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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

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Judgment reserved on: 21.09.2023
Judgment pronounced on: 13.10.2023

+ **ITA 972/2018****MEHRA JEWEL PALACE PVT LTD**

..... Appellant

Through: Mr Salil Aggarwal, Sr Adv. with Mr
Madhur Aggarwal and Mr Uma
Shankar, Advs.

versus

PR. COMMISSIONER OF INCOME TAX

..... Respondent

Through: Mr Sunil Agarwal, Sr Standing
Counsel with Mr Shivansh Pandya,
Standing Counsel along with Mr
Utkarsh Tiwari, Adv.

+ **ITA 15/2021****MEHRA JEWEL PALACE PVT LTD**

..... Appellant

Through: Mr Salil Aggarwal, Sr Adv. with Mr
Madhur Aggarwal and Mr Uma
Shankar, Advs.

versus

PR. COMMISSIONER OF INCOME TAX – 6

..... Respondent

Through: Mr Sunil Agarwal, Sr Standing
Counsel with Mr Shivansh Pandya,
Standing Counsel along with Mr
Utkarsh Tiwari, Adv.

CORAM:**HON'BLE MR. JUSTICE RAJIV SHAKDHER****HON'BLE MR. JUSTICE GIRISH KATHPALIA**



GIRISH KATHPALIA, J.:

1. These two appeals brought by the same assessee under Section 260A of the Income Tax Act, challenging order dated 20.03.2018 (for Assessment Year 2011-12 in ITA 972/2018) and order dated 14.11.2019 (for Assessment Year 2012-13 in ITA 15/2021) of the Income Tax Appellate Tribunal. These appeals were taken up together for disposal in view of similar factual and legal matrix.

2. Broadly speaking, in the course of preliminary hearing dated 21.09.2023 two issues were laid before us, out of which for detailed reasons, we decided to examine only one issue and accordingly framed the solitary substantial question of law arising in the present appeals. For convenience, order dated 21.09.2023 in ITA 972/2018 is extracted below:

- “1. This appeal concerns Assessment Year (AY) 2011-12.
2. There are two issues which arise for consideration before this court.
2.1 First, as to whether the Income Tax Appellate Tribunal [in short, “Tribunal”] had rightly upheld the disallowance of salary by the Assessing Officer (AO) by taking recourse to Section 40A(2)(b) of the Income Tax Act, 1961 [in short, “Act”]?
2.2 Second, whether the Tribunal was correct, in the facts and circumstances of the case, in sustaining the disallowance of interest concerning interest-free loans and advances made over to persons referred to in the assessment order?
3. Insofar as the second issue is concerned, which relates to interest paid on interest-free loans and advances given to certain persons, the details with regard to the same, as given in the assessment order, are set forth hereafter:

Name	Loans/Advances (A.Y. 2011-12)	Loans/A dvances (A.Y. 2010-11)
C.L. Mehra	10,44,351	13,78,377
C.L. Mehra & Sons	21,98,004	13,92,839



Chand Mehra	18,94,492	9,95,907
Mehra Sons Jewelers P. Ltd.	23,50,000	-
Namita Mehra	6,94,914	6,94,914
Pawan Mehra	-	1,54,521
Sakshi Mehra	2,57,779/-	5,39,449
Vinay Mehra	11,71,865	5,40,237
Total	96,11,405/-	56,96,244/-

4. The finding of fact returned by the AO is that the said advances were given to incur medical expenses and expenses towards children's education. These expenses are obviously not related to the business of the appellant/assessee.

4.1. The counsel for the appellant/assessee has sought to justify these advances by referring to the agreement dated 01.02.2003 between the appellant/assessee and Mr Charanjit Lal Mehra and specifically, to clause four (4) of the said agreement.

4.2. The AO, however, noted that no written agreements were submitted by the assessee company. Given this position, the AO disallowed Rs. 10,47,593/- paid by way of interest by concluding that the conditions provided in Section 37, read with Section 40A(2)(b) of the Act were not fulfilled.

