

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 10.04.2018

CORAM :

The Hon'ble Ms.INDIRA BANERJEE, CHIEF JUSTICE

AND

The Hon'ble Mr.JUSTICE ABDUL QUDDHOSE

T.C.A.Nos.129 to 131 of 2018
and C.M.P.Nos.1743 and 1744 of 2018

Principal Commissioner of Income Tax 4,
No.121, Mahatma Gandhi Road,
Chennai 600 034. ... Appellant in all appeals

-vs-

M/s.Madras Engineering Industries
Pvt. Ltd., 14, Sathyanarayana Avenue,
R.A.Puram, Chennai 600 028. ... Respondent in all appeals

Appeals filed under Section 260A of the Income Tax Act, 1961, against the order dated 21.09.2016 passed in I.T.A.Nos.126/Mds/2016, 125/Mds/2016 and 130/Mds/2016 by the Income Tax Appellate Tribunal, Madras 'A' Bench, in respect of Assessment Years 2010-11, 2011-12 and 2012-13 respectively arising against the common order of the Commissioner of Income Tax(A)-8, Chennai dated 30.10.2015 in I.T.A.Nos.18/2013-2014; 18/2014-2015 & 61/2015-2016, respectively against the Assessment order dated 27.03.2013 for the year 2010-2011 assessment order dated 28.03.2014 for the year 2011-2012 and Assessment order dated 31.03.2015 for the year 2012-2013.

For Appellant : Mr.Karthik Ranganathan
Sng. Counsel, assisted by
Mr.Vijay Kumar Punna

COMMON JUDGMENT

(Delivered by Ms.Indira Banerjee, Chief Justice)

These appeals filed by the Revenue are against a common judgment and order dated 21.09.2016 passed by the Income Tax Appellate Tribunal, 'A' Bench, Chennai, in the appeals of the Revenue being I.T.A.Nos.126/Mds/2012 pertaining to the assessment year 2010-11, I.T.A.Nos. 125/Mds/2012 relating to the assessment year 2011-12 and I.T.A.No. 130/Mds/2012 relating to

the assessment year 2012-13.

2.The short question in these appeals is whether the Tribunal erred in law in deleting the disallowance of the claim of the assessee M/s.Madras Engineering Industries Private Limited to deduction from the income of payments of commission made to the Directors/Managing Director of the respondent assessee.

3.It appears that the assessee paid commission of Rs.349.37 lakhs to Sri.E.K.Parthasarathy, the Chairman cum Managing Director of the assessee towards profit commission in the assessment year 2010-11. His salary during the aforesaid year was Rs.32 lakhs. In the following assessment year, that is, 2011-12, when Sri E.K.Parthasarathy's total salary was Rs.60 lakhs, he was paid commission of Rs.371.86 lakhs and in 2012-13, when his total salary was Rs.60 lakhs, he was paid commission of Rs.347.01 lakhs.

4.It appears that the commission was computed at the rate of 20% of the profit of the assessee before tax. The Assessing Officer found that the amount of commission paid to Sri.Parthasarathy fell within the ambit of Section 40A(2) of the Income Tax Act, 1961, hereinafter referred to as 'the said Act', which is set out herein below for convenience.

Expenses or payments not deductible in certain circumstances.

40A. (1) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head "Profits and gains of business or profession".

(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:

Provided that for an assessment year commencing on or before the 1st day of April 2016 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 any relative of the individual assessee
- (ii) where the assessee is a any director of the company, firm, company, partner of the association of persons firm, or member of the or Hindu un-divided association or family, or family any relative of such director, partner or member;
- (iii) any individual who has a substantial interest in the business or profession of the assessee, or any relative of such individual;

.....

