आयकर अपीलीय अधिकरण "बी" न्यायपीठ पुणे में ।
IN THE INCOME TAX APPELLATE TRIBUNAL "B" BENCH, PUNE

श्री डी. करुणाकरा राव,लेखा सदस्य, एवं श्री विकास अवस्थी, न्यायिक सदस्य के समक्ष
BEFORE SHRI D. KARUNAKARA RAO, AM AND SHRI VIKAS AWASTHY, JM

आयकर अपील सं. / ITA Nos. 2611 & 2612/PUN/2012
निर्धारण वर्ष / Assessment Years : 2002-03 & 2003-04

Kirloskar Brothers Limited,
Yamuna, Survey No.98/3 to 7,
Baner, Pune – 411 045
PAN : AAACK7300E .....अपीलार्थी / Appellant

बनाम / V/s.

DCIT, Circle-11(1),
Pune .....प्रत्यर्थी / Respondent

Assessee by : Shri Sharad Shah
Revenue by : Shri Mukesh Jha

सुनवाई की तारीख / Date of Hearing : 30.07.2018
घोषणा की तारीख / Date of Pronouncement : 19.09.2018

आदेश / ORDER

PER D. KARUNAKARA RAO, AM:

There are 2 appeals under consideration and both are filed by the assessee involving A.Yrs. 2002-03 and 2003-04 against the two different orders of the CIT(A) commonly dated 19-10-2012. In both these appeals, the facts relating to claim of expenses, disallowances, arguments, penalty provisions, explanations, the issues for adjudication raised in the grounds are identical. The core issue relates to the correctness of levy of penalty u/s.271(1)(c) of the Act qua the addition on account of expenditure for payment of transportation charges, aftersales fee etc. Assessee paid to the entities in Dubai and Jordan in connection with the export sales of the assessee. Relying on the Volcker Committee Report

the AO disallowed the claim u/s.37(1) of the Act. CIT(A)/ITAT confirmed the same on merits on the ground of discharge of onus. Therefore, AO levied the penalty u/s.271(1)(c) of the Act and the CIT(A) confirmed the same. Therefore, the assessee is in appeal before the Tribunal for both the years.

For the A.Y. 2003-04, the validity of the reassessment proceedings is the additional legal issue raised in particular for adjudication vide the appeal ITA No.2612/PUN/2012.

2. Assessee raised various grounds originally. However, during the proceedings before us, assessee filed concise grounds and the said grounds for A.Y. 2002-03 are as under :

> *"Ground of appeal No.1:*
>
> *The Ld. AO erred in CIT(A) erred in confirming the levy of penalty amounting to Rs.32,00,000/-.*
>
> *Ground of appeal No.2 :*
>
> *The Ld. AO & CIT(A) erred in not considering the explanations and submission filed by the assessee and also erred in not appreciating the fact that the assessee had no malafide intentions and has disclosed all relevant facts."*

3. Briefly stated relevant facts on merits include that the assessee is a Manufacturer of Pneumatic Tools. In the re-assessment proceedings for both the years, AO made additions of Rs.89,40,596/- and Rs.1,57,09,142/- for the A.Y. 2002-03 and A.Y. 2003-04 respectively. These amounts are paid by the assessee to M/s. Azhar Trading Company, Dubai and M/s.Alia for Transportation and General Trading

Company, Jordan for receipt of services in the A.Yrs. 2002-03 and 2003-04 respectively. These payments are made to them towards availing the logistic services like Transportation charges, Aftersales fee, Service charges etc.

Further, Assessee's name appeared in the list of the persons enlisted in the Volcker Committee Report (in short 'VCR'). Other names appeared in the list of VCR includes the names of M/s. Air Pac Exports, TIL Limited, Mohan Exports, Ajanta Pharma Ltd., Man Industries, M/s. Exim Trade links India Pvt. Ltd., M/s.Godrej & Boyce Co. Ltd., Bajaj International Pvt. Ltd., Reliance Industries Ltd., Cosmos International and Mather and Platt Pumps Ltd. etc.

4. **Re-assessment Proceedings :** During the re-assessment proceedings in both the assessment years under consideration, in response to the AO's queries on the genuineness of these payments and the applicability of provisions of section 37(1) of the Act, assessee responded by explaining that the payments to Azhar Trading Company, Dubai was paid towards Inland Transportation fee and partly paid to Kisloskar Middle East. When it comes to the payment to M/s. Alia and General Trading Company, Jordan, the said payments were made for transportation fees. These services are availed by the assessee in connection with the export of the goods by the assessee and the said payments were made to the above said persons in connection with the export sales to Iraq. The total export sales for the A.Y. 2002-03 and 2003-04 to Iraq are Rs.8,35,21,002/- and Rs.16,78,78,707/- respectively. In support, the assessee filed the Bills and Invoices. The

Bank details in support of the genuineness of the payments to the said parties are also furnished. It is the case of the assessee before the AO that the said payments were for commercial expediency and therefore, the payments are genuine. The payments were made through banking channels. However, the AO rejected the same stating that the assessee failed to discharge the onus in matters of genuineness of the services rendered by them to the assessee. AO invoked the restrictive provisions of the Explanation to section 37(1) of the Act and proposed for disallowance in both the assessment years. Further, reference is made by the AO to the contents of the VCR regarding the Kickbacks paid by the assessee to Iraq Government. However, it is submitted by the assessee that payments made by the assessee are only to the said persons and not to the Iraq Government authorities/officials. Eventually, the AO rejected the explanation of the assessee and proceeded to make addition of the same in both the years. The penalties u/s.271(1)(c) of the I.T. Act were levied in connection with the said additions and the penalty in both the years are Rs.32,00,000/- and Rs.60,00,000/- respectively.

