

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated : 06.01.2010

Coram :

THE HONOURABLE MR.JUSTICE D.MURUGESAN
and
THE HONOURABLE MR.JUSTICE P.P.S.JANARTHANA RAJA

Tax Case (Appeal) No.625 of 2004

The Commissioner of Income Tax,
Trichy

... Appellant

v.

M/s Premier Poly Sacks (P) Limited,
No.12D Sipcot Complex,
Pudukottai-622 002.

... Respondent

Appeal filed under section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Chennai 'D' Bench dated 19.12.2003 made in ITA No.1967/Mds/2002.

For appellant : Mr.K.Subramaniam
For respondent : Mr.M.P.Senthil Kumar for
Mr.Philip George

JUDGMENT

(Judgment of the Court was delivered by P.P.S.JANARTHANA RAJA,J.)

The appeal is filed by the revenue as against the order of the Income Tax Appellate Tribunal, Chennai 'D' Bench dated 19.12.2003 made in ITA No.1967/Mds/2002.

2. The appeal was admitted on 01.09.2004 on the following substantial questions of law:

"1.Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding and justifying the commission paid to the Directors of the company and set aside the order of the Commissioner of Income-tax (Appeals) in confirming the order of the assessing officer?

2.Whether on the facts and in the circumstances of the case, the Appellate Tribunal was justified in granting deduction a sum of Rs.13,47,894/- being the interest payable in respect of investments made in M/s Virgo Polymers India Limited as mentioned in the Tribunal's order?

3. The assessee is a private limited company engaged in the business of manufacture of HDPE pipes. The relevant assessment year is 1997-1998 and the corresponding accounting year ended on 31.03.1997. The assessee/respondent has filed return of income admitting 'nil' income for the said assessment year after setting off unabsorbed loss, investment allowance and business losses of earlier years to the extent of Rs.20,12,148/-. The said return was processed under Section 143(1)(a) of the Income Tax Act, 1961 and notice under Section 143(2) of the Act was also issued. The assessing officer has completed the assessment under Section 143(3) of the Act and demanded a sum of Rs.59,292/-. While completing the assessment, the assessing officer disallowed the assessee's claim of deduction on account of sales commission amounting to Rs.4,20,000/- paid to three Directors and proportionate disallowance of interest amounting to Rs.13,47,894/- with reference to the investments made by the assessee in the case of M/s Virgo Polymers (India) Limited by treating such investment as not relating to business. Aggrieved by that order, the assessee has filed an appeal before the Commissioner of Income Tax (Appeals), Tiruchirapalli. The said Commissioner has confirmed the order of the assessment in respect of the above. Aggrieved by that order, the assessee has filed an appeal before the Income Tax Appellate Tribunal. The Tribunal allowed the appeal and set aside the order of the lower authorities. As against the same, the revenue has filed the present appeal.

4. The learned counsel appearing for the revenue submitted that the order passed by the Tribunal is contrary to the facts and circumstances of the case and that there is no evidence for the services rendered in respect of the claim of Rs.4,20,000/- and the commission was paid not for securing orders but only for giving personal guarantee to M/s Shree Balaji Poly Packs. He further contended that the claim regarding sales commission is not a business expenditure. He has also contended that the Tribunal is wrong in deleting the disallowance of proportionate interest at Rs.13,47,894/- and the borrowed amount is diverted to non business purpose and hence, the Tribunal ought not to have allowed the claim of the assessee and has also relied on a decision in the case of COMMISSIONER OF INCOME-TAX VS V.I. BABY AND CO., reported in (2002) 254 ITR 248(Ker) in support of his proposition and seeks to set aside the same.

5. The learned counsel appearing for the assessee submitted that the sales commission paid to the Directors is business expenditure and also the said amount comes to less than 5% of the total value of the orders secured by the Directors from M/s Shree Balaji Poly Packs and the Directors also gave bank guarantee to the said company and therefore, it is allowable expenditure and the Tribunal is correct in allowing the claim of the assessee in respect of the commission paid to the three Directors. In respect of disallowance of the proportionate interest, the learned counsel appearing for the assessee submitted that no part of the investment in shares of M/s Virgo Polymers Ltd., had been made out of interest bearing borrowed funds and there was no nexus between the interest bearing borrowed funds and the investments and also the revenue has not established that the borrowed amount was actually diverted for the purpose of investment. Therefore, the Tribunal has considered all the facts and circumstances of the

case and rendered its finding, which is in accordance with law and the same has to be confirmed.

