IN THE INCOME TAX APPELLATE TRIBUNAL "A" BENCH, MUMBAI
BEFORE SHRI G.S.PANNU, AM AND SHRI RAVISH SOOD, JM

ITA No.3260/Mum/2014
(**निर्धारण वर्ष** / Assessment Years:2008-09)

M/s Avdel (India) Private Limited 169, Backbay Reclamation, Mumbai-400 020.	**बनाम**/ Vs.	Deputy Commissioner of Income Tax-1(1), Mumbai
स्थायी लेखा सं./जीआइआर सं./PAN No. AABCA3977E		
(अपीलार्थी /**Appellant)**	**:**	**(**प्रत्यर्थी / **Respondent)**

अपीलार्थी की ओर से / **Appellant by**	:	Shri Alok Saksena, A.R
प्रत्यर्थी की ओर से**/Respondent by**	:	Shri Rajesh Kumar Yadav, D.R

सुनवाई की तारीख / **Date of Hearing**	**:**	15.03.2018
घोषणा की तारीख **/** **Date of Pronouncement**	**:**	08.06.2018

आदेश / **O R D E R**

PER RAVISH SOOD, JUDICIAL MEMBER:

The present appeal filed by the assessee is directed against the order passed by the CIT(A)-1, Mumbai, dated 28.02.2014, which in itself arises from the order passed by the A.O under Sec. 143(3) of the Income Tax Act, 1961 (for short 'Act'), dated 30.11.2010 for A.Y 2008-09. The assessee assailing the order of the CIT(A) had raised before us the following grounds of appeal:

"1. Disallowance of Rs. 10.66.596/-:

The learned CIT(A) has erred in law, facts and in circumstances of the case while confirm the disallowance of adhoc 20% of Rs. 5332,980/- amounting to Rs. 10.66,596/- being payments made to Related parties u/s 40A(2)(b) of Income Tax Act, 1961.

2. Ignoring the order no. CIT(A)-I/IT-279/09-I0 dated 9/04/2010 of CIT(A)-1 (Predecessor) for A.Y. 2006-07 in appellants own case with similar facts, the learned CIT(A) has erred in confirming the disallowance of adhoc 20% of the expenditure amount inc Rs. 10.66.596/- being payment to related party.

3. Disallowance of Rs. 1,52,834/-:

The learned CIT(A) has erred in law, facts and in circumstances of the case by con firm rig the disallowance of Bad debts of Rs. 1.52,834/-.

4. Ignoring the order no. CIT(A)-I/IT-279/09-I0 dated 19/04/2010 of CIT(A)-I (Predecessor) for A.Y. 2006-07 in appellants own case with similar facts, the learned CIT(A) has erred in confirming the disallowance of had debts of Rs. 1,52,834/-.

5. The learned Assessing Officer has erred in law, facts and circumstances of the case by initiating interest u/s 234B & 234C.

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

7. Prayer:

The Appellant prays your honor for allowing the appeal."

2. Briefly stated, the facts of the case are that the assessee company which is engaged in the business of manufacturing and trading of Industrial fasteners had filed its return of income for A.Y 2008-09 on 26.09.2008, declaring total income at Rs.1,52,65,883/-. The return of income filed by the assessee was processed as such under Sec. 143(1) of the Act. Subsequently, the case was selected for scrutiny assessment under Sec. 143(2).

3. During the course of the assessment proceedings, it was observed by the A.O that the assessee had made payments to the following persons specified under Sec. 40A(2)(b) of the Act.