5. **Before the CIT(A) & ITAT :** In the First and Second Appellate proceedings in quantum appeals, the additions in both the years were confirmed. While the CIT(A) relies on the applicability of the provisions of Explanation 1 to section 37(1) of the Act, the Tribunal invoked the said provisions and held that the assessee failed to discharge the onus in matters of establishing the payments are made for the business purposes and not as kickbacks to Iraq Government. Further, the Tribunal also

referred to the UN Resolution-986 on one side and to the Volcker Committee on the other. The Tribunal also referred to a letter from Kirloskar Middle East (KMC) dated 02-01-2002 which contains certain ambiguities while confirming the addition on its merits. Thus, the quantum additions have attained finality against the assessee at the level of ITAT.

6. Regarding the penalty proceedings finalized by the AO for both the years, the facts include that AO levied the penalty of Rs.32,00,000/-_for A.Y. 2002-03 and Rs.60,00,000/- for the A.Y. 2003-04. In both the assessment orders, the case of the AO is that the sum of Rs.89,40,596/- and Rs.1,57,09,142/- were paid to Azhar Trading Company, Dubai and M/s. Alia and also the assessee's name is found in the list of records of VCR. These payments constitute the kickbacks paid to the Iraq Authorities in connection with the supply of portable centrifugal pumps to Ministry of Irrigation, Government of Iraq, under the Oil for Food Programme. In Para No. 5 of the penalty order, the AO referred to the allegations of receipt of kickbacks by the Iraq Government from the suppliers. On these allegations, United Nations appointed a commission under the Chairmanship of Mr. Paul Volcker which submitted a report. The committee finds that the Iraq Government charged fee, i.e. inland transportation fees and also in the name of the aftersales fees at the rate of 10% of sales. Apart from many others assessee's name also appeared in the list of said suppliers. On these facts, AO holds that said payments of alleged kickbacks attract the provisions of the Explanation 1 to section 37(1) of the Act. In this regard, the assessee furnished written

submissions which were extracted by the AO in Para 2 of the penalty order. On considering the explanation, AO rejected the explanation of the assessee and held the penalty is leviable for the allegation of furnishing of inaccurate particulars of income without having reasonable explanation. In the order, AO relies on the Supreme Court judgments in the case of Union of India Vs. Dharmendra Textile Processors (306 ITR 277) and in the case of CIT Vs. Reliance Petro Products Ltd. (322 ITR 158) for levying the penalty of Rs.32 lakhs for the A.Y. 2002-03 and another sum of Rs.60 lakhs for the A.Y. 2003-04 with identical reasons.

7. The only difference for the A.Y. 2003-04 is on the figures that the assessee made sales of Rs.16.79 crores (rounded off) to the Iraq Government and the payment is made to M/s.Alia for transportation fees and towards aftersales fees to the tune of Rs.1,57,09,142/-. Thus, figuring the assessee's name in the VCR on one side, the provisions of Explanation 1 to section 37(1) of the Act are the dominant reasons for levy of said penalties in both the assessment years. CIT(A) confirmed the said penalty stating that the UN Security Council's Resolution-986 is legally binding on United Nations Organization.

8. Aggrieved with the above orders/findings of the CIT(A), the assessee filed the present appeals before us with the grounds summarized above.

PROCEEDINGS BEFORE THE TRIBUNAL – DECISION

9. During the proceedings before us, Ld. Counsel for the assessee explained the above facts of the case and referred to various documents from the paper books. Assessee filed the paper book before us in support of the arguments that the penalty should be deleted on the ground of (A) commercial expediency; (B) Non-binding nature of the UNO Resolution in the absence of any domestic law in support of restricting the rights of citizens of India in doing business with Iraq institutions; (C) debatability of the issues on merits as well as law; (D) Deemed provisions – No Penalty etc.

10. We shall deal with each of them separately in the succeeding paragraphs of this order. The arguments of the Counsels on each of these issues and the decision of the Tribunal in this regard are discussed and given on each of the major arguments of the counsels in the following paragraphs.

A. COMMERCIAL EXPEDIENCY

11. Ld. Counsel for the assessee explained the facts on the merits of addition of disallowance of expenditure and submitted briefly that the assessee exported "portable centrifugal pumps" (PCPs) to Iraq in the assessment years under consideration. PCPs are useful for transfer of fluids/water/liquids by use of centrifugal force. Accordingly, the turnover in this regard in both the years are Rs.8,35,21,002/- and Rs.16,78,78,707/- respectively. Exporting them is the business activity of the assessee. In this regard, assessee made the payments to Azhar

Trading Company, Dubai and Kirloskar Middle East FZE (in short 'KME') to the tune of Rs.87,61,920/- and also Rs.1,78,676/- towards inland transportation fees, aftersales service fee etc., Further, assessee paid Rs.1,57,09,142/- to Alia and General Trading Company, Jordan towards transportation fees/aftersales service. Such payments are not new in this line of business.

Assessee paid Rs.1,78,676/- to (1) Azhar Trading Company, Dubai for inland transportation fee, aftersales service fee etc., (2) Rs.87,61,920/- to Kirloskar Middle East FZE, (3) Rs.1,57,09,142/- to M/s. Alia and M/s. General Trading Company, Jordan for transportation fees and aftersales service fee.

