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Court : Income Tax Appellate Tribunal ITAT Chennai

Decided On : Apr-21-2006

Reported in : (2006)104TTJ(Chennai)410

Judge : M Chaturvedi, Vice, C Poojari

Appellant : Diebold Systems (P) Ltd.

Respondent : Assistant Commissioner of Income

Judgement :

1. This appeal by the assessee for the asst. yr. 2001-02 is directed against the order of the CIT(A), dt. 28th Feb., 2005. The first two grounds are general in nature where the assessee contends that the assessment is bad in law and passed without application of mind. These grounds were not pressed and, therefore, not adjudicated.

2. The next ground is with regard to allowability of deduction under Section 80-IA of the IT Act. This issue came up for consideration before this Tribunal for the asst. yr. 1996-97 in ITA No. 1313/Mds/2002 in the assessee's own case and the Tribunal, vide order dt. 20th Jan., 2006 has held that the benefit of deduction as per the mandate of the statute could only be given to the profits and gains derived from the industrial undertaking. Benefit under this section is available to the undertaking and not to the assessee. The income earned from AMC charges (Annual Maintenance Charges of ATM), installation and technical charges, consultation charges and licence fee of software constitute income of the

assessee and not of industrial undertaking situated at Pondicherry since this income was not derived from this industrial undertaking as the men, material and machinery of Pondichery industrial undertaking were not used to earn this income and hence, not eligible for deduction under Section 80-IA of the Act. Further, for this assessment year the income on account of the above elements was not earned from eligible business referred to in Section 80-IA(4) of the Act. The assessee is not also entitled for deduction under Section 80-IB though this section is applicable, for the same reason stated therein in that order as the above earnings were not from industrial undertaking situated at Pondicherry, as the benefit of deduction can be given only to the profit and gains derived from industrial undertaking as per Section 80-IB(4) of the Act. Accordingly, this ground is rejected.

3. The next ground is that the CIT(A) has erred in confirming the disallowance of Rs. 53,21,968 as inflation of expenses on purchase of software.

4. The brief facts of the case are that the assessee has passed a journal entry on 31st March, 2001 debiting the purchase of software at Rs. 3,03,53,558 by JE No. JL559. This entry was passed to match the receipt on account of. software licence fee of Rs. 5,40,05,000. The assessee reversed the provision of purchase towards actual purchase on 1st April, 2001 at Rs. 2,49,31,590. According to the AO, this has resulted in reduction of profit of Rs. 53,21,968 for the asst. yr.

2001-02. The AO has made an enquiry for making such a provisional entry and also the reason for reversing the provisional entry by actual purchase for lesser amount. The assessee submitted that at the time of assessment due to delay in completion of licensing formalities with Diebold Inc., advance copies of software were installed at customer bank site and sales invoice was raised for the year 2000-01. Provision for the purchase of software was made on the basis of "indication available". The difference between the provisions and the actual cost has been reversed in the next financial year, i.e., 2001-02 and included in the return of income for the next asst. yr. 2002-03. There is no qualification in the audit report for the asst. yr. 2002-03 regarding declaration of this additional income. The AO was of the opinion that the assessee has deliberately claimed excess

expenditure with an intention to conceal the income.

5. The assessee submitted before the AO that the effect of this entry is compensatory in nature and there is no actual suppression of income and the Revenue's interest has not been affected and there was no motive to suppress the income. This is the method of accounting followed by the assessee regularly and consistently from year-to-year.

However, the AO, not being satisfied with the contentions of the assessee, has made addition of Rs. 53,21,968, being difference between the provision of purchase entry and actual purchase. On appeal, the CIT(A) has confirmed the action of the AO. However, he has given direction to verify from the records of succeeding year and allow actual amount for which the software purchases were made by the assessee and not debited to the account of that year. In other words, the CIT(A) was of the opinion that there shall not be any double addition or taxation in the next year.

6. The learned Counsel for the assessee submitted that provision was towards the cost of software for which the assessee has placed orders with the NRI vendors. The statement given by the director, Shri Harish Murthy on 10th Jan., 2003 cannot be relied upon as he is not conversant with the accounting procedures and IT law and that cannot be used as an evidence against the assessee to disallow the claim of the assessee.

Actually, there was no suppression of any income by inflating the purchase figures as the assessee was consistently following this method of accounting of making provision towards the purchase on the last day of the year and reversing it on the immediate next day of the subsequent year. He further submitted that the admission to declare this amount as income for the asst. yr. 2001-02 was erroneously made and there was no evidence with the Department to show that the assessee has suppressed the income. He relied on the judgment of Hon'ble apex Court in the case of CIT v. C. Parakh & Co. (India) Ltd. and the judgment of Hon'ble Delhi High Court in the case of Swaran Yash v. CIT . He further submitted that even if the assessee has admitted the addition, the addition cannot be made and the assessment shall be completed in accordance with law.

7. The learned Departmental Representative, on the other hand submitted that this was only provision for purchase. Actually, there was no purchase at all. Had the assessee purchased the goods, there should be equivalent amount of stock and the assessee has admitted vide letter dt. llth April, 2003 to offer this difference of Rs. 53,21,968 as additional income for this assessment year and no appeal lies against the agreed addition. He relied on the order of this Tribunal in ITA No.1867/Mds/2000 dt. 7th June, 2005 in the case of Indo-Doha Chemical Pharmaceuticals Ltd. v. Dy. CIT wherein this Tribunal has concurred with the view of the Department that the assessee cannot be said to be aggrieved if the revision of assessment is on agreed basis.

