IN THE INCOME TAX APPELLATE TRIBUNAL,
AHMEDABAD "D" BENCH, AHMEDABAD

[Coram: Justice P P Bhatt, President and Pramod Kumar, Vice President]

ITA No.: 184/Ahd/17
Assessment year: 2012-13

Rotomag Motors & Controls Pvt Ltd **……...……..Appellant**
C-1/5, Vitthal Udyognagar, GIDC Estate
Vitthal Udyognagar, Anand 388 121
[PAN:AAACR 9061 K]

Vs.

Deputy Commissioner of Income Tax
Anand Circle, Anand **……..….....Respondent**

Appearances by
Shailesh Shah, *for the appellant*
Lalit P Jain *for the respondent*

Date of concluding the hearing : December 6, 2018
Date of pronouncement : March 4, 2019

O R D E R

Per Pramod Kumar, VP:

1. This appeal, filed by the assessee, is directed against the order dated 17th October 2016 passed by the CIT(A) in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2012-13.

2. Grievance of the assessee, in substance, is against learned CIT(A)'s confirming the disallowance of Rs 14,67,000, in respect of remuneration to directors, under section 40A(2)(b) of the Act.

3. The issue in appeal lies in a narrow compass of material facts. During the course of assessment proceedings, the Assessing Officer noticed that there is a fall in turnover of the assessee and the net profit rate of the assessee. While the turnover has reduced from Rs 21,20,03,364, in the immediately preceding year, to Rs 19,93,43,791 in the present assessment year, the net profit rate has decreased from 13.85% to 11.70%. The Assessing Officer also noted that, at the same time, the remuneration to the directors, which was admittedly not revised in the last 5 years, has increased from Rs 34,08,000 to Rs 48,75,000. The increase of Rs 14,67,000 was considered "excessive and unreasonable having regard to the fair market value of goods, services or facilities etc" as there was no specific reason warranting the increase and the mere fact that it was not revised in last 5 years was, by implication, not considered reason enough. It was also observed that there is a fall in turnover and profitability. Accordingly, Rs.14,67,000 was disallowed. Aggrieved, assessee carried the matter in appeal but without any success. It was contended that there is not even an iota of

evidence to suggest that the remuneration paid to the assessee was excessive or unreasonable vis-à-vis fair market value of such services. The CIT(A) was of the view that there is no material on record to show that the assessee and the recipient of the directors' remuneration were in the same bracket and that there was no tax evasion. He further observed that "there is no need for him *(the Assessing Officer)* to prove the market value of the services as was held by Hon'ble Gujarat High Court in the case of Coronation Flour Mills Vs ACIT [(2010) 188 Taxman 257 (Guj)]. The disallowance was thus confirmed. The assessee is not satisfied and is in further appeal before us.

4. We have heard the rival submissions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

5. We find that learned CIT(A)'s reliance on the case of Coronation Flour Mills (supra) was clearly ill conceived inasmuch as in that case, Their Lordships were dealing with a situation in which the "expenditure *(was held)* to be excessive having regard to the legitimate needs of the business". The disallowance was thus not on the ground that the expenditure was unreasonable or excessive, as in this case. It was in this context that Their Lordships had observed as follows:

> **In relation to the disallowance under the provisions of section 40A(2) of the Act, a plain reading of the provision reveals that where an assessee incurs any expenditure in respect of which payment is required to be made or has been made to any person referred to in clause (b) of section 40A(2) of the Act and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to (a) fair market value of the goods, services or facilities for which the payment is made; or (b) the legitimate needs of the business of the assessee; or (c) the benefits derived by or accruing to the assessee on receipt of such goods, services or facilities, then the Assessing Officer shall not allow as a deduction so much of the expenditure as is so considered by the Assessing Officer to be excessive or unreasonable. Therefore, it becomes apparent that the Assessing Officer is required to record a finding as to whether the expenditure is excessive or unreasonable in relation to any one of the three requirements prescribed, which are independent and alternative to each other. All the three requirements need not exist simultaneously. In a given case, if any one condition is shown to be satisfied the provision can be invoked and applied, if the facts so warrant. The contention raised on behalf of the appellant-assessee that the fair market value having not been ascertained by the Assessing Officer no disallowance could have been made, therefore, does not merit acceptance. As already noted hereinbefore, the Assessing Officer has held a part of the expenditure to be excessive having regard to the legitimate needs of the business and for recording such a finding cogent reasons are assigned by the Assessing Officer**.

6. The observations so made by Hon'ble jurisdictional High Court as thus not relevant in the present context, i.e. when disallowance is sough to be made on the ground that the payment is excessive or unreasonable having regard to the fair market value of the services. The assessment order, at page 3, specifically states, in as many words, that the payment for remuneration to directors was "excessive and unreasonable having regard to the fair market value of goods, services or facilities etc". The case before Hon'ble High Court was a case in

which "**a part of the expenditure to be excessive having regard to the legitimate needs of the business"-** a situation materially different from the situation before us.

