

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 6<sup>TH</sup> DAY OF JANUARY 2021

PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE NATARAJ RANGASWAMY

**I.T.A. NO.192 OF 2013**

**BETWEEN:**

1. THE COMMISSIONER OF INCOME-TAX  
C.R.BUILDING  
QUEENS ROAD  
BANGALORE.
2. THE DEPUTY COMMISSIONER OF INCOME TAX  
CIRCLE - 11 (3)  
RASHTROTHANA BHAVAN  
NRUPATHUNGA ROAD  
BANGALORE

.... APPELLANTS

(BY MR.K.V.ARAVIND, ADVOCATE)

**AND:**

M/S FIBRES & FABRICS  
INTERNATIONAL PVT. LTD.,  
NO.21, E-1, II PHASE,  
PEENYA INDUSTRIAL AREA  
BANGALORE - 560 058.

... RESPONDENT

(BY MR.V.CHANDRASHEKAR ADV. FOR  
MR.M.LAVA, ADVOCATE)

- - -

THIS I.T.A. IS FILED UNDER SEC. 260-A OF INCOME TAX ACT 1961, ARISING OUT OF ORDER DATED 30.11.2012 PASSED IN ITA NO.1269/BANG/2010 FOR THE ASSESSMENT YEAR 2006-07, PRAYING TO:

(i) FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN.

(ii) ALLOW THE APPEAL AND SET ASIDE THE ORDERS PASSED BY THE ITAT, BANGALORE IN ITA NO.1269/BANG/2010 DATED 30.11.2012 CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER AND CONFIRM THE ORDER PASSED BY THE DEPUTY COMMISSINOER OF INCOME TAX, CIRCLE-11(3), BANGALORE.

THIS I.T.A. COMING ON FOR HEARING, THIS DAY, **ALOK ARADHE J.**, DELIVERED THE FOLLOWING:

### **JUDGMENT**

This appeal under Section 260-A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act', for short) has been filed by the revenue. The subject matter of the appeal pertains to the Assessment Year 2006-07. The appeal was admitted by a Bench of this Court vide order dated 03.07.2013 on the following substantial question of law:

*"Whether the appellate authorities were correct in allowing remuneration paid to the Managing Director nearly 90% of the returned income of the assessee company ignoring the applicability of Section 40A(2) and also ignoring the facts that the MD's*

*physical presence was only 15 days in the year and when the Managing Director was not aware of the existence and termination of agreement in favour of SEL wherein huge payments were made by the assessee company under various heads and consequently recorded a perverse finding?"*

2. Facts leading to filing of this appeal briefly stated are that the assessee is engaged in the business of manufacture and export of readymade garments. The assessee filed the return of income for the Assessment Year 2006-07 declaring total income of Rs.9,03,70,920/-. The return filed by the assessee was taken up for scrutiny and a notice under Section 143(2) of the Act was issued on 02.11.2007. The Assessing Officer by an order dated 08.12.2009 disallowed a sum of Rs.8,14,25,233/- which was paid as remuneration to the Director on the ground that there is no material to establish that the Director had rendered services to the company warranting payment of Rs.8,14,25,233/-

except being Managing Director. The Assessing Officer disallowed the entire sum of Rs.8,14,25,233/- which was paid to the Managing Director. The assessee thereupon approached the Commissioner of Income Tax (Appeals) by filing an appeal who by an order dated 11.08.2010 inter alia held that the Managing Director is directly responsible for business of the company and he has got sales from Italy and other European countries and therefore, is entitled for remuneration. In the result, the addition made by the Assessing Officer was disallowed and the appeal preferred by the assessee was allowed. The revenue thereupon approached the Income Tax Appellate Tribunal (hereinafter referred to as 'the tribunal' for short). The tribunal by an order dated 30.11.2012, upheld the order passed by the Commissioner of Income Tax (Appeals). In the aforesaid factual background, the revenue has filed this appeal.

3. Learned counsel for the revenue submitted that the finding recorded by the Commissioner of

Income Tax (Appeals) as well as the tribunal that Managing Director of the assessee has solicited global orders for the products of the assessee is based on surmises and conjectures. Learned counsel for the revenue has also invited our attention to the statement of the Managing Director of the company, which was recorded during post survey enquiry and has pointed out that the answers given by the Managing Director clearly establish his involvement in the business and from perusal of his statement, it is evident that he has expressed his ignorance of any of the contracts signed by the company and any payments made. It is also submitted that 90% of the returned income of the assessee company was paid to the Managing Director as remuneration. It is further submitted that no material was produced by the assessee that the Managing Director had procured the orders globally for the company. It is also contended that the tribunal committed an error in shifting the burden on the

