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IN THE HIGH COURT OF DELHI AT NEW DELHI

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Judgement delivered on: 15th February, 2017

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ITA 795/2016 & CM No.41578/2016

SIGMA CORPORATION INDIA LTD.

..... Appellant

Through: Mr. Aseem Chawla and Mr. Manu K. Giri, Advocates.

Versus

DCIT

..... Respondent

Through: Mr. Dileep Shivpuri, Mr. Sanjay Kumar and Mr. Vikrant A. Maheshwari, Advocates.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE NAJMI WAZIRI

S. RAVINDRA BHAT (Oral):-

CM No.41578/2016

1. For the reasons stated in the application, the delay of 11 days in re-filing the appeal is condoned. The appeal is taken on record.
2. The application stands disposed off.

ITA 795/2016

3. The question of law which arises for consideration is as follows:-

"Did the ITAT fall into error in restoring the disallowance of 50% of ₹48 lakhs paid to the appellant/assessee employee for the relevant assessment year validly under Section 40A(2)(b) of the Income Tax Act, 1961?"

4. The Assessing Officer (AO) had, for Assessment Year 2009-10, disallowed 50% of the payments made on account of professional remuneration to Mr. Preetpal Singh from the assessee's claims. The AO had required details of the remuneration and the nature of services provided by Mr. Preetpal Singh. The AO felt that the assessee had not adequately addressed the concerns with respect to the time spent for its work, having regard to the qualifications and expertise of the said expert, and therefore, disallowed 50% of the claimed expenditure i.e. ₹48 lakhs. The Commissioner of Income Tax (Appeals) [CIT(A)] after analysing Section 40A(2) of the Income Tax Act, 1961 (hereinafter to be referred as 'the Act') discussed the submissions of the parties and then on the basis of the analysis of previous Tribunals' rulings as well as that of the High Courts, concluded that in the circumstances it could not be said that the expenditure was excessive. The CIT (A)'s reasoning is as follows:-

“Ground No.I :-is in respect of disallowance of 50% of remuneration amounting to Rs.24 lakhs u/s 40A(2)(b). The Payment was made to Sh Preetpal Singh a related party. Sh Preetpal Singh was a Bachelor of Engineering from USA and MBA in Marketing and Finance.

Before discussing the matter further, I shall quote Section 40A(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 Income-tax Officer is of 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."

In view therefore the AO should have been of the view that the expenditure was excessive and unreasonable having regard to the Fair Market Value of the goods services or facilities for which the payments was made or legitimate needs of the business or profession of the appellant or the benefit derived. However nowhere has the AO given any such finding. The AO has not made any attempt to find out the salary which would have been payable to a person with similar qualifications. The AO has nowhere discussed the legitimate needs of the business and profession and why the payment was not justified.

On the other hand the appellant on being asked to justify salary of four lakhs per months to Sh Preetpal Singh has furnished copy of a letter from Swastik Outsourcing which states:-

'We have been in touch with at least eight organization for discussing your CV as advised by you. Please note general consensus is that based on your qualifications and experience we can get you an yearly package of around Rs. 48 to Rs. 60 lakhs alongwith perks.

If you agree on this package please let us know to enable us to discuss your credentials with top management of few companies. Please note though your base office may be NCR, Delhi but your work area may extend to USA. Europe and certain parts of China but not to Russia, Australia and Middle East as agreed earlier."

The appellant has also given reason to justify the benefit to the business from employing Sh. Preetpal Singh. The appellant states that Sh Preetpal Singh was a highly qualified person and was engaged to establish the software process infrastructure and boost the market reach of the company. The appellant has quoted various case laws which support the

contentions of the appellant.

In my view the salary paid to Sh Preetpal Singh appears to be in line with the market salary paid to a person of his qualification. The salary of Rs. 4 lakhs to Sh.Preetpal Singh appears reasonable. In view of his qualification which are an engineering degree and MBA degree. The letter from the placement agency reaffirms this aspect. The addition of Rs 24 lakhs is therefore deleted.”

5. In the appeal by the Revenue, the ITAT took note of the Tribunal’s decision in ***Deputy Commissioner of Income Tax Vs. Spark Hotels (P.) Ltd. [2012] 22 taxmann.com 257 (Delhi)*** and concluded that disallowance to the tune of 50% made by the AO in respect of ₹48 lakhs paid to Mr. Preetpal Singh was warranted and based on a rational principal.

6. Learned counsel for the assessee relies upon the ruling of this Court in ***Commissioner of Income Tax Vs. Modi Revlon (P.) Ltd. [2012] 26 taxmann.com133 (Delhi)*** and the previous decision in ***Hive Communication (P.) Ltd. Vs. Commissioner of Income Tax [2011] 26 taxmann.com 287 (Delhi)***. Learned counsel for the Revenue, on the other hand, urged that the findings of the ITAT are based upon sound reasons and that the mere inability of the AO to make any comparison cannot invalidate the disallowance.