5. Under Section 40A of the said Act and in particular, 40A (2) (a) and 40A(2) (b) (i), (ii) and (iii), where an individual assessee incurs expenditure on payment of commission or any other payment to any relative of the assessee, or an assessee which is a company incurs expenditure on payment to any Director, Partner, Member of association or family or any relative of such Director, Partner or Member, 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 means of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, the Assessing Officer might disallow deduction of so much of the expenditure as is considered by the Assessing Officer to be excessive or unreasonable. In the assessment orders for the years in question, the Assessing Officer deleted the expenditure as aforesaid on profit commission of Rs.349.37 for the Assessment Year 2010-11, Rs.371.86 lakhs for the Assessment Year 2011-12 and Rs.347.01 for the Assessment Year 2012-13 holding the same to be unreasonable.

6. The Assessing Officer disallowed the profit commission inter alia on the following grounds:

"(1) The phenomenal increase in the requirement of Automatic Slack Adjusters was attributable to change in Government policies rather than to individual efforts of Mr. Parthasarathy;

(2) The increase in sales in the preceding two years was mainly due to the entry into the Russian Market and the person who was instrumental for this,

Mr. John Bruce, had been rewarded separately;

(3) Though the payment of commission is granted by the Board of Directors, the major shareholding is in the hands of family members of Mr. Parthasarathy. The resolution of the Board and approval of the shareholders was under the influence of Mr. Parthasarathy; and

(4) Similar expenditure incurred in other companies could not be a benchmark as each case was different from the other."

7. The Assessing Officer, however, duly acknowledged the qualities, qualifications and technical knowledge of Mr. E. K. Parthasarathy.

8. Being aggrieved, the assessee appealed before the Commissioner of Income-tax (Appeals). The Commissioner of Income-tax (Appeals) set aside and/or deleted the disallowances under Section 40A. After recording the submissions made on behalf of the parties, the Appellate Commissioner, observed that the Assessing Officer was required to consider the fair market value of the services rendered, the benefit accrued to the assessee and the legitimate needs of the business of the assessee before invoking the provisions of Section 40A(2). The learned Commissioner of Appeals observed that "Further, the legitimate needs of the business or the benefits accrued to the appellant are to be considered from the standpoint of a prudent businessman and could not be left to the assessing authorities as declared by the Larger Bench of the Supreme Court in CIT vs. Edward Keventer (P) Ltd., 1978 CTR (SC) 164; (1978) 115 ITR 149 (SC) and by the High Courts of Allahabad and Gauhati in the case of Kashiprasad Carpets (P) Ltd. vs. CIT (148 ITR 0710) and Pheros & Co. P. Ltd. vs. CIT, (175 ITR 0044), respectively.

9. The Appellate Commissioner further found that the Assessing Officer could not have decided what the assessee should do and pay. Disallowance could be made under Section 40A(2) only when warranted and when the conditions of the said section were satisfied.

10. The Commissioner of Income-tax (Appeals) also took note of the fact that Mr. Parthasarathy was assessed to tax in the highest tax bracket and therefore, there was no loss of revenue with regard to the expenditure incurred on account of profit commission paid by the respondent assessee. The Commissioner of Income-tax (Appeals) accordingly held that the case of the assessee did not call for disallowance of profit commission. He held that the profit commission incurred by the assessee was

reasonable keeping in view the legitimate needs and benefit derived by the assessee due to the services rendered by Mr.E.K.Parthasarathy.

11. Being aggrieved, the Revenue filed appeals before the Income Tax Appellate Tribunal, 'A' Bench, Chennai, hereinafter referred to as the Appellate Tribunal. The Appellate Tribunal upheld the decision of the Appellate Commissioner in this regard and dismissed the Cross Appeals filed by the Revenue insofar as the Cross Appeals related to profit commission paid to Mr.E.K.Parthasarathy. The Appellate Commissioner and the learned Appellate Tribunal have concurred in their finding that the profit commission paid to Mr.E.K.Parthasarathy was neither unreasonable nor excessive. The finding is on facts. The question is whether the appeals can be entertained.

12. Section 260A of the Income Tax Act, 1961, provides as follows:

"Section 260A. Appeal to High Court.

(1) An appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal before the date of establishment of the National Tax Tribunal, if the High Court is satisfied that the case involves a substantial question of law.

.....

(3) Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question.

