

आयकर अपीलीय अधिकरण, इन्दौर न्यायपीठ, इन्दौर

**IN THE INCOME TAX APPELLATE TRIBUNAL  
INDORE "SMC" BENCH, INDORE**

**BEFORE SHRI KUL BHARAT, JUDICIAL MEMBER**

**ITA No.152/Ind/2019  
Assessment Year: 2015-16**

M/s. Viraje Cargo Care Pvt. Ltd. 302/A, 3 <sup>rd</sup> Floor, The Mark, 20 Old Palasia Indore, M.P. (Appellant)	<u>बनाम/</u> Vs.	ACIT-4(1) Range-4 Indore (Revenue )
P.A. No.AACCV9586D		

Appellant by	Shri S.N. Agrawal, A.R. & Shri Pankaj Mogra, D.R.
Respondent by	Shri Punit Kumar, Sr. D.R.
<b>Date of Hearing:</b>	<b>23.01.2020</b>
<b>Date of Pronouncement:</b>	<b>28.01.2020</b>

**आदेश / O R D E R**

**PER KUL BHARAT, J.M:**

This appeal by the assessee is directed against order of the Ld. CIT(A)-2, Indore dated 27.11.2018 pertaining to the

assessment year 2015-16. The assessee has raised following grounds of appeal:

1. That on the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in maintaining the disallowance of Rs.5,00,000/- made by the assessing officer out of director remuneration by invoking the provisions of section 40A(2)(b) of the Income Tax Act without properly appreciating the facts of the case and submissions made before him.
2. The appellant reserves its right to add, alter and modify the grounds of appeal as taken by it.

2. The only effective ground is against addition of Rs.5 lakhs made on account of disallowance of Director's remuneration by invoking provisions of section 40A(2)(b) of the Income Tax Act, 1961 (hereinafter called as 'the Act'). The facts giving rise to the present appeal are that case of the assessee was picked up for scrutiny assessment and the assessment u/s 143(3) of the Act was framed vide order dated 17.11.2017. While framing the assessment, the A.O.

observed that during the financial year 2014-15, the assessee company paid Rs.10 lakhs each to the Directors remuneration. This is substantial increase from the last year when they were paid only Rs.12,50,000/-. The A.O. therefore issued a show cause to the assessee calling him to explain as to why there is such increase in the remuneration of the directors. In response thereto, the assessee filed a reply. However, that reply was not acceptable to the A.O. Therefore, he made addition of Rs.5 lakhs. Aggrieved against this, the assessee preferred an appeal before Ld. CIT(A), who after considering the submissions dismissed the appeal. Now the assessee is in further appeal before this Tribunal.

3. Ld. Counsel for the assessee reiterated the submissions as made in the written synopsis. For the sake of clarity, the submissions of the assessee are reproduced as under:

SYNOPSIS OF THE APPEAL AS FILED

1.1] The Appellant company had filed its return of total income for the Asst Year 2015-16 on 30-09-2015 declaring total income at Rs 36,13,470/-

1.2] The case of the above appellant company was selected in scrutiny. In the scrutiny assessment an amount of Rs 5,00,000/- was disallowed and income finally assessed at Rs 41,13,470/-.

1.3] The appellant company preferred an appeal before the Ld CIT(A). The Ld CIT(A) vide his order dt 27-11-2018 has rejected the claim of the appellant and maintained the addition as made by the assessing officer.

1.4] The appellant has taken the following grounds of appeal before the Hon'ble ITAT:

[1] That on the facts and in the circumstances of the case and in law, the Ld CIT (A) erred in maintaining the disallowance of Rs 5,00,000/- made by the assessing officer out of director remuneration by invoking the provisions of section 40A(2)(b) of the Income Tax Act without properly appreciating the facts of the case and submissions made before him.

1.5] The appellant company had paid salary to the directors and its Staff for the year under appeal and also in the immediate preceding year is as under:

S.No	Particulars	F.Y.2013-14	F.Y 2014-15	Increase/ Decrease
1	Salary to Staff	31,80,243	27,75,194	[4,05,049]
2	Salary to Directors	12,50,000	20,00,000	7,50,000
		44,30,243	47,75,194	3,44,951
	Increase of total salary in term of percentage			7.79%

1.6] The aggregate amount of salary as paid increased by 7.79% only. However, the assessing officer considered the amount of director remuneration paid by the assessee company. The assessing officer considered the increased by 22% as reasonable and accordingly restricted the amount of Director remuneration at Rs 15,00,000/- as against Rs 20,00,000/- as actually claimed by the assessee and balance amount of Director remuneration of Rs 5,00,000/- considered as excessive and disallowed the same and added to the total income of the assessee.

