in the following terms:

'*17.12 Thus we are inclined to hold that the sales commission/ price difference paid/allowed to the sister concerns cannot be disallowed by treating them as sham transactions or invoking provisions of section 40(A) of the IT Act, as we have already held that the Assessing Officers could not have/had not resorted to Section 40(A)(2).'*

15. The facts and circumstances in relation to price differences have been assumed by the tribunal to be the same as sales commission which is incorrect. In this view of the matter, the issue of price difference shall be decided afresh by the tribunal after due opportunity to assessee as well as income tax department within a period of ninety days from the date of receipt of a copy of this order. Substantial question of Law No.2 is returned unanswered. Tax Case (Appeals) 700, 701, 702, 719 and 830 of 2004 are partly allowed. No costs.

16. Tax Case (Appeal) No.831 of 2004 is filed by the Revenue against the order passed by the Income Tax Appellate Tribunal dated 15.9.2003.

17. It is fairly stated by the learned counsel appearing for both parties that the Tribunal has not considered the grounds raised before it and,

therefore, it would be just and proper for this Court to remand the matter back to the Tribunal for consideration of all the grounds raised in the appeal. The Tax Case (Appeal) is thus disposed of remanding the matter back to the Tribunal for consideration of all grounds raised in accordance with law. No costs.

[H.G.R.J.] & [A.S.M.,J.]

15**.02.2017**

Index: Yes/No

Internet:Yes/No

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HULUVADI G. RAMESH, J

AND

Dr.ANITA SUMANTH,J

Pre-delivery judgment in

T.C.A. Nos.700, 701, 702 and

719 , 830 and 831 of 2004

15.02.2017