A. Further, it is the case of Ld. Counsel for the assessee that these amounts were paid in connection with the export sales for facilitating transport of goods to the end point and for rendering other services such as aftersales as per the agreement. Making of such payments for said services/fee is essential and therefore, incurring of the same constitutes allowable "business expenses". All these payments are not only borne out of the accounted books of the assessee but also made involving banking channels. Hence, these claims are allowable in view of the set principles of commercial expediency. Assessee relies on various decisions in this regard. CIT Vs. Walchand and Company Pvt. Ltd. 65 ITR 0381, Dr. G. G. Joshi V. CIT 209 ITR 0324 (Gujarat) are relevant for the proposition that the allowance of payment by way of commission or kickbacks is allowable although the same is against the good morality and public policy. However, these decisions were delivered prior to the

relevant amendment to section 37(1) of the Act w.e.f. 01-04-2015 introduced by the Finance No.2 Act, 1998 with retrospective effect. By the said legislation, the new Explanation is inserted to section 37(1) of the Act making certain expenditure **"not deemed to be incurred"** for purposes of the business and hence disallowable u/s.37 of the Act. AO is of the view that these payments by the assessee is meant for kickbacks to Iraqi Authorities for allowing the exports to Iraq under "Oil and Food Programme. VCR is relied heavily by the ITAT/CIT(A) & the AO.

B. According to said Explanation 1 to section 37(1) of the Act, any expenditure incurred for any purpose which is (1) an offence or (2) prohibited by law, is deemed disallowable ones despite their business connection. This provision is for "not deeming" the business expenses as not allowable ones. In this regard, Ld. AR for the assessee laboured a lot to demonstrate that the payment for Transportation charges, Aftersales service etc. do not constitute the one incurred for the purpose of committing any offence or any purpose prohibited by any domestic law. Further, Ld. AR argued that the payments were made to M/s. Alia, M/s. Azhar Trading Company, Dubai, and General Trading Company, Jordan, etc. for defined services. It is not for the assessee to monitor the money outflow of those payees. The payees are free to appropriate their funds in the manner they find it appropriate. Assessee is not the financial Auditor/Mentor for these payees. Assessee's responsibility stops with the making of the payments to the payees for the services received by the assessee. If the payees incurred any expenditure for kickback to Iraqi authorities, it is for them to explain and face the penal provisions as

applicable to them in their country. Thus, the Explanation 1 of the section 37(7) of the Act does not apply to the transactions held between the payees and the Iraqi Authorities and they apply to ones between the assessee and the payees only. So far as the assessee's payment is concerned, the same are incurred by the assessee for its business purposes and not for the purposes of committing an offence and any purposes prohibited under Indian Laws. As per Ld. AR, if the said expenditure is not incurred, the assessee could not have recorded the export turnover of Rs.8,35,21,002/- and Rs.16,78,78,707/- in the assessment years under consideration. Referring to the order of the Tribunal on the disallowances, Ld. Counsel submitted that the addition was confirmed due to discrepancy in a letter between the assessee and the foreign entity.

C. Further, Ld. Counsel submitted that amongst number of cases appeared in the VCR, the assessee's case is a solitary exception to the rule that in no case the additions are sustained on merits. Therefore, in many those cases, there is no issue of penalties u/s.271(1)(c) of the Act. In other cases, the penalty stands deleted by the Tribunal. In this regard, Ld. Counsel filed a note on the list of cases where similar additions are deleted and penalty was also deleted on the ground of other decisions/judgment. Thus, according to Ld. Counsel, the payments are made in view of the commercial expediency. Assessee never paid the kickbacks to the Iraqi Authorities; all the facts are disclosed in the books of the assessee etc. Therefore, it is not a fit case for levy of penalty u/s.271(1)(c) of the Act. Ld. Counsel also submits that the assessment

and penalty proceedings are two different proceedings and therefore, the confirming of the additions by the CIT/ITAT should not influence the confirming of the penalty.

D. Per Contra, Ld. DR for the Revenue rely heavily on the orders of the AO/CIT(A). Particularly, Ld. DR rely on the finding of the Tribunal on the merits of the addition made u/s.37(1) of the Act. It is the case of the Revenue and Ld. DR that the assessee failed to evidence the rendering of transport/aftersales service. Ld. DR relied on the failure of the assessee in discharging the onus. Ld. DR rely heavily on the finding of the Tribunal on this failure of the assessee.

12. We heard the parties on this issue of allowability of the claim of business expenditure qua the commercial expediency. Further, we find this issue involves not deeming such business expenditure as not allowable u/s.37(1) of the Act. We find that there is no dispute on facts, i.e. (a) export of sales to Iraqi; (b) making the payments to aforesaid parties in Dubai and Jordan; (c) accounting these transactions in the books of account of the assessee etc. The issue of Revenue is that the said payments are made for the purpose of paying to Iraqi Authorities by way of kickbacks. Further, it is also a fact that the payments were paid to parties in Dubai and Jordan and not paid as kickbacks to Iraqi Authorities. The payments were made only to the aforesaid parties. It is also a fact that the name of the assessee appeared in the VCR along with many other names from India. We also find similar disallowance stand allowed in favour of the assessee except in this case of the assessee. In other words, similar expenses are not deemed as incurred for business

purposes in those cases. The assessee's solitary case is a case where the additions are confirmed and therefore, case is that the assessee is an exception to the rule where the expenses are "not deemed' so. Not deeming so happened in this case on technicalities relating to failure of assessee to discharge the onus and failure to file evidences or filing some irrelevant and messy evidences, a letter between the assessee and KME, etc., It is not the case that the AO is in possession of some incriminating evidences to prove that the services are not rendered by the said Dubai/Jordan entities or assessee paid kickbacks to Iraqi Authorities. Therefore, similar payments are found to be allowable business expenses incurred for business purposes. While this being the finding of the Tribunal in many other cases and, only in this case, the Tribunal held otherwise on technicalities. The confirming of addition is mainly due to the failure of the assessee in discharge of onus and non demonstration of onus in matters of rendering of services by the said Dubai/Jordan entities. Thus, on similar facts, there are divergent views of the Tribunal of various benches. Thus, there exists a debate on if the said expenditure should be either "not deemed" as ones covered by the provisions of Explanation of section 37(1) of the Act or not. Further, it is a settled legal proposition that the penalty is not leviable u/s.271(1)(c) of the Act when the issue suffer from the dispute or debate. We hold accordingly.