6. Heard the learned counsel appearing for the appellant and perused the materials available on record. In respect of the first question of law, the assessee-respondent has claimed deduction towards payment of sales commission at Rs.4,20,000/- to its three Directors. The details regarding the same are as under:

- 1.A.Ramadoss amount paid Rs.1,20,000/-;
- 2.R.Lalathi amount paid Rs.1,20,000/- and
- 3.R.Chakravarthy amount paid Rs.1,80,000/-

Total claim	----- Rs.4,20,000/- -----
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The said directors secured orders from M/s Shree Balaji Poly Pack to the value of Rs.30.72 lakhs for the assessment year 1996-1997; Rs.32.24 lakhs for the assessment year 1997-98 and Rs.25.34 lakhs for the assessment year 1998-99. The said sales commission payment were made to these three Directors at 5% of the total value of orders received by the assessee. Besides the commission, on securing order from the said company, the said company insisted on bank guarantee or personal guarantee for the performance and value of goods delivered for conversion. The said Directors also furnished guarantees for the purpose of meeting the demand made by M/s Shree Balaji Poly Packs and also it is pertinent to note that the assessee also passed a resolution dated 04.03.1996, wherein the assessee company should pay commission for a personal guarantee given by them. It is also pertinent to note that the amount received by the above Directors have been shown in the respective returns and the same were assessed for tax. The bona fide nature of the transaction as well as the reasonableness of the transactions have not been questioned by the assessing officer. The assessing officer has also not invoked Section 40A(2)(a) of the Income Tax Act, 1961. After considering these facts, the Tribunal held that it is business expenditure and the assessee was justified in paying commission to its Directors against the value of the order secured from M/s Shree Balaji Poly Packs and the personal guarantees offered by the Directors for the performance and value of goods delivered for conversion. In para 4.3, the Tribunal held as follows:

"On this issue, we have heard rival submissions and contentions and perused the materials placed before us. The counsel also placed before us, a paper book containing pages 1 to 36. It is seen that the sales commission was paid to the three directors @ 5 per cent of the total value of the order secured from M/s Balaji Poly Packs for the value of Rs.30.72 lakhs for the year 1996-97, 32.24 lakhs for 1997-98 and Rs.25.34 lakhs for the year 1998-99 for these years, all the three directors stood personal guarantee for the performance of value of goods and in order to meet the above demand of personal guarantee by the directors, the appellant company had paid sales commission/guarantee commission as insisted by M/s Shree Balaji Poly Packs vide letter dated 26.02.1996 and all the directors had declared the income from sales commission to the extent of Rs.4,20,000/- in their respective Returns of Income for the relevant assessment years. Even it is not denied by the Assessing Officer or it is claimed by the Assessing Officer that excess payments have been made. Even the first Appellate Authority had not

doubted these payments or its reasonableness. Rather, the Commissioner of Income Tax (Appeals) had admitted that the three Directors have offered personal guarantee to M/s Shree Balaji Poly Packs for performance and value of goods. Rather, the Commissioner of Income Tax (Appeals) suggested that there was no reason why the appellant did not show the commission in question under the head "guarantee commission" which would have been appropriate. It is seen from the order of the Commissioner of Income Tax (Appeals) that the three Directors have given personal guarantees to several concerns for securing loan for M/s Virgo Polymers India Ltd. The learned Commissioner of Income Tax (appeals), in his order has tried to find a nexus between the guarantees given by the three directors and the net worth and that in the business it is common and usual that guarantees are given and taken. By these means, expenditure on sales commission cannot be disallowed. Rather, it shows that the three directors are men of 'mean' especially when Tamil Nadu Industrial Investment Corporation Ltd., the Lakshmi Vilas Bank Ltd., the Commercial Tax Department of the Govt. of Tamil Nadu and M/s Industrial Development Bank of India have accepted their guarantees as per the Commissioner of Income Tax (Appeals). Even, it is not the case of the revenue that the expenditure incurred or payment made is excessive or unreasonable having regard to the Fair Market Value (FMV) of the services rendered or facilities for which payment is made or the legitimate needs of the business of the assessee and the benefits derived by the assessee. The Assessing Officer has not even invoked the provisions of Section 40A(2)(a) of the Act. In view of the above submissions and discussions, the appellant was justified in paying commission to its directors against value of the order secured from M/s Shree Balaji Poly Packs and the personal guarantee offered by the Directors for the performance and value of goods delivered for conversion. In view of the above, we allow this issue of this appeal in favour of the assessee and set aside the order of the Commissioner of Income tax (Appeals) in confirming the order of the Assessing Officer on this issue."

From a reading of the above finding, it is clear that the amount is paid for the purpose of securing the order from M/s Shree Balaji Poly Packs as well as for personal guarantee given by the Directors. Therefore, the Tribunal held that the expenditure incurred is a revenue expenditure. The finding given by the Tribunal is based on valid material and evidence and therefore the first question is answered in favour of the assessee and as against the revenue.

