IN THE INCOME TAX APPELLATE TRIBUNAL
[DELHI BENCH: 'E' NEW DELHI]

BEFORE MS. SUCHITRA KAMBLE, JUDICIAL MEMBER
A N D
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

I.T.A. No. 4090/Del/2017
(Assessment Year: 2012-13)
(THROUGH VIDEO CONFERENCING)

Mercury Fabric Creations Pvt. Ltd., D – 58, Phase – I, Okhla Industrial Area, New Delhi – 110 020. **PAN : AAACM0284D** **(APPELLANT)**	Vs.	Income Tax Officer, Ward : 16 (2) New Delhi. (**RESPONDENT)**
Assessee by :		Ms. Gunjan Jain, C.A.;
Department by:		Mr. Gaurav Pundir, Sr.DR;
Date of Hearing		27.07.2021
Date of Pronouncement		27.07.2021

ORDER

PER PRASHANT MAHARISHI, AM :

01. This appeal is filed by the assessee against the order of the ld. Commissioner of Income Tax (Appeals)–33, New Delhi, dated 11.04.2017 for assessment year 2012-13, raising the following grounds of appeal:-

" 1. That having regard to the facts and circumstances of the case Ld C.I.T.(A) has erred in law and on facts in confirming the action of Ld A.O. in making addition of Rs.50000/- as per clause(iii) of sub-rule(2) of Rule 8D being 0.5 percent on average value of investment of Rs. 100000/-.

2. Ld C.IT.(A) has erred in law and on facts in confirming disallowance at Rs. 1766377/- out of total disallowance made by the Ld A.O. at Rs.5299130/- increasing net profit being one percent of turnover by applying provision of Section92BA of The Act.

3. Ld C.I.T.(A) has erred in facts in confirming disallowance at Rs.36070/- out of total disallowance made by learned A.O. at Rs. 108210/- being 30 percent of Business Promotion and Advertisement expenses claimed at Rs.360707/-.

4. Ld C.I.T.(A) has erred in confirming depreciation of Rs.20475/- claimed at the rate of 60 percent on addition of Apple LED Cinema amounting to Rs.45500/- classified as computer including computer software.

5. Ld C.I.T.(A) has erred in law and on facts that Rs.297000/- being payment of rent to Smt.Maya Sachdeva and Sh Rahul Sachdeva being related parties within the meaning of Section 40A(2)(b) of The Act amounting of Rs. 180000/- each i.e. Rs.360000/-.

It is contented that rent so paid is neither excessive nor unreasonable. Similar rent have been paid in earlier years and have been allowed.

6. Ld C.I.T.(A) has erred in facts in confirming the disallowance of director's medical expenses claimed at Rs.29506/-.

It is contended that director of the company are also employee of the assessee company and expenses is allowable as per past history of the case.

7. Ld C.I.T.(A) has erred in facts and circumstances in confirming disallowance of Rs.194350/- being 10 percent of following expenses claimed -

Staff welfare	*278274*
Repairs	*200542*
Telephone and communication Expenses	*339418*
Travelling and conveyance	*558614*
Vehiclerunningand maintenance	*566673*
	1943521

It is contended all the above expenses is in relation to business of assessee company and Expenses is allowable as per past history of the company.

8. That the appellant craves leave to add, modify, amend or delete any of the grounds of appeal at or before the time of hearing and all the above grounds are without prejudice to each other. "

02. Briefly stated the facts shows that Assessee Company is carrying on the business of trading of fabrics and doing job work. It filed its return of income on 28.09.2012 declaring income of Rs.29,91,580/-. The assessment was passed under Section 143(3) of the Income Tax Act, 1961 (the Act) by the ld. Assessing Officer on 12.03.2015 determining total income of the assessee at Rs.1,12,21,078/-. He made several disallowances, which on appeal by the ld. CIT (Appeals) were deleted / scaled down substantially and, therefore, assessee is in appeal against the disallowance sustained by the ld. CIT (Appeals).

