

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "K", MUMBAI**

BEFORE SHRI G.S. PANNU (VP) AND SHRI RAM LAL NEGI (JM)

**ITA No. 7098/MUM/2012
Assessment Year: 2007-2008**

The DCIT-6 (2), Room No. 563, Aayakar Bhavan, M.K. Road, Churchgate, Mumbai - 400020	Vs.	M/s. E-Bay India Pvt. Ltd., 202, B-Wing, Phoenix House, 462, Senapati Bapat Marg, Lower Parel, Mumbai - 13 PAN: AABCB2307H
(Appellant)		(Respondent)

**CO No. 37/MUM/2012
Assessment Year: 2007-2008**

M/s. E-Bay India Pvt. Ltd., 14 th Floor, North Block, R-Tech Park, Western Express Highway, Goregaon (East), Mumbai - 400063 PAN: AABCB2307H	Vs.	The DCIT- Circle 6(2), Room No. 563, Aayakar Bhavan, M.K. Road, Churchgate, Mumbai - 400020
(Appellant)		(Respondent)

Revenue by : Shri Saurabh Deshpande &
S.K. Mishra (DR)

Assessee by : Shri M.P. Lohia &
Nikhil Tiwari (AR)

Date of Hearing: 21/12/2018
Date of Pronouncement: 18/03/2019

ORDER

PER RAM LAL NEGI, JM

These are the appeal and cross objection filed by the revenue and the assessee respectively against the order dated 18/09/2012 passed by the Ld. CIT (Appeals)-15, Mumbai, for the assessment year 2007-08, whereby the Ld.

CIT(A) has partly allowed the appeal filed by the assessee against the assessment order passed u/s 143 (3)/144C(3) of the Income Tax Act, 1961(for short 'the Act')

ITA No. 7098/MUM/2012 (Assessment Year: 2007-08)

2. Brief facts of the case are that the assessee formerly known as Baazee.com India Pvt. Ltd. engaged in the business of providing marketing support services to its clients, which are in the business of operating online market places, filed its return of income for the assessment year under consideration declaring Nil income. During the year under consideration the appellant incurred certain legal expenses amounting to Rs. 91,27,129/-in relation to a suit filed in connection with MMS case which had been filed prior to the entering into the agreement with e-Bay AG. It was mutually agreed between e-Bay AG and appellant that any legal expenses incurred on the MMS case would not form part of the cost of operation of the assessee for determining the cost plus remuneration of the services provided by the assessee to e-Bay AG as it pertains to erstwhile business of the assessee and not incurred while rendering services to AE. During the assessment proceedings, the assessee was asked to explain as to why expenses incurred on the MMS case should not be disallowed as an expenses u/s 37 (1) read with explanation 1 to section 37(1) of the Act. The assessee contended that the said expense is allowable u/s 37 of the Act and not hit by the explanation. Without prejudice the assessee submitted that the Ld. The AO rejecting the contentions of the assessee held that the expenses of Rs. 91,27,129/- are not allowable as per the provisions of section 37 and added the said amount to the income of the assessee. In the first appeal, the Ld. CIT (A) allowed the said legal expenses holding that the addition was on protective basis and that the AO has added the same to the total income of the assessee over and above the adjustment arrived by the TPO. However, the Ld. CIT (A) further held that the legal expenses incurred by the appellant on the MMS case should be considered at a

part of operating cost of the appellant for computing margins of the appellant for benchmarking the international transaction with AEs. The revenue is in appeal against the findings of the Ld. CIT (A) that the legal expenses are allowable u/s 37 of the Act.

3. The revenue has challenged the impugned order on the following effective grounds:

- 1) *“On the facts and in the circumstances of case and in law, the Ld. CIT (A) erred in deleting the addition of Rs. 91,27,129/- on account of Legal expenses.”*
- 2) *“On the facts and in the circumstances of case and in law, the Ld. CIT (A) erred in not appreciating the fact that such legal expenses are not allowable as per explanation to section 37(1) as they were incurred towards defence in a criminal proceedings”.*

4. Before us, the Ld. Departmental Representative (DR) relying on the assessment order passed by the AO submitted that the Ld. CIT (A) has wrongly deleted the addition of Rs. 91,27,129/- claimed by the assessee on account of legal expenses. The Ld. DR further contended the expenses claimed by the assessee are not allowable as per the explanation to section 37(1) as the same was incurred for defending a criminal case.