(4) The appeal shall be heard only on the question so formulated, and the respondents shall at the hearing of the appeal, be allowed to argue that the case does not involve such question:

Provided that nothing in this sub-section shall be deemed to take away or abridge the power of the Court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

(5) The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the grounds on which such decision is founded and may award such cost as it deems fit.

(6) The High Court may determine any issue which -

(a) has not been determined by the Appellate Tribunal; or

(b) has been wrongly determined by the Appellate

Tribunal, by reason of a decision on such question of law as is referred to in sub-section (1)."

13. An appeal lies under Section 260-A of the IT Act, on a substantial question of law. There not only has to be a question of law but a substantial question of law. We find that there is no question of law involved in these appeals, much less any substantial question of law.

14. In *Sir Chunilal V. Mehta & Sons Ltd. vs Century Spg. & Mfg. Co. Ltd.*, reported in AIR 1962 SC 1314, the Supreme Court agreed with and approved a Full Bench Judgment of this Court in *Rimmalapudi Subba Rao vs Noony Veeraju And Ors*, reported in AIR 1951 Mad 969 and laid down the principles for deciding when a question of law becomes a substantial question of law.

15. The Supreme Court held:

"When a question of law is fairly arguable, where there is room for difference of opinion on it or where the Court thought it necessary to deal with that question at some length and discuss alternative views, then the question would be a substantial question of law. On the other hand if the question was practically covered by the decision of the highest court or if the general principles to be applied in determining the question are well settled and the only question was of applying those principles to the particular fact of the case it would not be a substantial question of law."

16. In *Sir Chunilal V. Mehta & Sons Limited*, supra, the Supreme Court laid down the following test as proper test, for determining whether a question of law raised in the case is substantial:

"The proper test for determining whether a question of law raised in the case is substantial would, in our opinion, be whether it is of general public importance or whether it directly and substantially affects the rights of the parties and if so whether it is either an open question in the sense that it is not finally settled by this Court or by the Privy Council or by the Federal Court or is not free from difficulty or calls for discussion of alternative views. If the question is settled by the highest court or the general

principles to be applied in determining the question are well settled and there is a mere question of applying those principles or that the plea raised is palpably absurd the question would not be a substantial question of law."

17. In *Dy. Commr. v. Rama Krishna Narain*, reported in AIR 1953 SC 521 : 1954 SCR 506, the Supreme Court held that a question of law of importance to the parties was a substantial question of law entitling the appellant to a certificate under (the then) Section 100 CPC.

18. In *Santosh Hazari v. Purushottam Tiwari*, reported in (2001) 3 SCC 179, the Supreme Court held:

"To be "substantial" a question of law must be debatable, not previously settled by law of the land or a binding precedent, and must have a material bearing on the decision of the case, if answered either way, insofar as the rights of the parties before it are concerned. To be a question of law "involving in the case" there must be first a foundation for it laid in the pleadings and the question should emerge from the sustainable findings of fact arrived at by court of facts and it must be necessary to decide that question of law for a just and proper decision of the case. An entirely new point raised for the first time before the High Court is not a question involved in the case unless it goes to the root of the matter. It will, therefore, depend on the facts and circumstance of each case whether a question of law is a substantial one and involved in the case or not, the paramount overall consideration being the need for striking a judicious balance between the indispensable obligation to do justice at all stages and impelling necessity of avoiding prolongation in the life of any lis."

19. In *Hero Vinodh Vs. Seshammal* reported in (2006) 5 SCC 545, the Supreme Court summarized the tests to find out whether a given set of questions of law were mere questions of law or substantial questions of law, and held:

"21. The word substantial, as qualifying "question of law", means—of having substance, essential, real, of sound worth, important or considerable. It is to be understood as something in contradistinction with—technical, of no

substance or consequence, or academic merely. However, it is clear that the legislature has chosen not to qualify the scope of "substantial question of law" by suffixing the words "of general importance" as has been done in many other provisions such as Section 109 of the Code or Article 133(1)(a) of the Constitution. The substantial question of law on which a second appeal shall be heard need not necessarily be a substantial question of law of general importance.