7. Quite to the contrary of what has been canvassed by the learned CIT(A), Hon'ble jurisdictional High Court, affirming the views articulated by a coordinate bench of this Tribunal, has held that a finding about the fair market value of the goods, services or facilities is a *sine qua non* for making a disallowance under the related limb of Section 40A(2)(b). The observations made by Hon'ble jurisdictional High Court, in the case of **[CIT Vs Ashok J Patel (2014) 43 taxmann.com 227 (Gujarat)]**, are as follows:

> **…….Considering the provisions of Section 40A(2)(b) of the Act and the Evidence Act, if the AO was of the opinion that the payment for which disallowance is claimed, is excessive or unreasonable. In that case, it was for the AO to assess fair market price and give comparative instances for payment for similar transport service. In absence of such comparative cases brought on record, as rightly observed by the ITAT it was not open for the AO to make disallowance under section 40A(2)(b) of the Act. While deleting disallowance made by the AO under section 40A(2)(b) of the Act, the learned ITAT has observed and held in para 7 as under :—**
>
> > **"7. It is plain on principle that, so far as disallowance under Section 40A(2) for payment being excessive or unreasonable can only be made when the payment is made to the "specified persons" under clause 40A(2)(b) and "the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market price of the goods, services or facilities for which the payment is made". The opinion of the Assessing Officer for the expenditure being excessive or unreasonable is to be formed vis-a-vis fair market price of such goods services or facilities. It is thus sine qua non for making a disallowance under section 40(A)(2) that the Assessing Officer has to ascertain the fair market price of such goods, services or facilities, and then make a 'disallowance for the amount which is in excess of fair market value of such goods, services or facilities. Unless there is a categorical finding about the 'fair market value' and the assessee has an opportunity to be heard on Assessing Officer's finding about such 'fair market value', there cannot be an occasion to make a disallowance under section 40A(2). The very scheme of Section 40A(2) does not envisage an adhoc disallowance as has been made in the present case. For this short reason alone, the impugned deletion of disallowance must stand confirmed. There is, however, one more reason for doing so. As evident from a plain reading of the assessment order, the Assessing Officer, had called upon the assessee to demonstrate that the payment made by the assessee to the specified persons is not unreasonable or excessive, and it is thus failure of the assessee which has resulted in disallowance under section 40A(2). However, proving a negative, as the assessee has been called upon to do in this case, is an impossible onus to perform. In any event, this onus is on the Assessing Officer and the AO has failed to discharge the said onus. For this reason also, the disallowance is unsustainable in law. As regards the discrepancy in the figures of the tax audit report and the assessee, neither such a situation can be a reason enough to make a disallowance under**

section 40A(2) nor the onus of explaining such a variation is on the assessee. A tax auditor is an independent professional and any errors in his report cannot be put to assessee's disadvantage. In view of these discussions, as also bearing in mind entirety of the case, we approve the conclusions arrived at by the CIT(A) and decline to interfere in the matter."

We are in complete agreement with the view taken by the ITAT and the observations made by the learned ITAT while deleting disallowances made by the AO under section 40A(2) (b) of the Act on motor bus rent. No error has been committed by the learned ITAT which calls for interference of this Court. No question of law much less any substantial question of law arises.

8. Learned CIT(A) was thus clearly in error in his approach on the fundamental principle.

9. In the present case, there is no finding whatsoever about the fair market value of the services rendered by the directors. The only reason for making the disallowance is that enhancement in director's fees is not coupled with corresponding increase in turnover or profitability but that is wholly irrelevant in the context of Section 40A(2). It is a fact that there was no revision of remuneration in the last 5 years and that there is no finding that the remuneration, post this revision, was excessive or unreasonable vis-à-vis fair market price of such services. In these circumstances, the very foundation of the impugned disallowance is devoid of legally sustainable merits. For this short reason alone, the impugned disallowance of Rs 14,67,000 must stand deleted.

10. In view of the above discussions, and bearing in mind entirety of the case, we deem it fit and proper to delete the impugned disallowance of Rs 14,67,000 under section 40A(2) in respect of remuneration paid to the directors. The assessee gets the relief accordingly.

15. In the result, the appeal is allowed in the terms indicated above. Pronounced in the open court today on the 4th day of March, 2019.

Sd/- **Sd/-**

Justice P P Bhatt **Pramod Kumar**
(President) (Vice President)

Ahmedabad, dated the 4th day of March, 2019

Copies to: *(1)* *The appellant* *(2)* *The respondent*
(3) *CIT* *(4)* *CIT(A)*
(5) *DR* *(6)* *Guard File*

By order

True Copy

Assistant Registrar
Income Tax Appellate Tribunal
Ahmedabad benches, Ahmedabad