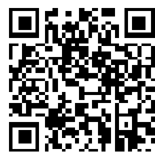

* IN THE HIGH COURT OF DELHI AT NEW DELHI

+ **I.T.A. No. 356/2009**

**25th August, 2009**

M/S. UNITED EXPORTS ...Appellant
Through: Dr. Rakesh Gupta, Mr. Tarun Kumar, Mr. B.B. Bhagat, Advocates

VERSUS

COMMISSIONER OF INCOME TAX, DELHI ....Respondent
Through: Ms. Prem Lata Bansal, Advocate

**CORAM:**
**HON'BLE MR. JUSTICE A.K.SIKRI**
**HON'BLE MR. JUSTICE VALMIKI J.MEHTA**

1. Whether the Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporter or not? Yes
3. Whether the judgment should be reported in the Digest? Yes

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**VALMIKI J.MEHTA, J**

1. By this appeal under Section 260-A of the Income Tax Act, 1961 the assessee challenges the orders of the Income Tax Appellate Tribunal dated 24.10.2008 whereby the Tribunal has reduced the Commission to be allowed for sale of the goods by the assessee to its sister concern from 8% as allowed by the CIT(A) to 5% and as against 11% claimed by the assessee and 3% allowed by the Assessing Officer.

**2.** The facts of the case are that the appellant is a partnership firm engag in the business of export of rice. A return of income for the year 2004-2005 was filed on 01-11-2004 declaring a total income of Rs. 87,47,807/-. In the profit and loss account filed along with the return the assessee firm had debited an amount of Rs. 1,26,45,614/- on account of trading discount allowed during the year under consideration and which amount was mainly on account of the trade discount of Rs. 1,25,05,062/- allowed to its sister concern M/s. United Overseas. The Assessing Officer required the assessee to justify the trade discount given to the sister concern because of Section 40-A(2)(b) of the Act as it was a higher rate compared to the discount given to the other parties. In reply the assessee submitted that in the year under consideration, the sale made to M/s. United Overseas increased to Rs. 11.11 crores as against Rs. 2.59 crores in the immediately preceding year and thus trade discount which was given at a higher rate of 11% was in proportion to the increased sales made to the sister concern and which in turn resulted in increase in the turnover of the assessee firm. It was further submitted that the assessee firm was receiving payment in advance from M/s. United Overseas against the sales made and as a result of such advance payment there was always a credit balance in the account of M/s. United Overseas. It was further contended that if notional interest is taken on this credit balance the same would work out to Rs. 68,80,738/-. It was, therefore, contended that the discount allowed to M/s. United Overseas at 11%

was thus in the interest of the business of the assessee and the same w commensurate with the business advantages accrued to it.

3. The Assessing Officer however allowed only a rate of 3% against the rate of 11% as claimed by the appellant on the ground that it was excessive considering the discount allowed to other parties and reasons offered by the assessee were found not good enough to justify such higher discount. As regards notional interest attributable to the credit balance with the assessee or M/s. United Overseas it was said to be only a self-serving statement and as regards the other justification of higher sales the Assessing Officer held that its explanation was too general to justify discount allowed at substantially higher rate.

4. In appeal the CIT increased the amount to 8% from 3% taking note of the fact that the discount was in conformity with the discount given in the earlier assessment year 2003-2004 and allowed under Section 143(3). The assessee had also contended before the CIT that it is normal market practice to give bulk discount besides normal discount. It was also submitted that the gross profit rate of the assessee firm had gone up from 18.5% as shown in the last year to 19.6% during the year under consideration. The CIT accordingly held as under:

> *"The above submissions of the appellant have been considered. It is seen that the AO did not give due credit or consideration to the arguments and submissions of the appellant which were statedly based on the requirement of business expediency. On the other hand it cannot be said that the AO was entirely incorrect in making the impugned addition. While analyzing the issue at hand it was seen that the g.p. rate of the appellant*