8. We have heard the rival submissions and perused the material on record. Admittedly, the assessee has passed a journal entry for purchase of software on 31st March, 2000 for Rs. 3,02,53,558 and reversed it on the first day of the next year at Rs. 2,49,31,590. This has resulted in claiming of excess expenditure for the assessment year before us to the tune of Rs. 53,21,968. The time gap between these two journal entries is just a day or less than a day. For both the entries, the assessee has not brought on record any evidence for determining the cost of purchase. According to the assessee, the entries were made as indications available. The nature and specific sources of indication have not been brought either to the notice of the authorities below or to our notice. In our opinion, it is just a discard entry. When this information was brought to the notice of the assessee, the assessee has agreed to offer this amount as income for the assessment year and also stated in the letter dt. 11th April, 2003 that excess provision in the purchase price has been reduced in the subsequent year. Hence, they will file revised return for the asst. yr. 2002-03. After this statement, the AO stopped the probe and added this amount to the income of the assessee. Further, in letter dt. 14th Oct., 2003, the assessee has reiterated as follows: The provision for purchases Rs. 3,02,53,558 was reversed on 1st April, 2001 and the actual purchases were accounted for.

During the course of assessment proceedings we have offered Rs. 53,21,968 as income for the asst. yr. 2001-02 and file a revised return claiming this amount as a deduction in the asst. yr. 2002-03.

We are waiting for the completion of this assessment to file the revised return.

9. The above contents show that the assessee is fully aware of the fact and consequence of its statement and submission. Now, the assessee coming back with the plea that the agreed addition was erroneously made cannot be accepted. First of all, there is no evidence to show that the provision for purchase was made on the basis of specific purchase price of the software. The assessee cannot also say that within less than 24 hours, it has collected full information regarding the actual purchase price of the software. Further, the assessee cannot have any grievance towards addition as the assessee itself has agreed for offering this amount for taxation while examining under Section 131 of the IT Act and also by its own letter cited (supra). In the case of Ramanlal Kamdar v.CIT , the Hon'ble Madras High Court has held that once the assessee had stated that it had no objection to the proposed revision or addition and the assessment was made as proposed by the assessee, the assessee could not be said to have been aggrieved by the order of the AO. The assessee can be said to have been aggrieved by the order of the AO only when the AO unilaterally made addition and in that case only the assessee has a right to appeal against that order.

10. In the present case the director, Shri Harish Murthy was examined on oath under Section 131 of the Act on 10th Jan., 2003 and he categorically admitted to offer this amount as income of the assessee.

Even if there was purchase amounting to Rs. 3,02,53,558 instead of Rs. 2,49,31,590, the balance of Rs. 53,21,968 should have been shown as stock which was not sold, whereas there was no indication that this amount was included in the closing stock. On this account also, the assessee has no case. Further, in the income-tax proceedings, each assessment year is an independent assessable unit and the real income of each assessment year shall be ascertained and taxed. Even postponement of tax liability from one year to another year is not permissible. In this background, if we analyze the strategy adopted by the assessee, the assessee has made an attempt to postpone the tax liability. The assessee is liable to compute the profits and gains of business in accordance with the method of accounting regularly employed by the assessee. If the method of

accounting employed by the assessee does not reflect the true picture or real profit of the assessee and the proper profit cannot be deduced from that account and account is not complete to the satisfaction of the AO, the AO has the liberty to compute the profit. Accordingly, we are convinced that the assessee has actually inflated the purchase without making any actual purchase to the above extent. Further, the CIT(A) has given specific directions to the AO that there shall not be any double addition in the asst. yr.

2002-03 and the assessee has the option to file the revised return. If the assessee opts not to file revised return for the asst. yr. 2002-03, then it is the fault of the assessee and not the fault of the Department. Hence, we have no hesitation in confirming the action of the lower authorities and reject the ground taken by the assessee.

11. The next ground is that the CIT(A) has grossly erred in law in not appreciating that given the facts of the present case, the AO erred in applying the provisions of Section 40A(2)(a) since the party to whom payments were made did not fall within the purview of Clause 2(a) of Section 40A of the Act.

12. The brief facts of the issue are that the assessee has a 50 : 50 joint venture with HMA Data Systems (P) Ltd., and Diebold Inc., USA engaged in the manufacture and trading of Automated Teller Machines & Accessories. M/s Chip Trans and M/s Diebold Inc., USA were associate concerns of the assessee-company. The managing director, Shri Harish Murthy was substantially interested in HMA Data Systems Ltd., and Chip Trans, USA. Thus, HMA Data Systems (P) Ltd., Diebold Inc., USA., HMA Software (P) Ltd., and Chip Trans, USA are specified persons as enumerated under Section 40A(2)(a) of the IT Act. During the year, the assessee has purchased software from Chip Trans, USA., Diebold Inc., USA and HMA Software (P) Ltd. The assessee has purchased ATM related software from Chip Trans, USA during the period 1st April, 2000 to 31st Oct., 2000. The AO compared the purchase cost and sales price of software. As mentioned by the AO, the purchase and sales cost of soft ware are as follows:---------- Name of the No. of software Purchase price Sale price Profit/Loss company (In

Rupees)----------Chip Trans, USA 312 6,46,39,832 5,48,94,300 (-) 97,45,532Diebold Inc., USA 282 49,31,590 5,40,05,000 (+) 2,90,73,450----------