1.7.1] Detail of Director remuneration as paid by the appellant company is as under:

S.No	Name of Director	PA No	Qualification	Amount [Rs]
1	Arun Dwivedi	AJSPD9987G	MBA	10,00,000
2	Shawaiz Ahmad	AHQPA5183R	MBA	10,00,000

1.7.2] The amount of Director remuneration as allowed by the assessing officer is as under:

S.No	Name of Director	PA No	Qualification	Amount [Rs]	Accepted by AO	Excessive
1	Arun Dwivedi	AJSPD9987G	MBA	10,00,000	7,50,000	2,50,000
2	Shawaiz Ahmad	AHQPA5183R	MBA	10,00,000	7,50,000	2,50,000
						5,00,000

1.7.3.1] Comparative chart of Revenue from operation and Net profit as shown by the assessee is as under:

S.No	Particulars	As on 31.03.2014	As on 31.03.2015
1	Revenue from Operation	13,32,83,237	14,32,55,918
2	Director remuneration	12,50,000	20,00,000
3	Net Profit	33,51,999	36,16,898

1.7.3.2] That even after the increase in the amount of Director remuneration the overall net profit of the appellant company was increased from Rs 33,51,999/- to Rs 36,16,898/-.

1.7.4] The assessing officer himself not doubted the genuineness of the services rendered by the directors. For this reason, he has accepted director remuneration upto Rs 15,00,000/- as against Rs 20,00,000/- as claimed by the appellant.

1.7.5] That both the directors in their Income Tax return as filed offered the amount of Director remuneration and paid legitimate amount of tax on the same.

1.7.6] That in case of Private limited company, there was no restriction for payment of Director remuneration. Since, the private limited company managed by close group of persons and public funds were not involved. Hence, there was no restriction for making of payment towards directors' remuneration in case of Private Limited company. In case of public limited company, restriction for payment was provided as per section 197 of the Income Tax Act.

1.8] That amount of salary as paid by the appellant company is also justifiable for the following reasons:

S.No	Reason for justification of salary as paid by the assessee
1	Both the directors are professionally qualified as MBA
2	Entire business activities were looked by both of them
3	Initial risk to start the business was also taken by both of them
4	In initial year, both of them have also taken very low director remuneration in absence of availability of profit
5	On the amount of Director remuneration, they have also paid Tax
6	Net profit even after increased in the amount of Director Remuneration was higher than last year
7	In case of Private limited company there was no restriction for allowance of salary to the directors
8	The amount of salary is to be decided by the Board of Directors. The said decision is exclusive with the Board and the assessing officer cannot sit on the arm chair of the businessmen to maximize the profit of the appellant

**1.9.1] That language of provision of section 40A[2][a] of the Income Tax Act read as under:**

(2)(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and **the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services** or facilities for which the payment

is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction.

1.9.2] The assessing officer in the present case in hand failed to form an opinion regarding excessiveness of the fair market value of services. Hence, there was no justification for making any disallowance by invoking the provision of section 40A[2] of the Income Tax Act. That disallowance of Rs 5,00,000/- as made out of Director remuneration was therefore not justified.

**1.10.1] That Hon'ble Apex Court in the case of *Commissioner of Income-tax-IV, Delhi Vs Glaxo Smithkline Asia (P.) Ltd.*[2010] 195 Taxman 35 has held that:**

“ 1. In this special leave petition, the key question which arose for determination before the Authorities below was, whether the assessee-Company and its service provider [GSKCH] are related Companies in terms of section 40A(2) of the Income-tax Act, 1961. If the answer to the said question was to be in the affirmative, then the next question on merits which arose for determination was, whether allocation of cross-charges by the assessee was the correct test applied by the assessee. In other words, whether allocation of cross-charges should be allowed or disallowed by the Department. The Authorities below have recorded a concurrent finding that the said two Companies are not related Companies under the said section. Being aggrieved by the said decision, the matter has come to this Court by way of a special leave petition filed at the instance of the Department. In this special leave petition, we are concerned with assessment year 2001-02.

2. Having gone through the relevant material placed before us concerning assessment year 2001-02, we are of the view that, as far as this special leave petition is concerned, no interference is called for as the entire exercise is a revenue neutral exercise. Hence, this special leave petition filed by the Department stands dismissed. However, we may clarify that proceedings are pending even today at various stages for different assessment years before the Authorities under the Income-tax Act. We express no opinion with regard to those proceedings.