B. BINDING NATURE OF THE INTERNATIONAL TREATIES / CONVENTIONS / AGREEMENTS – UNSUPPORTED ENACTMENTS OF INDIAN PARLIAMENT

A. Whether the UN Resolution-986 restricting the rights of citizens has binding effect on the assessee? In this regard, AO and the CIT(A) mentioned and relied heavily on the UN Council's Resolution-986 and submitted the same are binding on the Revenue. UN established OIP Programme called "Oil-for-Food Programme" in 1995 allowing the Iraq to sell their oil for Food and other humanitarian needs of its citizens. Under this programme, assessee along with many Indian exporters exported Portable Centrifugal Pumps to Iraq. However, there are various allegations of abuse of the said OIP programme and payment of kickbacks (commission) by various entities to the Iraqi Authorities by way of transportation fees, aftersales service charges etc. United Nations instituted an enquiry commission under the Chairmanship of Shri Volcker. He submitted a report called "VCR". The VCR contains various Indian exporters names and assessee is one of them. All these exporters are said to be the parties to the said alleged kickbacks. In these cases of exporters, the allowability of the expenses was the common issue. In few cases, AOs invoked the amended provisions of Explanation to section 37(1) of the Act and held that the said payments made by assessee are routed to the Iraq authority by way of kickbacks. This is merely an allegation and there is no finding of fact by any judicial forum. In this context, referring to the UN Resolutions, terming these allegations as unsustainable ones, Ld. Counsel submitted that the assessee never made any payment for the kickbacks. Ld. Counsel for the assessee submitted that no international agreements/conventions/treaties/UN Resolution-986 etc. are not binding on the citizens of India unless the said resolutions of UNO/agreements/conventions/treaties obtain the

status of domestic Acts duly passed by the Indian Parliament with due process of legislation in India. In this regard and to support his argument, Ld. Counsel for the assessee relies heavily on the Supreme Court judgment in the case of Maganbhai Ishwarbai Patel etc. Vs. UOI and others AIR 1969 SC 783

B. Relying heavily on the said judgment of Supreme Court in the case of Maganbhai Ishwarbai Patel etc. Vs. Union of India and others (supra), Ld. Counsel argued that the said resolutions /agreements /conventions /treaties are applicable to the Indian citizens so long as they do not have any adverse impact on the rights of the citizens of India. He mentioned that there is a requirement of converting such resolutions /agreements /conventions/treaties into a law, the moment the rights of the citizens are infringed by such international treaties/resolutions etc. Relying on the said judgment of Apex Court, Ld. Counsel for the assessee submitted that the said judgment was not available to ITAT/CIT(A)/AO at the time when the quantum appeals were heard and finalized by the Tribunal. Had this judgment been brought to the notice of the Tribunal, the outcome of the proceeding on merits might have been different.

C. **UN Resolution-986 has the adverse effect on the right of business of the assessee :** Mentioning about the rights of doing export business of the assessee and notwithstanding the decision of the Tribunal against the assessee on the quantum proceedings, when it comes to the penalty proceedings, the said Apex Court judgment and its *ratio decidendi* becomes extremely relevant. Further, as per Ld. Counsel,

the violation by the assessee to the UN Council's Resolution- 986 does not become an offence or violation of any law as no Indian Law classifies such payments to parties at Dubai/Jordan or Iraq as an offence or otherwise. Consequently, the provisions of Explanation 1 to section 37(1) of the Act is not validly invoked by the AO. The ratio of said Apex court judgment in the case of Maganbhai Ishwarbai Patel Vs. UOI and others (supra) does not allot the UN Resolution-986 as equivalent of Indian Laws. Further, relying on the jurisdictional High Court judgment in the case of Karan Dileep Nevatia Vs. The UOI in Writ Petition No.7852/2008 (page 392 of the paper book) and the judgment of Hon'ble Karnataka High Court in the case of Civil Rights Vigilance Committee, SLSRC College of Law, Bangalore Vs. UIO and others (Page 392 of paper book No.4), Ld. Counsel for the assessee submitted that the positive commitment to International accords of Government ignites legislative action at home but does not automatically make the covenant an enforceable part of corpus juris of India.

Relying on these judgments, Ld. Counsel summed up by stating that assessee did not commit any offence or executed any activity prohibited under law of India in matters of export sales or making payments to M/s. Azhar Trading Company, Dubai, M/s. Alia and General Trading Company, Jordan, etc.

