

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED :: 18-03-2019

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI

AND

THE HON'BLE MR.JUSTICE C.V.KARTHIKEYAN

T.C.A.No.1800 of 2008

M/s.FFE Minerals (I) P Ltd.
(now known as FL.Smith
Minerals Private Ltd.)

...

Appellant

-VS-

The Deputy Commissioner of Income Tax,
Company Circle (II) (1)
Chennai -600 034.

...

Respondent

Appeal under Section 260A of the Income Tax Act,1961, against the order of the Income Tax Appellate Tribunal, Chennai 'A' Bench, dated 25.10.2007, passed in ITA.No.672/MDS/2006.

For Appellant : Ms.Mallika Srinivasan

For Respondent : Mr.Karthick Renganathan,
Senior Standing Counsel.

JUDGMENT

(Judgment of the Court was delivered by **Dr.Vineet Kothari,J.**)

Assessee has filed this Appeal under Section 260A of the Income Tax Act,1961, raising the following Substantial Questions of Law, arising from the order of the learned Income Tax Appellate Tribunal, dated 25.10.2007, whereby the learned Tribunal allowed the appeal of the Revenue in part for Assessment Year 2002-2003. The two Questions of Law, on which the present Appeal was admitted by a Co-ordinate Bench of this Court on 21.11.2008, are quoted below for ready reference :

“1. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the appellant is not entitled to deduction in respect of provision for liquidated damages and retention of money on the ground that it is a contingent liability, without appreciating the facts and the terms of the contract ?

2. Whether on the facts and circumstances of the case, the Tribunal was right in law in confirming the disallowance of interest under Section 40 (a) (i) ignoring

the fact that the interest amount is paid by the appellant only to their banker in India and as such no TDS has to be made from interest paid to Indian Bankers under Section 194 A ?”

2. As far as Question No.1 is concerned, the learned counsels at Bar fairly submitted that the controversy has been decided in the case of the Assessee itself by a Co-ordinate Bench of this Court for Assessment Year 1998-1999 on 13.08.2018 in *FFE Minerals India (P) Ltd. v. Joint Commissioner of Income Tax*, (2018) 98 Taxmann.com 170 (Madras), in which, it was held that when a provision was made for liquidated damages to be paid by the Assessee to the companies with which it executed certain turnkey projects and delay occurred in execution of such turnkey projects, the liability for liquidated damages made by the Assessee had not crystallized during the previous year in question and, therefore, the same was not allowable towards **business expenditure** under Section 37 (1) of the Act. The Co-ordinate Bench followed a decision of the Hon'ble Supreme Court in the case of *Rotork Controls India (P.) Ltd. v. CIT*, (2009) 314 ITR 62 (SC), and held as under :

"22. After we have elaborately heard the learned counsels for the parties, we are required to consider the aspect as to whether the assessee is entitled for deduction under [Section 37\(1\)](#) of the Act in respect of provision made towards damages that the assessee is liable to pay to the organisation for whom they have already done turnkey projects, which has been provided by them in their books of accounts. We may note that [Section 37](#) of the Act uses the word any expenditure. Therefore, an expenditure, which is referred to therein, viz., [Section 37\(1\)](#), would be entitled for being claimed as a deduction. Thus, the test to be satisfied by the assessee to claim a provision to be an expenditure in terms of [Section 37\(1\)](#) of the Act, the onus is heavily on the assessee and the assessee has to necessarily discharge the obligations, which have been laid down by the Hon'ble Supreme Court in **Rotork Controls India (P) Ltd. (supra)**, which has been popularly known as triple test. The Hon'ble Supreme Court in the said decision, explained as to what is a provision? in the following terms:-

'10. What is a provision? This is the question which needs to be answered. A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is

*recognized when: (a) an enterprise has a **present obligation as a result of a past event**; (b) it is **probable that an outflow of resources** will be required to settle the obligation; and (c) a **reliable estimate** can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized.*

12. A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that is recognized as provision. For a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation.'

23. Thus, the three tests being that (a) an enterprise has an obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. The Revenue cannot dispute

the fact that the assessee in the instant case satisfied test Nos.(a) and (c).

