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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Feb-12-1991

Reported in : (1991)38ITD80(Mum.)

Judge : O Jain, M Ajinkya

Appellant : Panama Industries and

Respondent : inspecting Assistant

Judgement :

1. This is a miscellaneous application arising out of the order of the Tribunal in I.T.A. No. 4283 (Bom.)/1983 decided on 19-10-1988.

2. The Tribunal in this case was dealing with cross appeals by the assessee and by the revenue for the assessment year 1979-80. The issue arising in the miscellaneous application relates to the Tribunal's decisions in the appeal of the revenue bearing No. 4283 (Bom.)/1983.

The brief facts relating to this appeal are as follows : The assessee is a registered firm carrying on business of manufacturing pharmaceuticals, drugs, etc. The raw materials arc purchased by the assessee and the manufacturing is done by an allied company named M/s.

Wockhardt Pvt. Ltd. For the year ended 30-6-1978, the assessee paid a total amount of Rs. 33,22,486 as processing charges of Wockhardt P.Ltd. The assessing authority disallowed a sum of Rs. 12,64,212 as excess processing

charges paid to Wockhardt P. Ltd. The Commissioner (Appeals) deleted such disallowance and hence the revenue came in appeal before the Tribunal. While setting the background of this controversy, the Tribunal pointed out that a similar issue came before the assessing authority for the assessment year 1978-79 when the assessee had made an additional debit of Rs. 7,48,947 on the ground that the processing charges for different products were revised from 1-7-1976. This additional debit was treated for that year by the assessing authority as fictitious payment and disallowed. Such disallowance was sustained in appeal. The assessing authority's argument was that Wockhardt Pvt. Ltd. and the assessee-firm belonged to one family, namely Akbarallys. The shareholders of Wockhardt P. Ltd. were the senior members of the family of Akbarallys whereas the partners of M/s. Panama Industries & Laboratories, the assessee herein, were the junior members of the same family. Therefore, by applying the provisions of Section 40A(2), the assessing authority disallowed Rs. 12,64,212 as excessive processing charges.

3. When the matter went before the Commissioner (Appeals), the Commissioner (Appeals) felt that it was necessary to ascertain the market price of services rendered by Wockhardt P. Ltd. and unless such prices were ascertained, the assessing authority could not state whether what was paid to them was excessive. The Commissioner (Appeals) also felt that the onus of proving that the provisions of Section 40A(2) would apply was on the assessing authority and such onus was not discharged inasmuch as the assessing authority had not established that the market price paid to Wockhardt P. Ltd. for the services rendered by them was lower than the amount actually paid by the assessee. Before the Tribunal it was argued on behalf of the department that the Commissioner (Appeals) had failed to take into account the fact that the subsequent payment made by the assessee represented the charges calculated with retrospective effect on increased rate of processing charges relating to the earlier previous year. The sale of these goods at a lesser price admittedly was to a sister concern. It was also pointed out that there was no increase in the sale price to justify increase in the processing charges and no evidence had been brought on record by the assessee to establish that the cost of processing had gone up with effect from the beginning of the earlier previous year.

4. The counsel for the assessee, on the other hand, pointed out that for the earlier year when the Commissioner (Appeals) had confirmed similar disallowance, the Tribunal also confirmed such disallowance.

But the counsel relied on certain observations of the Tribunal in paragraph 32 of its order for the assessment year 1978-79. The Tribunal in paragraph 10 of its order firstly referred to the Board's Circular No. 6-P (LXXVI-66) of 1968 dated 6-7-1968 reproduced at pages 1502 to 1504 in Vol. 2 of Chaturvedi & Pithisaria s Income-tax Law, Third Edition and reproduced a paragraph from the Board's Circular, which, the Tribunal observed, would appear to provide guidelines to the assessing authority about when and how the provisions of Section 40A(2) would be applicable.