D. Further, Ld. Counsel submitted that the payments made by the assessee for Transportation and other logistical services are not for the purpose of kickbacks to the Iraqi authorities. Therefore, the same is not against any Indian Public Policy as the assessee never incurred

kickbacks directly. Referring to VCR, Ld. Counsel submitted that the VCR is merely an opinion of a committee and it never passed the test of legal scrutiny. Therefore, the same is wrongly treated by AO/CIT(A) as sacrosanct and made an unsustainable additions. So far as the assessee is concerned, it is the case of making payment for business contingency and how the said payment is appropriated is not for the assessee to monitor. Further, Ld. Counsel submitted that in making the said payments, there is no intention in furnishing any inaccurate particulars of income as alleged by the AO and the CIT(A). Therefore, it is the case of the assessee that the cited purpose of an offence or purposes of committing any act prohibited by law mentioned in the explanation 1 to section 37(1) of the Act are not done in the hands of the assessee. Therefore, as per Ld. Counsel, the said provisions are wrongly invoked by the authorities for levying the penalty. No domestic law was ever violated by the assessee in making the said payments to M/s. Azhar Trading Company, Dubai, M/s. Alia and General Trading Company, Jordan, KME, etc as the case may be. The UN Council's Resolution-986 is neither the law of the land nor it does not infringe the rights of the Indian businessman.

13. Per Contra, Ld. DR submitted that the India is a signatory to the UN Resolution-986 and therefore, it has binding effect on the citizens of India. Further, Ld. DR fairly submitted that the said judgment of Supreme Court did not exist in the past and mentioned that the facts of said judgment are distinguishable.

14. We have heard both parties on this aspect of UN Resolultion-986, ratio of Hon'ble Supreme Court's judgment in the case Maganbhai Ishwarlal Patel (supra), Karan Dileep Nevatia etc. The ratio of judgment of Supreme Court in the case of Maganbhai Ishwarlal Patel (supra) is extracted as under :

> *"77. The effect of an international treaty on the rights of citizens of the States concerned in the agreement is stated in Oppenheim's International Law, 8th Edn., at p. 40 thus*
>
> *"Such treaties as affect private rights and, generally, as require for their enforcement by English courts a modification of common law or of a statute must receive parliamentary assent through an enabling Act of Parliament. To that extent binding treaties which are part of International Law do not form part of the law of the land unless expressly made so by the legislature."*
>
> *and at p. 924 it is stated :*
>
> *The binding force of a treaty concerns in principle the contracting States only, and not their subjects. As International Law is prim- arily a law between States only and exclusively, treaties can normally have effect upon States only. This rule can, as has been pointed out by the Permanent Court of International Justice, be altered by the express or implied terms of the treaty, in which case its provisions become self-executory. Otherwise, if treaties contain provisions with regard to rights and duties of the subjects of the contracting States, their courts, officials, and the like, these States must take steps as are necessary according to their Municipal Law, to make these provisions binding upon their subjects, courts, officials, and the like."*
>
> *In Wade and Phillips' Constitutional Law, 7th Edn., :It is stated at p. 274 :*
>
> *" At first sight the treaty-making power appears to conflict with the constitutional principle that the Queen by prerogative cannot alter the law of the land, but the provisions of a treaty duly ratified do not by virtue of the treaty alone have the force of municipal law. The assent of Parliament must be obtained and the necessary legislation passed before a court of law can enforce the treaty, should it conflict with the existing law."*
>
> *On p. 275 it is stated that "treaties which, for their execution and application in the United Kingdom, require some addition to, or alteration of, the existing law" are treaties which involve legislation. The statement made by Sir Robert Phillimore, Judge of the Admiralty Court in The Parlement Belge(1)-(though the ultimate decision was revised by the Court of Appeal in another point [vide (1880) 5 P. D. 197] in dealing with the effect of a "Convention regulating Communications,by Post" signed and ratified in 1876 which purported to confer upon Belgian mail streamers. immunity of foreign warships is appropriate :*

"If the Crown had power without the authority of parliament by this treaty to order that the Parlement Belge should be entitled to all the privileges of a ship of war, then the warrant, which is prayed for against her as a wrong- doer on account of the collision, cannot issue, and the right of the subject, but for this order unquestionable, to recover damages for the injuries done to him by her is extinguished.

This is a use of the treaty-making prerogative of the Crown which I believe to be without precedent, and in principle contrary to the laws of the Constitution."

78. In Walker v. Baird(2) the Judicial Committee, affirming the decision of the Supreme Court of Newfoundland, observed that the plea of act of State raised in an action for trespass against the Captain of a British fishery vessel who was authorised by the Commissioners of the Admiralty to superintend the execution of an agreement between the British Crown and the Republic of France, which provided that no new lobster factory shall be established on a certain part of the coast of Newfoundland could not be upheld.

79. The Judicial Committee in Attorney-General for Canada v. Attorney-General for Ontario and Others(3) made some observations in the context of a rule applicable within the British Empire, which are pertinent :

"It will be essential to keep in mind the distinction between (1) the formation, and (2) the performance, of the obligations constituted by a treaty, using that word as comprising any agreement between two or more sovereign States. Within the British Empire there is a well-established rule that the making of a treaty is an executive act, while the performance of its obligations, if they entail alteration of the existing domestic law, requires legislative action. Unlike some other countries, the, stipulations of a treaty duly ratified do not within the Empire, by virtue of the treaty alone, have the force of law. If the national executive, the Government of the day, decide to incur the obligations of a treaty which involve alteration of law they have to run the risk of obtaining the assent of Parliament to the necessary statute or statutes.....Parliament, no, doubt, ... has a constitutional control over the executive : but it cannot be disputed that the creation of the obligation.-. undertaken in treaties and the assent to their form and quality are the function of the executive alone. Once they are created, while they bind the State as against the other contracting parties, Parliament may refuse to perform them and so leave the State in default."

