



* REPORTABLE
 IN THE HIGH COURT OF DELHI AT NEW DELHI

+ ITA 306/2011

JUDGMENT DELIVERED ON: JULY 08,2011

HIVE COMMUNICATION PVT. LTD. . . . APPELLANT

Through : Mr. Satyen Sethi,. Advocate with
 Mr. Arta Trana Panda, Advocate

VERSUS

COMMISSIONER OF INCOME TAX . . .RESPONDENT

Through: Mr.Kiran Babu, Sr.
 Standing Counsel

CORAM :-

**HON'BLE MR. JUSTICE A.K. SIKRI
 HON'BLE MR. JUSTICE M.L. MEHTA**

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J. (ORAL)

1. The assessee/appellant is engaged in the business of advertising and media. For the assessment year 2005-06, it filed return declaring total income at ₹19,67,165/-. The assessment was completed under section 143 (3) of the Income-Tax Act (hereinafter referred to as the Act) at a total income of



₹62,37,332/-. While making this assessment, the AO found that Directors of the assessee company were paid remuneration. The two Directors namely Mr. R.P. Singh and Mr. Vishal Sharma were receiving the remuneration of ₹7.20 lacs and ₹9.60 lacs respectively. According to the Assessing Officer since the job profile of both the Directors were same namely client management, remuneration paid to Mr. Vishal Sharma was excessive by ₹2.40 lacs in comparison with the remuneration given by Mr. R.P. Singh thus invoking the provisions of Section 40A (2) of the Act. The AO disallowed a sum of ₹ 2.40 lacs paid to Mr. Vishal Sharma thereby bringing the remuneration of both the persons at par i.e. 7.20 lacs.

2. Another Director Mr. Sushil Pandit was given remuneration of ₹25,20,000/-. He was having job profile of Media Consultant which was different from the job profile of aforesaid Directors namely client management. Still the Assessing Officer was of the view that the remuneration of ₹25.20 lacs paid to him was substantially higher than what was paid to other two directors, he took into consideration the fact that one M/s Utopia Consulting who does the job of media consultancy for the assessee company as an independent person was paid professional charges of ₹ 6 lacs. The Assessing Officer held the



view that the remuneration of Mr.Sushil Pandit should not be more than double the amount paid to M/s Utopia Consulting. On this basis, he formed an opinion that the professional charges paid to Mr. Sushil Pandit should be ₹12 lacs and on this basis invoking the provisions of Section 40A (2) of the Act, he disallowed a sum of ₹13.20 lacs as unreasonable. In the process he also noted that Mr. Sushil Pandit was holding 65% shares in the company and, therefore, provisions of Section 40A (2) were clearly attracted.

3. The assessee preferred appeal there against which was dismissed upholding the disallowance made by the AO. Still aggrieved, the assessee preferred appeal before the Tribunal. This appeal has been decided vide impugned orders dated 30.6.2010. The Tribunal has deleted the addition of ₹ 2.40 lacs made on account of remuneration paid to Mr. Vishal Sharma holding that the same was not excessive. However, the deletion in respect of Mr. Sushil Pandit in the sum of ₹ 13.20 lacs had been upheld. It would be pertinent to mention that the Tribunal has held the view that comparison to Utopia is incorrect for the reasons that Utopia was not being remunerated on an ongoing basis as the payment was made only in respect of one project and whereas Mr. Sushil Pandit was working throughout the year as its



Managing Director with media consultancy portfolio. Still the Tribunal has upheld the disallowance on the basis of share holding of the directors taking note of the fact that Mr.Sushil Pandit was holding 65% in the company and his remuneration was much more than the remuneration paid to other two Directors. The Tribunal thus opined that remuneration paid to Mr. Sushil Pandit is excessive and unreasonable.

4. Dissatisfied with the aforesaid outcome of the Tribunal, the appellant has approached this Court by filing present appeal under Section 260-A of the Act which we have admitted on the following substantial question of law:-

“Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in upholding the disallowance of ₹13,20,000/- out of remuneration paid to Mr. Sushil Pandit by invoking the provisions of Section 40A(2) of the Act?”

5. With the consent of the parties, we have heard the matter finally at this stage itself.

6. After considering the arguments of the counsel for the counsel for the parties, we are of the opinion that the question of law needs to be answered in favour of the assessee and against the revenue. Our reasons for this are as follows:-



It is not in dispute that Mr. Sushil Pandit holds 65% share holding in the assessee company as against 20% and 15% held by Mr. R.P. Singh and Mr. Vishal Sharma respectively. For this purpose, it can also be safely assumed that provisions of Section 40A(2) of the Act can be attracted. However, in order to sustain the addition made by the AO it is also essential to show that the remuneration paid to Mr. Sushil Pandit was excessive or unreasonable. Having regard to the fair market value of the goods, services or facilities for which the payment is made. This yardstick is provided in sub Section (2) of Section 40A which reads as under:-

“40A Expenses or payments not deductible in certain circumstances.