13. During the year, according to the AO, the assessee has purchased 312 sets of software from Chip Trans and 282 sets of software from Diebold Inc., USA. The AO has collected the costing details of software supplied by these companies which are as follows:1064ix FL All figures in INR unless otherwise mentioned Hardware 46.35 to a $ Software----------CIF Chennai $ 7,396.50 CIF Chennai US $---------- ----------Assessable value (AV) 3,46,256.05 Assessable value (AV) 58,797.761% x CIF 1% x CBasic customs duty (BCD) 69,251.21 -(AV x 25%)Counterveiling duty (CVD) 66,481.16 -(AV + BCD + SG x 16%)Customs duty 1,55,011.91 Clearing charges 3.5% on 2,351.91AV---------- ----------Ex factory price hardware 5,12,823.13 Ex factory software price 60,567.51----------

----------Total ex factory cost (HW & SW) 5,73,390.64----------Commission 2,80,000.00----------Total Cost 8,53,390.64----------Total order value (HW & SW) 10,14,215.69Total margin 1,60,825.05Margin percentage 15.86%----------1062ix FL All figures in INR unless otherwise mentioned Hardware 47.00 to a $ Software----------CIF Chennai $ 8,358.38 CIF Chennai US $ $ 1,328.00----------Assessable value (AV) 3,96,772.06 Assessable value (AV) 63,040.161% x CIF 1% x CBasic customs duty (BCD) 99,193.02 -(A.V x 25%)Counterveiling duty (CVD) 79,354.41 -(AV + BCD + SC x 16%)---------- ----------Ex factory Price Hardware 6,09,424.05 Ex factory Software Price 64,622.41---------- ----------Total order value HW 9,55,882.35 Total order value SW 2,00,000Margin on HW 3,46,458.30 Margin on SW 1,35,377.59----------Total ex factory

cost (HW & SW) 6,74,046.46----------Brokerage 4,20,000.00Total cost 10,94,046.46----------Total order value (HW & SW) 11,55,882.35Total margin 61,835.89Margin percentage 5.35%---------- According to the above chart, the cost of cash dispenser software supplied by Diebold Inc., was Rs. 60,567 and the ATM software was Rs. 64,622. This cost of software matches with the value of software in closing stock for the asst. yr. 1998-99 and 1999-2000. The AO further discussed on the purchase price and sales price of software sets purchased from Chip Trans and Diebold Inc., as under: Bank of Punjab Ltd., by Chip Trans. & Diebold in asst yr. 2001-02.----------S. No.Purchase from Chip Trans Inv. No. Selling price Purchase price----------1. BOP Autocare Centre, New Delhi 1,110 2,25,000 3,17,646----------2. BOP Laxmi Super New Delhi 1,111 2,25.000 3,17,646----------3. BOP Shamnath Marg, New Delhi 1,112 2,25,000 3,17,646----------4. GT Mandigobindge Punjab 1,164 2,25,000 3,23,148----------5. GT Road Malout, Punjab 1,165 2,25,000 3,23,148----------6. Circular Road, Punjab 1,166 2,25,000 3,20,259----------7. Bengali Market, New Delhi 1,237 2,25,000 3,20,259----------8. Tobaco House, Calcutta 1,560 2,25,000 3,31,010----------9. Sector 32, Chandigarh 1,601 2,25,000 3,34,004----------10. Pakhwal RS, Ludhiana 1,602 2,25,000 3,34,004----------11. S.D.

Road, Secunderabad 1.742 2,25.000 3.31,010----------

S. No. Purchased from Diebold Inc.

Inv. No.	Selling price	Purchase price
1. BOP Jalandhar	318	2,25,000 50,568
2. BOP Banga	319	2,25,000 50,568
3. BOP Patiala	320	2,25,000 50,568
4. BOP Nabha	321	2,25,000 50,568
5. BOP Ghandni Ghowk	322	2,25,000 50,568
6. BOP Jalandhar	323	2,25,000 50,568
7. BOP Chandigarh	324	2,25,000 50,568

---------- Thereafter, the AO has arrived at the cost of 282 sets of software purchased from Diebold Inc., at Rs. 88,410 each (Rs. 2,49,31,590 divided by 282) and the cost of 312 sets of software purchased from Chip Trans at Rs. 2,05,090 (Rs. 6,39,88,366 divided by 312). According to the AO, the average price paid to Chip Trans for the same software purchased from Diebold Inc., was very excessive as compared to the cost of Diebold Inc. On comparison, the AO was of the opinion that the cost price paid to Chip Trans was very heavy and unreasonable compared to the prevailing market price which is not legitimate. Therefore, he invoked the provisions of Section 40A(2)(a)(b) of the IT Act. Thus, the AO fixed the cost of software purchased from Diebold Inc at Rs. 88,410 and to this cost he added 10 per cent to the software purchased from Chip Trans as these were supplied on credit basis, thus arriving at the cost of software purchased from Chip Trans at Rs. 97,251 and thereby arrived at the cost of 312 sets as under:(a) Amount actually paid for 312 sets of software .... Rs. 6,39,88,366(b) Amount payable to Chip Trans for 312 sets

of .... Rs. 3,03,42,312 software at Rs. 97,251 each This excess payment of Rs. 3,36,46,054 to Chip Trans was disallowed under Section 40A(2)(a) of the IT Act by the AO. Against this disallowance, the assessee went in appeal before the CIT(A) who has confirmed the action of the AO. Aggrieved, the assessee is in appeal before us on this issue.