03. The first ground of appeal is against the disallowance under Section 14A of the Act confirmed by the ld. CIT (Appeals) to the extent of upholding of the disallowance by the ld. CIT (Appeals) of Rs.50,000/- being 0.5% on the average value of investment.

04. The ld. AR submitted that assessee has not earned any exempt income during the year. In view of this, we find that the issue is squarely covered in favour of the assessee by the decision of the Hon'ble Delhi High Court in the case of Cheminvest Limited Vs. CIT in ITA. 749 of 2014 dated 2.09.2015 wherein it has been held that in absence of exempt income during the year no disallowance under Section 14A of the Act can be made. Thus, ground No. 1 is allowed.

05. Ground No. 2 is with respect to the disallowance on account of increase in net profit being 1% of the turnover made by the ld. Assessing Officer by disallowing the expenditure amounting to Rs.5299130/- scaled down by the ld CIT (Appeals) to Rs. 1766377/-. Facts shows that the management of the assessee has another related concern having common directors and carrying on the same business as that of the assessee and the entire purchases of the assessee amounting to ₹ 51 crores were purchased from that party. The learned assessing officer was of the view that though the provisions of Section 92BA relating to the related party domestic transactions are effective only from 1 April 2013 but he looked into the reasons for making hundred percent purchases

from a related party and whether the transactions are at arm's-length or not and unreasonable profit has not been transferred to the other related party. This was also for the reason that assessee has very low gross profit and net profit margins. Therefore the assessee was asked to prove the prices paid for goods and services to the related party whether they are at arm's-length price supported by documentary evidences and the prices charged was not excessive and was comparable unreasonable. The assessee was also asked to show the profit and loss account and balance-sheet of the related party. Assessee submitted that assessee is engaged in the marketing of the fabric whereas the related parties engaged in manufacturing activities of the fabric the related party manufactures, sales those product to the assessee and then assessee sales those products in the market this practice is followed since long. Assessee also stated that though both the companies are Under the same management but the products benefit should by the sister concern are of specific quality and for specific customers as per the requirement. Therefore it cannot be purchased from another independent supplier. Assessee also submitted the annual accounts of the sister concern. The learned assessing officer after comparison of the gross profit and net profit ratio of the assessee with the related party stated that gross profit ratio of the assessee is to .519% whereas the gross profit of the related parties 37.175% and net profit ratio of the assessee 0.603% whereas of the related party is 2 .575%. Therefore, he increased the net profit of the assessee company by 1% of the turnover of Rs.52.99 cores andmade addition of Rs.52,99,130/-. The ld. CIT (Appeals) restricted the addition by applying the provisions of Section 92BA of the Act. He held that there is a difference in the tax liability of both the companies as Mercury Fabrics Pvt. Ltd. was paying tax under MAT @ 18.5% whereas the assessee is paying tax @ 33% and, therefore, there is a tax arbitrage of 10%. Accordingly he restricted the disallowance / addition to Rs.17, 66,377/-.

06. We find that the learned AO and ld. CIT (Appeals) has applied provisions of Section 92BA of the Act and reducing the addition to that extent by applying the respective clause for payments made to a related party , whichhas been omitted with effect from 1.04.2017. This issue is now squarely covered by the Hon'ble Karnataka High Court in the case of Principal Commissioner of Income tax – 7 *v.* Texport Overseas (P.) Ltd. 2020] 114 taxmann.com 568 (Karnataka)/ [2020] 271 Taxman 170 where in it has been held that Clause (i) of section 92BA having been omitted by Finance Act, 2017 with effect from 1-4-2017 from statute, resultant effect is that it had never been passed and, hence, decision taken by AO under effect of section 92BA and reference made to Transfer Pricing Officer under section 92CA was invalid and bad in law. However looking at the issue from the different perspective to note that neither the learned assessing officer nor the learned CIT – A has applied the provisions of Section 92BA of the income tax act in its true spirit. In fact the adjustment has been made by disallowing part of the purchase prices from the related party by the learned assessing officer which is actually in conformity with the provisions of Section 40A (2) of the act. Now it is required to be seen whether the addition made by the learned assessing officer and partly confirmed by the learned CIT – AE is in accordance with that provisions of not. In fact the AO is right that the hundred percent purchases of the assessee are from the related parties. However the hundred percent sales of the related party is not to the assessee. The turnover of the assessee is ₹ 52.99 crores whereas the turnover of the sister concern is Rs 69.95 crores. Further assessee has stated that the sister concern is the manufacturing unit of the group whereas the assessee is a marketing unit of the group. Therefore comparison of the gross profit and net profit of a manufacturing unit with a marketing unit is not proper. If the revenue wanted to apply the provisions of Section 40A (2) of the act it has to prove that purchase price paid by the assessee are unreasonable and excessive looking to the market rate of such goods and further the needs of the business of the assessee. No such exercise