5. The main point made by the applicant in this miscellaneous application is that there is apparent contradiction in the observations of the Tribunal in paragraph 10 of its order to the effect that the assessee had not been able to produce any material to establish the basis for increase, except correspondence between the assessee and Wockhardt P. Ltd. and the further submission that Shri Dastur had filed a statement before us to show the percentage of increase with overheads of various types from year to year. The Tribunal took cognisance of this statement at some considerable length as can be seen from the following observations of the Bench in its order, viz: 10... Shri Dastur has filed a statement before us to show the percentage of increase with overheads of various types from year to year. This statement requires proper scrutiny. It is necessary to find out how such increase in overheads would affect the processing charges. For example, there is an increase of as much as 21.31% in interest liability and 27.09% in travelling & conveyance. The maximum percentage of increase is under the head 'payments to and provisions' which has gone up to 45.90% in the year 1977-78 and 46.13% in the year 1978-79. The reason for such increase and its relation to the processing charges has to be enquired into particularly in the light of the fact that there is no increase in the sale price in the manufactured goods sold by the assessee-firm to Wockhardt P. Ltd. As regards the CIT (A)'s finding about the tax effect, we have examined the statement filed by Shri Dastur in which it is stated that the tax paid by the company on Rs. 12,64,212 received by it by way of processing charges is

about Rs. 7,96,452.

The registered firm's tax on the total income returned by the assessee-firm is Rs. 4,30,043 and the firm tax on the assessed income of the firm is shown to be Rs. 3,88,922 to show that there is only a difference of Rs. 3,48,922 in registered firm's tax, whereas the limited company has paid tax of Rs. 7,96,452. However, the total tax liability of all the partners of the firm after taking into account the assessed income of the firm at Rs. 28,80,671 has not been shown in this statement nor has it been taken into account by the CIT(A). It is not disputed that the shareholders of Wockhardt P. Ltd. and the partners of the assessee firm are members of the same family. Therefore, the reasoning of the CIT(A) based on the tax effect which is relatively small does not appear to be quite convincing. It is necessary that the applicability of Section 40A(2) is considered again by the IAC in the light of our observations hereinabove. The order of the CIT(A) on this issue is set aside and the matter is restored to the IAC for re-examination.

In spite of such detailed reference to the statement, the applicant has made much of the fact that there is no reference to the letters dated 9-4-1976 and 12-5-1976 addressed by two companies - one Dextromed Remedies Pvt. Ltd. and the other Deltaken Pharmaceuticals Private Limited. The Tribunal did not consider it necessary to deal with these letters because they did not constitute relevant material, nor were they pointedly brought to the notice of the Bench at the time of the original hearing. Further it is not necessary that the Tribunal must refer to each and every paper that is filed by the assessee in the course of its argument. The substantial question before the Tribunal was whether the processing charges claimed were excessive and whether the provisions of Section 40A(2) could be invoked. What was considered relevant by the Tribunal has been discussed, referred to and the Tribunal has arrived at the conclusion that this bit of evidence in the form of statement showing increase in overheads on the basis of the total production required further scrutiny. Further, the Tribunal has not given any finding on the merits of the case.

6. There is one more issue that requires to be dealt with. There was a similar disallowance of Rs. 7,48,947 for an earlier year, which was confirmed by the

Commissioner (Appeals) and which was also confirmed in appeal by the assessee before the Tribunal. The portion of the Tribunal's order on which Shri Dastur relied upon has been reproduced in paragraph 8 of the Tribunal's order. In our opinion, the Tribunal had made only a passing of reference to the order of the Commissioner (Appeals) for the subsequent year and has not given any finding on the merits of the decision of the Commissioner (Appeals) for the assessment year 1979-80, as indeed it could not have. Further, such stray observations of the Tribunal cannot be relied upon to support the assessee's case and, in any case, are not binding on another Bench of the Tribunal which is independently deciding the issue for a different assessment year. The Tribunal took note of the fact that similar disallowance made by the assessing authority was not only confirmed by the Commissioner (Appeals) but also was confirmed by the Tribunal. We are not concerned with what the Tribunal observed about the considerations that might have weighed with the Commissioner (Appeals) while deciding the same issue for the assessment year 1978-79. The Tribunal while deciding the departmental appeal for the assessment year 1979-80 has to judge the merits of the case independently and cannot be unduly swayed by the counsel's reliance on some stray and passing observations of the Tribunal's order for the earlier year. In not relying on such observations we do not think that we have committed a very great error, which has to be rectified through a miscellaneous application of this type. In view of these facts, we fail to see any substance whatsoever in this miscellaneous application, which is an attempt to get the decision of the Tribunal reviewed. As we have pointed out, the Tribunal has not given any finding on the merits. The issue has been sent back with specific directions and the assessee would have a fresh opportunity of arguing the case before the assessing authority. There is absolutely no mistake either of law or of fact, which calls for rectification under Section 54 of the Act. The miscellaneous application is, therefore, dismissed.