14. The learned Counsel for the assessee submitted that the assessee has purchased 709 sets of software from Chip Trans, USA., though it was stated as 696 before the AO and filed an affidavit confirming the purchase of 709 sets of software. He further submitted that the mistake was due to wrong punching of number of software sets imported. Further, the software sets purchased or sold consists of large number of individual software which were bundled or embedded as per needs of the customers. They were collectively called as software sets and the assessee has maintained regular books of account and stock register showing purchase, sales and stock. He further submitted that the AO wrongly took the purchase from Chip Trans at 312 instead of 709 sets.

The purchase of 312 sets is factually incorrect. Actually it was 709 sets which is supported by purchase bills. He drew our attention to pp.

197 to 199 of the paper book I which shows the details of purchase of 697 sets of software from Chip Trans during the year 2000-01 at a cost of Rs. 6,27,24,879. He further drew our attention to the paper book filed on 6th March, 2006 containing Annexs. I to VII as below:----------S. No. Anuexure No. Particulars Page No.---------- 1.

Annexure 1 Affidavit of the appellant under Rule 10 of the 1-2 ITAT Rules, 1963 to affirm the fact that 709---------- 2.

Annexure 2 Invoicewise details of the software sets 3-20 imported showing reconciliation with similar----------

4.

Annexure 4 Quantitative details of software, namely 147 opening balance, receipts, issue & closing---------- 5.

Annexure 5 Copy of the software stock register 148-244---------- 6.

Annexure 6 Quantitative reconciliation of the software 245-248 sourced from M/s Chip Trans, USA with the---------- 7.

Annexure 7 Quantitative Reconciliation of the software 249-252 issued with the stock register---------- 15.
The learned Counsel for the assessee vehemently argued that all purchases were approved by the customs authorities and as such, customs approved details cannot be questioned by the Department. He contended that when payments are approved by one wing of the Government, there is no question of such payments being treated as excessive or unreasonable. For this purpose, he relied on the judgment of the Hon'ble Delhi High Court in the case of CIT v. Shriram Pistons & Rings Ltd. ; and in the case of Addl. CIT v. Nestle India Ltd. (2005) 94 TTJ (Del) 53 and decision of the Pune Bench of the Tribunal in the case of Kinetic Honda Motor Ltd. v. Jt. CIT (2001) 72 TTJ (Pune) 72 : (2001) 77 ITD 393 (Pune).

16. The learned Departmental Representative, on the other hand, submitted that there is no merit in the claim of the assessee that it has purchased 709 sets of software from Chip Trans. At the time of assessment, it was stated that the assessee has purchased 696 sets of software. Now the assessee is changing its stance and stating that it has purchased 709 sets of software and made an affidavit to that effect. This is only self-serving in nature. On llth April, 2003, the assessee has filed a letter where it is clearly mentioned that it is 312 sets of software and it has given item-wise cost of each set of software and sale price. He drew our attention to the details of software purchased by the assessee which was enclosed to the letter dt.

llth April, 2003. According to this, the assessee has purchased only 312 sets at a cost of Rs. 6,46,39,832 and sold the same for Rs. 5,48,94,300. The sale price mentioned in the statement fully agrees with the sale price mentioned by the AO in the assessment order at p.

20, which is reproduced above. He further submitted that had the assessee purchased 709 sets or 696 sets of software, there should be equivalent number of software sets in the closing stock. But actually, the closing stock shows only 131 sets and this statement was produced by the assessee as Annex. IV in p. 147 of the paper book vide letter dt. 6th March, 2006. According to this statement, there is no equivalent amount of closing stock. Further, he drew our attention to the order-sheet entry of assessment record dt. 19th Dec., 2003 wherein the assessee has stated as follows: Shri P. Giridhar, Director Finance attended with Shri J. Vinodh, Executive (Finance) and furnished letter dt. 19th Dec, 2003. It is contended that 696 pieces of software has been purchased from Chip Trans as against 312 agreed earlier which is the quantity of software sold and purchased, details of which were furnished along with letter dt. 11th April, 2003. Software stock record is also produced. When asked to clarify as to how the assessee determined the sale value and purchase price of software given vide letter dt.

11th April, 2003, it is stated that sale price has been determined on the basis of actual invoice issued to the bank. As regards the cost of software the software required as per the requirement of bank is prepared by the assessee by combining 2 to 3 softwares and the cost as per letter dt. 11th April, 2003 is the actual cost of such combined software.

As far as sale and purchase out of provisions (software supplied by Diebold Inc. USA entry dt. 31st March, 2001), the set of software as required by bank has directly been sent to India. Thus, the software supplied by Diebold is a made to order software and hence there was delay in supply of software.

17. We have heard the rival submissions and perused the material on record. Though the assessee has stated that it has purchased 709 sets of software from Chip Trans, USA., it has not been able to co-relate as to how the 709 sets of software were embedded or grouped and sold to various parties. The assessee

has not corroborated the unit-wise purchase cost and sale price of software set in its new place of purchase of 709 software sets. It is clear beyond doubt that the sale was for 312 sets of software only as the assessee itself has admitted vide letter dt. llth April, 2003 that it has sold 312 sets of software for Rs. 5,48,94,300, the purchase cost of which was Rs. 6,46,39,832.