Sr. No.	Name of the party to whom the	Amount (Rs.)	Nature of payment

	payment is made		
1.	Ramon Publication Pvt. Ltd	26,10,120	Business centre fees
2.	Autobrite (India) Pvt. Ltd.	17,86,860/-	Warehouse rent
3.	Annet Impex Pvt Ltd.	9,36,000/-	Software development
	Total	53,32,980/-	

It was observed by the A.O that in the preceding year, by characterising the aforesaid related party payments as being excessive in nature, disallowance of 20% of the same was made by his predecessor under Sec. 40A(2)(a) of the Act. The explanation of the assessee that the payments made to the aforesaid related parties were reasonable and as per market price did not find favour with the A.O. The AO being of the view that the assessee had neither filed the copy of the agreements entered into with the aforementioned related parties, nor proved the reasonability of the payments made to them, hence following the view taken by his predecessor disallowed 20% of the aforesaid expenses and made an addition of Rs.10,66,596/- under Sec.40A(2)(a) of the Act. Still further, the A.O observed that a perusal of 'Annexure E' to Form No. 3CD of the audit report filed by the assessee, revealed the following prior period expenditure:

Sr. No.	Particulars	Amount(Rs.)
1.	Sundry de tors balance w/off	1,45,666/-
2.	Debits of arlier year	7,168/-
	Total	1,52,834/-

The assessee submitted before the A.O that the aforesaid expenses booked in its profit and loss account were not prior period items, but were the debts which having been rendered as irrecoverable were written off and claimed as bad debts under Sec. 36(2) of the Act. However, the AO was not persuaded to subscribe to the said claim of the assessee, primarily on two grounds, viz. (i) the tax auditor of the assessee had reported in Form No. 3CD that sundry balance written off of Rs.1,45,666/- was the prior period expenditure; and (ii) the assessee had failed to prove that as per the mandate of Sec. 36(2)(i) of the Act, the aforesaid debts had been taken into account in computing the income of the assessee of the previous year in which the amount of such

debt or a part thereof was written off or that of an earlier previous year. On the basis of his aforesaid deliberations, the A.O disallowed the aggregate amount of Rs.1,52,834/- which was claimed by the assessee in its profit and loss account.

4. Aggrieved, the assessee carried the matter in appeal before the CIT(A). The CIT(A) after deliberating on the contentions advanced by the assessee, was however not persuaded to subscribe to the same. The CIT(A) on being confronted by the fact that his predecessor while disposing off the appeal of the assessee for A.Y 2006-07 had decided both the issues involving the same facts in the favour of the assessee, observed that as his predecessor had failed to appreciate the issues in the right perspective, hence declined to follow the same. On the basis of his aforesaid observations the CIT(A) dismissed the appeal of the assessee.

5. The assessee being aggrieved with the order of the CIT(A) had carried the matter in appeal before us. The ld. Authorized Representative (for short 'A.R') for the assessee took us through the facts of the case. It was vehemently submitted by the ld. A R that similar issues were decided by the then CIT(A) while disposing off the appeal of the assessee for A.Y 2006-07. The ld. A.R to support his aforesaid contention drew our attention to Page 87-93) of the 'Paper book of the assessee (for short 'APB'). The ld. A.R further drew our attention to the order passed by the CIT(A) in the assesses own case for A.Y 2008-09 wherein too similar issues had been decided in favour of the assessee. On similar footing, it was the claim of the ld. A.R that even the appeals of the assessee for A.Y's 2010-11 and 2011-12 involving the same facts were decided by the CIT(A) in favour of the assessee. However, in all fairness it was conceded by the ld. A.R that in neither of the aforesaid cases any further appeal was filed by the revenue on account of low tax effect involved in the said respective cases. On merits, it was submitted by the ld. A.R that as the payments made to the related parties towards business centre fees, warehouse rent and software development charges were reasonable and as per the market value, hence no disallowance under Sec.40A(2)(a) was called for in the hands of the assessee.

