



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

Judgment reserved on : 04.09.2008
% Judgment delivered on : 06.11.2008

+ **ITA No. 631/2007 & ITA No.632/2007**

**COMMISSIONER OF
INCOME TAX.**

..... Appellant

-versus-

DR R. N. GOEL

..... Respondent

Advocates who appeared in this case:

For the Appellant	:	Mr Prem Lata Bansal
For the Respondent	:	Mr C S Aggarwal, Sr Advocate with Mr Prakash Kumar

CORAM :-

**HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE RAJIV SHAKDHER**

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

RAJIV SHAKDHER, J

1. This is an appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act") against a common judgment dated 23.12.2005 passed by the Income Tax Appellate Tribunal (hereinafter referred to as the "Tribunal") in ITA No. 180/Del/2000 and



ITA No.598/Del/2000, in respect of, assessment year 1996-97. Before the Tribunal both the assessee, as well as, Revenue had preferred appeals against the order of the Commissioner of Income Tax (Appeals) (hereinafter referred to as "CIT(A)"). Before the Tribunal the appeal filed by the assessee was numbered as ITA No. 180/Del/2000, whereas the appeal filed by the Revenue was numbered as ITA No.598/Del/2000. By the impugned judgment, the appeal of the Revenue has been dismissed and that of the assessee has been allowed in respect of issues raised in grounds 1 to 6 raised in his appeal filed before the Tribunal. In this Court the Revenue has filed two appeals being ITA No. 631/2007 and ITA No. 632/2007 against the impugned judgment.

2. In order to dispose of the two appeals following facts require to be noted:-

3. On 30.10.1996 the assessee filed his return of income declaring an income of Rs 18,97,440/-. The return was processed under Section 143(1)(a) of the Act. The return was picked up for scrutiny. A statutory notice under Section 143(2) of the Act was issued to the assessee. During the course of the assessment proceedings queries were raised, inter-alia, in respect of receipt of commission in the sum of Rs.30,39,710/- and service charges of Rs.8,21,621/- paid by the assessee to one Chemline India Ltd



(hereinafter referred in short as CIL) . During the course of the assessment proceedings the assessee filed a letter dated 19.1.1999, wherein the assessee disclosed that CIL was appointed by the assessee as a consignment agent under an agreement dated 01.4.1995. The assessee further informed the Assessing Officer that the said consignment agent had been appointed to market its products and also undertake development of its products in the market. It was also disclosed that CIL was a public limited company in which the assessee held 39% shares and, was also, one of the three directors, managing CIL. It was further disclosed that due to the efforts of the consignment agent i.e., CIL, the turnover of the assessee had increased over the past few years. The figures disclosed by the assessee to the Assessing Officer were as follows:-

<u>A.Y.</u>	<u>Turnover (Rs)</u>
1994-95	Rs.92,47,736.40
1995-96	Rs.1,01,79,754.08
1996-97	Rs.2,14,46,562,28

3.1 The assessee also informed the Assessing Officer that for the services rendered in respect of sales made by the assessee through CIL, commission @ 15% was paid to CIL. These were classified by assessee as indirect sales. As regards sales made by the assessee directly the assessee



paid service charges @ 18% to CIL for the purposes of developing the market.

3.2 The Assessing Officer after considering the explanation given by the assessee came to the conclusion that the payment of commission was unreasonable and, in particular, in the absence of proof of service rendered by CIL held it to be excessive in terms of Section 40A (2)(b) of the Act read with the explanation. However, curiously, despite this observation, the Assessing Officer allowed an expenditure on commission paid to CIL to the extent of 5%. The remaining commission of 13% was disallowed. The disallowance of commission was quantified at Rs 21,95,347/-.

3.3 The broad reasons which weighed with the Assessing Officer in disallowing the commission were as follows:-

- (i) a perusal of the details filed by the assessee had shown that the customers both in the preceding year and the year under consideration had remained almost the same;
- (ii) another consignment agent i.e., M/s Mahendru Chemicals Pvt. Ltd. appointed on the same day i.e., 01.4.1995 had received commission @ 5% and;
- (iii) as stated above, there was no evidence of service rendered by CIL.



3.4 In respect of service charges, the Assessing Officer was of the view that since, its consignment agent played no role in the sales and no services were rendered in that regard, the entire service charges had to be disallowed. Accordingly, expenditure incurred on service charges to the extent of Rs 8,21,621/- paid by the assessee to CIL were disallowed and added back to the income of the assessee.

4. In the result, an assessment order dated 24.3.1999 was passed under Section 143(3) of the Act.

5. Aggrieved by the order passed by the Assessing Officer, the assessee preferred an appeal with the CIT(A). The CIT(A) by an order dated 04.10.1999 allowed, completely, the expenditure incurred by the assessee on commission charges paid to CIL. However, the CIT(A) in respect of service charges restricted the allowable expenditure to 3%. As against total service charges of Rs.8,21,621/- the CIT(A) allowed a sum of Rs.1,36,935/- and sustained disallowance of a sum of Rs.6,84,686/-.