7. In respect of second question of law is concerned, the assessing officer disallowed the interest at Rs.13,47,894/- with reference to the investments made by the assessee in M/s Virgo Polymers India Ltd. During the assessment years 1996-97 and 1997-98, the assessee had acquired Rs.3,98,200/- worth shares of M/s Virgo Polymers India Ltd., at a total consideration of Rs.95,09,550/-. The assessee had shown loss of Rs.31,70,350/- in the profit and loss account for the year ended on 31.03.1997 and the investment made by them. The assessing Officer was of the view that the investment made by the assessee was not relating to the business and therefore, he disallowed a sum of Rs.13,47,894/- towards interest attributable on investment to the extent of 18% per annum. The assessing officer further held that money borrowed from various concerns including THIC Limited was diverted for non business purpose. The Tribunal had given a factual finding that the assessee used to get orders from M/s Virgo Polymers India

Limited and also the existence of the assessee company depended on the orders received from the said M/s Virgo Polymers India Limited. It is also to be noted that the assessee/respondent depended on the orders received from M/s Virgo Polymers India Limited and to the extent of 80 to 90 per cent of the orders are from the said company. Therefore, the Tribunal has come to the conclusion that the investment was made for the purpose of commercial interest of the assessee. It is also pertinent to note that one of the objects of the Memorandum of Association is that the assessee company can make investment in shares in companies. The assessee has received a sum of Rs.60,00,000/- from TIIC on 23.05.1996. The assessing officer was of the view that the said amount was invested in the shares. Actually investment was made on or before 03.04.1996 by the assessee. The said borrowal from TIIC on 23.05.1996 is much later than the investment already made by the assessee i.e. on 03.05.1996. So, the revenue has also not produced any evidence to show that the borrowal money was diverted for investment. There is no material available on record and the assessing officer failed to correlate that the borrowed amount was diverted for the investment purpose. Therefore, it is useful to refer a decision of the Supreme Court in the case of S.A.BUILDERS LTD., V. COMMISSIONER OF INCOME TAX (APPEALS) AND ANOTHER reported in 2007 (288) ITR 1, wherein it has considered as to whether the interest on funds borrowed by the assessee to give an interest free loan to a sister concern should be allowed as a deduction under Section 36(1)(iii) of the Income Tax Act, 1961 and one has to enquire whether the loan was given by the assessee as a measure of commercial expediency and held as follows:

"We agree with the view taken by the Delhi High Court in CIT v. Dalmia Cement (B.) Ltd. (2002) 254 ITR 377 that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize his profit. The income-tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits."

In this case, the assessee has an object for investment and has also got orders from the said M/s Virgo Polymers India Limited to the extent of 80 to 90 percent and hence, there is a commercial expediency. Further there is no proof that the borrowed amount has actually been diverted to investment. Therefore, after taking into consideration the object of the assessee as well as the investment was made due to commercial expediency and also there is no nexus between the borrowed amount, the Tribunal is correct in holding that the investment in shares was made keeping in view the commercial interest of the assessee.

8. The learned counsel appearing for the revenue relied on the decision of Kerala High Court in the case of COMMISSIONER OF INCOME TAX V. V.I.BABY

AND CO., reported in 2002 (254) ITR 248, wherein the assessee, a firm dealing in piece goods, had paid interest on its borrowings from banks and since, the assessee had transferred sizeable amounts to the personal accounts of its partners and also advanced amounts to relatives of the partners and sister concerns; but no interest was charged and the assessing officer disallowed the proportionate interest in respect of the amounts so advanced by the assessee firm. On an appeal to the CIT (Appeals), the Commissioner has confirmed the order of the assessing officer. On further appeal by the assessee, the Tribunal allowed the claim of the assessee. The Kerala High Court reversed the order of the Tribunal and confirmed the order passed by the assessing officer on the ground that the assessee had not derived any benefit from the advances to the partners, their relatives and the sister concerns and therefore, held that the same was not for business purpose. In the present case, the assessee solely depends upon the orders of the M/s Virgo Polymers India Limited and therefore in the interest of the assessee the investment was made and also has one of the objects as investment and hence, the above cited decision of Kerala High court is factually different from the present case. So that judgment is not helpful to the revenue. The finding given by the Tribunal is based on valid materials and evidence and it is a question of fact. It is not a perverse order. We do not find any error or illegality in the order of the appellate Tribunal warranting interference. The second question of law is also answered in favour of the assessee and as against the revenue. Therefore, the appeal filed by the revenue is devoid of merits and the same is dismissed.