It was claimed by the ld. A.R that the A.O had disallowed 20% of the aforesaid expenses without establishing any excessiveness or unreasonableness of the amount which was paid by the assessee to its related parties. The ld. A.R further adverting to its claim of bad debts of Rs.1,52,834/- submitted that as the said amounts represented short payments received by the assessee in respect of the sales conducted during the period 2007-08 and earlier years, thus the same having been written off by the assessee in its books of account were allowable as bad debts under Sec.36(1)(vii) r.w. Sec. 36(2) of the Act. It was submitted by the ld. A.R that the amounts stated to be prior period expenses were characterised under the said head, for the reason that part of the amount so written off pertained to the current year and part to the prior period. The ld. A.R submitted that the lower authorities had gravely erred in drawing adverse inferences, merely on the basis of the nomenclature adopted by the assessee, rather than the substance of the transactions under consideration. It was thus, the claim of the ld. A.R that the lower authorities had erred in disallowing the claim of the assessee towards bad debts. The ld. A.R in order to drive home his contention that the claim of the assessee towards bad debts duly satisfied the mandate of Sec. 36(1)(vii) r.w Sec. 36(2) of the Act, relied on the judgment of the Hon'ble Supreme Court in the case of T.R.F Ltd. Vs. CIT (2010) 190 Taxman 391 (SC). Per contra, the ld. Departmental Representative (for short 'D.R') relied on the order of the CIT(A).

6. We have heard the authorized representatives for both the parties, perused the orders of the lower authorities and the material available on record. We find that our indulgence in the present appeal has been sought by the assessee appellant for adjudication of two issues, viz. (i) maintainability of the disallowance of Rs.10,66,596/- made under Sec.40A(2)(a) of the Act; and (ii) the validity of disallowance of Rs.1,52,834/- in respect of bad debts.

7. We shall first advert to the disallowance of Rs.10,66,596/- made by the A.O under Sec.40A(2)(a) of the Act. We find that the assessee on being called upon to explain as to why the disallowance under Sec.40A(2)(a) of the

Act may not be made in respect of payments made to its related parties, had submitted that as the respective payments were reasonable and as per the market value of the services or facilities availed, hence no disallowance under the aforesaid statutory provision was called for. The assessee in respect of the payment of rent to M/s Ramon Publications Pvt. Ltd. of Rs.26,10,120/- submitted that the same was in respect of fully furnished premises in prime location of Churchgate. It was the claim of the assessee before the lower authorities, that in case it would have taken its own office of 400 to 500 sq. ft fully furnished with all such amenities, the cost of the same would have been substantially more than the aforesaid amount. In respect of payment of Rs.17,86,860/- by the assessee to Autobrite (India) Pvt. Ltd., it was the claim of the assessee that the same was for one gala that had been taken to store the products which were imported by the assessee. It was submitted by the assessee that the rent charged by Autobrite (India) Pvt. Ltd. was reasonable and as per the market value. As regards the payment of software development charges of Rs.9,36,000/- to M/s Annet Impex Pvt. Ltd, it was submitted by the assessee that the payment made to the said concern towards its expertise in the field of software development was reasonable and well in conformity with the market value of the services rendered by it. Thus, in the backdrop of the aforesaid submissions, it was the claim of the assessee that as the respective payments made to the related parties for the services or facilities availed were reasonable and in conformity with the market value, hence no disallowance under Sec. 40A(2)(a) of any part of the same was called for in its hands .

8. We find that the CIT(A) was neither persuaded to accept the aforesaid claim of the assessee, nor did he find favour with the view arrived at by his predecessor in respect of the issues under consideration while disposing off the appeal of the assessee for A.Y 2006-07. The CIT(A) while declining to accept the claim of the assessee observed that as per Sec.40A(2), once the A.O had formed an opinion on the reasonableness of the payments, thereafter no further requirement of proving the same was cast upon him,