4.3. The AO in the assessment order has also noted that the appellant/assessee's loans and advances figure had increased to Rs.1,03,10,277/- from a figure of Rs.79,88,155/- as obtaining in the preceding AY. Likewise, the interest-free advances given by the appellant/assessee had enhanced from a figure of Rs.56,96,244/- in the preceding AY, to Rs.96,11,405/- in the AY in issue i.e., AY 2011-12.

5. It is required to be noticed that the AO disallowed interest on loan taken by the appellant/assessee, which, in turn, was given out to the aforementioned persons as interest-free loans and advances.

6. In the appeal, the CIT(A) gave a partial relief. The CIT(A) sustained the disallowance of interest against certain advances, and in this regard, made the following observations:

"Ground No. 6 relates to disallowance of interest of Rs 10.48 Lakhs u/s 37 r.w.s 40A(2b).

This disallowance relates to advances given by the assessee to nine parties which have gone up from 56.96 lacs of earlier year to 96.11 lacs in the present year.

The AO discussed about advancing amount in a very cryptic manner and stated that no details were produced and hence disallowance is made. The AR produced before me the documentary [sic: documentary] evidence and the explanation which was produced before the AO on 07.03.2014 at the time of assessment proceedings and the issues are decided as under:

1. C. L. Mehra. : The advance of Rs 10,44,351.10 shows a decline of from: Rs.13,78,377.00 as on 31.3.2010.



2. C. L. Mehra & Sons (HUF): The advance increased from Rs. 13,92,839/- as on 31.3.2010 to Rs 21,98,004/- as on 31.3.2011. An increase of Rs 8,05,168/-

Submission of the assessee

Shri C. L. Mehra is the owner of the trademark "Mehrasons." The Company approached Shri C. L. Mehra to permit the Company to use the trademark "Mehrasons" for its jewellery business. The Company has been using the trademark of "Mehrasons" since 2003-04, when the Company entered jewellery retail. The trademark "Mehrasons" is a valuable asset and carries considerable goodwill. The use of the "Mehrasons" trademark was crucial in enabling the Company to mobilize working capital loans from banks, build credibility with customers, build credibility with suppliers, take the loan from the bank to purchase the C-11 Connaught Place, New Delhi 11 0001 property, etc. The Company earned handsomely by utilizing the "Mehrasons" trademark. Shri C. L. Mehra permitted the Company to utilize the trademark. Without any fee, royalty, share in profits, etc. **The understanding was that if Shri C. L. Mehra, or his HUF, or co-parcenors of the HUF, required funds (within reasonable limits) to meet requirements such as medical expenses, education of children, etc, the Company would extend them a loan, interest free. The trademark "Mehrasons" was the security held by the Company for- the said advances.**

CIT(A)'s FINDINGS

The assessee's contention is found to be hollow and without any merit. **The assessee failed to prove that Shri C.L.Mehra owns the trademark of "Mehrasons". There is a case going on between C.L.Mehra and his cousins of Yaspal group in the High Court of Delhi regarding the ownership of this trademark. At the District Court level Mr. CL.Mehra lost the case and he only filed an appeal in the High Court as plaintiff. Everyday in the newspaper, jewellery ads come in the name of "Mehra Sons" and it is issued by Y ash Pal Group but not by the assessee. All these facts show that Mr. C.L.Mehra is not at all the owner of trademark "Mehra Sons" and the amounts advanced/spent by the assessee to Mr C.L.Mehra cannot be treated as prudent or expedient for business purpose.**

The interest disallowance made by AO on this ground is upheld.

3. Chand Mehra. The advance increased from Rs 9,95,907.60 as on 31.3.2010 to Rs 18,94,492.60 as on 31.3.2011. An increase of Rs 8,98,585/-.

Submission of the assessee

Shri Chand Mehra has a BA (Economics) from Claremont McKenna College, Claremont, California, United States of America. Claremont McKenna College is ranked # 6 among the liberal arts colleges in the United States. He further has a MBA from the Peter F. Drucker School of Management, Claremont Graduate University, Claremont, California, United States of America. Shri Chand Mehra did a lot of work for the Company, provided assistance in handling disputes, negotiations with banks, etc. the Company did not pay him any fees for his work, and thereby saved on salary expenses.