These observations are valid in the context of our constitutional set up. By Art. 73, subject to the provisions of the Constitution, the executive power of the Union extends to the matters with respect to which the Parliament has power to make laws. Our Constitution makes no- provision making legislation a condition of the entry into an international treaty in times either of war or peace. ***The executive power of the Union is vested in the, President and is exercisable in accordance with the Constitution. The executive is qua the State competent to represent the State in all matters international and may by agreement, convention or treaties incur obligations which in international law are binding upon the State. But the- obligations arising under the agreement or treaties are not by their own force binding upon Indian nationals. The power to legislate in respect of treaties lies***

with the Parliament under Entries 10 and 14 of List I of the Seventh Schedule. But making of law under that authority is necessary when the treaty or agreement operates to restrict the rights of citizens or others or modifies the laws of the State. If the rights of the citizens or others which are justiciable are not affected, no legislative measure is needed to give effect to the agreement or treaty.

80. The argument raised at the Bar that power to make treaty or to implement a treaty, agreement or convention with a foreign State can only be exercised under authority of law, proceeds upon a misreading of Art. 253. Article 253 occurs in Ch. 1 of Part XI of the Constitution which deals with legislative relations: Distinction of Legislative Powers. By Art. 245 the territorial operation of legislative power of the Parliament and the State Legislatures is delimited, and Art. 246 distributes legislative power subject-wise between the Parliament and the State Legislatures. Articles 247, 249, 250, 252 and 253 enact some of the exceptions to the rule contained in Art. 246. 'Me effect of Art. 253 is that if a treaty, agreement or convention with a foreign State deals with a subject within the competence of the State legislature, ***the Parliament alone has notwithstanding Art. 246(3), the power to make laws to implement the treaty, agreement or convention or any decision made at any international conference, association or other body.*** *In terms, the Article deals with legislative power thereby power is conferred upon the parliament which it may not otherwise possess. But it does not seek- to circumscribe the extent of the power conferred by Art. 73. If, in consequence of the exercise of executive power, rights of the citizens or others are restricted or infringed, or laws are modified, the exercise of power must be supported by legislation: where there is no such restriction, infringement of the right or modification of the laws, the executive is competent to exercise the power.*

…….

99. The appeal and the writs are dismissed."

Considering the said judgment, on one side and the UN Resolution-986 on the other, we find that there is need for domestic legislation for restricting the business rights of the citizens in India.

14.1 The Hon'ble Supreme Court pronounced the judgment in the context of ceding of part of land qua the order of International Tribunal. The above said judgment of Supreme Court in the case of Maganbhai Ishwarbhai Patel etc (supra) is categorical in pronouncing that no order of an International Court effect adversely the rights of the citizens in

India. In this regard, we proceed to examine if the UN Resolution-986 has the capability of infringing the rights of Indians. As per the said UN Resolution-986, the Indian, along with other member countries abroad, are allowed to export to Iraq only under Oil-for-Food programme and not otherwise. As such, no domestic enactment exist to support the same. From this point of view, the effect of UN Resolution-986 infringes on the rights of citizens. Such resolution, being in the nature of executive order do not have the power of taking away the rights of the Indian citizens. As such UN Resolution-986 cannot decide if an Indian citizen can export his goods to Iraqi or not either under Oil-for-Food programme or otherwise.

From this view point, we are of the view that the failure of the assessee in not complying with the UN Resolution-986 do not constitute an "offence" for the purpose of Explanation 1 to section 37(1) of the Act. Thus, for the purpose of levy of penalty u/s.271(1)(c) of the Act in respect of the payments for transport charges, aftersales fees to M/s. Azhar Trading Company, Dubai, M/s. Alia and General Trading Company, Jordan, KME etc., the penalty is not sustainable. The payments do not constitute for the purpose of committing an offence or the same is prohibited by any law. We order accordingly. When there is no restrictive provisions, assessee is free to export his goods to any country including Iraq. Therefore, no international treaty or UN Resolution-986 can take away that right of the Indian businessman.

C. WHEN THE ISSUES ARE DEBATABLE – NO PENALTY IS LEVIABLE

15. The allowability of the payments made to M/s. Azhar Trading Company, Dubai, M/s. Alia and General Trading Company, Jordan, KME etc. towards transportation/aftersales services etc. u/s.37(1) of the Act attracted attention of the various benches of the Tribunal on one side and the Calcutta High Court on the other side. The same is relevant in the context of UN Council Resolution-986 qua the 'Oil-for-Food Programme. The allegation of kickbacks to the Iraq Government was examined by the said High Court/Tribunals. In large number of cases mentioned above, the expenditure claimed by the assessee on accounts of transportation charges and aftersales services fee were found allowable u/s.37(1) of the Act. The only difference in this case is with reference to messy letter dated 01-02-2012 of KME which created negative opinion against the assessee. The said letter may be sufficient evidence to make addition but not for levy of penalty. According to Ld. Counsel for the assessee, if the said letter is ignored, the facts of the present case is exactly similar and therefore, the additions are unsustainable. The Tribunal deleted similar addition in the other group cases of the assessee, i.e. Kirloskar Oil Engines Ltd.. Therefore, the penalty is not leviable in view of the above referred series of decisions tabulated above.

D. DEBATABILITY

Regarding the debatability, Ld. Counsel for the assessee submitted that the assessee's case is the only one case, where the additions are confirmed on merits. In all other cases, assessee was found eligible for

claim of expenses and which were allowed. Therefore, on this issue of claim of expenditure, there is variance, i.e. (1) same assessee never claimed such expenditure as allowable expenditure at all; (2) others like CIT Vs. Rajarani Exports Pvt. Ltd. (361 ITR 152 (Cal.) (DCIT Vs.Rajrani Exports Pvt. Ltd.17 ITR (Trib.) 239 (Kol.) case claimed and were allowed too; (3) assessee claimed as allowable but disallowed by the AO and confirmed by the Tribunal in the present case. Thus, there is huge amount of debate on the nature of allowability of the claim that the payments made to M/s. Azhar Trading Company, Dubai, M/s. Alia and General Trading Company, Jordan, KME. In such case, the issue is debatable and therefore, penalty should not be levied.