3. However, we direct the Authorities to examine as to whether there is any loss of revenue in any of the assessment years in question. If, however, the Authorities find that the exercise is a revenue neutral exercise, then the matter may be decided, accordingly. We say no more in that regard.”

**1.10.2] That Hon’ble Bombay High Court in case of CIT V/s INDO SAUDI SERVICES (TRAVEL) (P.) LTD. 310 ITR 306) (Bom)**

"Under the CBDT Circular No. 6-P, dated 6th July, 1968 it is stated that no disallowance is to be made under section 40A(2) in respect of the payments made to the relatives and sister concerns where there is no attempt to evade tax. The Tribunal was correct in coming to the conclusion that the CIT (A) was wrong in disallowing half per cent commission paid to the sister concern of the assessee during the asst. yrs.1991-92 and 1992-93. The advocate appearing for the Revenue was also not in a position to point out how the assessee evaded payment of tax by alleged payment of higher commission to its sister concern since the sister concern was also paying tax at higher rate and copies of the assessment orders of the sister concern were taken on record by the Tribunal."

**1.10.3] That Hon’ble Mumbai Bench of ITAT in the case of Edwise Consultants (P.) Ltd. v. Deputy Commissioner of Income-tax, 4(3), Mumbai\* reported in [2017] 83 taxmann.com 27 (Mumbai - Trib.) has held that:-**

20. We have earlier noticed that all the directors are in charge of the entire operations of the assessee company and the financial/operational results of the company are growing every year. Hence, on that count alone, the salary and incentive paid to the directors could be justified and could not be found fault with, without bringing the fair market value of services. In our view, the financial and operational results, justify the payments made to the directors. At this juncture, it is pertinent to refer to the binding decision rendered by the Hon'ble jurisdictional Bombay High Court in the case of *CIT v. Indo Saudi Services (Travel) (P.) Ltd.* [2009] 310 ITR 306, wherein the Hon'ble Bombay High Court referred to the Circular issued by CBDT with regard to sec. 40A(2)(a) as under:-

"Under the CBDT Circular No. 6-P, dated 6th July, 1968 it is stated that no disallowance is to be made under section 40A(2) in respect of payments made to relatives and sister concerns where there is no attempt to evade tax."

In the case before the Bombay High Court, the revenue was not in a position to show as to how the assessee therein evaded payment of tax by alleged payment made to its sister concern, since the sister concern was also paying tax at higher rate and hence the disallowance made u/s 40A(2)(a) was deleted. We further notice that the Hon'ble Bombay High Court has expressed identical view in the case of *CIT v. V.S. Dempo & Co. (P.) Ltd.* [2011] 336 ITR 209/196 Taxman 193/[2010] 8 taxmann.com 159 also. The Hon'ble Punjab & Haryana High Court has also expressed similar view in the case of *CIT v. Siya Ram Garg (HUF)* [2012] 20 taxmann.com 622.

**1.10.4] That Hon'ble Delhi Bench of ITAT in the case of Deputy Commissioner of Income-tax, Circle-9(1), New Delhi v. Spark Hotels (P.) Ltd.\* [2012] 22 taxmann.com 257 (Delhi) has held that**

6. We have heard the learned DR and gone through the facts of the case. As is apparent from the aforesaid facts, the issue before us is as to whether remuneration paid to director of the company is excessive and unreasonable and therefore, could be disallowed u/s 40A(2)(a) of the Act. The AO disallowed an amount of Rs. 30 lacs out of total salary of Rs. 36 lacs, in terms of provisions of sec. 40A(2)(a) of the Act while the Id. CIT(A) deleted the disallowance. Before proceeding further, we may refer to the provisions of section 40A(2) (a) of the Act, the relevant portion of which read as follows :

"40A(2)(a). Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing, to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction."

6.1 A mere glance at the aforesaid provision reveals that the expenditure mentioned therein is in relation to any person referred to in clause (b) of the subsection and the expenditure has to be considered in relation to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to the assessee therefrom. Hon'ble Gujrat High Court observed in *Coronation Flour Mills v. Asstt. CIT* [2010] 188 Taxman 257 that in relation to the disallowance under the provisions of section 40A(2)(a) 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 AO 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 AO shall not allow as a deduction so much of the expenditure as is so considered by the AO to be excessive or unreasonable. Therefore, it becomes apparent that the AO 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. Thus, only so much of the expenses, if paid to a person referred to in clause (b), are allowable which are found to be not excessive and unreasonable and the excessive or unreasonable portion has to be disallowed. It is well settled that the provisions of section. 40A(2)(a) of the Act cannot have any application unless it is first concluded that the expenditure was excessive or unreasonable, as held in the case of *Upper India Publishing House (P.) Ltd. v. CIT* [1979] 117 ITR 569/ 1 Taxman 365 (SC). In the instant case, there is nothing to suggest that the AO found the payment of remuneration to director excessive having regard to either (a) fair market value of the services or facilities; 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 services or facilities. The AO while making the disallowance observed that disallowance was made keeping in view