1. These are cross appeals for the assessment year 1979-80 by the assessee and the department. We will first deal with the appeal of the assessee.

2. The first ground in the assessee's appeal is directed against addition on account of free samples distributed to the extent of Rs. 1 lakh confirmed by the CIT(Appeals). The assessee is a registered firm carrying on business of

manufacturing pharmaceu-ticals, drugs, etc. The raw materials are purchased by the assessee and the manufacturing is done by an allied company named M/s. Wockhardt Pvt. Ltd. The assessee, in addition to manufacturing trade packs of finished goods for sale, also manufactures sample packs of smaller size for distribution to the medical profession.

The IAC noticed that the assessee had distributed certain quantities of trade packs as samples in the earlier years. The percentage of such samples distributed was certain cases very high compared to the goods processed. Such percentage in respect of the four products was found by the IAC to be as under :----------S. Name of Total pro- Samples Value to Quanti- ValueNo. Product duction value ty to in quantity rupees1. Proxyvon 1,50,38,408 5,79,612 3.86% 3.85% 1,82,577 Cap.

Cap.2. Sp. Proxyvon 51,21,452 760340 14.31% 14.84% 2,56,614 Cap.

Cap.4. Sedex 50Ml.

11948 Lit. 3109 Lit.

30.5% 26% 1,57,845 -------- It was argued that distribution of such samples was a common practice in the pharmaceutical industry. The types of goods manufactured by the assessee were such that they were available only on a prescription of a registered medical practitioner. Therefore, such a sample had to be distributed as a part of the marketing/sales strategy directed towards doctors, physicians and surgeons. When similar issue came before the CIT(A) for an earlier year, the CIT(A) observed that while any sales of samples outside the books could not found by the IAC, it could also be said that all the issues shown as samples were established to be issued and given away as samples by any contemporaneous records maintained by the assessee. This issue went before the Tribunal and the D-Bench of the Tribunal by their order in ITA No. 1123(Bom.)/82 for the assessment year 1978-79 dated 29-01-1985,deleted the addition sustained by the CIT(A) of Rs. 2,00,000. The addition made by the ITO for that year was Rs. 8,98,731. It was, reduced by the CIT(A) to Rs. 2 lacs. The Tribunal, after a very detailed consideration, recorded its finding in para 21 of its order, the relevant part

of which reads as under :- Considering the manner in which the assessment has been made and the order in the departmental appeal, we are of the opinion that were the CIT(A)'s action of sustaining a part of the addition of Rs. 2,00,000 to be upheld to an extent an action would be incongruent to the decision arrived at in the order No. 2097 (Bom.)/1982 dated 16-9-1983. For the reasons given above, we accept the assessee's appeal on the first dispute. The assessee gets relief of Rs. 2,00,000.

Shri Dastur relied on the order of the Tribunal. He also relied on the fact that a reference application by the Department against this finding was dismissed by the Tribunal in R.A. No. 492 (Bom.)/85 dated 30-9-1986 and argued that since the Tribunal in its order had considered the percentage of samples distributed to production from assessment years 1976-77 to 1980-81 and since further the CIT(A) had based his finding on the reasoning adopted by the CIT(A) for the assessment year 1978-79, which addition was not sustained by the Tribunal, the addition for the assessment year 1979-80 also requires to be deleted. We have gone through the order of the CIT(A) and we have also gone through the order of the Tribunal. All aspects of the matter have been considered by the Tribunal at great length by the Tribunal for the assessment year 1978-79. For the reasons stated in that order, we would hold that there is no justification for sustaining an addition of Rs. 1 lakh which is made by the CIT(A) on similar lines as those adopted by him for the assessment year 1978-79. The assessee is entitled to succeed on the first issue.

