

(2013) 07 GUJ CK 0007
In the Gujarat High Court
Case No : Tax Appeal No. 705 of 2012

Jayesh Raichand Shah

APPELLANT

Vs

Assistant Commissioner of Income Tax

RESPONDENT

Date of Decision : 02-07-2013

Acts Referred:

Citation : (2014) 360 ITR 387

Hon'ble Judges : Sonia Gokani, J; M.R. Shah, J

Bench : Division Bench

Advocate : Tushar P. Hemani and Ms. Vaibhavi K. Parikh, for the Appellant;
Pranav G. Desai, for the Respondent

Judgement

M.R. Shah, J.—The present appeal has been preferred by the appellant-assessee challenging the impugned judgment and order passed by the income tax Appellate Tribunal, Rajkot (hereinafter referred to as "the ITAT") in I.T.A. No. 445/Rjt/2011, by which the Tribunal has allowed the said appeal preferred by the Revenue with respect to the assessment year 2008-09. The facts leading to the present appeal, in a nut-shell, are as under:

1.01. That the assessee filed his return of income for the assessment year 2008-09 declaring a total income of Rs. 16,04,107. That the case was selected for scrutiny and subsequently notice u/s 143(2) of the Act was issued by the Assessing Officer. Thereafter, the case was assigned to the Additional Commissioner of income tax, Range-5, Rajkot, who issued notice upon the assessee u/s 142(1) of the Act. That during the assessment proceedings, vide order dated December 16, 2010, the representative of the assessee was directed to explain infirmities in the books of account on account of discrepancy in stock. It appears that no explanation was submitted by the assessee and, therefore, the Assessing Officer, while passing the order of assessment, rejected the books of account of the assessee u/s 145 of the Act observing that he is not satisfied with the correctness and completeness of the books of account.

1.02. It appears that sufficient opportunity was also granted to the assessee to give explanation in respect of the infirmities found in the books of account. However, the assessee failed to avail of the same. That thereafter and after rejecting the books of account u/s 145 of the Act, the Assessing Officer made addition of Rs. 1,61,39,361 towards excessive payment of salary and interest to the relatives covered u/s 40A(2)(b) of the Act, in the income of the assessee.

1.03. Feeling aggrieved by the order of assessment dated December 27, 2010, passed by the Assessing Officer, the assessee preferred an appeal before the Commissioner of income tax (Appeals) and produced certain documents and made submissions which were not even made before the Assessing Officer, and, consequently, held that the Assessing Officer was not justified in rejecting the books of account and making addition of Rs. 1,07,39,574 and, therefore, deleted the estimation of additional profit of Rs. 1,07,39,574 made by the Assessing Officer. The Commissioner of income tax (Appeals) also deleted the addition of Rs. 7,46,965 as well as Rs. 30,48,715 and, consequently, allowed the appeal, vide order dated September 29, 2011.

1.04. Feeling aggrieved by and dissatisfied with the order passed by the Commissioner of income tax (Appeals) dated September 29, 2011, in allowing the appeal preferred by the assessee, the Revenue preferred an appeal before the income tax Appellate Tribunal, Rajkot, and considering the fact that the Commissioner of income tax (Appeals) passed the order and set aside the order of the Assessing Officer with respect to the rejection of the books of account, considering the explanation before the Commissioner of income tax (Appeals), which was never furnished by the assessee before the Assessing Officer, by the impugned judgment and order, the Tribunal has allowed the said appeal and remanded the matter back to the Assessing Officer. So far as the order passed by the Commissioner of income tax (Appeals) deleting the addition of Rs. 7,46,965 as well as Rs. 30,48,715 made by the Assessing Officer u/s 40A(2)(b) of the Act, the income tax Appellate Tribunal has allowed the said appeal qua the aforesaid two amounts and has set aside the order passed by the Commissioner of income tax (Appeals). Feeling aggrieved by and dissatisfied with the impugned judgment and order passed by the income tax Appellate Tribunal, Rajkot, the assessee has preferred the present appeal with the following proposed questions of law:

(i) Whether, in the facts and in the circumstances of the case, the income tax Appellate Tribunal was right in law in adjudicating upon the aspect of rejecting the books of account of the appellant u/s 145 of the Act without there being any ground raised before it in the appeal memo?

(ii) Whether, in the facts and in the circumstances of the case, the income tax Appellate Tribunal was right in law in setting aside the issue of rejection of books of account and the estimation of gross profits back to the file of the Assessing Officer without there being any cogent reasons or grounds for the same?

(iii) Whether, in the facts and in the circumstances of the case, the income tax

Appellate Tribunal was right in law in confirming the order of the Assessing Officer in disallowing the claim of interest payment amounting to Rs. 7,46,965?