5. On the other hand, the Ld. counsel for the assessee relying on the findings of the Ld. CIT (A) submitted that the Ld. CIT (A) has rightly deleted the addition made by the AO. The Ld. counsel submitted that on 27.11.2004 one of the registered users of e-Bay website listed an item with the description titled ‘DPS Girls having fun’ MMS clip in contravention of user agreement signed by the users with the assessee. Accordingly, FIR was lodged on 09.12.2004 against the user, Managing Director (MD) and Head of the Trust and Safety Functions. Consequently, the MD and head of the Trust and safety functions were summoned to face trial. The MD filed petition before the Hon’ble Delhi High Court u/s 482 of the Code of Criminal Procedure for quashing of the

proceedings before the Additional Chief Metropolitan Magistrate. The Hon'ble Court quashed the proceedings *qua* the offences u/s 292 and 294 of the IPC, however, declined to quash proceedings in respect of offences under the Information Technology Act and further passed certain adverse remarks. Mr. Avnish Bajaj and e-Bay India filed SLP before the Hon'ble Supreme Court against the aforesaid order of the Delhi High Court. The Hon'ble Supreme Court allowed the petition and quashed all the criminal charges against Avnish Bajaj and e-Bay India. The Ld. counsel placing reliance on the various decisions of the Tribunal as well as the High Courts, submitted that since the expenditure had been incurred in connection of the business the Ld. CIT(A) has rightly allowed the expenditure in question u/s 37 of the Act and deleted the addition. The Ld. counsel further contended that since the findings of the Ld. CIT(A) are based on the settled law, there is no merit in the appeal of the revenue. The Ld. counsel relied on the following cases to substantiate the contention of the assessee:-

1. *Maruti Udyog Limited (92 ITD 119) Delhi Tribunal.*
2. *J B Advani & Company Limited (18 ITR 557) (Bombay High Court)*
3. *National Rayon Corporation (155 ITR 413) (Bombay High Court)*
4. *J N Singh & Company Private Limited (60 ITR 732) (Punjab & Haryana High Court)*
5. *Ahmedabad Controlled Iron & Steel Reg. Stockholders Association Private Limited (99 ITR 567) (Gujarat High Court).*

6. We have heard the rival submissions and also perused the material on record including the cases relied upon by the parties. The only grievance of the department is that the Ld. CIT (A) has wrongly deleted the addition of Rs. 91,27,129/- made by the AO on account of disallowance of claim made by the assessee towards legal expenses. The Ld. CIT (A) has allowed this ground of appeal of the assessee by holding as under:-

“6.4 I have considered the facts of the case and the submissions of the appellant as against the observations/findings of the AO in his order u/s 143 (3)/144C(3) of the Act. The contentions and submission of the appellant are being discussed and decided as under:-

- i) It is the facts of the case that the expenditure in question has been incurred by the appellant as legal expenses. The legal proceedings were initiated against the Managing Director of the Company and head of trust and safety functions (Avinash Bajaj and Sharat Digumarti) and such legal proceedings were initiated against such designated employees of the company in their official capacity and the proceedings as such therefore cannot be construed to be for any offence that they may have committed in their individual capacity.*
- ii) The appellant is an intermediary and provides a web platform and have transactions. For the purpose of such transactions it enters into agreement with the user of the said platform.*
- iii) In the facts of the case and in the instant case of MMS user of the platform had in contravention to the agreement used the web platform of the appellant which gave rise to such legal proceedings.*
- iv) The appellant company has decided to defend the case of the Managing Director to safeguard its intermediary position which could have a significant impact on the business goodwill, reputation and could further have significant financial impact on the Appellant and the continuity of the operations of running the website as an intermediary.*
- v) In the facts of the case such legal proceedings are not on account of any direct offence committed by any individual employee of the company which have been sought to be defended by the appellant and the legal expenditure has been incurred for that purpose. The AO has relied upon certain case laws which have been summarized hereinabove at para6.2. In all these cases the offence committed had been in respect of such individuals who were occupying the positions and the offences were directly related to actions of such individuals in*

those organizations. In the case on had the offence in person was committed by an individual who had entered into an agreement with the appellant to use its web platform as intermediary. The primary offence in this case therefore would be against the person who uploads such MMS in the web platform of the appellant for its gains. The appellant as an intermediary and owner of the website became party to such incidence.