Leave alone the benefit to the assessee because of Mr Chand Mehra, the assessee failed to prove with evidence any services at all rendered by



Mr. Chand Mehra to the assessee.

The disallowance made on this ground by the AO is upheld.

4. Mehraons Jewellers Pvt Ltd: RS 23,50,000/-.

The Company rented out its space to M/s Reebok India Limited. It therefore needed to take a place on rent. In order to save on expenses, the Company negotiated an arrangement with M/s Mehraons Jewellers Pvt Ltd, which owned a property in Karol Bagh, wherein the Company would extend it an advance, and utilize its space rent free.

This is also treated as advance for business purpose and assessee's contention is accepted.

5. Namita Mehra : Rs 6,94,914/-. The amount of advance is the same as on 31.3.2010 and there has not been any increase. Smt. Namita Mehra was an employee of the Company and the Company was duly paying her a salary. In previous years, she was extended an advance against her salary. However, as the Company ran into losses on account of the global financial crisis, it could not afford to pay her a salary. The amount continued to be shown as an advance.

This is also treated as advance for business purpose and assessee's contention is accepted.

6. Sakshi Mehra: Rs 2,50,799/-. The amount decreased from Rs5,39,449/- as on 31.3.2010, i.e. a decrease of Rs 2,88,650/-. Smt. Sakshi Mehra was given an advance against salary; and the said amount was being paid back gradually, thus the decrease.

This is also treated as advance for salary purpose and assessee's contention is accepted.

7 Vinay Mehra: Rs 11,71,865.30. The amount has increased from Rs 5,40,237.30 as on 31.3.2010, i.e. an increase of Rs.6,31,628/-. Shri Vinay Mehra has a B. Com (Hons) degree from Sri Ram College of Commerce, Delhi University and Shri Vinay Mehra consulted with the Company from time to time on matter pertaining to commerce, trade, finance, etc. and the Company did not pay him for his services.

The assessee failed to prove with evidence whether any services at all were rendered by Mr. Vinay Mehara. Hence these advances are treated diversion of business funds and interest disallowance is upheld on this ground.

In all the above cases, AO is directed to calculate the disallowance of interest only for the period concerned, which relates to diversion of business funds. ”

[Emphasis is ours]

7. The Tribunal, while sustaining the order of the CIT(A), made the following observations:

“20. After hearing both the sides, we find the Id. CIT(A) sustained the disallowance made by the Assessing Officer on the ground that the assessee failed to prove that C .L. Mehra owns the trademark "Mehraons" and C.L. Mehra is not at all the owner of the trademark "Mehraons" and the amount advanced to C.L. Mehra cannot be treated as prudent and expedient for the business purposes. Similarly, in the case of Chand Mehra, he observed that the assessee failed to prove with evidence that any service has been rendered at all by Chand Mehra to the



assessee. However, in the case of advance given to "Mehra Sons Jewelers Pvt. Ltd. of Rs.23,50,000/-, Namita Mehra of Rs.6,94,914/- and Sakshi Mehra of Rs.2,57,779/- these were allowed by him on the ground that these advances are for business purposes. So far as advance of Rs.11,71,865/- to Vinay Mehra is concerned, he gave a finding that the assessee failed to prove with evidence as to whether any service at all has been rendered by Mr. Vinay Mehra and, therefore, he held that these advances are nothing but diversifying of business fund for which he upheld the disallowance of interest.

21. Aggrieved with such order of the ld. CIT(A), the assessee as well as the Revenue are in appeal before the Tribunal.

22. We have heard the rival arguments made by both the sides and perused the material on record. So far as disallowance of interest on advances paid to Mehra Sons Jewelers Pvt. Ltd. Namita Mehra and Sakshi Mehra are concerned, the ld. CIT(A) has given a categorical finding that these advances are for business purpose or salary advance for which no disallowance of interest is called for. So far as advances to other parties are concerned, ld. CIT(A) has given a finding that the assessee could not substantiate with evidence regarding the justification of diversification of interest bearing funds for which he sustained the disallowance of interest. Under these circumstances and in view of the detailed reasoning given by the ld. CIT(A) on this issue, we find no infirmity in his order on this issue. Accordingly the order of the ld. CIT(A) on this issue is upheld and the ground raised by the assessee and the Revenue are dismissed."

