

**IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH MUMBAI**

**BEFORE SHRI BR BASKARAN, ACCOUNTANT MEMBER &
SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER
ITA No.2990/Mum/2022
(Assessment Year: 2015-16)**

M/s. AC Chokshi Share Brokers Pvt Ltd, 2 nd Floor, ITTS House, 28K Dubash Marg, Kala Ghoda, Fort, Mumbai-400023.	बनाम/ Vs.	ACIT, CC-1(3) 905, 9 th Floor, Pratishtha Bhavan, Old CGO Annex, M.K.Road, Mumbai-400020.
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AABCA3464E		
(अपीलार्थी/ Appellant)		(प्रत्यर्थी/ Respondent)

Assessee by :	Shri.Dharan Gandhi.AR
Revenue by :	Shri.Manoj Kumar Sinha.DR

सुनवाई की तारीख / Date of Hearing	08/12/2023
घोषणा की तारीख / Date of Pronouncement	23/01/2024

आदेश / ORDER

PER PAVAN KUMAR GADALE - JM:

The appeal is filed by the assessee against the order of the CIT(A)-47 Mumbai passed u/sec 250 of the Act. The assessee has raised the following grounds of appeal:

- Ld. CIT(A) erred in upholding the action of the Ld. AO in disallowing a sum of Rs 85.00.000/- being amount paid for an out of court settlement in respect of a criminal complaint under Explanation 1 to section 37(1) of the Act.*
- The Ld. CIT(A) erred in upholding the action of the Ld. AO in disallowing a sum of Rs 38.30.000/- being legal fees paid for defending a criminal complaint under Explanation 1 to section 37(1) of the Act.*

3 The Ld. CIT(A) has erred in passing the order dated 06.10.2022 in gross violation of principles of natural justice.

4 The Ld. CIT(A) has erred in stating that the "it is seen from the submission of the Appellant, that the appellant has traded in the account of his client without his consent which is an offence as per law of the land"

5 The Ld. AO has erred in initiating penalty proceedings u/s 271(1)(C) of the Act

6 The Appellant craves leave to add, to amend, alter/delete and/or modify the above grounds of appeal on or before the final hearing.

2. The brief facts of the case are that, the assessee company is engaged in the business of stock broking and operates in the equity, cash and derivatives segments of both NSE and BSE. The assessee has filed the return of income for the A.Y 2015-16 on 30.09.2015 disclosing a total loss of Rs.40,51,770/-. Subsequently the case was selected for scrutiny and notice u/sec 143(2) and U/sec 142(1) of the Act are issued. In compliance to the notice, the Ld. AR of the assessee appeared from time to time and submitted the details and the case was discussed. The Assessing Officer(AO) on perusal of the audited financial statements, in particular profit and loss account found that the assessee has debited an amount of Rs. 1,23,30,000/- as "exceptional item" and in the notes to financial statements, it has disclosed that during the year, the assessee company in consent terms filed with the Hon'ble Bombay High Court

has paid settlement amount of Rs. 85 lakhs to one of the client in respect of trading loss incurred in his account and the assessee company has incurred an amount of Rs. 38,30,000/- towards legal expenses. Whereas the AO found that the claim is not incurred for the purpose of business purpose and to verify the disputed issue has called for the detailed explanations. In compliance, the assessee has filed the submissions mentioning that the expenses has been incurred by way of out of court settlement as there has been a criminal complaint filed against the assessee by its client. Hence Rs. 85 lakhs was claimed as out of court settlement and Rs.38,30,000/- was claimed as lawyer fees. The AO found that the entire expenditure is intended by misdeed amounting to infringement of law, resulting in out of court settlement and it is clearly a character of payment covered by explanation 1 to Sec. 37(1) of the Act and disallowed Rs.85Lakhs. Similarly the AO has also disallowed the payment of Rs. 38,30,000/- paid towards legal fees in respect of criminal complaint for out of court settlement and has a direct nexus to settlement of criminal appeal and therefore hit by the provisions of explanation 1 to Sec. 37(1) of the Act and was disallowed. Further the AO found that the assessee has debited loss on fixed assets of Rs. 40,789/- and is not allowable. Finally the AO has assessed the total income of Rs.83,19,019/- and passed the order u/sec 143(3) of the Act 29.12.2017.