3. The second ground in assessee's appeal is against disallowance of interest on deposit account of employees of Rs. 56,700. The IAC has dealt with this issue in para 6 of his order. The assessee had debited to the profit and loss account an interest amount of Rs. 56,700. The IAC found that the interest was paid on loans that were taken during the previous year but remained outstanding for payment till the end of the present accounting year. The IAC had not accepted the genuineness of the loan for the assessment year 1978-79. He, therefore, following the same stand, disallowed this amount. The CIT(A) had confirmed that these loans were spurious in character. However, when the matter went before the Tribunal for the assessment year 1978-79, the Tribunal, in the aforementioned

order, restored the matter for reconsideration to the IAC with a direction that the IAC should furnish the assessee with the copies of the depositions of the various depositors and allow the assessee an opportunity to cross examine the deponents. The Tribunal, before reaching this decision, took into account the fact that there was a similar disallowance of as much an interest amount as Rs. 56,700 for the subsequent year (which is the year under appeal). Shri Dastur has filed before us a copy of the order of the IAC under Section 43(3) read with Section 54 purporting to give effect to the aforementioned order of the Tribunal for the assessment year 1978-79. In this order, the IAC has accepted the genuineness of the loans as well as the interest paid thereon and has reduced the disallowance sustained by the CIT(A) from the total income determined by the CIT(A) for that year. In view of this fact and in view of the further fact that no fresh loans were taken during this year, the addition of Rs. 56,700 has to be deleted.

4. The third and the last ground of appeal is that the CIT(A) erred in confirming the addition of Rs. 50,616 on account of alleged under-valuation of finished goods. The CIT(A) has dealt with this issue in para 3 of his order and the Tribunal for an earlier year has dealt with a similar issue in paras 33 to 36 of their order. The Tribunal sustained the addition of Rs. 5,23,059 made on similar ground for an earlier year for the reasoning given by the Tribunal for the assessment year 1978-79 and in view of the fact that the addition for this year is made on similar ground, the CIT(A)'s order confirming the addition of Rs. 50,616 on account of undervaluation of closing stock of finished goods will have to be sustained and this ground will have to be decided against the assessee.

6. We will now deal with the departmental appeal. There are two grounds raised in the departmental appeal. The first ground is directed against deletion of the addition of Rs. 12,64,212 made by the IAC. The CIT(A) has dealt with this issue in para 6 of his order. The IAC had disallowed a sum of Rs. 12,64,212 as excess processing charges paid to Wockhardt P. Ltd. The assessee firm, as stated earlier, gets its pharmaceutical drugs manufactured by Wockhardt P. Ltd. and for the year ended 30-6-1978, the firm paid a total amount of Rs. 33,22,486 as processing charges. The IAC questioned the assessee regarding this claim of expenses. It was explained that the processing bills up to January 1978 were made at old rates

although the processing charges for different products were revised from 1-7-1976, i.e., from the beginning of the preceding previous year. Wockhardt P. Ltd., therefore, issued a debit note of Rs. 9,04,563 being the price difference of the earlier years processing charges which were added to the current previous year's processing charges of Rs. 24,17,902. It appears that similar issue came before the IAC for the assessment year 1978-79 when the assessee had made an additional debit of Rs. 7,48,947 under similar circumstances and the IAC held that the arrangement of price difference was only a make believe and that the additional debit of Rs. 7,48,947 was fictitious in nature. Such disallowance was sustained in appeal.

The IAC observed that Wockhardt P. Ltd. and the assessee firm belonged to one family i.e., Akbarallys. The shareholders of Wockhardt Pvt. Ltd. were the senior members of the family of Akbarallys, whereas the partners of Panama Industries & Laboratories are the Junior members of the same family. Therefore, the increase in sale price had to be considered as excessive and unreasonable in terms of Section 40A(2).