7. Section 40A(2) of the Act reads as follows:-

“40A Expenses or payments not deductible in certain circumstances.

(1).....

(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 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.”

8. In ***Hive Communication’s*** case (*supra*), this Court took note of the CBDT Circular dated 06.07.1968, which clarified what is meant by “reasonable expenditure” in the context of the AO’s discretion under Section 40A. The CBDT had stated that whenever an AO proposes disallowance, he has to examine the matter in a fair and reasonable manner and what should be borne in mind is that the provision is intended to check evasion of tax through excessive or unreasonable payments to relatives and associate concerns, and should not be so applied as to “cause hardship in *bona fide* cases”. ***Hive*** (*supra*) also considered the effect of the Allahabad High Court’s decision in ***Abbas Wazir (P.) Ltd. Vs. Commissioner of Income Tax [2004] 265 ITR 77*** and the Madras High Court’s ruling in ***CIT Vs. Computer Graphics Ltd. [2006] 285 ITR 84***. The Court also relied upon the Calcutta High Court’s ruling in ***CIT Vs. Edward Keventer (P.) Ltd. [1972] 86 ITR 370***. In ***Edward Keventer’s*** case (*supra*), the Court had stated that the reasonableness or otherwise of the expenditure should take into account firstly the legitimate business needs of the assessee or the company, secondly, benefits derived by or accruing to the company, and that while doing so, the view point of the company or concern having regard to prudent business practices, should prevail. This decision was affirmed by the Supreme Court in ***CIT Vs. Edward Keventer (P.) Ltd. [1978] 115 ITR 149***.

Pertinently, the Calcutta High Court in **Edward Kevender (P.) Ltd.** (supra) summarised the position as follows:-

“13.....It is not for the Assessing Officer to dictate what the business needs of the company should be and he is only to judge the legitimacy of the business needs of the company from the point of view of a prudent businessman. The benefit derived or accruing to the company must also be considered from the angle of a prudent businessman. The term “benefit” to a company in relation to its business, it must be remembered, has a very wide connotation and may not necessarily be capable of being accurately measured in terms of pound, shillings and pence in all cases. Both these aspects have to be considered judiciously, dispassionately without any bias of any kind from the view-point of a reasonable and honest person in business.”

9. Likewise in **Modi Revlon’s** case (supra), the Court additionally also took note of **S.A. Builders Vs. Commissioner of Income Tax [2007] 289 ITR 26**, where the Supreme Court had said that the Revenue ought not to place itself in the arm chair of businessman in dealing with such matters. **Modi Revlon** (supra) further emphasised that:-

“25. This Court notices that in order to determine whether the payment is not sustainable, the AO has to first return a finding that the payment made is excessive, under Section 40-A (2) of the Income Tax Act. If it is found to be so, then the AO has to determine what constitutes the fair market value of the services rendered and disallow the difference between what is claimed and what is such value determined (as fair market value). Apart from the fact that no such exercise was undertaken by the AO, the Court sees that the assessment order went off into a tangent, in following a method that was clearly inapplicable. The annual cap of ₹30 lakh payable to managerial personnel applied to public limited companies, and not those such as the assessee. This aspect was noticed by the CIT (A) who set aside

the disallowance. The Tribunal upheld that finding. Such view (of admissibility of similar consultancy charges) is supported by several decisions, which have been noticed in the detailed order of the CIT (A). This Court finds no valid grounds to interfere with those findings, which are both sound and reasonable.”

10. Having regard to the above position, this Court is of the opinion that the ITAT in the present case overlooked the materials that were to be taken into account, i.e. reasonableness of the expenditure having regard to the prudent business practice from a fair and reasonable point of view. The AO's order nowhere seeks to benchmark the expertise of Mr. Preetpal Singh with any other consultant and proceeds on an assumption that he could not have performed multiple tasks for more than one concern. In this Court's opinion, such a stereotyped notion can hardly be justified in today's business world where consultants perform different tasks, not only for one concern but for several business entities. A common example would be that of an accountant or a legal professional, who necessarily has to multi task and are recipients or retainers of payments from many concerns having regard to their special expertise. Likewise in other fields i.e. journalism, the medical profession etc. more than one entity may engage or retain a single professional on the basis of his experience, learning and expertise, unless there is a deeper scrutiny that involves comparable analysis of like situations (a highly difficult task), additions made under Section 40A(2) would be suspect.

11. In the circumstances, this Court is of the opinion that the ITAT's conclusions were not justified. The impugned order is accordingly set aside. The CIT (A)'s order is restored. The question of law is answered in favour

of the appellant/assessee and against the Revenue. The appeal is allowed in the above terms.

S. RAVINDRA BHAT, J.

NAJMI WAZIRI, J.

FEBRUARY 15, 2017

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