

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**TAX APPEAL NO. 205 of 2002****FOR APPROVAL AND SIGNATURE:****HONOURABLE MR.JUSTICE AKIL KURESHI****and****HONOURABLE MR.JUSTICE Z.K.SAIYED**

1	Whether Reporters of Local Papers may be allowed to see the judgment ?	
2	To be referred to the Reporter or not ?	
3	Whether their Lordships wish to see the fair copy of the judgment ?	
4	Whether this case involves a substantial question of law as to the interpretation of the Constitution of India or any order made thereunder ?	

PATEL BROTHERS....Appellant(s)

Versus

DY.C.I.T.....Opponent(s)

Appearance:

MRS SWATI SOPARKAR, ADVOCATE for the Appellant(s) No. 1

MRS MAUNA M BHATT, ADVOCATE for the Opponent(s) No. 1

CORAM: HONOURABLE MR.JUSTICE AKIL KURESHI**and****HONOURABLE MR.JUSTICE Z.K.SAIYED****Date : 22/02/2016****JUDGMENT****(PER : HONOURABLE MR.JUSTICE AKIL KURESHI)**

1. This appeal is filed by the assessee challenging the judgements of the revenue authorities and that of the Income Tax Appellate Tribunal. While admitting the appeal, following substantial questions of law were framed:

“1. Whether, in the facts and circumstances of the case, the Tribunal was right in law in confirming the dis-allowance amounting to Rs. 17,03,055/- claimed as secret commission?”

2. Whether in the facts and circumstances of the case, ITAT was right in law in holding that explanation appended below section 37[1] of the Act is applicable to the facts of the case?”

2. Brief facts are as under:

Assessee is a partnership firm which is engaged in the business of electrical contractor. For the assessment year 1997-98, the assessee had filed the return of income on 27.10.1997 and had declared a total income of Rs. 6.68 lacs (rounded off). Such return was taken in scrutiny by the Assessing Officer. One of the questions came-up for consideration during such scrutiny assessment was the assessee's claim for deduction of Rs. 19.85 lacs (rounded off) by way of expenditure. The assessee claimed that he had paid such sum of Rs. 19.85 lacs to various persons by way of secret commission. The case of the assessee was that to the employees of different companies, who had given the business to the assessee, such secret commission was paid to enhance the assessee's total turnover. The Assessing Officer questioned the very expenditure and called upon the

assessee to justify the same. The assessee pointed out that such expenditure was claimed and allowed by the Revenue for several past years including for the assessment year 1989-90 till 1996-97. The assessee, however, even when asked to do so, could not produce the names, addresses and details of the recipients of such secret commission. The assessee claimed that entire amount was paid in cash but produced no receipts from the recipients of such commission.

3. The Assessing Officer questioned the very expenditure and noticed several factors to come to conclusion that the same was not allowable deduction at all. In addition to noticing that the assessee had not produced any details of whom such payments were made, no accounts were maintained by the assessee nor any receipt produced, the Assessing Officer further compared the commission paid and the percentage of such commission in relation to the sales of the assessee for the earlier years. The Assessing Officer noticed that there had been a considerable rise in the rate of such commission starting with 2.77% of the turnover of the assessee for the assessment year 1989-90 till the current year; where against the turnover of Rs. 2.82 crores, the assessee had paid commission of Rs. 19.85 lacs, close to 7.03%. The Assessing Officer also compared the gross profit to the sales and noticed that, in the assessment year 1997-98, there had been a drop in the gross profit ratio. The Assessing Officer referred to several decisions of this Court and other High Courts cited before him but came to the conclusion that the expenditure

in question failed to fulfill the conditions for claiming deduction under Section 37 of the Income Tax Act, 1961. He recorded that the assessee failed to establish that there was a practice for payment of such commission in the particular line of business; the assessee failed to adduce satisfactory evidence to show that the payments were actually made and, lastly, that the assessee failed to establish that such payments were wholly and exclusively for the purpose of business. In that view of the matter, the Assessing Officer disallowed the entire claim of the expenditure of Rs. 19.85 lacs.