E. LIST OF THE LEGAL PRECEDENTS ON THE SIMILAR PAYMENTS MADE TO SIMILAR PARTIES ABROAD AMDN MENTIONED THE DIVERGENT FINDINGS BY VARIOUS BENCHES OF THE TRIBUNAL

16.A. Ld. Counsel for the assessee mentioning the divergent findings by various Benches of the Tribunal submitted that, in the following cases, the payments were made to M/s. Azhar Trading Company, Dubai, M/s. Alia and General Trading Company, Jordan, KME etc. and the said payments were found allowable u/s.37(1) of the Act. Consequently, penalties do not survive.

B. To start with, Ld. Counsel mentioned that in the case of Kirloskar Oil Engineers Ltd. in ITA No.1170/PN/2011, the Pune Bench of the Tribunal considered the payments are genuine and held allowable u/s.37(1) of the Act. Referring to the order of the Mumbai Bench of the Tribunal in the case of M/s.Exim Trade Links India Pvt. Ltd. in ITA

No.4266/Mum/2009, Ld. Counsel submitted that the payments was found allowable. Therefore, the question of levy of penalty does not arise. Various other cases, where the allegation of Kickbacks made to Iraq Government is there, were found allowable by various benches of the Tribunal/High Court.

C. Further, there is debate on if the payments made by the assessee are for kickbacks at all in the present case and allowable u/s.37(1) of the Act or not. He submitted that the Tribunal confirmed the addition in the present case for failure to discharge of onus by the assessee and not because of any adverse and direct evidences against the assessee in matters of rendering of services. As such, there is no direct evidence in support of payment of the kickback to Iraqi Authorities. Further, there is debate on the sacredness of the VCR and their findings and they were never scrutinized legally in forms of law. Therefore, assessee ought to win on the issue of penalty on the ground of debatability. There are catena of binding judgments for the legal proposition that the penalty u/s.271(1)(c) of the Act are not sustainable when the issue is not free from the debate. We order accordingly.

F. EXPLANATION 1 TO SECTION 37(1) –DEEMED PROVISIONS – NO PENALTY IS LEVIABLE

17. Notwithstanding the above arguments, Ld. Counsel brought our attention to the Explanation 1 to section 37(1) of the Act argued that the Explanation 1 merely constitutes deemed provisions and the same may be appropriate so far as the disallowance of expenditure is concerned.

However, when it comes to the levy of penalties u/s.271(1)(c) of the Act is concerned, the penalties linked to the deemed income are not validly levied. Relying on the various decisions in this regard, Ld. Counsel for the assessee submitted that the penalties are required to be deleted since the same are deemed to have been incurred for the purpose of business or profession. Assessee also relied on various decisions in this regard.

PENALTY – CONCLUSION OF THE TRIBUNAL

18. Thus, we have so far dealt with each of the issue-centric arguments of Ld. DR as well as Ld. Counsel for the assessee on each of the issues, i.e. (1) Commercial Expediency; (2) Binding nature of the International Treaties/Conventions/Agreements; (3) Applicability of Judgment of Supreme Court in the case of Maganbhai Ishwarbhai Patel etc Vs. Union of India and others; (4) Debatability of the issues; (5) Legal precedents on the similar payments made to similar parties abroad; and (6)Deemed Explanation 1 to section 37(1) of the Act etc.,

We have also analysed facts of the issue on one side and the provisions of section 37(1) and the Explanation (1) wherever applicable and find the Explanation (1) does not permit deduction or allowance out of the business expenses if certain expenses are not to be deemed to have been incurred for business purposes. We have held that the said Explanation is a deeming provision in the context of business expenditure only. The language in the Explanation is negatively worded for not deeming certain business expenses as not allowable or deductible business expenditure u/s.37(1) of the Act. Further, in the context of

commercial expediency, we have analysed the expenditure incurred is for transportation charges, aftersales service fee etc. which are obviously business and allowable expenditure but for the deeming provisions of the Explanation. Whether such expenditure falls under the category of expenditure not to be deemed as incurred for business purposed within the meaning of said Explanation (1), we observed that there is no evidence on records to indicate that the assessee paid the kickbacks directly to the Iraqi Authorities. Therefore, in the penalty proceedings, the payments made by the assessee needs to be considered for the transportation charges, aftersales service fee in the context of export of the portable centrifugal pumps for use in Iraq under Oil-for-Food Program of United Nations Organisation. Such claims are allowed in favour of the assessee in large number of cases mentioned above. Further, we have analysed the series of decisions and various types in it and held, barring the instant case of the assessee, in all other cases, the expenditure was found allowable u/s.37(1) of the Act on similar facts. Further, we have dealt that the principle of debatability on various counts connected to the claim of the assessee. On merits of the claims, there are divergent decisions in favour and against allowing the claim of deduction. Further also, the decision of Hon'ble Supreme Court in the case of Maganbhai Ishwarbhai Patel etc. Vs. Union of India and others (supra) was analysed and found the same is relevant for the proposition that, wherever the rights of the citizens are restricted by way of Treaties/Conventions/Agreements etc. like the case of UN Resolution-986, there is a requirement of domestic law ratifying the said restrictions of the UN Resolution. In the absence of any domestic law passed by the

Indian Parliament, such resolution cannot create an offence in the context of Explanation (1) to section 37(1) of the Act and against the assessee.

