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

Date of decision: 12th December, 2018

+ **ITA 120/2018**

SIGMA RESEARCH & CONSULTING PVT. LTD..... Appellant

Through: Mr.K.V.S. Gutpa and Mr.
HarishKumar Tyagi, Advs.

versus

COMMISSIONER OF INCOME TAX & ANR. Respondents

Through: Mr.Zoheb Hossain, Sr. St. Counsel

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE ANUP JAIRAM BHAMBHANI

SANJIV KHANNA, J. (ORAL):

CM.APPL No.4018/2018 (*exemption*)

Allowed, subject to all just exceptions.

CM.APPL No.4020/2018 (*seeking condonation of delay*)

Delay of 03 days in re-filing the appeal is condoned for the reasons explained and stated in the application. Application is allowed.

CM APP No. 4019/2018 (*Stay*)

Disposed of as not pressed, in view of the fact that the appeal is taken-up for hearing.



ITA No.120/2018

Present appeal under Section 260A of the Income Tax Act, 1961 ('Act', for short) by Sigma Research & Consultancy Pvt. Ltd. (appellant-assessee, for short) relates to assessment year 2011-2012 and arises from the order dated 29.08.2017 passed by the Income Tax Appellate Tribunal ('Tribunal', for short).

2. The appeal was admitted for hearing vide order dated 02.02.2018 on the following substantial question of law:-

"Whether the ITAT fell into error in upholding the disallowance under Section 40A (2) in the facts and circumstances of the present case."

3. Disallowance referred to the above question relates to payments made by the appellant-assessee to its directors Tilak Mukherji, Dr. U.V. Somayajulu and Arindam Ganguly. Assessing Officer invoking Section 40A(2)(a) of the Act had disallowed payments to the extent of Rs.16,29,954/- and Rs. 10,47,497/- from the salary paid to Tilak Mukherji and Dr. U.V. Somayajulu and Rs.8,49,500/- from the advisory fee paid to Arindam Ganguly as excessive and unreasonable expenditure. Additions made by the Assessing Officer was deleted by the Commissioner of Income Tax (Appeals). However, the disallowance made by the Assessing Officer has been resorted by the Tribunal on the appeal preferred by the Revenue vide the impugned order for the following reasons:

"7. However, when the reasons recorded by ld. CIT (A) while deleting the addition made by AO are examined in the light of the arguments addressed by ld. AR for the assessee who has



relied upon order dated 17.05.2016 passed by ld. CIT (A)-8, New Delhi qua AY 2012-13 in assessee's own case, it is proved on record that the assessee company is increasing the salary of the aforesaid three Directors as per its subjective satisfaction and not on the basis of any objective criterion by taking into account the qualifications, experience and nature of duties rendered by aforesaid persons.

8. When we peruse the salary of the companies having been paid to aforesaid three Directors in AY 2012-13, there is no increase in their salary as has been made during the year under assessment. Whereas when assessee company has paid salary to Shri Tilak Mukherji and Dr. U.V. Somayajulu to the tune of Rs.14,32,391/-, Rs.27,81,720/- & Rs.73,57,484 in FY 2008-09, 2009-10 & 2010-11 respectively and fees paid to Shri Arindam Ganguly to the tune of Rs.1,82,500/-, Rs.4,05,000/- & Rs.13,76,000/- in FY 2008-09, 2009-10 & 2010-11 respectively which is an increase in the range of 250% to 300% without explaining that if there was a change in the nature of their work or they have put more time while rendering services to the assessee company or they have improved their qualification or expertise in one year. Because when Shri Tilak Mukherji and Dr. U.V. Somayajulu were getting salary of Rs.27,81,720/- in FY 2009-10 suddenly their salary enhanced to Rs.73,57,484 in FY 2010-11.

9. During the course of arguments, the ld. AR for the assessee contended that their salary was enhanced as the company has earned more profit during the year under assessment. But this contention is not sustainable for the reason that the salary of a person cannot be based upon losses and profits of the company but it needs to be commensurate to the nature of their work, qualification and services rendered. Despite the fact that there was not an iota of material before the ld. CIT (A) to



objectively come to the conclusion that their salary/ fees have been rightly increased to the tune of 250% to 300%, the addition has been deleted”.

4. Section 40A(2)(a) of the Act reads as under :

“(a) Where the assessee incurs any expenditure in respect of which payment has been or to be made to any person refer-red to in clause (b) of this sub-sections and the Income-tax 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 there from, 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 the provisions of this section shall not apply in the case of an assessee being a company in respect of any expenditure to which sub-clause (i) of clause (c) of section 40 applies.”

Section 40A(2)(a) applies to transactions between related persons specified in clause (b) to Section 40A(2) of the Act. Assessing Officer in exercise of power vested vide Section 40A(2)(a) can examine such transactions having regard to the fair market value of the goods, services or facilities for which payment is made; or legitimate needs of the business or profession of the assessee; or benefit derived by or accruing to the assessee to disallow excessive or unreasonable expenditure. This power to disallow under Section 40A(2)(a) can be exercised by the Assessing Officer notwithstanding anything contained in any other provision including Section 37 of the Act. As the facts relating to reasonableness and fair market value



of the expenditure incurred and benefit accrued are within the knowledge of the assessee the onus to produce evidence and place relevant material on record to justify quantum of payment is also on the assessee. Thereupon, it is for the Assessing Officer to objectively check and examine the evidence and material and rationally decide disallowance, if any, which would be justified under Section 40A(2)(a) of the Act.

5. Delhi High Court in *Hive Communication Pvt. Ltd. Vs. Commissioner of Income Tax*, (2013) 353 ITR 200, has observed that any determination on the question of reasonableness and excessiveness requires several facets and parameters to be kept in mind, albeit the approach has to be from the standpoint of a reasonable and prudent businessman. The Assessing Officer's judgment of disallowance, if any, to be made has to be an objective and fair decision, as the provision is made to check evasion of tax and not to cause hardship in *bona fide* and genuine cases. Arms-length price paid for a fair market value should not be disallowed. The factors to be taken into consideration are those specified in Section 40A(2)(a); i.e. fair market value of the goods, services and facilities and whether they were for legitimate use of the business; and benefit derived or accruing to the assessee from the expenditure so incurred. Benefit accruing to the company or the assessee in the context of the section has to be viewed in a pragmatic way and not measured in terms of Pound, Shillings and Pence. Benefit accruing has to be considered judiciously, dispassionately and without any bias from the view-point of a reasonable and honest person in business. Aforesaid ratio elucidated relies and refers to several earlier judgments including *CIT vs. Edward Keventer Pvt. Ltd.*, (1972) 86 ITR 370 (Cal)



which was affirmed by the Supreme Court in *CIT Vs. Edward Keventer Pvt. Ltd. (1978) 115 ITR 149 (SC)* and *CIT vs. Shatrunjay Diamonds (2003) 261 ITR 258 (Bom)*. Similar view has been expressed by the Delhi High Court in *Sigma Corporation India Ltd. vs. DCIT*, ITA No. 795/2016 decided on 15.02.2017.

6. In the present case, the Tribunal has failed to apply test of prudent and reasonable business person. The disallowance was solely predicated on percentage of increase in the payments made to the directors and not whether payments made were reasonable, fair and commensurate with the market value of the work and services rendered or benefit accrued. Further several aspects and findings recorded and highlighted by the Commissioner of Income Tax (Appeals) relevant and important for deciding the issue and question have not been noticed and ignored. These are:-

(i) The appellant-assessee company was established and set up by Tilak Mukherji, Dr. U.V. Somayajulu and Arindam Ganguly on 28.08.2008. It was engaged in the business of market research in the social sector.

(ii) Dr. U.V. Somayajulu was Master of Business Administration and Doctorate (Ph.D.). He was having more than two decades of experience in a wide variety of social development and demographic research with several articles and papers to his credit. He was associated with Indian Association for the Study of Population and Indian Association of Social Sciences & Health and has been involved in demographic studies, programme development and evaluation, population, health and family welfare, etc.



(iii) Dr. U.V. Somayajulu was earlier working with TNS India Pvt. Ltd. and had drawn salary of Rs.17,95,215/- as per Tax Deduction at Source Certificate (TDS certificate, for short) for the period between 01st April, 2008 and 27th August 2008. This salary amount included gratuity of Rs.3,50,000/-.

(iv) Tilak Mukherji was again highly qualified being M.Sc. in Maths from Birla Institute of Technology & Science, Pilani. Tilak Mukherji had twenty years experience in handling various social/developmental marketing and communication research, public opinion polling and retail audits in India, Bangladesh and Sri Lanka. He was a member of the Consultative Committee, Department of Adult Education, Indian Association for Study of Population, etc. He was co-author of many publications with Dr. U.V. Somayajulu and had personally conducted and supervised studies for UNICEF, World Bank, Future Group, the Urban Institute (USA) and some universities. Tilak Mukherji was also earlier working with M/s. TNS India Pvt. Ltd. and had drawn salary of Rs. 42,99,530/- per annum as per the TDS certificate.

(v) Arindam Ganguly, an alumnus of St. Xavier's College, Calcutta was a strategy and marketing professional with multiple-industry experience in India as well as in the global market in consumer electronics, information and technology and telecom. He had been associated with several start-up brands and enterprises.

7. Appellant-assessee had explained the reason for low salary/remuneration accepted by the three directors in the earlier year which did not commensurate and was far less than the fair market value keeping in



view their qualifications, experience, expertise and work and input involved. Appellate-assessee as a start-up enterprise had commenced business in 2008 and therefore as promoter, the directors did want to burden the appellant-company which they had set up. Thus, they had not drawn and paid adequate and fair salary/remuneration in earlier years. Unfortunately, the Tribunal instead by appreciating the stand and stance of Dr. U.V. Somayajulu, Tilak Mukherjee and Arindam Ganguly took a very narrow and an incorrect view to observe that the earlier salary/remuneration would be the benchmark for deciding what was fair and just salary/remuneration for the services rendered and performed. This was clearly not the right approach and would be contrary to the principles and ratio expounded in the above judgments. By the same argument, Tribunal should not have discarded independent evidence in the form of TDS certificates showing the salary/remuneration drawn by Dr. U.V. Somayajulu and Tilak Mukherji when they were working with a third party. These were arms-length payments market driven and for market value. This was the best evidence. Educational qualifications and work experience of the directors were ignored as irrelevant because of the low salary/remuneration benevolently and magnanimously accepted by them in the earlier years. Professional and fair conduct in earlier years should have been appreciated and not frowned to be treated as a ground to disallow fair and genuine payment under Section 40A(2)(a) read with Clause (b) of the Act. A provision which requires a just and fair approach by the assessee must be interpreted and applied in a just and fair manner by the authorities.

8. The Commissioner of Income Tax (Appeals) had also pointed out that these three directors had earned income which was taxable at the maximum



rate of tax. Therefore, this was not a case where an attempt was made to evade taxes. The salary/remuneration paid was taxed in the hands of the recipients at the highest slab. Expenditure incurred was income earned. Former was allowed as a deduction and the latter was taxed as taxable income. This is an added factor which should have been considered, but was ignored and not treated as relevant.

9. In view of the aforesaid discussion we decide the substantial question of law in favour of the appellant-assessee and against the Revenue. The appeal is allowed and the addition made under Section 40A(2)(a) of the Act is directed to be deleted. There would be no order as to costs.

**SANJIV KHANNA
(JUDGE)**

**ANUP JAIRAM BHAMBHANI
(JUDGE)**

DECEMBER 12, 2018/neelam