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

\+ **INCOME TAX APPEAL No. 1094/2018**

Date of decision: 12th December, 2018

PR. COMMISSIONER OF INCOME TAX DELHI-5..... Appellant
Through Mr. Zoheb Hossain, Sr. Standing Counsel.

versus

M/S. LOK ADVISORY SERVICES PVT. LTD. ..... Respondent
Through Mr. Jitendra Jain, Mr. R. Sudhinder & Ms. Saumya Mehrotra, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE ANUP JAIRAM BHAMBHANI

SANJIV KHANNA, J. (ORAL):

CM No. 40854/2018

Delay of 57 days in re-filing of the appeal is condoned as the application is not opposed by the counsel for the respondent. Application is allowed.

INCOME TAX APPEAL No. 1094/2018

This appeal by the Revenue under Section 260A of the Income Tax Act, 1961 (Act, for short) in the case of M/s Lok Advisory Services Private Limited ('respondent-assessee', for short) relates to Assessment Year 2012-

13 and arises from the order of the Income Tax Appellate Tribunal ('Tribunal', for short) dated 24th January, 2018.

2. The respondent-assessee, a company, was engaged in providing managerial, technical, consultancy and investment research services to two overseas funds, namely, Lok I and Lok II. The two overseas funds had on the basis of inputs and details furnished by the respondent-assessee made investments in Indian micro-finance companies, health care and education services sector. For rendering the aforesaid services, the respondent-assessee was paid a fee by the two overseas funds.

3. During the year in question, the respondent-assessee under an agreement had paid Rs.2,88,43,934/- to Lok Foundation, an associated entity registered in Mauritius. Respondent-assessee had justified this one-time payment stating that due to the efforts of one Donald Peck, co-founder of Lok Foundation, the total fund size of the investments in India had increased from US$ 36,550,000 in January 2011 to US$ 65,000,000 by the end of financial year. The payment, it was stated, was directly relatable to the substantial increase in the fund size, which had accordingly contributed to increased fee being charged and paid to the respondent-assessee.

4. Payment of Rs.2,88,43,934/- to Lok Foundation was disallowed in the assessment order for the following reasons :-

> "The assessee vide its reply dated 24.02.2015 furnished the details. According to the assessee, the assessee company had advisory agreements with Two Overseas funds named Lok I and Lok II to provide them with non-binding investment advisory services in consideration for advisory fee. In the light of these advisory agreements the assessee company entered into an agreement with Lok Foundation to help identify certain investors and influence them to participate in

Lok II. Further, the assessee goes on to say that because of the efforts of the Donald Pact, co-founder of LF the total fund size increased from USD 36,550,000 in Jan 2011 to USD 65,000,000 by the end of the Financial Year. For this one time fund raising fee of Rs.2,88,43,934/- have been paid by the assessee to the Lok Foundation, the assessee pleads that this consultancy fee is a allowable deduction of the assessee as it meets all test laid down by Section(sic) 37(1) of the IT Act, 1961. The assessee goes on to quote the judicial pronouncement in its favour.

The reply of the assessee is considered. Basically, the entity Lok Foundation is helping the foreign funds in raising funds overseas as is clear from the assessee's own admission that because of the efforts of the LF the fund size has increased substantially. The Lok Foundation is not actually giving any direct services to the assessee company. In fact the Lok Foundation is giving services to the overseas funds to which assessee company is giving advisory for investing in India in appropriate projects. The Lok Foundation should charge the overseas funds for the services rendered to them rather than the assessee company paying consultancy to Lok Foundation. This entity has not given any advisory services or any consultancy to the assessee company. According to the reply dated 24.02.2015 the amount of Rs. 2,88,43,934/- is a one time fund raising fee equivalent to USD 578,000 as a consideration for the services rendered by Lok Foundation. In fact no services has been rendered by the Lok Foundation to the assessee. According to assessee's own admission this is a fund raising fee. We know that no fund have been raised by the assessee. The funds have been raised by the overseas funds, therefore, there is no direct nexus between the so called fee paid by the assessee and its business. It is not out of the context to mention here that the Lok Foundation is established in Mauritius, which is a tax heaven with an effective tax rate of around 3%. The assessee company is employing this ploy by which the profits are being siphoned off in the garb of consultancy fee to Lok Foundation situated in Mauritius where ultimately no tax or miniscule tax will be paid on this amount. The area of

the operation of the assessee company is in India and the assessee is identifying the projects situated in India for which it is issuing advisory to the funds. I wonder how an entity based in Mauritius give any advisory to the assessee company regarding the projects situated in India.

