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

\+ ITA 316/2022

K S COMMODITIES PVT LTD .....Appellant

Through: Mr. Salil Aggarwal, Sr. Adv. with Mr. Mahir Aggarwal, Mr. Madhur Aggarwal, Ms. MeeraBhatia & Mr. Uma Shankar, Advs.

versus

PR COMMISSIONER OF INCOME TAX .....Respondent

Through: Mr. Siddharth Sinha, SSC.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE HARISH VAIDYANATHAN SHANKAR

<u>O R D E R</u>

% **27.02.2025**

1. The assessee impugns the order of the **Income Tax Appellate Tribunal**[1] dated 24 March 2022. We had in terms of our order dated 11 July 2023 admitted this appeal on the following two questions of law:

> (i) Whether the Tribunal misdirected itself in law and in facts in applying the provisions of Section 40A(2)(b)(iii) of the Income Tax Act, 1961 [in short, "the Act"] read with the explanation appended to the section, which defines "substantial interest" *qua* commission paid by the appellant/assessee to one Ms Seema Verma, considering the fact that in the relevant period i.e., Financial Year (FY) 2012-13 [Assessment Year (AY) 2013-14] she held only 17.05% equity in the appellant/assessee, which is less than the prescribed threshold of 20%?
>
> (ii) Whether the Tribunal had returned a perverse finding that the brokerage commission paid to Ms Seema Verma and Trust

[1] Tribunal

Commodities Pvt. Ltd. was excessive and/or unreasonable, and thus fell within the purview of Section 40A of the Act?"

2. The solitary question which arises for our consideration was whether the allocation of shares to one Ms. Seema Verma would have warranted disallowances being made in terms of Section 40A of the **Income Tax Act, 1961**[2].

3. From a reading of the order passed by the Tribunal, it is apparent that there were three persons who were stated to have received excessive commissions in **Assessment Year**[3] 2013-14. These were identified to be Trust Commodities Pvt. Ltd. and which was stated to hold 9% of the shareholding of the assessee company, Ms. Seema Verma, an employee of the assessee who held 17.05% of the equity and NRG Consultants Pvt. Ltd.

4. The Tribunal notes that the **Assessing Officer**[4] had on facts found that the commission paid to these three parties were substantially higher than the average rate of commission paid by the assessee to others. It is this conclusion which led to the disallowances being made in terms of Section 40A with the AO being of the opinion that the assessee had incurred excessive expenditure on commission. While dealing with this question the Tribunal has in Paras 15 & 16 held as follows:

> "**15.** Now, come to the payment of commission made to Trust Commodities Pvt. Ltd. and Miss. Seema Verma. As per the tax report of the Trust Commodities Pvt. Ltd., it is an entity owned by the Directors of the assessee and Ms. Seema Verma is on the Board of Directors as admitted by the assessee before the AO. The said Trust Commodities Pvt. Ltd. was also having 9% share in the assessee Company. Further, <u>Ms. Seema Verma was 16% share</u>

[2] Act
[3] AY
[4] AO

holder of the assessee Company and she was employed with the assessee Company in the relevant FY 2012-13 and later she has also been inducted as Director of the Company in the FY 2015-16. Therefore both the above persons are 'related persons' to the assessee as per Section 40A(2) of the Act.

16. Now come to the quantum of the commission paid to the above two entities. The average rate of commission paid by the assessee to others in respect of Soybean meal was 12.5, but the rate of commission paid to Trust Commodities Pvt. Ltd. was 45 and the difference of rate of commission is 32.5%. Further, the average rate of commission paid by the assessee to others in respect of rice was 20, but rate of commission paid to Ms. Seema Verma was at 215 and the difference of rate of commission is at 195%. The said deference is not only excessive and the same is unrealistic in the market. The AO has rightly made the comparison of the average rate of commission paid by the assessee himself in the case of non related parties to come to the said conclusion. Further, the Ld. CIT(A) has also given specific opportunity to the counsel of the assessee to explain the reason for commission being extraordinary in excess over the average expenditure, but no substantive reason was furnished by the assessee even before CIT(A) proceedings. In our opinion, the said commission paid to those two entities are not only excessive and also unrealistic compared to average rate of commission paid by the assessee itself."

5. The Tribunal has essentially come to hold that Ms. Seema Verma, by virtue of the percentage of equity held in the company coupled with her being employed in **Financial Year**[5] 2012-13 and later on being inducted as a Director of the company in FY 2015-16, would be sufficient to place her in the category of "related persons" and thus justifying the disallowance made under Section 40A(2).

6. For the purposes of examining the challenge which stands raised, we deem it apposite to extract Section 40A insofar as it is relevant for our purposes hereinbelow:

"[Expenses or payments not deductible in certain circumstances.

[5] FY

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 individual any relative of the assessee;

(ii) where the assessee is a company, firm, association of persons or Hindu undivided family any director of the company, partner of the firm, or member of the association or family, or 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;

(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.

7. As is manifest from a reading of Section 40A(2)(a), where an assessee incurs expenditure in respect of a payment made to any person referred to in clause (b) and the AO be of the opinion that such expenditure is either excessive or unreasonable, having regard to the fair market value of goods, services or facilities in respect of which payments have been made, it may disallow the expenditure to the extent that the same is considered excessive or unreasonable. As is manifest from a reading of Section 40A(2)(a), the AO must come to the firm conclusion that the payment has firstly been made to a person who would fall within the ambit of clause (b) of sub-section (2) and that the payment made or benefit derived or accrued is found to be excessive or unreasonable.

8. Insofar as the respondents are concerned, they had firstly placed the case of Ms. Seema Verma within the ambit of clause (b)(ii) and which alludes to Directors of a company or a partner of a company,

firm or association. Undisputedly, and as the Tribunal itself came to record, Ms. Seema Verma was inducted as a Director in the company only in FY 2015-16 and thus corresponding to AY 2016-17. It is thus *ex facie* apparent that clause (b)(ii) would have had no application to AY 2013-14.

9. That then leads us to consider whether the aforenoted individual could be said to be a person who had a *"substantial interest"* in the business of the assessee. The phrase "substantial interest" is what stands defined in the Explanation appended to clause (b) and which brings within its fold persons employed by a company and in which the said individual may be the beneficial owner of shares carrying not less than 20% of the voting power. Clause (b) to the Explanation constitutes the residuary clause and which deals with all other contingencies and speaks of persons who at any time during the previous year could be said to be a beneficiary entitled to not less than 20% of the profits of such business or profession.

10. As is manifest from the above, the Tribunal has chosen to answer the issue of substantial interest solely on the basis of Ms. Seema Verma holding 16% of the equity of the assessee company. It is well settled that percentage of equity, and which alone is an aspect which has been alluded to and taken into consideration by the Tribunal, would neither be equivalent to voting power nor be representative of a share of profits in the business of the assessee. In view of the above, we find ourselves unable to sustain the view as taken by the Tribunal.

11. We, consequently, answer question no. (i) as posed in the negative and against the respondents and question no. (ii) in the

affirmative.

12. The appeal shall, consequently, stand allowed. The order of 24 March 2022 shall stand set aside to the aforesaid extent.

YASHWANT VARMA, J

HARISH VAIDYANATHAN SHANKAR, J

FEBRUARY 27, 2025/kk