Had it sold 709 sets of software, corresponding amount of balance should have been there in the closing stock. But according to the statement furnished at p. 147 of Annex. IV of the paper book submitted by the assessee on 6th March, 2006, the stock available was 131 only from the purchase made from Chip Trans, USA.18. Another argument of the assessee is that it has clubbed the software according to the requirement of the customers. It transpires from the order sheet entry dt. 19th Dec., 2003 that the software was prepared according to the need of the customer bank by clubbing more than one software and cost was determined on actual cost basis of the combined software and the cost of this software was as mentioned in the letter dt. 11th April, 2003. In this letter, the assessee has given the details of software, sale value and purchase price of them. According to this letter, the assessee has sold 312 sets of software for a sale value of Rs. 5,48,94,300 and its purchase price was Rs. 6,46,39,832.

The assessee has not denied that these details have not been supplied by it. From this it is inferred that the assessee has purchased the software on the order of the customers and combined the software together at the time of sale. It is also evident from the statement furnished by the assessee on llth April, 2003 that the assessee has effected sales of 312 sets from the purchase made during the year and even according to its own calculation, the assessee has incurred loss.

We have also gone through the cost analysis statement submitted by the assessee itself (which is reproduced above) which shows that the cash dispenser software purchased from Diebold Inc., was Rs. 60,567 and cost of ATM software was Rs. 64,622. The software supplied by Chip Trans was at Rs. 88,410 as is evident from the actual purchase entry made on 1st April, 2001 by journal entry for Rs. 2,49,31,590 for 282 sets (2,49,31,590 divided by 282). The AO has given 10 per cent margin on this at Rs. 8,841 [8,8410 (+) 8,841] and arrived at the amount

payable to Chip Trans at Rs. 97,251 per set as the software sets supplied by both the parties are identical in nature since the end user is common.

It is also an admitted fact that the assessee has switched over to the purchase of software from Chip Trans to Diebold Inc., USA w.e.f. 31st Oct., 2000. The purchase was stopped because, the managing director, Harish Murthy was no more managing director of the assessee-company and also the new managing director, was not interested in Chip Trans.

19. Further, when we analyze the purchase price and the sale price, it is interesting to note that the sale price of software sold by the assessee-company to various banks was usually same, i.e., Rs. 2,25,000.

However, the purchase price of software purchased from Chip Trans varies from Rs. 3,17,646 to Rs. 3,34,004. In the case of Diebold, the purchase price of software was usually Rs. 50,568. The assessee was selling the software set at loss when the purchase was made from Chip Trans and made exorbitant profit when the purchase was made from Diebold Inc. Even at the cost of repetition, we reproduce the relevant chart below: Comparative chart Indicating software purchase price regarding supply toBank of Punjab Ltd., by Chip Trans. & Diebold in Asst. yr. 2001-02.----------S. No. Purchase from Chip Trans Inv. No. Selling price Purchase price----------1. BOP Autocare Centre, New Delhi 1,110 225,000 317,646----------2. BOP Laxmi Super, New Delhi 1,111 225,000 317,646----------3. BOP Shamnath Maig, New Delhi 1,112 225,000 317,646----------4. GT Mandigoblndge Punjab 1,164 225,000 323,148----------5. GT Road Malout, Punjab 1,165 225,000 323,148----------6. Circular

Road, Punjab 1,166 225,000 320,259----------7. Bengali Market, New Delhi 1,237 225,000 320,259----------8. Tobaco House, Calcutta 1,560 225,000 331,010----------9. Sector 32, Chandigarh 1,601 225,000 334,004----------10. Pakhwal RS, Ludhiana 1,602 225,000 334,004----------11. S.D. Road, Secunderabad 1,742 225,000 331,010----------

S. No.Purchased from Diebold Inc.

Inv. No. Selling price Purchase price----------1. BOP Jalandhar 318 225,000 50,568----------2. BOP Banga 319 225,000 50,568----------3. BOP Patiala 320 225,000 50,568----------4. BOP Nabha 321 225,000 50,568----------5. BOP Chandni Chowk 322 225,000 50,568----------6. BOP Jalandhar 323 225,000 50,568----------7. BOP Chandigarh 324 225,000 50,568---------- 20. Now we have to consider whether invoking the provisions of Section 40A(2)(a) of the IT Act by the AO is justified or not. Section 40A(2)(a) reads as under: 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 AO 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.

Section 40A(2) of the Act put curb on expenditure in respect of payment made to close associates referred in Clause (a) of the section towards purchase of goods, services rendered, facilities offered and it empowers the AO to disallow so much of expenditure in respect of which payment has been made to the above category of persons as is considered by the AO excessive or unreasonable having regard to the fair market value of the goods, service rendered or facilities offered for which the payment was made or the legitimate needs of business of the assessee or the benefit derived by or accruing to the assessee therefrom. There is no plea by the assessee that Chip Trans, USA., is not a specified person and Section 40A(2)(a) is not applicable.