Assessing Officer to establish the absence of Managing Director from the work place and the burden is on the assessee to establish that the expenditure in the form of remuneration to the Managing Director was incurred for the purpose of business and the same was proportionate to the services rendered to the assessee. It is also pointed out that under Section 40A(2) of the Act empowers the Assessing Officer to disallow the expenditure / payment made to the related person i.e., the payment made by a company in favour of a Director if the expenditure is excessive and unreasonable. It is also submitted that the aforesaid provision casts a burden on the assessee to establish that the payment made in favour of the Managing Director is neither excessive nor unreasonable and the benefit derived is commensurate with the payment made to the Managing Director. In support of aforesaid submissions, reliance has been placed on decision of the Supreme Court in **'GANAPATHY & CO. VS. COMMISSIONER OF**

**INCOME-TAX, BANGALORE', (2016) 65  
TAXMANN.COM 194 (SC).**

4. On the other hand, learned counsel for the assessee submitted that the Assessing Officer disallowed the amount paid to the Managing Director solely on the ground that the Managing Director of the assessee stays in India not for more than 14 to 15 days. It is further submitted that the remuneration of the Managing Director has been taxed in the hands of the Managing Director under Section 143(3) of the Act and tax has been deducted at source. It is submitted that the action of the Assessing Officer in disallowing the payment made to the Managing Director amounts to double deduction which is impermissible in law. It is also contended that Managing Director of the assessee is responsible for sales and marketing of the companies products and the remuneration which is paid to him works out to 50% of the total sales. It is further submitted that no disallowance is called for as the

amount in question has been taxed in the hands of the Managing Director and therefore, there is no loss of revenue to the exchequer. It is also submitted that concurrent findings of fact have been recorded in favour of the assessee by the Commissioner of Income Tax (Appeals) and the tribunal and therefore, no interference is called for in this appeal. In support of aforesaid submissions, reliance has been placed on decisions in **'CIT VS. BILAHARI INVESTMENTS PVT LTD', 299 ITR 1, 'CIT VS. EXCEL INDUSTRIES LTD.', 358 ITR 295, 'CIT VS. DURGA PRASAD MORE', (1971) 82 ITR 540 (SC), 'SUDARSHAN SILKS & SAREES VS. CIT', 300 ITR 205 SC, 'VIJAY KUMAR TALWAR VS. CIT, NEW DELHI', 330 ITR 1 SC/2010, 'K.RAVINDRANATH NAIR VS. CIT', 247 ITR 178 (SC).**

5. We have considered the submissions made by learned counsel for the parties and have perused the record. Before proceeding further, it is apposite to take



note of Section 37(1) and relevant extract of Section 40A(2)(a) of the Act, which is reproduced below for the facility of reference:

*37. (1) 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 out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".*

*2) (a) Where the assessee incurs any expenditure in respect of which payment has been or to be made to any person referred 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:*

*(b) The persons referred to in clause (a) are the following, namely:—*

*(ii) where the assessee is a company; firm, association of persons or Hindu undivided family any director of the company, partner of the firm, or member of the association or family, or any relative of such director, partner or member;*

6. Thus, from perusal of the aforesaid provisions, it is evident that the burden is on the assessee to establish that the amount was expended wholly and exclusively for the purpose of business or profession and Section 40A(2)(a) of the Act permits the Assessing Officer to disallow the expenditure which is excessive or unreasonable.

7. From perusal of the order passed by the Assessing Officer, it is evident that the Assessing Officer has disallowed the payment made to the Managing Director merely on the ground that total stay of the Managing Director in India is for a period 14 to 15 days. The aforesaid finding has been set aside in appeal by the Commissioner of Income Tax (Appeals) on the ground that the Managing Director is directly responsible for the business of the company and in fact, has brought the sale from Italy and other European countries and therefore, is entitled to remuneration. The aforesaid finding has been affirmed by the tribunal. However, the Commissioner of Income Tax (Appeals) as well as the tribunal have completely failed to establish that no material was produced by the assessee to demonstrate that the Managing Director had secured the business of the company from Italy and other European countries. The provisions of Section 40A(2) which are applicable to the fact situation of the case have also not been taken

into account by the Commissioner of Income Tax (Appeals) as well as the tribunal. In the facts and circumstances of the case, we deem it appropriate to quash the order passed by the Commissioner of Income Tax (Appeals) and the tribunal and remit the matter to the Commissioner of Income Tax (Appeals) to decide the appeal afresh by taking into account the provisions of Section 40A(2) of the Act and the fact that the assessee had failed to adduce any material to show that the Director of the company had procured business for the company from Italy and other European countries. Accordingly, the substantial question of law is answered.

In the result, the appeal is disposed of.

**Sd/-  
JUDGE**

**Sd/-  
JUDGE**