4. The Assessee carried the matter in appeal. The CIT(Appeal) did not dispute the allowability of such an expenditure. He, however, formed an opinion that the expenditure claimed by the assessee was excessive compared to the preceding years and also compared to the turnover. He also marked that the GP rate had come down from Rs. 13.26% in the earlier year to 10.26% in the current year. He, therefore, while allowing the expenditure, limited the same to 1% of the total sales and, thus, allowed expenditure of Rs. 2.82 lacs (rounded off). CIT(Appeals) held and observed as under:

“8. Keeping in view the totality of all the above facts and ratio of various above referred judgements, while it is difficult to say that no secret commission whatsoever is paid by the appellant, yet the claim of such high expenditure of about Rs. 20 lakhs which as resulted in reducing the gross profit from about Rs. 49 lakhs to about Rs. 29 lakhs is not justified. Moreover, the claim of such a high expenditure of the order of

Rs. 20 lakhs which cannot be brought to tax in the hands of the recipients, in the absence of their names and addresses, is against the spirit of policy of taxation and not in public interest. The claim also does not fall into the parameters which have been spelt out in various cases laws. Specifically in the case of CIT vs. Goodlas Nerolac Paints Ltd. vs. CIT(188 ITR 1) and ITR vs. Wanson (India) Pvt. Ltd. (35 ITR 42) due notice has been taken of the fact that the quantum of secret commission was very meager. Moreover, in the case of the appellant since it is not possible to relate individual payments of secret commission to specific orders procured/executed, it cannot be said that secret commission has been paid in respect of each and every sale and as such the claim of secret commission at 7% of the total sales is highly excessive and not at all justified. Further, it does not appear that a prudent business man would allow 7% out of his gross profit of 16.53% to go out of its coffers for expenses, which cannot even be supported with the help of proper evidence. On the facts and circumstances of the case of the appellant, I would consider it most reasonable and fair to allow deduction for the claim of such commission paid for procuring orders at 1% of the total sales, which works out to Rs. 2,82,200/-. Addition to the extent of Rs. 17,03,955/- is therefore, confirmed and the balance is deleted. This disposes of all the grounds of appeal of the appellant.”

5. The assessee carried the matter in further appeal before the Tribunal. Counsel for the assessee would point out that the Revenue did not file independent appeal. Learned counsel for the Revenue, on the other hand, would contend that even, at the relevant time, CBDT circulars provided a limit of tax effect below which, the Revenue would not carry matter any further. With the reason why Revenue did not file appeal, we are not directly concerned. Since the Tribunal has not reversed the judgement of the CIT(Appeals), to the extent, the same was against the Revenue, mere non-filing of the appeal by the

Revenue would not limit our scope of examining all legal contentions arising out of judgement of the Tribunal. What may be limited is, relief that can be granted and not the contentions.

6. The Tribunal, in a detailed judgement, held that the entire expenditure was not allowable. The Tribunal referred to the explanation to Section 37(1) of the Act added by Finance (No.2) Act, 1998 with retrospective effect from 01.04.1962 to hold that the expenditure was barred by such provision. The Tribunal concluded that the secret commission claimed by the assessee of Rs. 19.85 lacs does not constitute permissible business expenditure as explained under Section 37(1) of the Act. However, since the CIT(Appeals) had already restricted the disallowance to the extent of Rs. 17.03 lacs, the Tribunal upheld the order of CIT(Appeals) as it is. It is this judgement of the Tribunal which is in challenge before us.

7. Learned counsel Mr. Soparkar for the appellant raised following contentions:

- (i) The Tribunal has applied concepts of morality and thereby expanded the scope of Section 37(1) of the Act.

- (ii) Explanation to sub section (1) of Section 37 of the Act was simply not applicable. As recipients are the employees of private company and not the Government employees, the commission was not barred by any law nor the act of the

assessee amounted to any offence.

(iii) In earlier assessment years, the expenditure was allowed after scrutiny barring 10% disallowance. This would demonstrate a consistent practice insofar as the assessee is concerned and any departure would also be hit by the principles of consistency.

(iv) Restricting the expenditure to 1%, as was done by the CIT(Appeals), was wholly without any justification.

8. On the other hand, learned counsel Mr. Bhatt for the Revenue opposed the appeal contending that the entire expenditure was not allowable since the assessee failed to establish that such expenditure was made exclusively for the purpose of business. The Assessing Officer questioned the very relation of the expenditure with the business carried out by the assessee. The Tribunal has also given cogent reasons.