(iv) Whether, in the facts and in the circumstances of the case, it is open to the income tax Appellate Tribunal to completely change the basis of disallowance from u/s 40A(2)(b) which invoked by the Assessing Officer to section 36(1)(iii) which had not been invoked by any of the lower authorities?

(v) Whether, in the facts and in the circumstances of the case, the income tax Appellate Tribunal was right in law in confirming the order of the Assessing Officer in disallowing the salary expenditure amounting to Rs. 30,48,715?

(vi) Whether, in the facts and in the circumstances of the case, is it open to the income tax Appellate Tribunal to completely change the basis of disallowance from u/s 40A(2)(b) which was invoked by the Assessing Officer to section 37 which had not been invoked by any of the lower authorities?

(vii) Whether, in the facts and under the circumstances of the case, the order of the income tax Appellate Tribunal is perverse inasmuch as:

(a) it was passed without giving proper opportunity of hearing to the counsel of the appellant who was prevented from arguing the appeal because the Tribunal indicated that there was no merits in the appeal of the Revenue and, therefore, there was no need to argue;

(b) it considers the material and evidences, which are not emanating from the orders of the lower authorities and further erred in considering the irrelevant and extraneous materials ignoring the provisions of law;

(c) it upholds the conclusions of the Assessing Officer entirely on different and factually and legally erroneous grounds;

(d) it does not consider the relevant documents filed and placed before in the paper book;

(e) it reverses the findings of the Commissioner of income tax (Appeals) without giving sufficient and cogent reasons.

2. Having heard Mr. Hemani, learned advocate appearing on behalf of the appellant-assessee. With respect to the impugned judgment and order passed by the income tax Appellate Tribunal remanding the matter to the Assessing Officer on the issue of rejection of books of account u/s 145(3) of the income tax Act and, consequently, addition of Rs. 1,07,39,574 by way of estimation of gross profit is concerned, as the matter is remanded to the Assessing Officer and sufficient opportunity will be given to the assessee to make submissions and submit explanation, we do not think it proper to interfere with the impugned order of remand by the income tax Appellate Tribunal with respect to the aforesaid issue. However, suffice it to say that despite the sufficient opportunity given to the assessee to explain the discrepancies in the books of account as well as stock, the assessee failed to availed of the opportunity and furnish the

explanation before the Assessing Officer. Thereafter, before the Commissioner of income tax (Appeals) for the first time the assessee furnished the explanation which came to be considered by the Commissioner of income tax (Appeals) and considering the said explanation, the Commissioner of income tax (Appeals) held that sufficient explanation has been furnished by the assessee and, therefore, the Assessing Officer erred in rejecting the books of account. Considering the fact that the assessee did not furnish explanation before the Assessing Officer and furnished explanation before the Commissioner of income tax (Appeals) for the first time and the Assessing Officer was not given opportunity to consider the explanation, the income tax Appellate Tribunal has rightly remanded the matter to the Assessing Officer on the aforesaid issue. Under the circumstances, no interference of this court is called for with respect to the aforesaid order of remand.

3. Now, so far the issue with respect to the addition made by the Assessing Officer of Rs. 7,46,965 on account of disallowance of interest payment u/s 40A(2) (b) of the Act, confirmed by the income tax Appellate Tribunal, is concerned, it is required to be noted that the assessee claimed disallowance of the aforesaid amount u/s 40A(2)(b) of the Act on the amount of loan taken from three persons, namely, Mr. Bhavik J. Shah, Mr. Tejas Shah and Mr. Jignesh Shah and the interest paid to them at the rate of 16 per cent, per annum. It was found that so far as Mr. Bhavik J. Shah is concerned, he is son of the assessee and Mr. Tejas Shah and Mr. Jignesh Shah are his nephews. It was also found by the Assessing Officer as well as the income tax Appellate Tribunal that the assessee made gift of Rs. 20,00,000 to each of the three persons, namely, Mr. Bhavik J. Shah, Mr. Tejas Shah and Mr. Jignesh Shah on June 19, 2007, and immediately thereafter the aforesaid three persons placed the same amount in the hands of the assessee on which interest at the rate of 16 per cent, aggregating to Rs. 7,46,965 was claimed as deduction by the assessee. While disallowing the aforesaid claim and making addition of the aforesaid amount of Rs. 7,46,965 to the total income, the Assessing Officer observed as under:

Here it is important to mention that business exigency and prudence are the two basic parameters to determine the allowability of any expenditure. Therefore, no prudent businessman will gift his money when there is certain exigency of money. In the instant case, it is seen that the assessee has made gift of Rs. 20,00,000 to each to Shri Bhavik J. Shah, Shri Tejas Shah and Shri Jignesh Shah on June 19, 2007, June 19, 2007, and June 16, 2007, respectively, and almost the same amount is received as loan from these persons just after 3 days that is on June 22, 2007. This action of the assessee clearly transpires that business exigency was over looked and unreasonable interest was paid to the above persons. Therefore, the interest paid to the above persons on the amount gifted is not allowable as per section 40A(2)(b) of the income tax Act. Accordingly, I calculate the excessive payment of interest on the amount gifted as under:

The same came to be deleted by the Commissioner of income tax (Appeals) and

in appeal the income tax Appellate Tribunal reversed the order of the Commissioner of income tax (Appeals) and confirmed the addition made by the Assessing Officer. While restoring order passed by the Assessing Officer, the income tax Appellate Tribunal in the impugned order has observed and held as under:

17. We have heard both the parties. Observations made in the assessment order indicate that Rs. 60,00,000 were diverted by the assessee from his business in favour of three persons, namely, Shri Bhavik J. Shah, Shri Tejas R. Shah and Shri Jignesh R. Shah allegedly by way of gift. After the so-called gift, the assessee got back the same money from all the aforesaid three persons on which the assessee chose to pay interest at 16 per cent, which aggregated to Rs. 7,46,965. None of the aforesaid persons could have got interest at 16 per cent as the rate of interest given by the bank and financial institutions even on fixed deposit was not as high as 16 per cent, in the year under appeal. The assessee claims that Shri Bhavik J. Shah alone was related to the assessee within the meaning of section 40A(2)(b) and remaining two persons were not related to the assessee within the meaning of section 40A(2). It is, however, not in dispute that all the three persons were related to the assessee which may or may not be covered by section 40A(2)(b).

18. Section 36(1)(iii) allows deduction for payment of interest on capital borrowed for the purpose of business. In the present case, the money was first diverted by the assessee from his business disguising it as gift to the aforesaid three persons and thereafter the same money was taken back by the assessee from the aforesaid two persons on which the impugned interest was claimed by the assessee to have paid to them. On the facts of the case, there is no borrowing of capital and, therefore, the requirement of section 36(1)(iii) is not fulfilled. Without prejudice to the aforesaid, the entire series of transactions are illusory, colourable and not genuinely for the purpose of the business. In this view of the matter, the assessee is not entitled to deduction u/s 36(1)(iii). The order of the Assessing Officer making the impugned disallowance is, therefore, restored.

19. Reliance placed by the learned Commissioner of income tax (Appeals) on section 40A(2)(b) is completely misplaced for the reason that the deduction towards the interest paid on borrowed capital has to be examined firstly with reference to the provisions of section 36(1)(iii) and thereafter with reference to the provisions of section 40A(2). In the present case, the series of transactions carried out by the assessee simply indicate a colourable device to ensure deduction of interest from taxable income. They do not establish any genuine borrowing. It is quite well settled that illegal or colourable devices have to be ignored. The Commissioner of income tax (Appeals) ought to have ignored them and decided the issue in accordance with the provisions of section 36(1)(iii) which was relevant for deciding the issue under appeal. Ground 2 is allowed.

We are in complete agreement with the reasoning given by the income tax

Appellate Tribunal. The submissions on behalf of the assessee that out of the aforesaid three persons, two persons, namely, Mr. Tejas Shah and Mr. Jignesh Shah cannot be said to be related to the assessee within the meaning of section 40A(2)(b) of the Act is concerned, it is required to be noted that as such the aforesaid persons are found to be nephews of the assessee and the finding that money was first diverted by the assessee from his business as a gift to the aforesaid three persons and thereafter the same money was given to the assessee at the rate of 16 per cent, per annum and on which the assessee claimed the benefit u/s 40A(2)(b) of the Act and the entire series of transactions were illusory, colourable and not genuinely for the purpose of the business. It is rightly held that there is no borrowing of capital and, therefore, the requirement of section 36(1)(iii) is not fulfilled and, therefore, the income tax Appellate Tribunal has rightly restored the disallowance by the Assessing Officer. No interference of this court is called for.

4. Now, so far as the issue with respect to the disallowance of Rs. 30,48,715 of salary payment u/s 40A(2)(b) of the Act is concerned, it is required to be noted that both, the Assessing Officer as well as income tax Appellate Tribunal have specifically observed and held that the assessee has devised a colourful mechanism to avoid the tax liability in the hands of his proprietary business. It is required to be noted that the aforesaid amount of Rs. 30,48,715 has claimed to be paid to the aforesaid three persons, namely, Mr. Bhavik J. Shah (son), Mr. Tejas Shah and Mr. Jignesh Shah.