- vi) In respect of any legal proceedings which is intimated against the designated employees of the company for any purported offence which either the company or such designated employees have not committed in their individual and separate capacity and where appellant feels it necessary to defend its position which could have significant impact on its business goodwill, reputation and continuity of operations could only be termed as a business expenses incurred by the company.*
- vii) It is further seen that the appellant in its submission as extracted portion from memorandum explaining the provisions of the Finance Bill, 1998 which has explained insertion of the explanation to Sc. 37(1) of the Act that such amendment has been brought to result in disallowance of the claim made by the certain tax payers on account of protection money, extortion, hafta, bribes, etc. as business expenditure. The expenditure incurred in the defense against any legal proceedings instituted against the designated employees of the company cannot be interpreted to be in the same breath as protection money, extortion, hafta, bribes etc.*
- viii) In view of the facts of the case and discussion herein above, the case law related upon by the AO are found to be distinguishable on facts for the reasons that in all such cases the proceedings were against the individuals for the purported offence. As opposed to the facts in the appellant's case, where the offence came into existence on account of illegal selling of MMS clip which was uploaded and sold by a user in contravention of the user agreement entered into between the appellant and the registered user.*
- ix) Under aforesaid facts and circumstances the expenditure in question are found to be allowable u/s 37(1).*

- x) *The A.O. in its part 5.13 page 9 has mentioned that the TPO has included this amount on legal expenditure of Rs. 91,27,129/- for calculating mark up for the purposes of determining the remuneration to be paid by E-Bay A.G. to e-Bay India Private Ltd. and accordingly the disallowance so made under the provisions of explanation to Sec. 37(1) was made on protective basis.*
- xi) *Further, the AO has mentioned that these additions will sustained in the event of appellant contesting the addition made by the TPO on this issue and getting relief by the appellate authority. In this regard, it is mentioned that while deciding the ground No. 9 of the appellant, the expenditure of Rs. 91,27,129/- has been considered to be operating in nature and the actions in this regard of the TPO has been sustained. Accordingly, the protective addition so made by the TPO is not found to be sustainable.*
- xii) *It is further seen from the computation of Total Income given by the AO at para 6 page 9 of his order that he has further added Rs. 91,27,129/- on account of legal fee as per the discussions at para 5 of the order which means that the protective additions so made by the AO has been added to the total income of the appellant over and above the adjustment arrived at by the TPO.*
- xiii) *In view of the facts and circumstances of the case and discussion hereinabove such addition made by the AO is not found to be sustainable and accordingly Ground No. 10 & 11 so raised by the appellant are allowed”.*

7. The only contention of the revenue is that the relief granted by the Ld. CIT(A) is in contravention of explanation 1 to section 37 of the Act which says that “for the removal of doubts, it is hereby declare that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or disallowance shall be made in respect of such expenditure.” So, in order to determine as to whether the expenditure claimed by the assessee is allowable u/s 37 of the Act or the same

is hit by explanation 1 to section 37 of the Act, it is necessary to ascertain the nature of expenses incurred in the present case. Admittedly, the assessee has incurred the expenses in connection with the criminal case lodged against the User of the website, MD and the head of the Trust and Safety Functions (TSF). Now the question arises as to whether the MD and the Head of the TSF have in fact committed any offence individually or in connivance with the User who posted the objectionable item? In our considered view, the answer is no. Since the Hon'ble Supreme Court has quashed the entire proceedings against the Assessee Company, MD and Head of the TSF, it can safely be concluded that they had not committed any offence and they were made accused in an attempt to hold the company vicariously liable for the offences committed by the User. Since, they had not committed any offence the assessee company decided to defend the MD and Head of the TSF to protect the image and goodwill of the company.