*24. To be entitled to a deduction as claimed by the assessee, **the assessee has to cumulatively satisfy all the three tests.** Therefore, it has to be seen as to whether it is probable that an outflow of resources will be required to settle the obligation.*

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28. As pointed out by the Hon'ble Supreme Court, a past event that leads to a present obligation is called an obligating event and the obligating event is an event that creates an obligation, which results in an outflow of resources. Thus, only those obligations arisen for past event existing independently on the future contract of the enterprise is recognised provision. Admittedly, in the instant case, no such past events have been placed before the Assessing Officer to show that there is every probability that the expenditure will be incurred. At best, the assessee can pitch their case as a case of possibility but, not a case of probability. Thus, the assessee having failed to fulfil the triple test prescribed in Rotork Controls India (P) Ltd. (supra), is not entitled to the deduction as claimed by them.

29.The learned counsel for the assessee submitted that the assessee should be entitled to claim the same in the year when the damages had been recovered. Needless to state that it is for the assessee to disclose the same in the return of income to the relevant year, which will obviously be considered by the Assessing Officer in accordance with law. Accordingly, the second substantial question of law framed in these appeals is answered in favour of the Revenue and against the assessee."

3. In view of the aforesaid, we respectfully following the said decision of the Co-ordinate Bench based on the decision of the Supreme Court, answer the First Question of Law in favour of the Revenue and against the Assessee.

4. Coming to Second Question of Law on the applicability of Section 40 (a) (i) of the Act, we are of the opinion that the appeal of the Assessee deserves to be allowed and the Second Question of Law framed above deserves to be answered in favour of the Assessee and against the Revenue. The reasons are as follows.

5. The Assessing Authority, vide its order, dated 16.02.2005,

for Assessment Year 2002-2003, disallowed a sum of Rs.6,22,577/-, representing the interest paid by the Assessee to its Banker for import of certain goods made by the Assessee from a supplier in USA. The findings, as given in the Assessment Order, are also quoted below for ready reference:

"The assessee has remitted interest outside India without deduction of tax under chapter XVII B which is liable for disallowance u/s 40 (a) (i) (sic). On pointing out the aspect, the assessee has filed a copy of the letter dt.10.12.83 to the Income-tax Office, International Taxation-III, Chennai-34. In this letter it is stated that the interest payment even received by the supplier in USA and subject to tax in USA under the provision of double taxation agreement. However, in another letter dt.10.12.03, it was undertaken to deduct tax, the payment of interest. In the absence of proper details and clarification the amount on which tax omitted to deduct is disallowed u/s 40 (a) of the Act."

6. The CIT (A), however, allowed the appeal of the Assessee on this aspect and deleted the said addition, holding that the amount of interest was paid by the Assessee to its own Banker in India and, in view of

the exception under Section 194A (3), when the payment of interest is made by the Assessee to a banking company, no tax was required to be deducted at source and, therefore, the Assessing Authority was not justified in making the addition under Section 40 (a) (i) of the Act, which permits such disallowance to be made in the hands of the Assessee in case the Assessee, being under an obligation to deduct tax at source on payment of interest, does not do so. The relevant findings of CIT (A) are also quoted below for ready reference :

"3. The first ground raised in this appeal relates to the disallowance of interest of Rs.6,22,577/- u/s.40(a) on the ground that tax has been deducted on payments made to USA suppliers. The assessing officer has stated the assessee has remitted interest of Rs.6,22,577/- outside India without deduction of tax under chapter XVII B which is liable for disallowance u/s.40(a) (1) and in the absence of proper details and clarification the amount on which tax omitted to be deducted was disallowed u/s.40(a) of the Act. The appellant contended that

'the appellant company has purchased certain materials from abroad by opening LC in favour of the exporter abroad. The exporter was

*paid by his banker abroad who in turn **recovered the price of goods plus interest from the appellant's banker.** The appellant's banker then recovered the amount from the appellant. **Therefore, the interest amount is paid by the appellant only to their bankers u/s.194A.** Further as the interest is paid to Indian resident, provisions of Section 195 will apply. Section 195 will apply only to persons responsible for making the payment to the non-resident. In this case, the bank is responsible for making the payment to the non-resident and the **appellant is responsible for making payment to their banks in India.** **Therefore, there is no liability for the appellant to deduct tax at source u/s.195 or 194A.** In the circumstances the amount cannot be disallowed u/s.40(a)'.*

3.2. I have carefully considered the order of the assessing officer and the submission of the appellant. As I agree with the appellant I direct the assessing officer to (sic) delete the addition made towards non deduction of TDS of Rs.6,22,577/-. The appellant succeeds on this ground."