[Emphasis is ours]

8. The CIT(A), as would be evident, had disallowed interest concerning the advances made over to Mr C.L. Mehra, Mr Chand Mehra and Mr Vinay Mehra. Insofar as Mr Chand Mehra and Mr Vinay Mehra are concerned, it was noted that the appellant/assessee did not furnish evidence to show that they had rendered service to the appellant/assessee. Insofar as Mr C.L. Mehra was concerned, the appellant/assessee failed to demonstrate that he was the owner of the trademark "Mehrasons". In this regard, it is noted that litigation was pending with respect to ownership.

9. Qua these findings of fact, there is no material placed on record which would have us reach a different conclusion.

10. In our view, although both the Assessing Officer(AO) and the CIT(A) have referred to an understanding whereby the trademark "Mehrasons" was provided as security for advances inter alia, to Mr C.L. Mehra, the central point which arose for consideration was whether the loans and advances were extended for business purposes. Admittedly, the amounts were provided for medical purposes and children's education. None of these purposes can be said to be related to the business of the appellant/assessee. In our opinion, this was sufficient to sustain the disallowance of interest.

11. Thus, for the aforesaid reasons, in our opinion no



interference is called for with the view taken by the Tribunal and CIT(A) on this aspect. Mr Salil Aggarwal has failed to show that a substantial question of law arises, in this behalf.

12. Therefore, the only aspect that we intend to examine is that which is framed as the first issue. Accordingly, the following substantial question of law is framed for consideration by this Court:

(i) Whether the Tribunal erred in not appreciating that before the Assessing Officer could have taken recourse to the provisions of Section 40A(2)(b) of the Act, he ought to have given an opportunity to the appellant/assessee to produce the relevant evidence?

13. We have heard arguments on this aspect of the matter.

14. Judgment reserved.”

3. After framing the solitary substantial question of law cited above, with consent of both sides we heard final arguments for disposal of both appeals at this stage itself.

4. Learned counsel for appellant/assessee contended that the orders impugned in these appeals are not sustainable in the eyes of law because the appellant had described in detail circumstances under which no salary was paid to the persons concerned i.e. Shri Charanjeet Lal Mehra, Smt. Lata Rani Mehra, Smt. Namita Mehra and Ms. Sakshi Mehra in Financial Years 2008-09 and 2009-10 as well as circumstances under which a meagre salary was paid to them for subsequent years relevant for present purposes. In an effort to justify the payment of salary to the persons concerned, learned counsel for appellant/assessee took us through the detailed profile of the said persons including their educational qualifications, experience and job contribution in the business of the assessee company. On the other hand, learned counsel for respondent/revenue supported the impugned orders and submitted that since the appellant/assessee led no evidence in support of its contentions, there was no illegality in the impugned orders.



5. The provision under Section 40A(2)(b) of the Act stipulates:

“40A. Expenses or payments not deductible in certain circumstances.—(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 individual any relative of the assessee;*
- (ii) where the assessee is a company, any director of the company, partner of the firm, firm, association of persons or or member of the association or family, or any Hindu un-divided family 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;*
- (iv) a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member or any other company carrying on business or profession in which the first mentioned company has substantial interest;*





(v) a company, firm, association of persons or Hindu undivided family of which a director, partner or member, as the case may be, has a substantial interest in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member;

(vi) any person who carries on a business or profession,—

(A) where the assessee being an individual, or any relative of such assessee, has a substantial interest in the business or profession of that person; or

(B) where the assessee being a company, firm, association of persons or Hindu undivided family, or any director of such company, partner of such firm or member of the association or family, or any relative of such director, partner or member, has a substantial interest in the business or profession of that person.

Explanation.—For the purposes of this sub-section, a person shall be deemed to have a substantial interest in a business or profession, if,—

(a) in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) carrying not less than twenty per cent of the voting power; and

(b) in any other case, such person is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the profits of such business or profession”.