Admittedly, as enumerated in the facts of the case, Mr. Harish Murthy, managing director, of the assessee-company was interested in HMA Data Systems (P) Ltd., and also in Chip Trans, USA. The assessee is a specified person as per Section 40A(2)(a) of the Act. In our opinion, the conditions laid down in Section 40A(2)(a) are squarely applicable to the facts of this case. The purchase price paid by the assessee towards purchase cost of software has directly resulted in deriving benefit to the specified person who has substantial interest in other companies. The payment for purchase of software sets was very excessive and unreasonable having regard to the market value of the goods, legitimate needs of the assessee's business and benefit derived by the assessee. These facts are evident from the comparison of purchase price paid for software purchased from Diebold Inc., USA and Chip Trans, USA.The affidavit filed by the assessee regarding the purchase of 709 software and also the statement and the letter dt. 6th March, 2006 at Annexure (supra) are only self-serving in nature as the assessee has failed to furnish item-wise cost of each software embedded to each software set sold by the assessee and the assessee has not also co-related the cost of software

purchased with the software sold as it has made in the letter dt. llth April, 2003, wherein the assessee has furnished the purchase cost of each software set and sale value and the assessee itself has given that the assessee has purchased 312 sets at a cost of Rs. 6,46,39,832 and the sale value was Rs. 5,48,94,300 which is as follows:---------- Bank site Inv. No. Sale value Cost No. of sets----------Vysya Bank Ghaziabad 332 75,000 40,000 1----------Vysya Bank Kempagowda Rd 351 75,000 40,000 1----------UTI - Surat 352 2,28,000 2,40,512 1----------ICICI Bank - Saki Naka 353 1,75,000 1,74,715 1----------UTI - Madyamgram (Nabapally Br) 375 2,28,000 1,98,639 1----------UTI - Jublee Hills 376 2,28,000 1,98,639 1----------J&K Bank - Lajpat Nagar 377 2,00,000 2,01,979 1----------J&K Bank - Ansal Plaza 379 2,00,000 2,01,979 1----------Abhudaya Bank 380 41,000 36,246 1----------XXX XXX XXX XXX XXX----------XXX XXX XXX XXX XXX----------

*The list is very exhaustive and hence only an extract is copied for clarity.

It was also clarified in the order-sheet dt. 19th Dec., 2003 wherein the assessee has affixed its signature for the method adopted for determining the sale value and also actual cost of software set.

21. Another argument of the assessee is that the purchases were approved by the customs authorities and hence, cannot be questioned by the Department as excessive or unreasonable. This plea of the assessee has no merit since it is apparent from the facts of the case and material placed before us that the assessee has voluntarily paid excess amount than the fair market value, and the customs authorities have not approved the value of the goods but only collected the duty leviable on them. Hence, in our considered opinion, Section 40A(2)(a) is squarely applicable to the facts of this case and the lower authorities are justified in disallowing the excess payment made towards purchase of software sets and the same is confirmed. The ground taken by the assessee is rejected.

22. The next ground is that the CIT(A) erred on facts and in law in confirming the disallowance of Rs. 2,10,00,000 on account of excessive price paid for purchase of hardware.

23. The brief facts of this issue are that the assessee has purchased following hardware from Chip Trans and Diebold Inc., USA:----------Name of supplier Model No. of M/cs.

Consideration Au Price Basis----------Chip Trans 1064 CDs 84} 12,34,05,815 4,16,911 C&FDiebold Inc.

1064 CDs 6 22,71,317 3,78,552 FOB 1062 ATMs 268 10,23,81,069 3,82,018 FOB---------- The AO computed the average cost of CD and ATM purchased from Diebold Inc with CD and ATM purchased from Chip Trans. As mentioned above, the average purchase price of ATM from Chip Trans works out to Rs. 4,53,329 (9,61,05,815 divided by 212) as against Rs. 3,82,019 purchased from Diebold Inc. The assessee submitted before the AO that this variation was due to C&F freight in the case of Chip Trans. However, the cost of Diebold Inc., was as per FOB value. The AO, after giving credit to freight and insurance, estimated the variation at around Rs. 10,000 per ATM purchased from Chip Trans and in the opinion of the AO, the price paid to Chip Trans for the purchase of ATM is in excess of Rs. 10,000 and

thus, he estimated the addition in the purchase of 212 ATMs at Rs. 21 lakhs and added, the same to the income of the assessee, invoking the provisions of Section 40A(2)(a)/40A(2)(b) of the IT Act.

24. On appeal, the CIT(A) ascertained the average price of ATM purchased from Diebold Inc. at Rs. 3,91,188 on the basis of letter filed by the assessee on 23rd Dec., 2003. The computation was as follows: Thus, he considered at the cost of ATM supplied by Chip Trans at Rs. 3,26,651. He compared the cost of ATM CD supplied by Diebold Inc., at Rs. 3,91,589 with ATM CD supplied by Chip Trans at Rs, 3,26,651 and in the opinion of the CIT(A) the average cost of CD supplied by Diebold was more to the tune of Rs. 71,310. However, he sustained the addition made by the AO.25. After hearing he rival parties, we are of the considered opinion that the CIT(A) took the average cost of ATM CD supplied by Chip Trans at Rs. 3,26,651 as against the average cost considered by the AO at Rs. 4,53,329. The addition was made by the AO on account of payment of excess amount towards purchase of ATM CD from Chip Trans. In the findings of the CIT(A), the price paid to ATM CD purchased from Chip Trans was lower than the cost of Diebold Inc. In other words, Section 40A(2)(a)/40A(2)(b) was invoked in view of the fact that the price paid to Chip Trans was excess and unreasonable. The findings of the CIT(A) was contrary to the findings of the AO and he adopted the cost price of ATM CD supplied by Chip Trans at Rs. 3,26,651 which is lesser than the price paid to Diebold Inc. If it was actually lesser than the price paid to Diebold Inc., there could not have been any addition and the provision of Section 40A(2)(a)/40A(2)(b) of the Act would not have been invoked. The basis for adopting the average price of Rs. 3,26,651 for ATM CD supplied by M/s Chip Trans has not come through. Hence, we are not in a position to express any opinion on this. Accordingly, we set aside this issue to the file of the AO to examine the correct price paid for ATM CD to Chip Trans and thereafter compare it with the price paid to Diebold Inc. On comparison if the AO finds that the price paid to Chip Trans was excessive or unreasonable, then he is directed to invoke the provisions of Section 40A(2)(a)/40A(2)(b) of the Act and our findings with regard to purchase of software set in earlier paragraphs will be applicable to the purchase of hardware. In this context, we make it abundantly clear that the AO, while concluding this issue, is directed to give due credit towards the difference on

account of C&F Price and FOB price.