The provisions of Section 37(1) of the IT Act, 1961 are very clear that the expenditure should be made **wholly and exclusively** for the purposes of the business to be allowable in computing the income chargeable under the head Profits & Gains of Business or Profession. In view of the above discussion it is clear that the amount of Rs. 2,88,43,934/- spent as so called consultancy fee is not spent wholly and exclusively for the purpose of the business of the assessee, therefore, the same is disallowed and the income of the assessee is enhanced by Rs. 2,88,43,934/-.

In view of the facts and reasons discussed above, it is amply clear that the assessee company has furnished inaccurate particulars with a view to evade the tax. The reasons described above may be treated as my satisfaction note for initiating penalty proceedings under section 271(1)(c) of the Income Tax Act, 1961 for filling inaccurate particulars for the above addition made.

(Addition of Rs. 2,88,43,934/-)

With these remarks total income of the assessee is computed as under:-

Total income as per return of income	33,07,902/-
Add: (as discussed above) Disallowance u/s 37(1)	2,88,43,934/-
Total Income	3,21,51,836/-
Rounded Off	**3,21,51,840**

After discussion assessed at an income of Rs. 3,21,51,840/-. Issue notice of demand and challan. Charge interest as per the

> provisions of the Act. Give credit for taxes paid. Notice u/s 271(1)(c) of the Act issued for failure to furnish true particulars of income."

5. The Commissioner of Income Tax (Appeals), ('CIT (Appeals)', for short), deleted the addition, referring to several facts. Firstly, the respondent-assessee itself was paid advisory fee calculated as a percentage of committed capital to the funds. Thereafter the advisory fee was calculated and paid to the respondent-assessee as a percentage of assets under the management of the funds. The CIT(Appeals) observed that the Assessing Officer was wrong when he held that the assessee did not benefit from the fee paid to Lok Foundation as there was a quantum increase in the capital fund invested from US$ 36,550,000 to US$ 65,000,000 from 1st January, 2011 to 31st March, 2012, which was undisputed and an admitted position. Lok Foundation had provided services in the form of identifying and introducing potential investors in Europe, UK and USA; rendering services for reviewing and assisting in preparation of appropriate material to present a plan to the investors; assisting with the negotiations to arrive at a commitment and move towards a closing, influence the process at each fund source and getting a successful outcome.

6. The first appellate order refers to the details furnished with regard to the efforts made in the form of travel undertaken by Donald Peck, including the name of the countries, cities, investor meeting and names of the investor representatives to substantiate and show that actual services were rendered by Lok Foundation. These details and particulars, though submitted to the Assessing Officer, were ignored and not referred to and considered in the assessment order. Further, the assessee had deducted tax at source @ 10%

on the payment made to Lok Foundation and the same had been deposited with the Income Tax Department.

7. Having considered the facts, evidence and material on record, the CIT (Appeals) held as under:-

> "3.2. In order to decide the issue on hand, it is necessary to recapitulate the facts of the case. The appellant renders investment advisory services to certain Mauritius Funds called Lok Capital LLC I (Lok 1) and Lok Capital LLC II (Lok 2). The first Investment Advisory Agreement was entered into in September, 2006 and the second during the previous assessment year 2011-12 i.e. on 11.08.2010. The services to be rendered by the appellant include advice and comments on potential portfolio companies, potential disposition of investments, structuring of acquisitions and disposition of investments, advice on identification and arranging of process of finance along with review of all documents required, comments on the performance of portfolio companies and assistance in the preparation of annual audited accounts and quarterly reports. The advisory fee to be received by the appellant company, as per the agreements (clause 6.1) was calculated for the first five years at a certain percentage of the committed capital to the funds and thereafter as a percentage of the assets under management of the funds. The appellant entered into an agreement with Lok Foundation Mauritius (LFM) on 6.4.2011 in order to enlist its help in raising funds for Lok II, which would enable the appellant company to earn advisory fees from the said Lok II fund. As per the said agreement Lok Foundation Mauritius was to identify and introduce potential investors in Europe, UK and USA, review and assist in preparation of appropriate material to present plan to investors, assist with the negotiations to arrive at a commitment and move towards a closing and influence the process at each fund source to get a successful outcome.

