(2013) 01 AHC CK 0027

In the Allahabad High Court

Case No : Income Tax Reference No. 76 of 1986

S.M. Haq APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 10-01-2013

Acts Referred:

Citation : (2013) 358 ITR 246

Hon'ble Judges : R.K. Agrawal, J;Prakash Krishna, J

Bench : Division Bench

Advocate : Vikram Gulati, for the Appellant; A. Kumar, A.N. Mahajan, B. Agarwal, D. Awasthi, G. Krishna and S. Chopra, for the Respondent

Judgement

1. The income tax Appellate Tribunal, Delhi Bench "B", Delhi has referred the following questions of law u/s 256(2) of the income tax Act, 1961, hereinafter referred to as "the Act", for opinion to this court.

(i) Whether, on the facts and in the circumstances of the case, the learned Tribunal was justified in holding that the amount of commission paid was excessive and there was no commercial consideration or business expediency for the payment of such an excessive commission?

(ii) Whether, on the facts and in the circumstances of the case, there was any evidence before the Tribunal to come to the conclusion that the amount of commission amounting to Rs. 36,078 paid to Sri Habib Akhtar was excessive and that there was no commercial consideration or business expediency for the payment of such commission?

(iii) Whether, on the facts and in the circumstances of the case, the Tribunal was right in applying the provisions of section 40A(2) of the income tax Act, 1961, in disallowing the commission paid to the extent of Rs. 30,078 as against Rs. 36,078 paid by the assessee absolutely for business purpose and for the technical expertise of Sri Habib Akhtar in preparing the exportable quality of tobacco?

Briefly stated the facts giving rise to the present reference are as follows:

The reference relates to the assessment year 1977-78 to which the previous year is the year ending on March 31,1977. The applicant-assessee is a partnership firm, which enjoys the income from manufacture and sale of tobacco. For the assessment year in question it had filed its return of income declaring an income of Rs. 2,01,438. The proceeding u/s 143(2) of the Act was undertaken by the assessing authority and during the course of assessment proceedings it was noticed that the assessee had paid a commission of Rs. 36,078 to one Sri Habib Akhtar, son of the one of the partners. The assessee was asked to prove the services rendered by Sri Habib Akhtar for which commission was paid. The assessee took the stand that it had started a new factory in addition to the earlier one and that his services were utilised in execution of orders and supervision of the production. It was claimed that the production had increased from Rs. 20,56,956 in the preceding assessment year to Rs. 39,23,753 in the year under consideration.- The payment of commission of Rs. 36,078 to Sri Habib Akhtar was, therefore, justified. However, the assessing authority examined Sri Habib Akhtar on oath and invoked the provisions of section 40A(2)(a) of the Act. He allowed the deduction of Rs. 3,000 and the balance commission amounting to Rs. 33,078 was disallowed. The assessee preferred an appeal before the Commissioner of income tax (Appeals), who, vide order dated March 17, 1982, did not accept the plea of the assessee and confirmed the disallowance on this ground. Still feeling aggrieved the assessee presented a second appeal before the income tax Appellate Tribunal, Delhi Bench, which, vide order dated July 1,1983, partly allowed the appeal and enhanced the commission to Rs. 6,000 from Rs. 3,000 as allowed by the Assessing Officer. The balance amount of Rs. 30,078 remained disallowed.

2. We have heard the learned counsel for the parties.

3. Learned counsel for the applicant submitted that Sri Habib Akhtar had expertise in preparing mixture of perfumed tobacco and by his effort the production was increased almost 100 per cent, and, therefore, the commission of Rs. 36,078 paid to Sri Habib Akhtar was fully justified and the view to the contrary taken by the authorities including that by the Tribunal is erroneous and cannot be sustained.

4. Learned standing counsel relying upon the order of the Tribunal submitted that Sri Habib Akhtar was a man of 21 years of age and was a studying. He had no expertise and, moreover, the payment of commission did not relate to the services rendered by him. It was done only to reduce the profits, therefore, the Assessing Officer had rightly invoked the provisions of section 40A(2)(a) of the Act.

5. We have given our thoughtful consideration to the various pleas raised by the learned counsel for the parties. We find that the Tribunal while allowing the commission to the extent of Rs. 6,000 had recorded the following findings in its

order which for ready reference are reproduced below:

4. We have heard both the representative for the assessee, Mr. Gupta and the Departmental representative at length. It is an admitted position that Habib Akhtar is the son of one of the partners of the assessee-firm. As such, the matter has to be examined in the matter of the allowance of commission to Habib Akhtar in the light of the provisions of section 40A(2)(i) of the Act, which lays down that in respect of an expenditure of the type involved in the present case the income tax Officer has to form the opinion as to whether the payment of commission so made was excessive or unreasonable having regard to the fair market value of the services for which the payment was made or the legitimate needs of the business of the assessee or the benefit derived by or accruing to the assessee therefrom and to the extent of the expenditure being excessive or unreasonable the same was to be disallowed.