quantum and nature of business of the assessee. But how quantum or nature of business affected payment of salary to its director, has not been elaborated. 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. Not a whisper has been made by the AO in respect of any of these three ingredients in his assessment order. There is nothing to suggest that the AO ever brought any material on record on this aspect before concluding that remuneration @ Rs. 3 lacs pm was excessive or unreasonable nor even cited any comparable instances in respect of the fair market value of the services rendered by the director.

**6.2** Now we may have a look at the decision in *Eastern Condiments (P) Ltd.* (*supra*) relied upon by the Id. DR. In the said case, the assessee-company was engaged in the manufacture and export of spices. Export was done by a proprietorship concern of the managing director of the assessee-company. Though normal commission paid by the assessee for marketing its products was at 5 per cent, for the sales effected to the proprietorship concern of the managing director, the assessee paid commission at 10 per cent and claimed the same as deduction on the ground that additional commission was attributable to the packing cost incurred by the managing director. The AO noticed that the managing director had purchased machinery for packing in December, 2000 whereas exports were made by him from April, 2000 onwards. He further noted that goods, while in transit from the assessee to the managing director, straightway went to the export stream. Therefore, he disallowed additional 5 per cent commission paid to the managing director which was confirmed by the Commissioner (Appeals). On second appeal, the Tribunal, however, allowed the claim of the assessee. On further appeal, the Hon'ble High Court found that the Tribunal had not cared to consider any of the findings of the AO and had assumed the claim of the assessee that the additional discount was attributable to the packing cost incurred by the managing director, as true. In order to prove that the managing director was left with packing for export and sale of the commodity locally, it was for the assessee to prove that sales were in bulk quantity and the managing director was engaged in the packing. The finding of the AO was that the managing director had purchased certain machinery only in December, 2000 whereas goods

purchased from the assessee were from April, 2000 onwards. It was the further finding of the AO that the goods, while in transit from the assessee to the managing director, straightway went to the export stream which was impossible unless the goods were in packed condition., nor was there any finding by the Tribunal that the managing director had maintained even a single facility for packing. In the light of these observations, the Hon'ble High Court remanded the matter to the AO for giving an opportunity to the assessee as well as to the managing director to prove that packing was done by the managing director to justify additional discount granted and if the assessee failed to do so, disallowance could be made in the assessment. Now how this decision helps the Revenue ,has not been explained by the Id. DR.A mere glance at this decision reveals that facts and circumstances in the said decision are altogether different from the facts and circumstances of the case, especially when the AO nowhere established that the remuneration to director was excessive having regard to either (a) fair market value of the services or facilities; 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 services or facilities. Thus, reliance on the aforesaid decision is misplaced.

**6.3** In view the foregoing, especially when there is no material on record to hold that payment of remuneration @ Rs. 3 lacs pm to the director was excessive or unreasonable, we have no hesitation in upholding the findings of the Id. CIT(A). Therefore, ground no. 1 in the appeal of the Revenue is dismissed.

**1.10.5] That Hon'ble Allahabad High Court in the case of Abbas Wazir (P) Ltd V.s CIT as reported in [2003] 133 TAXMAN 702 (ALL.) has held that:**

**15. It is not for the Income Tax Officer to decide what would be the correct salary of the directors or other officers of the company, unless on the face of it the salary fixed is so exorbitant and absurd, that it can clearly be said to be fictitious and aimed at tax evasion.**

16. For the reasons given above, we answer the question referred in the negative, *i.e.*, in favour of the assessee and against the department and restore the order of the Commissioner of Income Tax (Appeals). Before parting with this case we would like to add that in the present environment when the Indian economy has been opened up and large salaries are being given to bright and highly qualified young recruits in business firms (sometimes as much as Rs. 50,000 to Rs. 1,00,000 per month as starting salary), it is not for the Income Tax Authorities to say that such salaries are excessive or unreasonable. **It is only if there is something 'absolutely fantastic or absurd' that the Income Tax Authorities can intervene in such matter. If we do not take such a view, then the best young talent in India, e.g., the best graduates from IIT/IIM etc. will leave the country and not stay in India and contribute to its progress. Hence we are of the opinion that the time has come when the approach of the authorities should change in the light of the new developments in the world so that the best talent may remain in India and not become part of the 'brain drain'.**