7. The Revenue took up the said issue further in appeal before

the learned Tribunal, which allowed the said appeal of the Revenue, following its previous decisions in other cases with the following observations :

"4.1. We have heard both the counsels and perused the relevant records. Similar issue was considered by this Tribunal in the case of M/s.Frontier Offshore Exploration (India) Ltd. vs. DCIT in I.T.A.No.2307/Mds/2006 for assessment year 2003-04 vide order dated 28.02.2007 where they have confirmed disallowance u/s 40(a). Moreover, this issue is also covered by the order of the Delhi Bench of this Tribunal in the case of HNS India VSAT Inc. Vs. Dy. Director of Income Tax (International Taxation) 95 ITD 157 (Del) wherein it was held that when no application was made u/s 195(2), the assessee was under obligation to deduct tax at source and once no such tax was deducted, then disallowance of such payments u/s 40(a) (i) were justified. In view of this, we allow this ground by the Revenue."

8. Being aggrieved by the same, the Assessee has come up in appeal before this Court and Question No.2 pertains to the aforesaid controversy.

9. Ms.Mallika Srinivasan, learned counsel for the

appellant/Assessee, has urged before us that payment of interest in question was made by the Assessee to its own Bank, which allows some grace period on the Letter of Credit given to the importer-Assessee and the documents for import of goods are released at the initial stage and imported goods are taken delivery by the Assessee but since the payment made by the Assessee is remitted to the foreign exporter-the company in USA- after some period, for such delay of time period, the Indian Bank recovers some interest from the Assessee and it was this interest that was paid by the Assessee to its Bank, on which the learned Assessing Authority applied the provision of Section 40 (a) (i) of the Act on the premise that the Assessee was liable to deduct tax at source on such payment of interest. She has further contended that the Assessing Authority could not have applied the provision of Section 195 of the Act, which requires such deduction of tax at source in case the payment of interest is directly made to a non-resident. The learned counsel also submitted that since payment of interest was made by the Assessee-company to its own Bank in India, the Assessee's case was covered by the exception in Section 194A (3) of the Act and tax was not required to be deducted thereon; hence, there was no question of applying Section 40 (a)

(i) of the Act and, therefore, the learned Tribunal has erred in restoring the order passed by the Assessing Authority and setting aside the order passed by the learned CIT (A) in this regard.

10. Conversely, Mr.Karthick Renganathan, learned Senior Standing Counsel for the respondent/Revenue, has submitted that since the interest in question was charged by a foreign supplier of USA on the delayed payment, the recovery of such interest from the Assessee was an interest paid to the US supplier- a non-resident- and, therefore, Section 195 of the Act applied. He further submitted that since the requisite details were not furnished by the Assessee before the Assessing Authority, such disallowance under Section 40 (a) (i) of the Act was justified.

11. Having heard the learned counsel for the parties, we are satisfied that the learned Assessing Authority was absolutely not justified in invoking Section 195 of the Act, ignoring the fact of payment made by the Assessee to its own Bank in India. There was no material on record either produced by the Assessee or brought on record by the Assessing Authority, on the basis of which a direct payment by the Assessee to the non-resident company in US could be inferred and, therefore, the applicability of Section

195 of the Act was out of question. Still, the Assessing Authority, without having any material on record, chose to ignore the provision of Section 194A (3) of the Act, which clearly provides that the provisions of Section 194A of the Act shall not apply in case such income is credited or paid to any banking company.

12. We find force in the contention raised on behalf of the learned counsel for the Assessee that payment of interest in question was made by the Assessee to its own Banker in India for the grace period or period of delay under the contract and such remittance was made to the exporter in USA through his Bank in USA. This is how in normal course export and import transactions take place and without the intervention of Banks, direct payment for import cannot be made and, therefore, the existence of a Bank in India through which such remittance was made by the Assessee during the year in question and payment of interest made by the Assessee to its Bank in India could not have been ignored by the Assessing Authority. Without there being any material on record in this regard, the learned Assessing Authority could not even have arrived at the figure of interest of Rs.6,22,577/-. Therefore, without verifying the details

of such interest payment made by the Assessee as to whom it was paid, the learned Assessing Authority seems to have applied these provisions just on assumptions and hypothetical facts, for which there was no basis.