8. In the case of *Maruti Udyog Ltd. vs. DCIT* (supra), the Delhi Bench of the Tribunal has held that it is the duty of the employer company to defend its employees if they had acted in good faith and the expenditure incurred by the employer in defending the employees to protect the image and good will are allowable business expenditure. The relevant para of the decision reads as under:-

“82. In the present case, the criminal proceedings were initiated against two employees of the assessee- company namely, Ambuj Jain and Pramod Kumar. Mr. Ambuj Jain has pleaded that he was appointed as a junior officer in 1989 and, thereafter, he was sent for training. Hence,, the case of the prosecution that he was present in the alleged meeting in April/May, 1989, was false. In the case of Pramod Kumar, his stand was that he acted in good faith all along keeping the interest of assessee-company. Further, all the transactions were directly between assessee-company and UCO Bank which was duly approved by the various resolutions. In our opinion, if the employees had acted in good faith, then it is the duty of the employer to defend them against any proceedings initiated

against such employee, otherwise the goodwill and image of the company would be spoiled in the commercial world and no person in future would join such company. Further, there may be unrest among the employees if the employer does not defend the case of employees who had acted in good faith on behalf of the employer. It is not the case of misappropriation of funds by the employees. It is a case where the transactions were effected between the assessee-company and UCO Bank through a broker Harshad Mehta. In fact, the company had appreciated the work of Pramod Kumar by giving him promotion. As far as Ambuj Jain is concerned, he has gone on training and, therefore, had no involvement in such transactions. In fact, he was acquitted on this ground. Considering the facts of the case, we are of the view that the company had incurred the expenditure to safeguard its goodwill and image by defending its employees and, therefore, such expenditure can be said to have been incurred for the purpose of business. Consequently, such expenses were allowable as revenue expenditure. The order of the CIT (A) is, therefore, set aside on this issue and the addition sustained by her is hereby deleted.”

9. In *J.B. Advani & Co. Ltd vs. CIT* (supra) the Hon'ble Bombay High Court has held that litigation expenses incurred for defending directors and salesman who were prosecuted for offences committed in the course of company's business are allowable deduction being incidental to the business of the assessee company. Similarly, in the case of *Commissioner of Income Tax vs. Rayon Corporation Ltd.* the Hon'ble Bombay High Court has held that litigation expenses incurred for defending an employee in criminal proceedings is in the interest of business of the assessee company therefore deductible as business expenditure. The Hon'ble High Court of Punjab and Haryana in the case of *J N Singh & Company Pvt. Ltd.*(supra), the Hon'ble High Court of Gujarat in the case of *Ahmadabad Controlled Iron & Steel Reg. Stockholders Association Pvt. Ltd.* (supra) have also held that the expenses for criminal litigation for the purpose of protecting business interest of the assessee-company are allowable as business expenditure.

10. Hence, in our considered view, the order passed by the Ld.CIT (A) is in accordance with the principles of law laid down by the various High Courts and the decision of the ITAT, Delhi discussed above. Therefore, we do not find any reason to interfere with the findings of the Ld. CIT (A) to interfere with. Accordingly, we uphold the order passed by the Ld.CIT (A) and dismiss the sole ground of the appeal of the revenue.

CO No. 37/MUM/2012 (Assessment Year: 2007-08)

The assessee has filed the cross objection on the following grounds:

1. *“On the facts and in the circumstances of the case, the learned Deputy Commissioner of Income Tax (‘AO’), Mumbai has erred in objecting to the order of Hon’ble Commissioner of Income Tax (Appeals) [‘CIT (A)’], in deleting the addition of Rs. 91,27,129/- being legal expenses incurred on the MMS case, when the AO himself had held that the impugned disallowance is being made on protective basis.*
2. *On the facts and in the circumstances of the case, the learned Commissioner of Income Tax (Appeals) has erred in holding that legal expenses of Rs. 91,27,129/- incurred by the Appellant on the MMS case should be considered to part of the operating costs of the Appellant for computing margins of the Appellant for benchmarking the international transaction with Associated Enterprises.*

The respondents crave, to consider each of the above cross objection without prejudice to each other and craves, leave to add, alter delete or modify all or any of the above grounds of cross objection.”