He, therefore, disallowed Rs. 12,64,212 charged in the present year as excessing processing charges.

7. When the matter went in appeal, the CIT(A) observed that before applying the provisions of Section 40A(2) it had to be seen whether these provisions were attracted on the facts of the case. It was necessary to establish that what was paid to Wockhardt P. Ltd. was in excess of the normal rate of processing charges. The CIT(A) felt that it was necessary to ascertain the market price of services rendered by Wockhardt P. Ltd. and unless such prices were ascertained, the IAC could not state whether what was paid to them was excessive. The CIT(A) felt that the onus of proving that the provisions of Section 40A(2) would apply was on the assessing authority and such onus was not discharged inasmuch as the IAC had not established that the market price paid to Wockhardt P. Ltd. for the services rendered by them was lower than the amount actually paid by the assessee. The CIT(A) took into account the fact that the recipient company, namely, Wockhardt P.Ltd., had accounted for these receipts and had paid tax thereon at the rate

applicable to the private limited company. The appellant, on the other hand, was a firm with 19 partners and the net tax paid by the partners was relatively smaller than the case of the private company.

The sales shown by the assessee-firm were accounted for as purchases by Wockhardt P. Ltd. Therefore, in the opinion of the CIT(A), Section 40A(2) could not be applied. It is against this finding that the department has come in appeal in the first ground.

8. While challenging the decision of the CIT(A), Shri Keshav Prasad, the learned Departmental Representative, argued that the CIT(A) failed to take into account the fact that the subsequent payment made by the assessee represented the charges calculated with retrospective effect on increased rate of processing charges relating to the earlier previous year. The goods manufactured after such processing charges were paid were sold to Wockhardt P. Ltd. and had been sold at a lesser price. The sale of these goods at a lesser price admittedly was to a sister concern. Shri Keshav Prasad further argued that there was no increase in the sale price to justify increase in processing charges and no evidence had been brought on record by the assessee to establish that the cost of processing had gone up with effect from the beginning of the earlier previous year, which evidence was necessary particularly when there was no increase in sale price of the manufactured goods.

9. Shri Dastur pointed out that similar issue came before the CIT(A) for the assessment year 1978-79. The CIT(A) confirmed the disallowance and the Tribunal dealt with this issue in their order for the assessment year 1978-79 in paragraphs 27 to 31 of their order. The Tribunal reached its conclusion after detailed examination of this issue in para 32, part of which reads as under :- We find merit in Shri Dastur's submission that since a final understanding was not reached till the end of the accounting year under consideration, the debit would be raised by the assessee in its books only by means of a journal entry. However, against this fact, one has to consider the second act recorded by the IAC at page 21 viz. that the limited company has passed entries in its books on 31-8-1977. It is accordingly that we find merit in Shri Shukla's submission that even though

admittedly letters have been exchanged on 30-6-1977, the final agreement appears to have been arrived at only in August 1977. In the circumstances, we find that on this issue the decision of the CIT(A) is correct not only for the reasons given in the year under consideration but also on the basis of the reasons given in his subsequent year's order to which our attention has been drawn by Shri Dastur. Accordingly, we hold against the assessee the third dispute.

The Tribunal confirmed the order of the CIT(A) for the assessment year 1978-79 about the disallowance of Rs. 7,48,947 but gave a finding that the final agreement regarding the increase in the processing charges appeared to have been arrived at only in August 1977. The Tribunal has made a passing reference to the order of the CIT(A).