27. The last issue is that the CIT(A) has erred on facts and law in confirming the disallowance of Rs. 4,164,000 on account of sales commission paid to independent parties as being excessive.

28. The brief facts of the issue are that the assessee was doing business with the Bank of Punjab Ltd., for many years. The assessee claimed payment of commission to the following four entities on account of sale order received from Bank of Punjab Ltd.:----------Sl.

Name of the concern to whom Date of Amount (Rs.)No. Brokerage/Commission is paid payment----------1.

General Glass Works, Mumbai 28.07.99 7,000,000----------2.

Kalpita Agencies, Mumbai 28.07.99 7,000,000----------3.

Silverline Appliances, New Delhi 02.05.2000 12,500,000----------4.

Monet E-Com Systems Ltd. 02.05.2000 8,500,000---------- Total 35,000,000---------- For the assessment year under consideration, the assessee claimed the payment of sales commission of Rs. 41,64,000. The payment of commission works out to 42 per cent in the case of Silver Line Appliances (P) Ltd., and 25 per cent each in the case of Kalpita Agencies and General Glass Works Ltd. The AO disallowed this commission for the reason that there was no evidence to show that these entities have rendered any kind of service and the Bank of Punjab Ltd., was not aware of these sales agents. On appeal, the CIT(A) confirmed the order of the AO.Aggrieved, the assessee is in appeal before us on this issue.

29. The learned Counsel for the assessee submitted that during the preceding year, the assessee appointed sales agents for increasing its sales and paid commission to them at piece rate on the basis of orders procured by them. The total commission that was payable to the agents on the order of 100 machines procured by them from Bank of Punjab Ltd., was Rs. 35,000,000. The main services rendered by the sales agent for which they were paid commission by the assessee are in the nature of relationship services to obtain orders and as the services are relationship based, and work on the contracts of persons involved, no contemporary/recordable documentation is generated. However, the payment of commission is made by cheque on receipt of order but the commission is charged to P&L a/c in the year the machine is dispatched and the payment mechanism is based on actual order received which is evident from the copy of the ledger account of commission and brokerage for the period 1994 to 2003, i.e., from the inception of the company.

These details were placed before the AO vide letter dt. 9th Dec., 2003.

The AO, though admitted that the commission was paid to get orders, he held it to be in the nature of kickback and corruption money and disallowed the commission payment. The learned Counsel for the assessee vehemently argued that the AO has not brought any evidence on record to prove that the money has flown to the assessee by way of kickback He contended that the oral denial of the purchaser as to the involvement of the agents does not in any way point out to the irresistible and irrevocable conclusion that commission was paid for no work done. There is no material on record to warrant such an inference. The reason as to why the payment of commission to sales agent was made is anybody's guess but it would not have been paid without the services having been rendered. The preponderance of probabilities favours the assessee. The learned Counsel for the assessee further argued that the commercial expediency and the reasonableness of the expenditure has to be determined by the assessee and it is not for the Department to determine the necessity, need and quantum of a particular expenditure.

The AO did not even examine the sales agents independently and the action of the AO in invoking the provisions of Explanation to Section 37(1) of the IT Act for making the disallowance is bad in law. He contended that this provision can be invoked only if the payment is incurred for any purpose prohibited by law or any purpose which is an offence. In this case, since no money has been paid to Government servant or the employee of the bank, the said Explanation is not applicable as the kind of expenditure is neither prohibited by law or is an offence. In support of this argument, the learned Counsel for the assessee relied on the following case law:K.N. Narayana Iyer v. CIT (3) A.P.L (India) (P) Ltd. v. Dy. CUT (2005) 97 TTJ (Mumbai) 187 : (2005) 96 ITD 227 (Mumbai) The learned Counsel for the assessee further submitted that the assessee has established the identity of the sales agents by producing documentary evidence which has not been rebutted by the AO and hence the assessee cannot be held to have failed to prove its case. The learned Counsel for the assessee also relied on the following case law:CIT v. Pune Pharma (P) Ltd. (2005) 193 CTR (MP) 73 : (2004) 270 TIR 382 (MP) (v) Bharat Bijlee Ltd. v. Dy. CIT (2001) 71 TTJ (Mumbai) 909 : (1999) 71 ITD 412 (Mumbai) 30. On the other hand, the learned Departmental Representative submitted that the commission was paid to identify the customers as evident from the agreement with the agents. This commission is said to have been paid for transactions with Bank of Punjab Ltd., The assessee was transacting with the Bank of Punjab Ltd., since 1995 and no commission was paid to anybody till 1999. It is, therefore, evident that no service was rendered by the so-called agents. He contended that for obtaining orders worth of Rs. 11 crores, commission was claimed to have been paid to the tune of Rs. 3.5 crores, i.e., about 32 per cent which is abnormally high. It is observed from the sworn statement from Shri P.P. Manjunath Rao, Vice President, Sales and Operations of the assessee-company that commission was paid to four concerns to identify only one customer, i.e., Bank of Punjab Ltd. The party to whom agents were stated to have been employed, i.e., Bank of Punjab Ltd., did not furnish any confirmation letter to that effect. The learned Departmental Representative relied on the judgment of the Hon'ble Supreme Court in the case of CIT v. Calcutta Agency Ltd. and submitted that the onus is on the assessee to prove that the expenditure was incurred wholly and exclusively for the purpose of business. He also relied on the decision of the