9. Sub section (1) of Section 37 of the Act provides that, any expenditure not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee laid down or expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". Thus any expenditure barring those excluded under sub section

(1) of Section 37 of the Act laid out or expanded exclusively for the purpose of business or profession would be allowable expenditure. In this context, no limitation is imposed in the said provision on any secret commission paid by the assessee, if it is otherwise demonstrated that the same was expended wholly or exclusively for the purpose of business or profession.

10. In this context, we may refer to the judgement of Division Bench in case of ***Dr. G.G.Joshi vs. Commissioner of Income Tax*** reported in ***209 ITR 324***. In the said decision, the assessee had claimed similar deductions on secret commission paid. While recognizing such expenditure the Court held that, in order to be entitled to deduction of payments made to persons whose names are not disclosed, the assessee has to (i) establish the practice prevailing in that line of business for making such payments; (ii) to adduce satisfactory evidence to establish the payments and; (iii) to satisfy the authorities that the payments were made for the purpose of business. In the said case, the Tribunal, had allowed such expenditure at the rate of 2 ½ per cent of the turnover of the assessee. The Court upheld such decision of the Tribunal observing that the High Court would not interfere with the finding of fact arrived at by the Tribunal unless such finding is perverse.

11. In the case of ***Commissioner of Income Tax vs. Transport Corporation of India*** reported in ***256 ITR 701*** the Division Bench of Andhra Pradesh High Court observed that

mere payment by the assessee itself would not entitle him to deduction of expenditure unless the same was proved to be paid for commercial considerations. It was observed that in such a situation, the burden of proof is on the assessee and not for the department to independently collect evidence and prove that the deduction claimed by the assessee is baseless.

12. While, therefore, the courts have recognized the allowability of a deduction in the nature of secret commission, have also placed considerable onus on the assessee to establish such fact and, further, as noticed in the decision of our Court in case of Dr. G.G.Joshi vs. Commissioner of Income Tax (supra) recognized a small percentage to which such expenditure would normally be recognized. Secret Commission would ordinarily in a nature of payment in which the assessee would be reluctant to reveal the identity of the recipients. Such expenditure when allowed as a deduction would reduce the income of the assessee without the revenue being able to verify whether the recipients\ had offered such income to tax. Even otherwise such commission by very nature of things would be a small portion of an assessee's turnover. Thus flow the requirements of keeping such deductions down to a small proportion and casting a heavy burden on the assessee to establish that such expenditure was made and that it was wholly and exclusively for the purpose of business.

13. Coming back to facts of the case, the Assessing Officer

questioned the very foundation of such expenditure. He was of the opinion that there was no nexus established by the assessee between the expenditure and the purpose of business. It was, in this background, after referring to the comparative data of the current year and the earlier years in relation to the assessee's turnover, expenditure under the head of secret commission and the gross profit ratio that the Assessing Officer disallowed the entire claim.

14. Had this been final finding approved by the CIT(Appeals) and the Tribunal, perhaps, the assessee would have been correct in contending that total disallowance was not justified, particularly, when year after year in the earlier assessment years, the assessee had claimed such deduction and the same, in principle, was also accepted by the Revenue. However, CIT(Appeals) has not disallowed the entire claim but limited it to 1% of the turnover of the assessee noticing that the claim of secret commission, had shot up to 7.03% of the turnover for the year under consideration whereas the gross profit rate had gone down from 13.26% to 10.26%. More importantly, it was noticed that as against the net profit of Rs. 6.14 lacs, the assessee claimed to have paid secret commission of Rs. 19.85 lacs. The revenue authorities also noted that the assessee had not kept any accounts or receipts of where and to whom such commission was paid.

15. When these are the parameters which the CIT(Appeals)

considered, for restricting the claim, we do not see any reason to interfere in exercise of our jurisdiction to consider substantial question of law. We may agree with the counsel for the appellant that the Tribunal went far beyond the principles adopted by CIT(Appeals). We may also, for the purpose of *prima facie* consideration, agree that the reference to the explanation of sub-section (1) of Section 37 may not be warranted. However, insofar as final outcome is concerned, eventually, what the Tribunal did was to confirm the decision of CIT(Appeals) as it stood. Therefore, without being seen as having approved the reasonings of the Tribunal in rejecting the assessee's appeal, insofar as the final conclusion of confirming CIT (Appeals) order is concerned, we see no scope for interference. The question is, therefore, answered in the negative. Tax appeal is dismissed.

(AKIL KURESHI, J.)

(Z.K.SAIYED, J.)

Jyoti