3. Aggrieved by the order, the assessee has filed an appeal before the CIT(A). Whereas the CIT(A) considered the grounds of appeal, submissions of the assessee and findings of the AO and has dismissed the assessee appeal observing at Para 5 to 6 of the order as under:

5 The appellant in his submission has stated that the Hon'ble Bombay High Court has observed that the dispute amongst the parties involved is prima facie of civil nature and not of criminal nature. Thus, the entire amount paid towards reimbursement, compensation, interest, and incidental legal fees of advocates are during the course of business activities and are inextricably linked to the needs of the business. Accordingly, the appellant, the entire amount of Rs. 1,23,30,000/- shown as exceptional item in the books of accounts, be allowed as deduction u/s 37(1) of the Income Tax Act, 1961 (the Act).

5.1 It is seen from the submission of the appellant that the appellant has only furnish copy of the consent term entered by it with its client and has not furnished the original complaint filed by the client before the Borivali police station, court orders of the lower court and the petition of the offences file before the Hon'ble Bombay High Court against which the consent term were been agreed to with the appellant company and his client. However, it is seen from the submission of the appellant that the appellant has traded in the account of his client without his consent which is an offence as per law of land.

5.2 Further, it is seen from the submission of the appellant that the appellant has furnish copies of the petition made by the appellant before the Bombay High Court, for quashing of the FIR filed by the client of the appellant company at the Borivali Police station u/s. 482 of the criminal procedure code, 1974.

5.3 As per the said petition a consent term has been agreed by both the parties, wherein, it is seen in clause 17 to 20 of the consent term that it has been agreed by the appellant that they shall remain physically present before the Income tax authority or any statutory bodies, if any queries raised by the said authorities with reference to the trading done by the appellant company in

the account of his client without his consent and in case of their failure to remain present they would be liable for any liability which will arise from the tax amount and penalty for assessment year 2012-2015.

5.4 Further, it is also stated in para 20 of the consent terms that whatever stated in Para No. B, C, E, H of grounds mentioned in the anticipatory bail application of the appellant before Hon'ble Bombay High Court stands with drawn by the client.

5.5 In this regards it would be pertinent to state that Explanation 1 of sub-section (1) of section 37 of the Act provides that if 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 allowance shall be made in respect of such expenditure.

5.6 On plain reading of the above explanation 1 to section 37(1) of the ITA it can be seen that, the explanation does not make any distinction between civil or criminal offences as stated by the appellant in his submission, but it only states that expenditure incurred by an appellant for any purpose which is an offence or which is prohibited by law shall not be allowed to be incurred for the purpose of his business.

5.7 It is seen from the submission of the appellant that the client of the appellant has registered an FIR at Borivali Police station u/s. 420, 465, 467, 468 and 34 of the IPC, and the said sections of the IPC are applicable for offences which are made with criminal act and a criminal intention for which the consent term has been agreed by the appellant and his client for which the expenditure has been incurred of Rs1,23,30,000/-.

5.8 Considering the above facts I am of the view that the Assessing Officer has rightly disallowed the amount paid for Out of Court Settlement amounting to Rs. 85,00,000/- and the amount of Rs38,30,000/- paid for legal fees for court case. The appeal of the appellant is dismissed.

6. In effect the appeal of the appellant for A.Y.2015-16 (u/s143(3)) is dismissed.

4. Aggrieved by the CIT(A) order, the assessee has filed an appeal before the Honable Tribunal.

5. At the time of hearing, the Ld. AR submitted that the CIT(A) has erred in sustaining the addition made by the AO in respect of the out of the court settlement amount and legal fee paid. The Ld. AR contentions are that the assessee has incurred this expenditure wholly and exclusively for the purpose of business and it is a allowable expenses u/sec37(1) of the Act. Th Ld. AR substantiated the submissions relying on the paperbook and judicial decisions and prayed for allowing the appeal.

6. Per Contra, the Ld. DR submitted that due to misconduct by the assessee ,there was a criminal case filed by the client of the assee and it is purely a criminal act done by the assessee broking company without the consent of client in his account and therefore the assessee cannot be allowed the claim of expenditure debited to profit & loss account and the Ld. DR relied on the judicial decisions and supported the order of the CIT(A).

7. We heard the rival submissions and perused the material on record. The sole matrix of the disputed issue envisaged by the Ld. AR that the CIT(A) has erred in sustaining the addition in respect of claim as exceptional items being out of court settlement amount of Rs. 85 lakhs and legal fees of Rs. 38,30,000/- invoking the explanation 1 to Sec. 37(1) of the Act. The Ld. AR contentions are that the assessee is a stock broker and as per the terms and conditions with client, the asssee has made trading in the client account but due to

loss in the transactions conducted by on behalf of the client, the client has filed a criminal complaint against the assessee compny. The Ld. AR submitted that based on the consent terms in the criminal application filed before the Hon'ble High Court, the assessee has paid the amount in out of court settlement and has relied on the decision of the Hon'ble High Court of Bombay. The Ld. AR mentioned that the nature of transaction is civil in nature and the assessee has rightly claimed the expenditure. The Ld. AR contented that the claim has to be allowed as it was incurred wholly and exclusively for the purpose of business. The Ld. AR relied on the following judicial decisions.