(emphasis is ours)

6. There is no dispute that the said persons, namely Shri Charanjeet Lal Mehra, Smt Lata Rani Mehra, Smt Namita Mehra and Smt Sakshi Mehra are persons covered under Section 40A(2)(b) of the Act. As reflected from record, the appellant/assessee was not granted fair opportunity to lead evidence in order to prove its justification for payment of salaries to the said persons.



6.1 For the Assessment Year 2011-12, the Assessing Officer held that the appellant/assessee had debited salary of Rs.29,42,930/- including Rs.24,00,000/- paid to the said persons covered under Section 40A(2)(b) of the Act despite there being a decline in the business during the relevant Financial Year and that there was no justification presented by the appellant/assessee in that regard, so an amount of Rs.20,40,000/- was liable to be disallowed being the difference between the salary paid to the persons concerned during the Financial Year 2010-11 and 2009-10.

6.2 The CIT(A) considered the salary component item wise and allowed the salary paid to Smt. Roshini Mehra and Smt. Aradhna Mehra at the rate of Rs.15,000/- per month on the basis of their academic qualification and nature of responsibility discharged by them during the relevant year, but as regards the salary paid to Shri Charanjeet Lal Mehra and Smt. Lata Rani Mehra at the rate of Rs. 25,000/- per month, sustained the additions made by the Assessing Officer on the ground that the turnover of the assessee company during the relevant year had come down heavily from Rs.3,50,00,000/- to Rs.46,00,000/- and the appellant/assessee had failed to substantiate with evidence, services if at all rendered by them or their justifiability. As regard the salary paid to Shri Pawan Mehra at the rate of Rs. 25,000/- per month, CIT(A) allowed the same on the ground that Shri Pawan Mehra was found entrusted with jobs involving collection rent, deposit of rent cheques with the banks, following up on service tax, supervising the office personnel, looking after the companies machinery etc. As regard salary paid to Smt. Sakshi Mehra at the rate of Rs. 25,000/- per month, CIT(A) sustained the additions made by the Assessing Officer on the



ground that the appellant/assessee could not substantiate the nature of work done by her.

6.3 The learned Tribunal in the impugned orders dated 20.03.2018 and 14.11.2019 simply recorded the above findings of the CIT(A) and expressed agreement with the same without adding their independent arguments/findings.

7. We have examined the explanations advanced on behalf of the appellant/assessee at different stages of the proceedings, whereby the appellant/assessee tried to justify payment of salaries to the persons concerned. But we find the same no better than mere curriculum vitae. No evidence at all was adduced before any of the authorities by the appellant/assessee as regards the educational qualification, experience and work profile of any of the persons concerned, which could be taken as their contribution in the growth of business of the appellant/assessee.

8. The provision under Section 40A(2)(a) of the Act, as extracted above, clearly shows that before recording disallowance, the Assessing Officer has to form an opinion; and that opinion has to be having regard to *inter alia* legitimate needs of the business or benefit derived or even what would be the fair payment outgo for services rendered. Such an opinion cannot be arrived at without adducing necessary evidence. That being so, the Assessing Officer was duty bound to provide an opportunity to the appellant/assessee to place on record the requisite evidence to justify its claim. But all that the Assessing Officer did was to ask the



appellant/assessee to justify the salaries paid, and without seeking relevant evidence, simply rejected claim.

9. To our mind, therefore, the best way forward would be to grant an opportunity to the appellant/assessee to adduce appropriate evidence – documentary or otherwise before the Assessing Officer in order to establish its claim regarding educational qualification, experience, the work profile and in particular the duties discharged by the concerned persons to justify claim of the appellant/assessee qua payment of salary to the persons concerned.

10. The orders impugned in the present appeals are set aside and matters are remanded to the Assessing Officer with liberty to the appellant/assessee to adduce evidence on the lines indicated above. For fresh/further proceedings, the Assessing Officer shall issue fresh notice to the appellant/assessee. Accordingly, the question of law framed above is decided in favour of appellant/assessee and against respondent/revenue. Both appeals are disposed of in above terms.

(GIRISH KATHPALIA)
JUDGE

(RAJIV SHAKDHER)
JUDGE

OCTOBER 13, 2023/as