10. We have considered the orders of the IAC and the CIT(A) and the arguments advanced on either side. The scope of Section 40A(2) of the Act was explained in a circular of the Board bearing No. 6-P(LXXVI-66) of 1968 dated 6-7-1968 reproduced at pages 1502 to 1504 in Vol. 2 of Chaturvedi & Pithisaria's Income-tax Law, third Edition. The following para in the Board's circular would appear to provide guidelines to the assessing authority about when and how the provisions of Section 40A(2) would be applicable :- 74. It may be noted that the new provision is applicable to all categories of expenditure incurred in businesses and profession, including expenditure on purchase of raw materials, stores or goods, salaries to employees and also other expenditure on professional services, or by way of brokerage, commission, interest, etc. Where payment for any expenditure is found to have been made to a relative or associate concern falling within the specified categories, it will be necessary for the Income-tax Officer to scrutinize the reasonableness of the expenditure with reference to the criteria mentioned in the section. The Income-tax Officer is expected to exercise his judgment in a reasonable and fair manner. It should be borne in mind that the provision is meant to check evasion of tax through excessive or unreasonable payments to relatives and associate concerns and should not be applied in a manner which will cause hardship in bona fide cases.

In our opinion, the conclusion reached by the CIT(A) regarding the admissibility of this amount and regarding the applicability of Section 40A(2) has been so reached without proper examination of relevant data.

The assessee has not been able to produce any material to establish the basis for increase except correspondence between the assessee and Wockhardt P. Ltd. It was argued that the processing charges were increased because there was an increase in overheads in the years 1977, 1978 and 1979 as compared to those for the year 1976. Shri Dastur has filed a statement before us to show the percentage of increase with overheads of various types from year to year. This statement requires proper scrutiny. It is necessary to find out how such increase in overheads would affect the processing charges. For example, there is an increaseofasmuchas21.31% in interest liability and 27.09% in travelling & conveyance. The maximum percentage of increase is under the head "payments to and provisions" which has gone up to 45.90% in the year 1977-78 and 46.13% in the year 1978-79. The reason for such increase and its relation to the processing charges has to be enquired into particularly in the light of the fact that there is no increase in the sale price in the manufactured goods sold by the assessee to Wockhardt P. Ltd. As regards the CIT(A)'s finding about the tax effect, we have examined the statement filed by Shri Dastur in which it is stated that the tax paid by the company on Rs. 12,64,212 received by it by way of processing charges is about Rs. 7,96,452. The registered firm's tax on the total income returned by the assessee-firm is Rs. 4,30,043 and the firm tax on the assessed income of the firm is shown to be Rs. 3,88,922 to show that there is only a difference of Rs. 3,48,922 in registered firm's tax, whereas the limited company has paid tax of Rs. 7,96,452.

However, the total tax liability of all the partners of the firm after taking into account the assessed income of the firm at Rs. 28,80,671 has not been shown in this statement nor has it been taken into account by the CIT(A). It is not disputed that the shareholders of Wockhardt (P.) Ltd. and the partners of the assessee firm are members of the same family. Therefore, the reasoning of the CIT(A) based on the tax effect which is relatively small does not appear to be quite convincing. It is necessary that the applicability of Section 40A(2) is considered again by the IAC in

the light of our observations hereinabove. The order of the CIT(A) on this issue is set aside and the matter is restored to the IAC for re-examination. He should give the assessee a proper opportunity of being heard and apply all the tests that are required to be applied before reaching the conclusion about the excessiveness or otherwise of the processing charges. The first ground in the departmental appeal will be treated as allowed for statistical purposes.

11. The second ground raised by the department is that the CIT(A) erred in allowing a deduction of Rs. 7,48,947 which was claimed by the assessee for the assessment year 1978-79 and which pertains to the current assessment year. The whole issue regarding the payment of higher processing charges requires, in our opinion, re-examination for the detailed reasons stated in the foregoing paragraphs. When the matter about disallowance of Rs. 7,48,947 went before the Tribunal, the Tribunal confirmed the disallowance and gave the finding in para 32 of their order which is reproduced above. The Tribunal has not given a clear-cut finding about the merits of increase in the processing charges nor has it said that the liability in respect of this liability in fact arose in the subsequent assessment year. The Tribunal has only made a reference to the order of the CIT(A) for the assessment year 1979-80 without pronouncing any opinion thereon. We would, therefore, direct that this issue also should be re-examined by the IAC in the light of our observations above.

12. In the result, the departmental appeal will be treated as allowed for statistical purposes.

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