Therefore, the allegation of committing the offence by the assessee, ignoring the fact of making payment by the assessee to the said entities and not to the Iraqi Authorities, is unsustainable legally. The said judgment of Hon'ble Supreme Court is very categoric in this regard. Further, this is a case where AO merely relied on VCR which is not a legal document duly scrutinised by any legal forum. Mere existence of assessee's name in the list of Indian entities appended to the VCR, cannot be accepted as sacrosanct in these penalty proceedings. The matters relating to income-tax has to be decided based on the income-tax law and not based on the VCR of UN Resolution. The above findings are borne out of the judgment/order in the case of CIT Rajarani Exports Pvt. Ltd. (supra). This judgment is relevant for the proposition that, no illegality in making payment of commission when there is no evidence to show the transaction relating to the payment of commission is not genuine or the payment is excessive or unreasonable. Relevant extract of the findings of the Tribunal in the case of DCIT Vs. Rajrani Exports Pvt. Ltd. (supra) are reproduced here below :

> *"15. The assessee has made payment for commission and has been rendered services in consideration of the same. As a matter of fact, it is not even revenue's case that no services have been rendered at all. The fact that services have been rendered by a party other than the agent to whom commission is paid is wholly immaterial so far as deductibility in the hands of the assessee is concerned.*
>
> *16. As for the position that the payment was highly excessive vis -à-vis the local costs, even if that be so, that aspect of the matter does not affect the deductibility in the hands of the assessee either. The assessee is concerned with commercial expediency of the said payment and not with*

what are the actual costs incurred in rendering the services for which the payment is made. As we have seen earlier in this order, from the extracts of the Volker Committee report itself, it was absolutely necessary for the assessee to make the impugned payments and, in any event, the commercial expediency of these payments has not even been called into question by the Assessing Officer. The case of the revenue is confined to invoking the Explanation to Section 37(1).

17. The objections to the said commission payments do not, therefore , are not therefore sustainable in law, so far as deductibility under section 37(1) is concerned."

The Revenue challenged the findings of the Tribunal before the Hon'ble Calcutta High Court. The Hon'ble High Court confirmed the findings of the Tribunal and held that where the assessee paid commission on exports through banking channel in pursuance of an agreement approved by Govt. of India and the United Nations, same could not be disallowed in absence of evidence of its illegality.

Relying on the said judgment, the Mumbai Bench of the Tribunal in the case of M/s.Man Industries India Ltd. in ACIT in ITA No.6695/Mum/2014 decided on 12-02-2017 deleted the penalty u/s.271(1)(c) of the Act read with Explanation 1 thereto considering the similarity of facts as well as the above legal proposition. Para No.6 of the order of Tribunal is relevant. For the sake of completeness, we proceed to extract the same below :

"6. The decision of the Tribunal has upheld by the Hon'ble Calcutta High Court by dismissing the appeal of the revenue by holding that there was no infirmity in the order of appellate authority and therefore the payment of commission should not be disallowed. By applying the same analogy to the present case, we hold that the penalty cannot be imposed merely on the basis that the assessee has not filed any appeal against the quantum addition and more so when the tribunal decision upholding the claim of the assessee to claim the payments of charges to Iraqi regime as admissible which stands upheld by the jurisdictional high court. The penalty proceedings are independent proceedings which are to be decided on the basis of merits of each case. ***In the present case, the Calcutta***

Bench of the Tribunal has already decided that the payment made on account of transportation charges as admissible which cannot be disallowed on the basis of Volcker Committee report and hence penalty on such disallowance which is wrong and against the spirit of the Act cannot be sustained. Accordingly, we set aside the order of ld. CIT(A) and direct the AO to delete the penalty."

Therefore, it is a case where debatability exists both on facts as well as on law. On law, the debate is whether the expenditure is allowable or not; and, on legal front, the debate is whether the payments made by the intermediaries to the Iraq Authorities constitutes an offence committed by the assessee or not. Amidst all these debatabilities, we are of the opinion that the levy of penalty in both the assessment years is unsustainable.

19. Further, with regard to the relevant A.Y. 2003-04, the assessee made a contention that the additions u/s.37(1) of the Act becomes unsustainable due to likely favourable finding on the invalidity of reassessment proceedings. In our view, adjudication of this issue becomes an academic exercise in view of the deletion of penalty by us on the ground of debatability. Accordingly, relevant grounds are dismissed as academic.

20. In the result, the appeal of the assessee for A.Y. 2003-04 is partly allowed.

21. To sum up, appeal of the Assessee for A.Y. 2002-03 is allowed and appeal of the assessee for A.Y. 2003-04 is partly allowed.

Order pronounced on 19th day of September, 2018.

Sd/-	Sd/-
(विकास अवस्थी /VIKAS AWASTHY)	**(डी. करुणाकरा राव/D. KARUNAKARA RAO)**
न्यायिक सदस्य/JUDICIAL MEMBER	**लेखा सदस्य/ACCOUNTANT MEMBER**

पुणे / Pune; दिनांक / Dated : 19th September, 2018.
Satish

आदेश की प्रतिलिपि अग्रेषित / Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant.
2. प्रत्यर्थी / The Respondent.
3. The CIT(Appeals)-1, Pune.
4. The Pr. CIT-1, Pune.
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, "**बी**" बेंच, पुणे / DR, ITAT, "B" Bench, Pune.
6. गार्ड फ़ाइल / Guard File.

आदेशानुसार / BY ORDER,

// True Copy //

Senior Private Secretary
आयकर अपीलीय अधिकरण, पुणे / ITAT, Pune