1. *ITO Vs. Reliance Share & Stock Brokers (P.) Ltd.*, [2014] 51 taxmann.com 215 (Mumbai - Trib)

2. *CIT Vs. Dhanrajgirji Raja Narasingirji*, [1973] 91 ITR 544 (SC).

3. *CIT Vs Shreyas S. Morakhia*, [2012] 19 taxmann.com 64 (Bombay

4. *Tata Consultancy services Ltd Vs DCIT&others Writ petition No.1964 of 2022(Bombay)*

5. *DCIT Vs Anil Dhirajlal Ambani* (2018)93 taxmann.com492(Mumbai-Trib).

6. *CIT Vs Desiccant Rotors International (p) Ltd* (2012)347 ITR 32(Delhi).

8. The Ld. AR emphasized on the explanation 1 to Sec. 37(1) of the Act and the CBDT circular No. 772 dated 23.12.1998. Whereas, the assessee due to trading in the client account, has incurred trading loss and the Client has filed the FIR and was registered with the Borivalli police station under various sections for the offence. Subsequently on the basis of consent terms referred in the criminal application filed before Honble High Court of Bombay and

also the assessee seeking quashing of the FIR filed against the assessee company and others has incurred expenditure by way of out of court settlement and legal fees. The Ld. DR emphasized on the facts that the assessee has not filed the copy of FIR and report of the criminal case and the criminal act done by a the assessee company broker cannot be accepted under the provisions of the Act and is not a compoundable. The Ld. DR relied on the following judicial decisions:

1. *Sri Satyanaraya Rice Mill Vs. CIT, [1985] 155 ITR 676, (AP)*
2. *Nahar Spinning Mills Ltd, Vs. CIT, [2014], 49 taxmann.com 565 (P&H)*
3. *CIT Vs Jayaram Metal Industries(2006)286 ITR 403.*
3. *PCIT Vs. Sushil Gupta, [2019], 102 taxmann.com 409 (Bombay)*
4. *Haji Aziz and Abdul Shakoor Bros, Vs. CIT, [1961] 41 ITR350 (SC)*

The Ld. AR emphasizing that the out of court settlement amount paid is in the nature of civil expenditure. We on perusal of the Statutory Audit report under the companies Act, in particular notes to the financial statement at note 25 find as read under :

“25. During the year the company, in terms of te consent term filed with the Hon. Bombay High court, has paid the settlement amount of Rs. 85 lakhs to its one of the client in respect of trading loss incurred in his account. Also the company has incurred the legal expense of Rs. 38,30,000 in connection thereto. The same is considered as exceptional item in the statement of profit and loss”.

9. Prima-facie we found that the assessee is a stock broker and was in the business as stock broking services and due to trading in the clients account, the client has filed the

criminal case. Further the AO has relied only on the facts in respect to the transactions of exceptional items claimed but there is no findings or information with respect to the FIR and report of the criminal case as it was not submitted by the assessee mentioned in the order of the CIT(A) and pointed out by the Ld.DR in the course of hearing. The assessee could not establish with the supporting evidences, that the claim of the assessee is a civil expenditure allowable under the Act. Therefore, considering the facts, circumstances, submissions and to meet the ends of justice, we shall provide with one more opportunity of hearing to the assessee to substantiate with the details, accordingly we set aside the order of the CIT(A) and restore the disputed issues to the file of the Assessing Officer to decide afresh on merits and the assessee should be provided adequate opportunity of hearing and to file the information and evidences on the disputed issue and shall cooperate in submitting the information. And we allow the grounds of appeal of the assessee for statistical purposes.

10. In the result, the appeal filed by the assessee is allowed for statistical purpose..

Order pronounced in the open court on 23.01.2024.

Sd/-

(BR BASKARAN)
ACCOUNTANT MEMBER

Sd/-

(PAVAN KUMAR GADALE)
JUDICIAL MEMBER

Mumbai, Dated 23/01/2024

KRK, PS

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

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

सत्यापित प्रति //True Copy//

1.

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Asst. Registrar)
आयकर अपीलीय अधिकरण, मुम्बई / ITAT, Mumba