Tribunal, Chennai Bench in the case of Tamilnadu Minerals v. Jt. CIT (2005) 95 ITD 294 (Chennai) in support of the above statement.

31. We have heard the rival submissions and perused the material on record. The AO issued summons to Shri P.B. Manjunatha Rao, Vice President (Sales and Operations) of the assessee-company and examined him on oath. On examination, Shri Manjunatha Rao stated as under: Q. 5 Is there any agreement with all these companies regarding services to be A.5 There is an agreement with Infoset E-Com Systems Ltd. With others there Q.6 Why is it that there is no formal agreement with 3 other concerns A.6 Their activity was lead generation and arranging meeting with the customers.

Q.7 Who were the customers introduced by the 3 entities, with whom you have not entered into an agreement A.9 From the side of Diebold HMA (P) Ltd., it was P.P. Manjunath Rao, Mr. Sachin Handoo, Harish Murthy and Rajeev Malhotra. Prom the bank side it was Mr. Chander Singh, D.P. Singh and finally the director Tejbeer Singh.

Q.10 When you have negotiated the deal with the banks directly, why was it that huge commission was paid to the 4 concerns referred to above A.10 They have done liaisoning work for the company. Q.11 Who were the persons representing A.11 As far as (a) General Glass Company (b) Kalpita Agencies and Silverline Appliances are concerned, right now I am not able to furnish details regarding the person/persons with whom the deal was negotiated.

Q.13 How did they meet you Where did they meet you And what was the basis for payment of commission A.13 I have not met them personally. As far as the basis of commission is concerned it is based on order quantity and a certain percentage of value.

Q.14 If the order is from one company, why should 4 entities be paid the commission Q.15 If one of the companies was capable of getting the order, why is it that others were approached for the same order A.15 The way they handled the deal, we were not comfortable and hence had to approach others who expressed their interest to represent us.

32. On going through the above questionnaire, even the person incharge of sales was not aware of the marketing activities done by the sales agents. He was not aware of the details of orders procured by these sales agents. Even the Vice President of the Bank of Punjab Ltd., was not aware of the sales agents. The assessee has been dealing with the Bank of Punjab Ltd., since 1995 and the business was continuous one. In our opinion, the assessee has failed to establish that there was necessity to identify once again the Bank of Punjab Ltd., as its customer. There is nothing on record to show that the assessee has derived business advantage by paying sales commission. The expenditure wholly and exclusively incurred for the purpose of business was allowable as business expenditure. The mere exchange of agreement between the assessee and its sales agents for payment of commission does not entitle the assessee to claim such an expenditure and does not prove that the payment was wholly and exclusively made for the purpose of assessee's business. Though there was existence of agreement and payment was made through banking channels, still it is open to the AO to consider the relevant factor and determine for himself whether the commission said to have been paid to the selling agents or any part thereof is properly deductible under Section 37 of the IT Act. The deposition recorded by the AO referred to above clearly proves beyond doubt that the selling agency is not known to the Bank of Punjab Ltd. If the selling agency actually identified the bank and negotiated business with them, at least the person in the high helm of affairs in the bank would have known. This is not the case here. The argument of the learned Counsel for the assessee has no merit. We are unable to accept the contention of the assessee. The AO has considered all relevant evidence and gave ample opportunity to the assessee to prove its claim but the assessee has failed to prove its case. Nature of service rendered by the agents are not at all available. We are, therefore, inclined not to accept the agreement exchanged between the assessee and the so-called selling agents as genuine. In our opinion, this arrangement was only a make believe arrangement as a devise to minimize the tax liability of the assessee firm for the primary reason that the assessee has been doing business with the Bank of Punjab Ltd., since the year 1995. We cannot accept this to be a business decision to boost the sales. When we see this arrangement in the light of the surrounding circumstances, we are driven to the

conclusion that the apparent is not real.

33. After going through the entire facts and circumstances of the case and evidence gathered by the AO, we are unable to disagree with the conclusion reached by the lower authorities. Avoidance of tax liability by so arranging commercial affairs that charge of tax is reduced is not prohibited. Taxpayer may resort to divert the income before it accrues or arises to him. Effectiveness of devise depends not upon considerations of morality but on the operation of the IT Act. But in this case, the assessee has adopted devices to make it appear that the income which belongs to the assessee had been earned by some other person by make-believe arrangements. In these circumstances, the income that may be proposed to be diverted should be brought to tax in the hands of the assessee only. In our opinion, the assessee has not expended any money towards sales commission as there was no evidence to show that the services were actually rendered by so-called sales agents. In view of the above findings, we reject this ground.

34. In the result, the appeal filed by the assessee is allowed in part for statistical purpose.

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