3.3 From the discussion in the preceding paragraph, it is revealed that the advisory fees received or receivable from the two Mauritius Funds are directly and intensically connected to the amount of committed funds received by them. It is, therefore, in the business interest of the appellant to ensure that maximum possible funds are raised for Lok-II which is in the fund raising phase having been set up in the August, 2010. It is an admitted fact that the funds size of Lok II increased from US $36,550,000 in January 2011 to US $ 65,000,000 by the end of the F.Y. 31.3.2012. As consequence of increase in the committed funds, the appellant's income from advisory fees increased from Rs. 4,77,17,289/- to Rs.9,21,51,932/- which is an increase of approximately 93% and which is a direct consequence of the increase in capital commitment. The services rendered by LFM as rightly stated by the AO indirectly results in a benefit to the appellant company as it enables the appellant company to help secure in committed funds from potential portfolio companies, assess the performance of the port folio company, to carry out identification, background checks and review of the sources of funding and the investment in different sectors in India. Therefore, for the AO to say that no direct nexus exists between the advice rendered by LFM and the business carried out by the appellant, is incorrect. It is not the AO's case that the expenditure in question is of a nature of expenditure described in sections 30 to 36 of the Act or that is capital or personal in nature. The grievance of the AO is that the amount has not wholly and exclusively expended for the purposes of business. This, as we have seen, is a fallacious grievance as the advisory/consultancy fees paid to LFM is directly connected to the funding of the two overseas funds, which in turn, directly influences the advisory fees received by the appellant. Thus the expenditure in question is fully covered within the purview of section 37(1). The other grievance of the AO is that the services have been rendered by LFM to the overseas funds whereas the appellant is rendering services to Lok II for investing in appropriate projects in India. This grievance is also not justified as the efforts of LFM in raising funds for Lok II directly impact upon the trading results of the appellant company and it is

only when the funds are received that the appellant company is called upon to advice the focus areas for investment by the fund holders in India. So far as the remarks of the AO that the overseas funds should have paid the fund raising fee to LFM and not the appellant, in view of the facts seated above and the accepted legal(sic) position that the reasonableness of an expenditure is to be adjudged from the point of view of the businessman [Walchand & Co.. Pvt. Ltd.(SC)], the consultancy fee paid is an expenditure wholly and exclusively incurred for the purposes of business. Undoubtedly the fund raising of LFM also benefits the overseas fund but there are several decisions of the Supreme Court wherein it has been held that where a transaction has been entered into by an assessee as a part of legitimate and commercially expedient activity and in order to facilitate the carrying out of its business, it is immaterial that the third party also benefits from its transaction. This material is available at Paras 1.36 to 1.39 of the submission reproduced herein above and need not be reiterated

3.3.1. In passing, it may be mentioned that the appellant has raised objection to the remarks of the AO with regard to the consultancy fees being a ploy by which profits are siphoned off to LFM which is situated in Mauritius, so that no tax or miniscule tax would be paid. In fact, there is no reason on the part Of the AO to attribute such motives. The appellant company had disclosed the related parties transactions in the report in Form 3 CEB filed along with the return of income and also provided to the AO during assessment proceedings. Apparently the issue of determining the arms length of the impugned transaction was not referred to the TPO but the AO was well within his duty to have gone for further details of comparables from the appellant and examining the issue at assessment stage. Having failed to do so and in the absence to complete facts to justify the statement that the payment amounts a tax avoidance measure, the AO was completely unjustified in making such uncharitable remarks.

3.3.2. In view of all the reasons discussed herein above the disallowance of Rs.2,88,43,934/- incurred by the appellant as

> professional and consultancy charges paid to Group Foundation Mauritius is held to be wholly and exclusively incurred for business purposes and the same is held to be allowable u/s 37(1). **Grounds 1, 2 & 6 are allowed.**"

8. The aforesaid reasoning notices and records that the Assessing Officer had not made any reference to the Transfer Pricing Officer to go into the question of arm's length payments made to Lok Foundation. The contention that the consultancy fee was a ploy to siphon away the profits was rejected as an assumption or inference drawn by the Assessing Officer without any basis, observing that such comments should not be made without a firm foundation.

9. The aforesaid findings have been affirmed by the Tribunal observing that there was substantial increase in the advisory fee earned by the respondent-assessee from Rs.4.7 crores in the preceding year to Rs.9.21 crores in the current year. The increase was nearly 93%. In the facts and circumstances, one time consultancy fee of Rs.2.88 crores to Lok Foundation, it was held was paid for the services rendered and business consideration. The reasons stated in the assessment order for not treating the expenditure as allowable under Section 37 of the Act was rejected.

10. In the present case, identity and existence of Lok Foundation was not doubted by the Assessing Officer. Actual payment of money was not doubted. What was questioned and doubted was the nexus between the expenditure and business of the respondent-assessee to hold that the expenditure was not 'wholly and exclusively' for the purpose of business as Lok Foundation had not 'directly' rendered services to the respondent-assessee but to the foreign investors and accordingly the foreign investors and not the respondent-assessee should have paid Lok Foundation. This

reason itself would accept that services were rendered by Lok Foundation. Appellate authorities have accepted that fee was paid to Lok Foundation for a gamut of services rendered outside India, namely to identify and introduce potential investors in Europe, UK and USA, review and assist in preparation of material, influence potential investors, assist in negotiations to arrive at a commitment, move towards a closing and get a successful closure. Respondent-assessee did not have a presence outside India and had not undertaken the said exercise. Expenditure of the said nature, if incurred by the respondent-assessee, would qualify for deduction as fully and exclusively for the purpose of business. Payments made by the respondent-assessee for the efforts and services rendered by a third person, in the present case by Lok Foundation, cannot be rejected as held in the assessment order as non-business expenditure on the ground that the foreign investors should have made that payment Lok Foundation. This is untenable and unacceptable. The efforts had benefitted the respondent-assessee in the form of increased investment in India resulting in increase in the advisory fee being paid to the respondent-assessee. The Assessing Officer should not have commented and decided on who should have paid commission. The investors may or may not be interested in paying fee to Lok Foundation. The respondent-assessee would be justified in making payment to expand and increase their business and income, which would be an expenditure wholly and exclusively for the purpose of business.

11. Another reason given by the Assessing Officer was that Mauritius was a tax haven in which tax was payable only @ 3%. He did not advert to the other facts including increase in investment, deduction of tax at source on payment made to Lok Foundation, and also the documents placed and relied upon by the respondent-assessee with reference to the services rendered by

Lok Foundation. The said documents and factum have been taken into consideration by the first appellate authority. The Assessing Officer had not bothered to even take on record and into consideration the factum that TDS @ 10% had been deducted. Thus, money remitted to Lok Foundation was taxed in India on gross receipt basis without reference to and deducting any expenditure incurred. Further, the Assessing Officer did not refer the question of quantum of fee paid to Lok Foundation to the Transfer Pricing Officer.

12. The aforesaid findings are primarily findings of fact, drawing inference and conclusions after referring to and based upon evidence and material on record. The findings as recorded are not illogical and perverse, which require interference. We would not reappraise the evidence as a normal appellate court while exercising jurisdiction under Section 260 of the Act.

13. Towards the end of his submissions, learned counsel for the Revenue had submitted that the matter should be remanded for fresh consideration. We do not agree, for there is no ground and evidence to justify the prayer for a fresh round.

14. In view of the above, we are not inclined to admit the appeal and the same is dismissed.

SANJIV KHANNA, J.

ANUP JAIRAM BHAMBHANI, J.

DECEMBER 12, 2018
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