but rather, it was the assessee o whom the onus was cast to rebut the same and support the reasonableness of the payments on the basis of necessary evidence. We have given a thoughtful consideration to the aforesaid observations of the CIT(A) and are unable to persuade ourselves to subscribe to the same. We find that a perusal of the Sec. 40A(2)(a) reveals that it is only where in respect of the payments made by an assessee to a related party, that the A.O is of the view 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 keeping in view the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, then so much of the expenditure as is considered by him to be excessive or unreasonable, shall not be allowed as a deduction. We though are in agreement with the view taken by the CIT(A), that once the AO forms an opinion that the expenditure incurred by the assessee in respect of the goods, services or facilities for which the payment is made to the related parties is found to be excessive or unreasonable, then the onus is cast upon the assessee to rebut the same and prove the reasonableness of the expenses. However, we find that the legislature in all its wisdom had in order to avoid any arbitrary exercise of powers by the A.O in the garb of the aforesaid statutory provision, had categorically provided that such formation of opinion on the part of the A.O that the expenditure incurred in respect of the related party payments is excessive or unreasonable, has to be arrived at having regard to the fair market value of the goods, services or facilities for which the payment is made by the assessee or keeping in view the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom. We are afraid that in the case of the assessee before us, the CIT(A) had upheld the adhoc disallowance of 20% of the payments made by the assessee to its related parties, without uttering a word as to on what basis the respective expenditure incurred by the assessee in context of the services or facilities availed from its related parties was found to be excessive or unreasonable, having regard to either the fair market value of the services or facilities for which the payment was made by the assessee or

the legitimate needs of its business or the benefit derived by or accruing to the assessee therefrom. We thus, in the absence of satisfaction of the basic condition for invoking of Sec. 40A(2)(a) by both of the lower authorities, thus are unable to sustain the disallowance of 20% of the related party expenses i.e Rs. 10,66,596/- made under Se. 40A(2)(a). Before parting, we may herein observe that the reliance placed by the CIT(A) on the judgment of the Hon'ble High Court of Bombay in the case of CIT(A) Vs. Shatrunjay Diamonds (2003)261 ITR 258 (Bom), to support his view that under Sec. 40A(2)(a) the reasonableness of a related party expenditure is to be proved by the assessee and not by the department, has been misconceived by him in the backdrop of the observations arrived at by the Hon'ble High Court. We find that in the case before the High Court, the A.O on comparing the price of the rough diamonds imported by the assessee from its foreign based related party as against the price of rough diamonds which were imported from other concerns, had observed that the assessee had paid excess price to the extent of Rs.12,50,000/- to its related party. Thus, it was in the backdrop of the aforesaid facts, that the High Court observing that though the A.O had established that the payment made by the assessee to its related party was higher than the fair market value of the goods, but the assessee had failed to substantiate the reasonableness of the payments made, had thus restored the matter to the file of the A.O with a direction to the assessee to establish that the price paid by it to its related party was not excessive or unreasonable. Still further, the judgment of the Hon'ble High Court of Gujarat in the case of Coronation Flour Mills Vs. ACIT (2009) 314 ITR 1 (Guj) relied upon by the CIT(A) is also distinguishable on facts and would not support the view arrived at by him. In the case before the Hon'ble High Court, the disallowance under Sec. 40A(2)(a) was upheld for the reason that the payments to the related party were found to be excessive having regard to the legitimate needs of the business of the assessee. We thus, are of the considered view that in the backdrop of our aforesaid observations, neither of the judicial pronouncements relied upon by the CIT(A) would support his view. We are of the considered view that as the lower authorities had carried out a disallowance under Sec. 40A(2)(a) on an adhoc basis, viz.

20% of the payments made to the related parties and had made an addition of Rs. 10,66,596/- without placing on record any material which could prove to the hilt that the payments were excessive or unreasonable, having regard to the fair market value of the services or facilities for which the same were made or keeping in view the legitimate needs of the business of the assessee or the benefit derived by or accruing to the assessee therefrom, hence the said disallowance cannot be sustained and is liable to be vacated. We thus, delete the disallowance of Rs.10,66,596/- sustained by the CIT(A) under Sec.40A(2)(a) of the Act. The **Grounds of appeal Nos. 1 and 2** are allowed.