13. We are very clear that if the provisions of Section 40 (a) (i) of the Act have to be invoked, the burden squarely lies on the Assessing Authority to establish in the first instance that the relevant TDS provisions were applicable to the facts of the case, casting a legal obligation upon the Assessee to deduct tax at source. Without such a finding or basis being found, the disallowance under Section 40 (a) (i) of the Act could not have been lightly made by the Assessing Authority. In the present case, we find it to be casually invoked by the Assessing Authority as well as the Tribunal. Therefore, we are of the opinion that Section 40 (a) (i) of the Act has been wrongly invoked by the Assessing Authority in the present case and the Assessee deserves to be granted relief in this regard. Appeal of the Assessee to this extent is, accordingly, allowed and Question No.2 is answered in favour of the Assessee and against the Revenue.

14. Appeal of Assessee is allowed in part, as above. No costs.

15. Before parting, we may add that we were inclined to fix the

responsibility in this regard on the Assessing Authority himself, who was Mr.V.Munusamy, Assistant Commissioner of Income Tax, Company Circle-II (1), Chennai-34, at the relevant point of time. But, at the request of the learned Senior Standing Counsel for the Revenue that it could be a bona fide wrong interpretation of provision of law, we, in this case, refrain from imposing any costs or passing any adverse order against the Assessing Authority, with the hope that the Central Board of Direct Taxes (CBDT) will issue appropriate guidelines for the Assessing Authorities to invoke Section 40 (a) (i) of the Act with appropriate legal basis or foundation for the same and only after arriving at appropriate findings of facts and applicability of relevant provisions of TDS on the Assessee.

16. We are also not satisfied with the manner in which the learned Members of the Tribunal also restored the order passed by the Assessing Authority, just citing two of its decisions in other cases. The final fact finding body, particularly while reversing the order of the First Appellate Authority, was expected to deal with the facts of the case and the legal position in detail, before restoring the addition made in the hands of the Assessee in the present case. The findings of facts by the final fact

finding body are not only of great relevance and significance for the higher Constitutional Courts, such as High Court under Section 260A of the Act in the present appeal, but, even otherwise also, the mandate of the Act is that the Tribunal should arrive at its own findings of facts based on relevant and cogent material.

17. Therefore, we direct the Registry of this Court to mark a copy of this order to the President of Income Tax Appellate Tribunals as well as the Tribunal concerned in the present case, namely, Income Tax Appellate Tribunal, Chennai, through the Registrar of Income Tax Appellate Tribunals; and also to the Assistant Commissioner of Income Tax, Company Circle-II (1), Chennai-34, (Mr.V.Munusamy, wherever he is posted now), for their information and needful.