has been carried out by the learned AO. In fact this exercise could have been carried out by the learned assessing officer by verifying the books of the sister concern where that sister concern sales to the assessee as well as to the other party. The learned assessing officer could have obtained the comparative prices of the similar goods supplied to the assessee by the sister concern and to the other parties. No such efforts have been made but merely a statistical analysis of the comparison of the profit was made by the learned assessing officer which is not warranted by the provisions of Section 40A (2) of the act. Further the learned CIT – A has also casually dealt with the whole issue by comparing the tax arbitrage and confirming the party addition looking to the tax benefit derived by the group. In view of this the addition sustained by the learned CIT – A is devoid of any merit and not in accordance with the law. Therefore, ground No. 2 is allowed.

07. Ground No. 3 is against confirmation of disallowance of Rs.36, 070/- being 30% of business promotion and advertisement expenditure disallowed by the ld., Assessing Officer restricted to the extent of 10% by the ld. CIT (Appeals). The Assessing Officer disallowed 30% of the business promotion and advertisement expenditure amounting to Rs.36,070/- for the reason that expenditure are incurred by the assessee through its Directors by credit cards and gifts to various customers. Therefore, these are expenditure in the guise of personal expenditure and he disallowed 30% thereof. The ld. CIT (Appeals) restricted the same to the extent of 10% as the Assessing Officer disallowed other expenditure to the extent of 10% on the same pretext. The details of the expenditure incurred by the assessee were submitted before the Assessing Officer. This expenditure was incurred through the credit cards of the Directors, but that fact itself cannot result into the disallowance. It needs to be tested under parameters of section 37 (1) of the Act. The details of the expenditure show that these are for the purchase of various diaries, Diwali expenditure and entertainment and gifts to the customers.

Naturally these expenditure are incurred by the Directors, but that does not mean that these are the personal expenditure and not incurred wholly and exclusively for the purposes of the business of the assessee. Even otherwise, in the case of the company assessee, there cannot be any personal expenditure. In view of this, Ground No. 3 of the appeal is allowed and the disallowance is directed to be deleted.

08. Ground No. 4 is with respect to the depreciation on Apple LCD monitor on which assessee claimed depreciation @ 60% stating it to be computer and the Assessing Officer and CIT (Appeals) allowed it @ 15% holding it to be not a computer but general plant and machinery. The assessee has purchased Apple LED DIS which is in fact a monitor for Rs.45, 500/- which is required for display at the time of conferences and presentation and is required to be attached to a CPU. In fact, it is a computer Monitor. Therefore, we hold that it is a computer entitled to 60% of the depreciation, as it is a monitor attached to the computers. Thus, ground No. 4 is allowed.

09. Ground No. 5 is disallowance of rent to the related parties of Rs.2, 97,000/-. The Assessing Officer found that assessee has paid rent to specified persons under Section 40A (2) (b) of the Act. The fact shows that assessee is paying rent of Rs.3,60,000/- to the related party in respect of premises E–434, Greater Kailash–II, New Delhi, where the family of the Directors are residing. Though the Directors have disclosed the perquisite value of rent-freeaccommodation in their hands, the same is valued at Rs.63, 000/- only which is less than he rent paid by assessee. Therefore, the Revenue was of the view that assessee has got a benefit of 30% tax arbitrage by paying rent of Rs.3,60,000/- to the related parties and only paying tax of Rs.63,000/- by showing the value as perquisites in the hands of the Director. Therefore, the addition to the extent of Rs.2, 97,000/- was confirmed.