9. We shall now advert to the sustaining by the CIT(A) of a disallowance of an amount of Rs.1,52,834/- made by the A.O in respect of prior period expenditure. As observed by us hereinabove, the auditor of the assessee in Annexure E to Form No. 3CD of his audit report had claimed an amount of Rs.1,52,834/- towards prior period expenditure. However, in the course of the assessment proceedings, it was submitted by the assessee that the said amount represented short payments received in context of the sales conducted during the period 2007-08 and the earlier years. The assessee explaining the reason for charactering the aforesaid amounts as prior period items, submitted that the same was so done as part of the sundry balances of Rs. 1,45,666/- pertained to the write off of Rs.1,45,666/- for the current year and the other part o the prior period. We find that the aforesaid claim of the assessee was not accepted by the lower authorities, primarily on two grounds, viz. (i) the amount was stated by the auditors as prior period expenditure in the audit report in Form No. 3CD; and (ii) the assessee failed to satisfy the conditions for allowability of bad debts under Sec. 36(1)(vii) r.w.s. 36(2) of the Act. We have given a thoughtful consideration to the issue before us and are of the considered view that as the assessee had duly explained the reason for characterising the aforesaid expenditure as prior period items, hence merely on the basis of the nomenclature adopted by the assessee, no adverse inferences as regards the substance of the transaction was liable to be drawn. This takes us now to the satisfaction by the assessee of the requisite conditions contemplated under Sec. 36(1)(vii) r.w. Sec.36(2)

of the Act, for entitling it to claim the aforesaid amount as bad debt. We are of the considered view that pursuant to the judgment of the Hon'ble Supreme Court in the case of T.R.F. Ltd. Vs. CIT(A) (2010) 190 Taxman 391 (SC), it is no more necessary for an assessee to establish that the debt in fact had become irrecoverable, for claiming the same as a 'bad debt'. We find that the Hon'ble Apex Court in the case of T.R.F Ltd. (supra) has clearly observed that it is enough if the 'bad debt' is written off as irrecoverable in the accounts of the assessee. We thus, are of the considered view that as the observations of the A.O that the assessee has failed to prove with documentary evidence that efforts were made to realise the debts can have no bearing as regards the claim of the assessee for 'bad debt' thus the same does not merit acceptance. However, we find substantial force in the observations of the lower authorities that as the assessee had failed to prove that the debt in question had been taken into account in computing its income of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, hence the same in the backdrop of Sec. 36(2)(i) cannot be allowed as a bad debt in the hands of the assessee. We are of the considered view that as the assessee except for raising an unsubstantiated claim that the amount written off as bad debt represented short payments of the sales made during the year under consideration and earlier years, had failed to adduce any documentary evidence in support thereof, hence the said claim does not inspire any confidence and cannot be summarily accepted on the very face of it. We thus, in all fairness and in the interest of justice restore the issue as regards the entitlement of the assessee towards claim of the amount of Rs.1,52,834/- as bad debt, to the file of the A.O for fresh adjudication. The A.O shall during the course of the set aside proceedings verify the veracity of the claim of the assessee as to whether the amount written off in its books of account represented short receipts of the sales carried out during the year under consideration and the preceding years, or not. In case the assessee is able to substantiate its claim as regards the allowability of the amount of Rs.1,52,834/- as bad debts under Sec. 36(1)(vii) r.w.s.36(2) of the Act, the A.O shall allow the same. Needless to say, the A.O shall during the course of

the set aside proceedings afford a reasonable opportunity of being heard to the assessee. The **Grounds of appeal No. 3 & 4** are allowed for statistical purposes.

10. That as regards the assailing of the charging of interest under Sec. 234B and 234C by the assessee, we are of the considered view that pursuant to the judgment of the Hon'ble Supreme Court in the case of CIT Vs. Anjum M.H. Ghaswala (2001) 252 ITR 1 (SC), as it is no more *res integra* that the charging of interest under Sec. 234B and 234C is mandatory, thus the **Ground of appeal No. 6** is disposed off as being consequential in nature.

11. The appeal of the assessee is partly allowed.

Order pronounced in the open court on 08.06 2018.

Sd/-	Sd/-
(G.S. PANNU)	(RAVISH SOOD)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

मुंबई Mumbai; दिनांक 08.06.2018
Ps. Rohit

आदेश की 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.

सत्यापित प्रति //True Copy//

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)

आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**