5. This takes us to the statement of Habib Akhtar, which is at page 6 of the paper book filed by the assessee. In the year under consideration, he was aged about 21 having born on August 9, 1955. He passed his Matriculation Examination in 1975. In the year under consideration, he was studying as he passed his Intermediate Examination in 1977. He claims in the said statement that in the new factor)7 he was preparing mixture of tobacco perfumed mixture, purchase of tobacco and despatch of goods. He used to purchase the tobacco of different qualities. He also decided as to the extent in which one quality tobacco will be mixed with another. He claims to have acquired this art since his childhood because that was done in his presence. He claims to have made the purchases from different places, such as Haji Nawab Ali, Sadiq Ali of Rampur from Chandausi though he does not remember other places from where he had purchased. He used to send the bills after his signatures as and when the goods were received. Let us now compare the said statement with the agreement entered into between the assessee and Habib Akhtar. According to that agreement which is in the form of a letter addressed by the assessee to Habib Akhtar, he was to look after the labour, production, packing and despatch. According to this letter, he was not to make any purchases. In the statement made by Habib Akhtar he does not talk about his looking after labour, packing and despatch of goods.

6. Habib Akhtar is a boy of 21. He was at the relevant time studying in a college. It is doubtful if he had such a mastery merely on the basis of what he used to see to know the art of mixing of different tobacco to produce the requisite results. The functions performed by him, according to his statement, are different from the purpose for which he was employed. He is paid commission not on the turnover of the new factory but of the entire production of the assessee, though he had not rendered any services in the old factory. Besides, Habib Akhtar, several other persons have been paid commission for working along with Habib Akhtar. We, therefore, keeping in view the facts and circumstances of the case and the material on record consider that the payment

of commission of Rs. 36,078 by the assessee to Habib Akhtar was highly excessive and unreasonable having regard to the fair market value of the services for which the payment was made for the legitimate business need of the assessee or the benefit derived by or accruing to it therefrom. At the same time, the extent of the expenditure held to be excessive or unreasonable at Rs. 33,078 was excessive. It would be fair and reasonable to consider an expenditure of Rs. 6,000 to be reasonable having regard to the services rendered and the legitimate needs of the business of the assessee or the benefit derived by or accruing to it therefrom. As such, the disallowance will be of Rs. 30,078. We hold likewise.

6. From the findings recorded by the Tribunal it is absolutely clear that Sri Habib Akhtar was aged about 21 years during the previous year relevant to the assessment year in question and was still studying. He had no expertise in preparing tobacco mixtures. Even though he claimed to have made purchases and placed orders he could only remember the names of two sellers and did not remember the names of the other sellers. The assessee-firm had engaged Sri Habib Akhtar to look after the labour, production, packing and despatch and he was not at all entrusted with the work of making purchases. In the statement given by Sri Habib Akhtar there is no whisper about his looking after the labour, production, packing and despatch of goods. The acquiring of expertise had also been doubted by the Tribunal. The Tribunal has also recorded that he had been given commission on the entire production whereas he was employed to render services only in the new factory. Besides Sri Habib Akhtar several other persons had been paid commission for working along with him. The Tribunal, therefore, restricted the payment of commission to Rs. 6,000 to Sri Habib Akhtar. On the finding recorded by the Tribunal we are of the considered opinion, that the Tribunal was justified in holding that the payment of commission was excessive as there was no commercial consideration or business expediency for payment of such excessive amount. Moreover, the findings recorded by the Tribunal are based on relevant material and evidence on record.

7. Learned counsel for the applicant has relied upon a Division Bench decision of this court in the case of Abbas Wazir (P) Ltd. Vs. Commissioner of Income Tax, and submitted that the reasonableness of an expenditure has to be considered from the view point of a prudent businessman. In the aforesaid case, this court has held that whenever a claim is made by the assessee before the income tax Officer for allowing an expenditure as a legitimate business expenditure, the approach of the income tax Officer (or other income tax authority) has to be that he has to look at the matter from the view point of a prudent businessman, and not from his own view point, and then ascertain whether the said expenditure has been incurred for the purpose of commercial expediency or not. In other words, the income tax Officer must try to put himself in the shoes of a prudent businessman and try to look at the matter from that point of view. The court has further held that a businessman may make an expenditure, which he is under no legal obligation to make, but if he does so as a measure of commercial expediency, it must be allowed u/s 37 of the Act as legitimate business

expenditure. The court came to the conclusion that when a company pay a higher salary to the directors or the managers or to other officers or employees as a matter of commercial expediency, it is not for the income tax Officer to say that in his opinion the said salary should not have been paid. A company may decide to pay a higher remuneration to its directors, officers or employees so as to encourage them to work hard, expand the business, or for a host of other commercial considerations and the matter has to be looked at from the view point of the company. Applying the principles laid down in the aforesaid case to the facts of the present case we find that in the case in hand the assessing authority has considered all the relevant factors, viz., the agreement, the work done in the new factory as also the quantum of amount paid with relation to the production done in the old as well as the new factory and had acted from the view point of a prudent businessman while invoking the provisions of section 40A(2) of the Act and disallowing a part of the commission on the ground of being excessive in nature. In view of the foregoing discussion, we answer all the three questions, referred to us for opinion, in the affirmative, i.e., in favour of the Revenue and against the assessee.