Index : Yes

Internet : Yes

Speaking Order

dixit

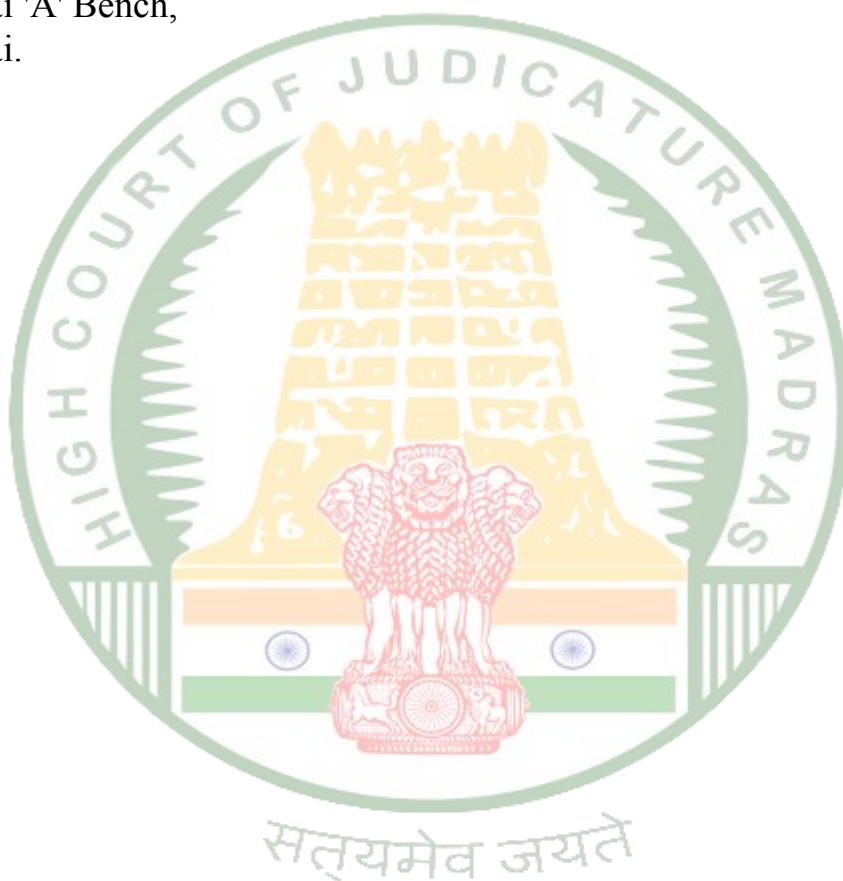
सत्यमेव जयते (V.K.,J.) (C.V.K.,J.)
18-03-2019

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To

1.The Deputy Commissioner of Income Tax,
Company Circle (II) (1)
Chennai -600 034.

2.Income Tax Appellate Tribunal,
Chennai 'A' Bench,
Chennai.

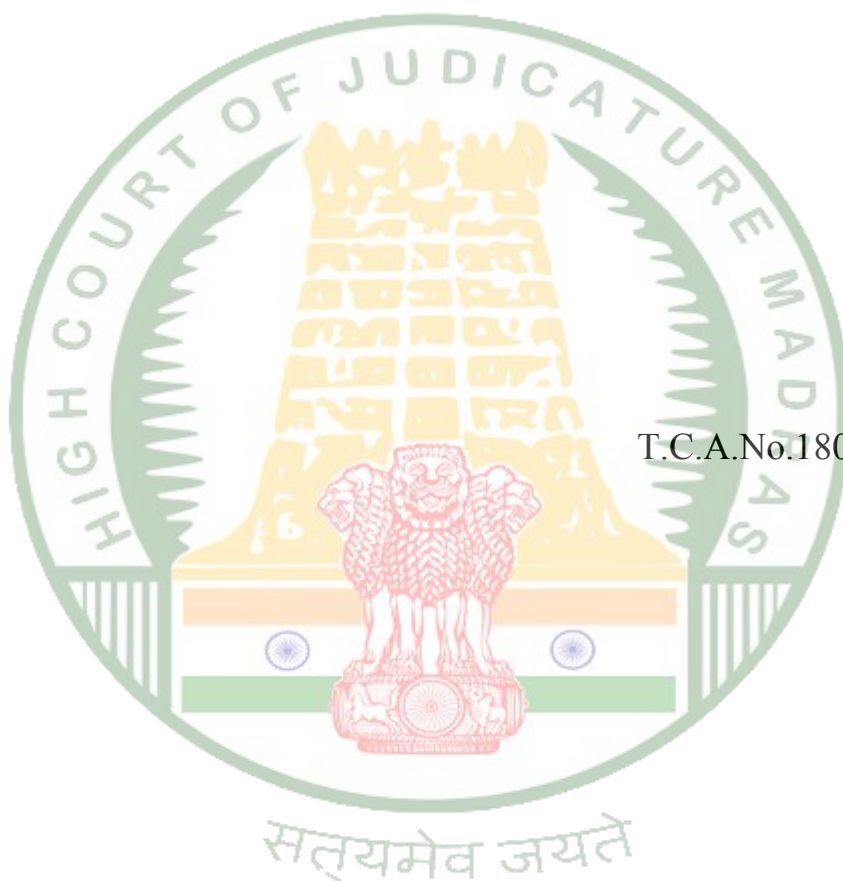


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