4. On the contrary, Ld. D.R. opposed these submissions and supported the orders of the authorities below.

5. I have heard the rival submissions, perused the materials available on records and gone through the orders of the authorities below. The A.O. has made disallowance by invoking the provisions of section 40A(2)(b) of the Act by observing as under:

*“If we calculate the PBT of the company for F.Y. 2014-15 and FY 2013-14 by adding back the Director’s remuneration, to see how much profits rose excluding this amount, we see that the PBT increased year on year by c. 22% - Rs.36,16,898/- + Rs.20,00,000/- (FY 2014-15) v/s Rs.33,52,000/- + Rs.12,50,000/- (FY 13-14).*

*Thus, at best, the increase in remuneration that can be justified is c. 22%, i.e. total of c. Rs.15,00,000/- (despite the fact that will reduce the distributable profits of the company by a larger proportion), rather than the 60% hike actually offered. Therefore, remuneration paid to Directors is being restricted to Rs.15,00,000/- and Rs.5,00,000/- is being disallowed u/s 40A(2)(b) of the I.T. Act, 1961.*

6. There is no ambiguity so far law is concerned. Section 40A(2)(b) of the Act authorizes the A.O. to make disallowance, if in his opinion the expenditure incurred in respect of which payment is made or is to be made in person referred to in clause (b) of the sub-section (2) of section 40A, he can make disallowance by considering the expenditure being excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit

derived by or accruing to him there from so much of the expenditure as is considered to be excessive or unreasonable. Therefore, the finding of the A.O. is required to be based upon the fair market value of the services, which is a condition precedent before making disallowance. The A.O. in the present case has not given such finding as what is the fair market value, what the A.O. has based his finding purely on the basis of the past history of the assessee. There is no such finding that under the identical facts and circumstances how much remuneration is being paid to the Directors by other similarly situated assesseees. The coordinate bench of this Tribunal in the case of Edwise Consultants Pvt. Ltd. Vs. DCIT (2017) 83 Taxmann.com 27 (Mumbai Trib.) has observed as under:

6. The provisions of sec. 40A(2)(a) reads as under:—

"40A(2)(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and the Assessing officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession or the benefit derived by or accruing to him there from, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction."

7. The Hon'ble Kolkatta Special bench of ITAT had an occasion to examine the provisions of sec. 40A(2)(a) of the Act in the case of *Jt. CIT v. ITC Ltd.* [2008] 112 ITD 57 (Kol.) (SB) and it has been held as under:—

"89. A plain reading of the provisions contained in section 40A(2)(a) makes it clear that it would be applicable only if the following conditions are satisfied:-

- (i) where the assessee incurs any expenditure;
- (ii) the payment for such expenditure is to be made to any person referred to in clause (b) of this sub-section;
- (iii) the assessing officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facility for which the payment is made.

90. All the above conditions must be satisfied so as to apply the provisions of Section 40A(2)(a). So

far as the facts of the case under consideration before us are that there is no dispute that the assessee has incurred the expenditure and the payment has been made to a person referred to in Clause (b). The only dispute is whether the payment for such expenditure is excessive or unreasonable having regard to the fair market value of the goods. In this regard, we agree with the submission of the Id. D.R. that whether the payment is excessive or unreasonable is to be examined in each year and merely because in the preceding year the addition was deleted by the ITAT would not be sufficient to delete the addition in subsequent year, because the payment may be reasonable in one year and it may be unreasonable or excessive in other year."

8. We have noticed earlier that the assessing officer has not examined the claim of the assessee in terms of the mandatory conditions prescribed u/s 40A(2)(a) of the Act. The Ld CIT (A) has also confirmed the disallowance made in all these three years by following his order for AY 2007-08.

7. In the present case also, the A.O. has not brought any material suggesting that fair market value of the remuneration paid to the Directors is lower than what is

paid by the assessee. In the absence of such finding, the disallowance made cannot be sustained and the A.O. is directed to delete disallowance.

8. In the result, the appeal filed by the assessee is ITA No.152/Ind/2019 for the A.Y. 2015-16 is allowed.

*Order was pronounced in the open court on 28.01.2020.*

Sd/-  
(KUL BHARAT)  
JUDICIAL MEMBER

Indore; दिनांक Dated : 28/01/2020  
VG/SPS

Copy to: Assessee/AO/Pr. CIT/ CIT (A)/ITAT (DR)/Guard file.

By order

**Assistant Registrar, Indore**