*has gone up from 18.5% in the last year to 19.6% during the year under consideration. It is not a disputed fact that the sister concern has lifted goods aggregating to Rs. 11.11 crores from the appellant firm and, therefore, as per prevailing business norms it was imperative on the part of the appellant firm to offer a better discount to the sister concern. However, this offer of higher discount was not because the other party was a sister concern but because of the high quantum of purchases made by the sister concern from the appellant. In such circumstances a higher discount to the sister concern cannot be treated as unjustified. Besides the fact that the sister concern offered credit facilities to the appellant also cannot be lost sight of. Keeping in view the facts and circumstances in their entirety in view, it is held that instead of disallowing the entire incremental 8% of the trading discount given to the sister concern, the AO should have disallowed 3% for the reasons discussed above. In other words, the discount to sister concern is to be allowed to the extent of 8% which is 5% more than the trade discount given by the appellant to other parties. Hence, the addition made by the AO is upheld to the extent of 3% and deleted to the extent of 5%."*

5. On further appeal by the assessee to the ITAT the Tribunal reduced the trade discount from 8% as granted by the CIT(A) to 5%. The Tribunal held in this regard as under:

*"11. We have considered the rival submissions and also perused the relevant material on record. It is observed that even though discount was allowed by the assessee firm to M/s. United Overseas during the year under consideration at the same rate of 11% as was allowed in the immediately preceding year, a similar discount was allowed to the other parties by it during the year under consideration at 3%. As M/s. United Overseas was admittedly a person as referred to in clause (b) of Section 40A(2), a prima-facie case for disallowance u/s 40A(2)(a) was made out by the AO and it was for the assessee firm to explain that the discount allowed to M/s. United Overseas at the rate of 11% as against 3% allowed to other parties was not excessive. In this regard, the explanation offered by the assessee to justify the higher discount allowed to M/s. United Overseas was two-fold i.e. receipt of bulk supply*

> *order from the said party and availability of surplus funds as a result of advance payments made by the said party against the supplies.*
>
> *12. As regards the explanation of the assessee that higher discount was allowed to M/s. United Overseas for bulk supply orders, we find that the same is duly supported and substantiated by the relevant facts and figures brought on record. In this regard, it is observed that total sales made by the assessee firm to the said concern during the year under consideration had gone up to Rs. 11.11 crores as against Rs. 2.59 crores in the immediately preceding year which clearly shows that there was some justification in allowing the discount at higher rate to M/s. United Overseas than the discount rate of 3% allowed to other domestic customers. It is, however, pertinent to note here that the total sales of the assessee had increased marginally to Rs. 13.20 crores in the year under consideration as compared to Rs. 10.89 crores in the immediately preceding year as pointed out by the AO on page No. 9 of his order and as the discount at the rate of 3% only was allowed on such domestic sales made in the immediately preceding year to other parties, the increase in such discount to 11% as allowed by the assessee firm on domestic sales made to M/s. United Overseas appears to be quite excessive."*

The ITAT further gave no weightage to the issue of credit balance of M/s. United Overseas the sister concern in the book of the assessee firm and further held that the expenditure as claimed fell under Section 40A(2) inasmuch as expenditure in question on account of discount was separately claimed by the assessee and it was not a case wherein sale price was charged net of such discount.

6. The counsel for the appellant has principally urged before us the following contentions:-

(i) On the principle of consistency discount at 11% ought to be sustained inasmuch as the same was allowed in the previous year;

(ii) The very fact that the transaction with the sister concern was much more than with the other buyers, clearly the assessee was justified in giving bulk discount. He referred to the fact that the sale to the others was just to the extent of Rs. 2.04 crores where the sale to the sister concern was to the tune of Rs. 11.11 crores. In the earlier assessment year the sale to the sister concern was just 2.09 crores and the sale to others was 8.30 crores and yet discount at 11% was allowed to the sister concern. Therefore, in the present year as contended by the counsel that it was entitled to give the bulk discount of 11% which in any case was given and accepted in the previous year by the Assessing Officer;

(iii) The counsel further contended that the trade discount was not an expenditure and, therefore, did not fell in Section 40A(2), and, mere fact that it was claimed separately, did not take away from the fact that in fact in reality the amount was actually a trade discount and whose character/type was not doubted by the Assessing Officer;

(iv) There is no rationale or basis for the authorities below in making ad hoc disallowance to 3% by the Assessing Officer, 8% by the CIT and reduced to 5% by the ITAT. The counsel contended that there is no rationale and valid basis for this ad hoc disallowance. It was contended that once the justification of the assessee was accepted by the Tribunal in paragraphs 11 and 12 of the judgment quoted above, then, in such circumstances there was no reason for making an ad hoc disallowance by reducing the trade discount to just 5%.

7. The learned counsel for the respondent/Revenue has supported the order of the Tribunal by relying on the same and referring to its paragraphs.

8. We feel that the Tribunal has clearly erred in law and, therefore, the appellant clearly deserves to succeed. At the time of admitting the appeal, the following questions of law were framed:

"a. Whether on the facts and circumstances of the case, the Hon'ble Tribunal was right in law in allowing ad hoc trade discount @ 5% without reference to any material, basis or evicence, more so when 11% rate was accepted by Revenue in A.Y. 2003-04 in assessment framed u/s 143(3).

b. Whether in the facts and circumstances of the case, Tribunal erred in law in holding trade discount allowed in earlier years, as excessive in the year under appeal.

c. Whether in the facts and circumstances of the case, Tribunal erred in law in interpreting Section 40A(2) and holding it applicable to the appellant, when trade discount is not expenditure paid and in any case, when it was lesser sales realization."

9. We now answer the said questions in the light of the facts of the present case.

10. The ITAT has clearly erred and its findings cannot be said to be those of a reasonable person. The conclusions are clearly perverse and are liable to be set aside by this Court in exercise of its powers under Section 260-A. Firstly, it is quite clear that a trade discount of 11% was allowed in the assessment year 2003-2004 and that too when the sales to the sister concern was Rs. 2.09 crores as compared to Rs.8.30 crores made to others. More so, when in the present assessment year the sale to the sister concern was 11.11 crores and to others it was Rs.2.09 crores, thus clearly justifying the trade discount at 11% which ought to be maintained as per the earlier year. Secondly, it is not unknown in trade circle to give bulk discount for bulk sales. The very fact that out of the total domestic sales of 13.20 crores, the sales to the sister concern is Rs.11.11 crores clearly justifies giving a trade discount of 11% to the sister concern as compared to 3% to the others. Further, there is no rationale or basis or any logic of the authorities below in unilaterally deciding a disallowance by reducing the entitlement from 11% as claimed by the assessee to 3% (by the Assessing

Officer), 8% (by the CIT(A) and 5% (by the ITAT). This ad hoc rough a ready method without any basis to support the same especially when in para 12 the Tribunal has accepted the contentions of the assessee that there was justification in allowing a higher discount than as given to other domestic customers.

11. Lastly, we fail to understand how the provisions of Section 40-A(2)(b) are, at all, applicable in the facts of the present case. Section 40A(2)(a) runs as under:-

> *"(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 sub-section, 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 or 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."*

This provision in the Act pertains to disallowance to an expenditure which is made by the assessee i.e. an amount actually spent by the assessee as an expenditure. The expression used in this provision is "**incurs** any **expenditure** in respect of which **payment** has been or is to be **made** to any person"(emphasis supplied). The emphasised words clearly show that actual payment must be made and there has to be an expenditure incurred before the provision can be said to be applicable. A trade discount, and admittedly it is not in dispute that the subject matter of the claim is a trade discount, and not an

expenditure, clearly therefore there does not arise the question of applicability of Section 40-A(2)(b).

12. In view of the above, we answer the two questions framed as under:-

(i) The Tribunal was not justified in allowing a trade discount of only 5% as compared to 11% as claimed by the assessee;

(ii) The provision of Section 40-A(2) did not apply to the facts of the present case inasmuch as the trade discount is not an expenditure which is incurred or with respect to which a payment is made.

13. The appeal is accordingly allowed in terms of the questions answered as above.

**A.K. SIKRI, J**

**VALMIKI J.MEHTA, J**

**August 25, 2009**

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