(1).....

(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 subsection, 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 for 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.”



7. The question whether the expenditure is excessive or unreasonable in a given case has to be examined keeping in mind the services (with which we are concerned in the present case) for which payment is made. In the process the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to the assessee from such services is also to be kept in mind. After applying this test if it is found that the expenditure is excessive or unreasonable excess, excess or unreasonable portion of the expenditure is to be disallowed. We have also kept in mind the provisions of sub Section 2 (b) of Section 40-A of the Act as per which the burden is upon the assessee to establish that the price paid by it is not excessive or unreasonable as in this case Mr.Sushil Pandit was holding substantial portion of share namely 65% in the assessee company.

8. When we apply the aforesaid principle in the facts of this case, we find that the assessee has been able to discharge the burden that the price paid by it to Mr. Sushil Pandit is not excessive or unreasonable.

9. As accepted by the Tribunal itself, the case of Utopia Consulting does not represent a valid comparable case for the



reason that it is not being remunerated on an ongoing basis as the payment had been paid only in respect one project. The Assessing Officer had made addition keeping in mind the fee paid to Utopia Consultancy. Once that basis is locked out, nothing remained for comparison. However, the Tribunal adopted another comparison namely that Mr. R.P. Singh to whom the remuneration of ₹7.20 lacs was paid, there was an internal comparable case. In the process what is totally glossed over and ignored by the Tribunal is that Mr. R.P. Singh was having the job profile of the client management whereas the job profile of Mr. Sushil Pandit was that of Media Consultant. Therefore, the case of Mr. R.P. Singh was also comparable.

10. It is to be kept in mind that the assessee is in the business of advertising and media. In such a business, the role of a media consultant is much more important than of the role of a client management. In fact, considering the nature of business, media consultancy is the back bone of such business and plays much more pivotal role than the persons handling client management. For this reason, if Mr. Sushil Pandit was paid higher remuneration than Mr. R.P. Singh, it could not be treated as excessive or unreasonable, more so, when the two cases were not at par and could be treated as comparable by any standards.



11. We may also refer to the scope of Section 40A (2) as explained by CBDT in Circular No. 6P, dated 6th July, 1968. The CBDT clarified that while examining the reasonableness of expenditure the Assessing Officer is expected to exercise his judgment in a reasonable and fair manner. It should be borne in mind that the provision is meant to check evasion of tax through excessive or unreasonable payments to relatives and associate concerns and should not be applied in a manner which will cause hardship in bona fide cases.

12. It will also be useful to refer to the judgment of Allahabad High Court in **Abbas Wazir (P) Ltd.** Vs. **CIT** (2004) 265 ITR 77 wherein the High Court held that even while invoking the provisions of Section 40A(2) of the Act, the reasonableness of the expenditure for the purpose of business has to be judged from the point of view of a businessman and not that of the revenue. The approach has to be that of a prudent businessman and the reasonableness must be looked into from businessman point of view. Similar view is held by the Madras High Court in **CIT** Vs. **Computer Graphics Ltd.** (2006) 285 ITR 84.



13. In ***CIT Vs. Edward Keventer (Private) Ltd.*** (1972) 86 ITR 370, the Calcutta High Court considering identical provision in 1922 Act, it was held that the section places two limitations in the matter of exercise of the power. The section enjoins the Assessing officer in forming any opinion as to the reasonableness or otherwise of the expenditure incurred must take into consideration (i) the legitimate business needs of the company and (ii) the benefit derived by or accruing to the company. The legitimate business needs of the company must be judged from the view point of the company itself and must be viewed from the point of view of a prudent businessman. It is not for the Assessing Officer to dictate what the business needs of the company should be and he is only to judge the legitimacy of the business needs of the company from the point of view of a prudent businessman. The benefit derived or accruing to the company must also be considered from the angle of a prudent businessman. The term “benefit” to a company in relation to its business, it must be remembered, has a very wide connotation and may not necessarily be capable of being accurately measured in terms of pound, shillings and pence in all cases. Both these aspects have to be considered judiciously, dispassionately without any bias of



any kind from the view-point of a reasonable and honest person in business.

14. The aforesaid judgment of Calcutta High Court was affirmed by the Apex Court in **CIT Vs. Edward Keventer (Private) Ltd.** (1978) 115 ITR 149 (SC). In the same line is the judgment of Bombay High Court in the case of **CIT Vs. Shatrunjay Diamonds** (2003) 261 ITR 258 (Bom).

15. We thus answer the question in favour of the assessee and in the negative holding that the Tribunal was not correct in law in upholding disallowance of ₹ 13.20 lacs out of remuneration paid to Mr. Sushil Pandit by invoking the provisions of Section 40A(2) of the Act. The disallowance made is thus deleted and this appeal is allowed.

16. No order as to cost.

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

JULY 05, 2011

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