5.1 The CIT(A) gave detailed reasons for allowing the expenditure incurred by the assessee on commission charges. These were broadly as follows:-

- (i) an examination of the profit and loss account and the balance sheet of the assessee revealed that, as a matter of fact,



no expenditure had been incurred by the assessee on sale or product development;

(ii) the entire marketing and sales of the product in issue was carried out by the consignment agent, i.e., CIL;

(iii) there was a perceptible increase in the turnover in the current year when compared with preceding years;

(iv) an examination of the books of accounts of CIL indicated that CIL had genuinely carried out sales and marketing activity for the assessee. A perusal of the profit and loss account of CIL had shown that except for a small sum which comprised of sales made on its own account a substantial part of its total receipt, earned as, commission and services charges were from service rendered to the assessee. Furthermore, the examination also indicated that CIL had incurred expenses on advertisement and publicity, printing and stationery, rebate and discount, salaries, staff welfare, sales promotion and other miscellaneous expenses. The CIT(A), thus found, as a fact, that the, said expenses had been rendered towards sales and promotions of the products;

(v) it was also found that in the year in issue, i.e., in assessment year 1996-97 CIL had shown a net profit of



Rs 4,83,207/-, and also, the fact that it was regularly assessed to tax by the AC Cir.21(1);

(vi) as against the view of the Assessing Officer that there was no development of the market since, sales of the products had been made to the old customers, it was found that there was a substantial increase in turnover in the assessment year 1996-97 as compared to the earlier years, from which, it was deduced that CIL had worked to develop the market and boost sales by retaining old customers and;

(vii) as regards the Assessing Officer's observations that other consignment agent i.e, Mahendru Chemicals Private Ltd, who was appointed on the same day as CIL, was paid commission at a lower rate of 5%, as against, that which is paid to CIL, it was explained by observing that the quality of services rendered by CIL was different. Mahendru Chemicals Pvt Ltd was required to only, book orders. CIL was a del credere agent. The assessee did not expose himself to any financial risk once the goods were despatched to the consignment agent, i.e, CIL. Under Clause XI of the consignment agreement CIL was responsible for recovering the sales proceeds.



5.2. Insofar as service charges were concerned the CIT(A) came to the conclusion that the service charges to the extent of only 3% was to be allowed in favour of CIL on the ground that it would have carried out some advertisement and publicity in respect of sales directly carried out by the assessee.

6. The assessee being aggrieved by the order of CIT(A) to the extent of disallowance of part of the services charges, preferred an appeal to the Tribunal. Similarly, the Revenue also preferred a cross-appeal to the Tribunal. By the impugned judgment the Tribunal disposed of both the appeals. The Tribunal after examining the record, returned findings a reference to which is made hereinbelow, in respect of, the expenditure incurred by the assessee both by way of commission, as well as, service charges paid to CIL. The Tribunal came to the conclusion that the assessee was entitled to expenditure on both counts i.e., commission, as well as, service charges and that too in entirety. The reasons which weighed with the Tribunal were briefly as follows:-

- (i) the assessee had claimed similar expenses on account of commission charges at higher rates in the preceding year which had been allowed by the Revenue;



(ii) the sales of the assessee had increased from Rs 1.02 crores, in assessment year 1995-96, to Rs 2.14 crores, in the assessment year under consideration i.e., 1996-97. Therefore, the Assessing Officer was wrong in brushing aside this material aspect of the matter, by simply observing, that the, sales by the assessee in the year under consideration had been made to existing customers;

(iii) the Assessing Officer by allowing commission to the extent of 5% as against 18% claimed by the assessee had in a sense accepted the fact that services had been rendered by CIL to the assessee. Given the fact that the services rendered by CIL were qualitatively different from that of the other consignment agent i.e, Mahendru Chemicals Private Ltd, the commission paid by assessee @ 18% was neither excessive nor unreasonable. Similarly, with regard to the service charges, Tribunal came to the conclusion that having accepted the fact that payment of commission charges to CIL was in order then, it would be difficult to sustain disallowance of services charges to the extent of 15% on the ground that service rendered by the commission agent, in respect of, direct sale by the assessee were relatively limited as compared to sales effected through CIL. The Tribunal



disagreed with the view of the CIT(A) that, service charges were required to be disallowed to the extent of 15% - on the ground that he had ignored the fact that, as per the agreement, entered into between CIL and assessee, CIL rendered services which involved development and promotion of the overall market for the assessee's products and, in consideration thereof, service charges which were paid by the assessee on direct sales were in the nature of overriding commission.

6.1. Thus, the Tribunal came to the conclusion that having regard to the nature and scope of service rendered by CIL, it was bound to have favourable effect on the overall sales of the assessee as was evident from the turnover and figures referred to by the assessee. The Tribunal concluded that service charges paid to CIL @ 18% was neither excessive nor unreasonable. The Tribunal also noted the fact that the income earned by CIL in the form of service charges and commission were duly reflected in the profit and loss account and return of income filed by CIL.

7. Having perused the record of the case, and after hearing the counsel for both the Revenue, as well as, the assessee, we are of the view that the issue involved before the authorities below was whether the expenses claimed by the assessee towards payment of commission, as well as,



service charges to CIL was reasonable having regard to the provisions of Section 40A of the Act. This issue according to us is a pure question of fact. The Supreme Court in *Upper India Publishing House Pvt Ltd v. CIT: (1979) 117 ITR 569* and the Division Bench of this Court in the case of *CIT v. Northern India Iron & Steel Company Ltd: (1989) 179 ITR 599* and *CIT v. Mohta Electrosteel Ltd: (1995) 215 ITR 522* have held that whether or not an expenditure is unreasonable and hence, merits disallowance under the provisions of Section 40A of the Act, is essentially a question of fact.

8. In view of the aforesaid statement of law and having examined for ourselves the orders of the authorities below, we do not find any perversity in the findings returned in the impugned judgment. In our view, no substantial question of law has arisen for our consideration. In the result, the appeal is dismissed.

RAJIV SHAKDHER, J

BADAR DURREZ AHMED, J

November 06, 2008

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