The Tribunal has dealt with the aforesaid issue in detail and in paragraphs 25 to 28, the Tribunal has observed and held as under:

25. We have heard both the parties and carefully considered their submissions. The impugned disallowance has been made by the Assessing Officer out of salary paid in the year under appeal to Shri Bhavik J. Shah, Shri Tejas J. Shah and Shri Jignesh R. Shah. The assessee claims that only Shri Bhavik J. Shah is related to the assessee within the meaning of section 40A(2)(b) and not others. He, however, does not dispute that all the three persons are closely related to the assessee which may or may not be covered by section 40A(2)(b).

26. Relationship by itself, without more, cannot lead to the inference of excluding the possibility of a payment being wholly and exclusively for the purpose of business. Dealing with relatives in contrast with or in preference to stranger is neither prohibited by law nor can be tabooed. Indeed, it is natural to do so but this does not give a licence to cover up dishonest transactions or impermissible transfers. The courts and authorities are not expected to wear blinkers to overlook or condone the passing off public revenue to one's own kith and kin by subterfuge clandestine or clever devices clothes in legalistic jargon, instead it is their duty to lift the veil of apparent legality and get to the truth or substance of a transaction to deal with it in accordance with law. It is only appropriate, indeed normal, that dealings involving transfer of funds to near and dear ones need to be looked into with care and caution and necessary inferences drawn if there are

abnormalities attaching to such transactions.

27. The relationship contemplated by section 40A(2)(b) is relevant for the purposes of that section only. The fact that the assessee is closely related to the aforesaid three persons is not denied by the assessee. Section 37(1) permits deduction for expenditure only if it is incurred wholly and exclusively for the purpose of the business. The word "wholly" refers to quantum of expenditure while the word "exclusively" reference to the motive, objective and the purposes of expenditure and gives jurisdiction to the taxing authorities to examine this matter. Expenditure is to be allowed only if it is incurred wholly and exclusively for the purposes of business and for no other purpose or with no other motive. In order to be allowable u/s 37(1), the expenditure must, therefore, satisfy the test of commercial expediency. Commercial expediency has to be form the point of view of an assessee who knows best how his business has to be run but such a point of view has to be reasonable point of view which is free from taint of excessiveness, collusiveness or colourable discretion.

28. Turning to the facts of the present case, Shri Bhavik J. Shah was paid salary amounting to Rs. 14,04,924 in the year under appeal as against Rs. 1,80,000 in the immediately preceding year, Shri Tejas R. Shah paid salary amounting to Rs. 14,04,924 in the year under appeal as against Rs. 1,80,000 in the immediately preceding year while Shri Jignesh R. Shah was paid salary amounting to Rs. 7,78,867 in the year under appeal as against Rs. 1,80,000 in the immediately preceding year. Perusal of part B of annexure to the tax audit report for the year under appeal shows that the gross turnover of the assessee in the year under appeal was Rs. 13,91,50,844 as against Rs. 12,29,62,979 in the immediately preceding year. Thus, there was marginal increase in the turnover in the year under appeal declined to Rs. 1,47,38,946 from Rs. 2,70,59,941. In the immediately preceding year. Similarly, the net profit before tax also declined to Rs. 5,37,950 in the year under appeal from Rs. 1,95,38,568. Thus, the submission of the assessee that the aforesaid three persons had enormously contributed to the growth in sales in the year under appeal over the immediately preceding year is not supported by the record. It is further noticed that the salary paid to the aforesaid three persons has increased by about 7 times. On being asked as to whether similar increase (more than 7 times over the preceding year) in salary was given to other staff member, the reply of the assessee was in the negative. The test of commercial expediency in giving seven times increase in their salary is not satisfied. There is nothing on record to show that the aforesaid three persons contributed more towards the sale or the profit or the well-being of the business of the assessee than what they had contributed in the past so as to justify more than seven times increase in their salary in the year under appeal. On the facts and circumstances of the case, we are satisfied that the increase in their salary in the year under appeal was not motivated by considerations of commercial expediency but by considerations extraneous to the business. In this view of the matter, the disallowance made by the Assessing Officer is restored.

5. We are in complete agreement with the reasoning given by the income tax Appellate Tribunal. The Tribunal has rightly observed that although payment might have been made and there might have been agreement in existence, still it would be open to the Assessing Officer to take into consideration various factors which would go to show whether the payment was made as required by section 37 of the Act or not. It is required to be noted that as such the Assessing Officer after taking into consideration the relevant factors came to the conclusion that the payment was not made wholly or exclusively for the purpose of the business of the assessee and, therefore, the Assessing Officer rightly disallowed the aforesaid deduction which has been rightly restored by the income tax Appellate Tribunal. In view of the above and for the reasons stated above, we see no reason to interfere with the impugned judgment and order passed by the income tax Appellate Tribunal more particularly when no question of law much less any substantial question of law arise in the present appeal. Hence, the present appeal deserves to be dismissed and is accordingly dismissed.