20. In *Guran Ditta v. Ram Ditta*, reported in AIR 1928 PC 172 the phrase "substantial question of law" as it was employed in the last clause of the then existing Section 100 CPC (since omitted by the Amendment Act, 1973) came up for consideration and their Lordships held that it did not mean a substantial question of general importance but a substantial question of law which was involved in the case.

21. The principles relating to Second Appeals under Section 100 CPC as summarised in *Hero Vinoth v. Seshammal*, supra, are:

"(i) An inference of fact from the recitals or contents of a document is a question of fact. But the legal effect of the terms of a document is a question of law. Construction of a document involving the application of any principle of law, is also a question of law. Therefore, when there is misconstruction of a document or wrong application of a principle of law in construing a document, it gives rise to a question of law.

(ii) The High Court should be satisfied that the case involves a substantial question of law, and not a mere question of law. A question of law having a material bearing on the decision of the case (that is, a question, answer to which affects the rights of parties to the suit) will be a substantial question of law, if it is not covered by any specific provisions of law or settled legal principle emerging from binding precedents, and, involves a debatable legal issue. A substantial question of law will also arise in a contrary situation, where the legal position is clear, either on account of express provisions of law or binding precedents, but the court below has decided the matter, either ignoring or acting contrary to such legal principle. In the second type of cases, the

substantial question of law arises not because the law is still debatable, but because the decision rendered on a material question, violates the settled position of law .

(iii) The general rule is that High Court will not interfere with the concurrent findings of the courts below. But it is not an absolute rule. Some of the well-recognised exceptions are where (i) the courts below have ignored material evidence or acted on no evidence; (ii) the courts have drawn wrong inferences from proved facts by applying the law erroneously; or (iii) the courts have wrongly cast the burden of proof. When we refer to "decision based on no evidence", it not only refers to cases where there is a total dearth of evidence, but also refers to any case, where the evidence, taken as a whole, is not reasonably capable of supporting the finding."

22. In *M. Janardhana Rao Vs. Joint Commissioner of Income Tax* [2005 273 ITR 50 (SC)], the Hon'ble Supreme Court held that the principles contemplated under Section 100 of the Code of Civil Procedure would apply to Section 260-A of the IT Act too.

23. Right of appeal is not automatic. Right of appeal is conferred by statute. When statute confers a limited right of appeal only in a case which involves substantial questions of law, it is not open for this Court to sit in appeal over the factual findings arrived at by the Appellate Tribunal.

24. In the instant case, Section 40A(2)(a) provides that if the officer is of opinion that expenditure to inter alia a Director of a company was excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment was made or the legitimate needs of the business, occupation of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as was considered by him to be excessive or unreasonable would not be allowed as a deduction. There is no yardstick or guideline for judging when the expenditure incurred by the assessee would be excessive or unreasonable. The decision is left to the Assessing Officer. The decision is a subjective decision having regard to the facts of the case. We find that there is no question of law far less any substantial question of law involved in these appeals.

25.The appeals are, accordingly, not entertained and the same are dismissed. No costs. Consequently, C.M.P.Nos.1743 and 1744 of 2018 also stand dismissed.

-s/d-

Assistant Registrar(CS-IV)

True Copy

Sub-Assistant Registrar

sra

To

1. The Deputy/Asstt. Registrar,
Income Tax Appellate Tribunal,
'A' Bench, Chennai.
 2. The Commissioner of Income Tax
(Appeals) - 8, 121, Mahatma Gandhi
Road, Nungambakkam, Chennai-600 034.
 3. The Deputy Commissioner of Income Tax,
Corporate Circle 4(1), Chennai.
 4. The Principal Commissioner of Income Tax 4
121,Uthamar Gandhi Road
Chennai 34.
- +1 CC to Mr. Karthick Ranganathan, sr 27317.

T.C.A.Nos.129 to 131 of 2018

CNR(CO)
SP(15/05/2018)

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