10. We find that every year the assessee is paying same rent and it is being allowed as deduction. There is no increase in the rent or terms of rent

agreement. For the purpose of Section 40A (2) (b) the Revenue authorities should have brought on record that the rent paid to the related party is excessive and un-reasonable. Merely the tax arbitrage cannot be the reason to make disallowance under Section 40A (2) (b) of the Act. Valuation of perquisite if shown properly by directors in their tax returns and if it is less than Rent paid by the assesse to the land lord in whose house the directors are residing, it is the duty of AO of the directors to see whether perquisites are correctly valued or not. It cannot straight away result in to disallowance u/s 40A (2) of the Act unless it is shown that it is unreasonable and excessive having regard to the fair market value of such service or legitimate needs of the business of the assesse. All these ingredients are absent in the disallowance made by the revenue. In view of this, we direct the ld. Assessing Officer to delete the disallowance of rent paid to related parties as Revenue failed to show that it is excessive and un-reasonable compared to the market rate.

11. Ground No. 6 is with respect to the disallowance of the medical expenses of the Directors amounting to Rs.29, 506/-. The assessee has incurred total medical expenditure of Rs.65, 053/- out of which Rs.29, 506/- related to the Directors of the company. The ld. Assessing Officer disallowed as neither the appointment letter of the Directors nor the resolutionswere filed. It were also not filed before the ld. CIT (Appeals), hence it was confirmed. Even before us, it was not shown that the Directors are employees of the company and they were entitled to reimbursement of medical expenditure as per their terms of appointment. In view of this, we do not find any infirmity in the orders of the lower authorities and ground No. 6 of appeal is dismissed.

12. Ground No. 7 is with respect to the confirmation of the disallowance of 10% of various expenditure such as Staff welfare, Repair, Telephone, Travelling, Vehicle running etc. The assessee has incurred total of these expenditure amounting to Rs.19, 43,521/-. The ld. Assessing Officer has disallowed 10% of such expenditure stating that the disallowance is in

order to check leakage of profit under the guise of personal expenses debited under these heads. He disallowed 10% of this expenditure. The ld. CIT (Appeals) held that the above disallowance is reasonable for the reason that appellant is a private company run by its Directors and naturally certain expenditure have to be of personal nature. We find that before the Assessing Officer assessee has submitted the complete details of this expenditure. Itis also submitted before us in Paper Book No. 2. We note that the assessee before us is a Pvt. Ltd. company and a company cannot have personal expenditure. It is not the case of the Revenue that disallowance is made as expenses are not incurred wholly and exclusively for the purposes of the business. No such instances despite submission of the details by the assessee were pointed out by the Revenue. The disallowance is also made on ad-hoc basis. Therefore, we reverse the order of the lower authorities and direct the Assessing Officer to delete the disallowance of Rs.1, 94,350/-. Ground No. 7 of the appeal is allowed.

13. In the result, appeal of the assessee is partly allowed.

Order pronounced in the open court on conclusion of hearing on **27/07/2021**

Sd/-	**Sd/-**
(SUCHITRA KAMBLE)	**(PRASHANT MAHARISHI)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated : 27/07/2021.

MEHTA

Copy forwarded to:

1. Appellant
2. Respondent

3. CIT

4. CIT (Appeals)

5. DR: ITAT

ASSISTANT REGISTRAR
ITAT NEW DELHI

Date of dictation	27.07.2021
Date on which the typed draft is placed before the dictating Member	27.07.2021
Date on which the typed draft is placed before the Other Member	27.07.2021
Date on which the approved draft comes to the Sr. PS/PS	27.07.2021
Date on which the fair order is placed before the Dictating Member for pronouncement	27.07.2021
Date on which the fair order comes back to the Sr. PS/PS	27.07.2021
Date on which the final order is uploaded on the website of ITAT	27.07.2021
Date on which the file goes to the Bench Clerk	27.07.2021
Date on which the file goes to the Head Clerk	