2. Before us, the Ld. counsel for the assessee submitted that as per the agreement dated March 17, 2005 entered into between the assessee and e-Bay AG agreed to remunerate the assessee @ 108% of operating costs incurred by the assessee in providing these services. The operating cost for the said

purpose has been defined in the agreement as all costs of operations of service provider as defined for the purposes of generally accepted accounting principles of the local jurisdiction of service provider, including operating expenses and cost of net revenues except interest expenses, foreign exchange gain or loss, income tax, expenses of third parties that are in the nature of pass-through expense and such other expenses as shall be determined by the parties in the annual budget preparation process. The Ld. counsel further submitted that from the agreement itself it is apparent that the expenses incurred by the appellant towards legal expenses has no nexus with the services rendered by the assessee. Therefore, no cost plus mark-up should be recovered on the legal expenses incurred in connection with the MMS case discussed in the revenue's appeal. The Ld. counsel placing reliance on the decision of ITAT, Delhi in the case of *Corporation Executive Board India Pvt. Ltd. ITA No. 4986/Del/2010*, *Exxon Mobile Gas (India) Pvt. Ltd. ITA No. 417/Del/2011*, decision of Hyderabad Tribunal in the case of *Plannet Online Ltd. ITA No. 464/Hyd/2014*, Pune Tribunal in the case of *Bobst India Pvt. Ltd. ITA No. 512/PN/2012*, Mumbai Tribunal in the case of *Emerson Process Management India Pvt. Ltd.* and the decision of the Hon'ble Delhi High Court in the case of the *Marubeni India Pvt. Ltd. ITA No. 1114/2011*, submitted that the legal expenses amounting to Rs. 91,27,129/- incurred during the year 2007-08 may be allowed as deduction u/s 37(1) of the Act and the same may not be treated as part of the operating cost and the operating margin of 7.39% on operating cost as computed by the appellant should be considered for determining the arm's length operating margin from its international transaction.

3. On the other hand, the Ld. Departmental Representative (DR) relying on the findings of the Ld. CIT (A) submitted that the Ld. CIT (A) has rightly held that the legal expenses amounting to Rs. 91,27,129/- incurred by the assessee on the MMS case should be treated as part of the operating cost of the

appellant for computing margin of the appellant for benchmarking the international transaction with AEs.

4. We have heard the rival submissions and also gone through the relevant material on record including the cases relied upon by the appellant/assessee. The assessee has taken the first ground of objection in support of the action of the Ld.CIT (A) in deleting the addition of Rs. 91,27,129/- being legal expenses incurred on MMS case. Vide Ground No. 2, the assessee has challenged the action of the Ld. CIT (A) in upholding that the legal expenses incurred by the assessee should be considered to be the part of the operating cost of the assessee for computing margins of the assessee for benchmarking the international transaction with its AEs. The Ld. TPO has included the amount of legal expenditure amounting to Rs.91,27,129/- in the operating costs for rendering services to e-Bay AG ignoring the terms of the Agreement.

5. In the case of *Corporate Executive Board vs. ITO* (supra) the Delhi Bench of the Tribunal has held that if the revenue arising from incurring of such expenses is linked with the preceding year then the claim of such expenses by way of write off made during the year cannot be considered as operating cost of the current year. Hence, the date on which such expenses were incurred is crucial to find out if the expenditure were incurred before or after the date of start of rendering services to its AEs. In the present case, admittedly the expenses incurred pertain to the period prior to the entering into agreement with e-Bay AG, the same cannot be treated as part of operating cost incurred by the assessee for rendering services. Secondly, as pointed out by the Ld. counsel, the expenditure in question is not relatable to the services rendered by the assessee so as to include the same to the operating cost. Hence, the findings of the authorities below are not based on the sound reasoning. We, therefore, allow the objection filed by the assessee in the present case and direct the AO to allow the legal expenses amounting to Rs. 91,27,129/-

incurred during the year 2007-08 as deduction u/s 37(1) of the Act and not to include the said amount in the operating cost.

In the result, appeal filed by the revenue is dismissed and cross objection filed by the assessee is allowed.

Order pronounced in the open court on 18th. March, 2019.

Sd/-
(G.S. PANNU)

VICE PRESIDENT

Sd/-

(RAM LAL NEGI)

JUDICIAL MEMBER

मुंबई Mumbai; दिनांक Dated: 18/03/2019

Alindra PS

आदेश प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त (अपील) / The CIT(A)-
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR,
ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai