

Tcv Engineering Ltd. Vs. Assistant Commissioner of Income Tax

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Court : Chennai

Decided On : Mar-14-2006

Reported in : (2006)205CTR(Mad)161; [2006]284ITR470(Mad)

Judge : R. Balasubramanian and ;P.P.S. Janarthana Raja, JJ.

Acts : Income Tax Act - Sections 40A(2), 132, 132A, 143(3), 158B, 158BD and 260A; Companies Act; DTL (Amendment) Act, 1987; [Finance Act, 2002](#)

Appeal No. : Tax Case (Appeal) No. 38 of 2003

Appellant : Tcv Engineering Ltd.

Respondent : Assistant Commissioner of Income Tax

Advocate for Def. : T. Ravikumar, Junior Standing Counsel

Advocate for Pet/Ap. : V. Ramachandran, Sr. Counsel for ;Anita Sumanth, Adv.

Judgement :

P.P.S. Janarthana Raja, J.

1. The present Appeals are filed by the assessee under Section 260A of the Income-tax Act (hereinafter referred to as 'the Act'), against the order passed by the Income-tax Appellate Tribunal, Madras 'A' Bench, dated 28.11.2002 in I.T.(SS) A No. 110/Mds/98. These appeals came up before this Court and this Court

admitted the appeals on 17.06.2003 and formulated the following Substantial Question of Law:-

(1) Whether the Tribunal is right in law in holding that the assessment pursuant to the notice under Section 158BD issued in the instant case based on the action under section 132A in the case of T.T.V.Dinakaran is valid in law notwithstanding that no part of the assessment made was based on any records seized in the course of the action under Section 132A?

(2) Whether the Tribunal is right in law in confirming the disallowance of supervisory charges, which were duly recorded in the accounts regularly maintained by the appellant and which were not seized or requisitioned either under Section 132 or Section 132A?

(3) Whether the Tribunal is right in law in directing a fresh assessment based on the records alleged to have been seized in the course of an action under Section 132A in the case of a third party assessee viz., Sengamala Thayar Educational Trust notwithstanding that no notice under Section 158BD was issued in respect of the said records?

2. In respect of Question Nos. 1 and 3, the Senior Counsel for the assessee stated that he is not pressing the same.

3. Now, we take up Question No. 2. The facts leading to Question No. 2 are as follows:-

The appellant is a company registered under the Companies Act. The assessee's main business is Civil Engineering Contracts which includes raising and levelling the earth with Earth Moving Equipments, raising the tank bunds etc. The Income Tax Department initiated proceeding under Section 132A of the Act on Mr. T.T.V.Dinakaran, Director of the assessee company. There were certain materials which related to the assessee. Consequently, the assessee was served with a notice under Section 158BD of the Act and based on such notice, proceedings were initiated on the assessee. The assessee filed a return of income on 25.03.1997 admitting undisclosed income of Rs. 1,41,04,160/-. For the purpose of

his business, the assessee had been using bulldozers, road rollers, jeep with a trailer and so on. The assessee claimed higher depreciation rate of 40% on the basis that these were earth moving machinery which included even the jeep with trailer. For the assessment years 1994-95 and 1995-96, supervisory charges payable to M/s.T.C.V. Packers were claimed at Rs. 24.68 lakhs and Rs. 33.67 lakhs respectively, while the amount that was actually found paid in the financial year relevant to assessment year 1994-95 was only Rs. 6 lakhs. The claim of the assessee was that the assessee was due to pay 10% of gross income on contracts executed to the said party. The Assessing Officer noted that for assessment year 1996-97, there was no such claim. The Assessing Officer further noted that M/s.T.C.V.Packers was a proprietary concern of Mr. T.T.V.Dinakaran upto 31.03.1994. It was stated to be owned by Mrs.D.Anuradha, wife of Mr. T.T.V.Dinakaran, thereafter. Mr. T.T.V.Dinakaran is a Director of the Assessee Company and his wife is also a Director. The said M/s.T.C.V.Packers apparently did not have any technical or non-technical staff so as to show that it had the capability to carry on the supervisory work. The equipments of M/s.T.C.V. Packers which were employed in the contract work was paid hire charges on which the Department had no dispute. In M/s.T.C.V. Packers, other than Mr. T.T.V.Dinakaran, there was no person having any knowledge or experience. The assessee was therefore called upon to justify the payment of supervisory charges. The claim of the assessee was that M/s.T.C.V. Packers provided coordination, monitoring constantly in the execution of the contracts, making it cost effective, monitoring careful deployment of labour and machines and movement of machines from site to site including vehicles and even looking after administrative work like raising of bills etc. and finally supervising the work of the Site Engineers and the staff. But for the supervisory work carried out by M/s.T.C.V. Packers, the turnover of Rs. 2.46 Crores and Rs. 3.36 Crores for the financial years 1994 and 1995 would not have been made possible. The Assessing Officer noted that the assessee was having administrative expenses which covered Director's remuneration also. Because of the fact that M/s.T.C.V.Packers had no administrative facility other than Mr. T.T.V.Dinakaran and the work in fact having been done by the staff of the assessee, may be under the supervision of M/s.T.C.V. Packers, the necessity of payment of supervisory charges to Mr.

T.T.V.Dinakaran, i.e., to his concern of M/s.T.C.V. Packers was only a cover up because the same work could have been carried out in the capacity as Director of the company. Therefore, the Assessing Officer was of the opinion that supervisory charges were not allowable and hence he disallowed the same under Section 40A(2) of the Income Tax Act and treated as undisclosed income and completed the Block Assessment on 27.03.1998 under Section 143(3) read with 158BD of the Income Tax Act. Aggrieved by the order of the Assessing Officer, the assessee filed an appeal to the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal dismissed the appeal and confirmed the order of the Assessing Officer.

4. The learned Senior Counsel for the assessee submitted that the said amount was duly recorded in the accounts regularly maintained by the appellant and any amount disallowed under Section 40A(2) of the Act, cannot be treated as undisclosed income under Chapter XIV-B of the Act. The learned Standing Counsel appearing for the Revenue submitted that the supervisory charges paid to M/s. T.C.V. Packers was highly excessive considering their experience, qualification, probable market value of the services and hence the provision of Section 40A(2) is clearly attracted for such payments made and hence such disallowance comes within the amended definition of undisclosed income as contemplated under Section 158B(b) of the Act.

5. We heard the counsel on both sides. Section 40A(2)(a) and (b) reads as follows:

(2) (a) 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 Assessing Officer is of 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.

Proviso omitted by DTL (Amend.) Act, 1987, with effect from 1-4-1989.

(b) The persons referred to in Clause(a) are the following, namely:-

i) Where the assessee any relative of is an individual the assessee.

ii) Where the assessee any director of is a company, firm, the company/association of per- partner of the sons or Hindu firm, or member undivided family of the association or family, or any relative of such director partner or member.

(iii) any individual who has a substantial interest in the business or profession of the assessee, or any relative of such individual;

iv) a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member;

(v) a company, firm, association of persons or Hindu undivided family of which a director, partner or member, as the case may be, has a substantial interest in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member;

(vi) any person who carries on a business or profession,-

(A) where the assessee being an individual, or any relative of such assessee, has a substantial interest in the business or profession of that person, or

(B) where the assessee being a company, firm, association of persons or Hindu undivided family, or any director of such company, partner of such firm or member of the association or family, or any relative of such director, partner or member, has a substantial interest in the business or profession of that person.

The important words found in the above section, namely, 'fair market value of the goods, services or facilities', are those which have a market value and which are commercial in character. In the later part of the section also, it is mentioned about the unreasonableness or excessiveness of a part payment. It is essential that one

should keep in mind the relevant consideration. Under the said section, any expenditure incurred in profession or business for which payment has been made to the tax payers, relatives or associate concerns, is liable to be disallowed in computing the profits of the business, profession to the extent that the expenditure is considered to be excessive or unreasonable. The reasonableness in any expenditure is to be judged having regard to the fair market value of the goods, services or facilities for which payment is made or the legitimate needs of the business or profession or the benefits derived by the assessee from the said expenditure. Only the expenditure which is excessive and unreasonable according to the opinion of the Income Tax Officer, is to be disallowed in computing the income of the business. As in this case, the Assessing Officer only invoked the provision of Section 40A(2) and disallowed the expenditure. The said disallowance of the expenditure could not be considered as undisclosed income of the assessee. The word 'undisclosed income' is defined in Section 158B(b) of the Income Tax Act, which reads as under:

includes any money, bullion, jewellery or other valuable article or thing or any income based on any entry in the books of account or other documents or transactions, where such money, bullion, jewellery, valuable article, thing, entry in the books of account or other document or transaction represents wholly or partly income or property which has not been or would not have been disclosed for the purposes of this Act, or any expense, deduction or allowance claimed under this Act which is found to be false.

6. The Finance Act of 2002 has inserted the words 'or any expense, deduction or allowance claimed under this Act which is found to be false' at the end of the Clause (b), with retrospective effect from July 1, 1995. The object of the amendment is to specifically provide that any expense, deduction or allowance claimed under this Act which is found to be false, shall be included in the undisclosed income as defined in this clause. The last line of the said definition 'or any expense, deduction or allowance claimed under this Act which is found to be false' makes it clear that unless and until the said deduction claimed by the assessee is found to be false by the Revenue, there is no scope for the Revenue to treat the disallowance made under Section 40A(2) as undisclosed income. As in

this case, the Assessing Officer had not given a finding that this expenditure claimed by the assessee was false. The Assessing Officer only disallowed the expenditure under Section 40A(2) on the ground that this expenditure is unreasonable. The disallowance made under Section 40A(2) of the Act, would not be considered for purpose of making block assessment under Chapter XIV-B of the Act, unless and until the Revenue gives a categorical finding that the whole expenditure of deduction is totally false. In the present case, the actual finding given by the Tribunal in respect of supervisory charges, is as under:

However by claiming certain expenditure as has been done in the instant case of supervisory charges, which is not legitimate business expenditure, the income which would have otherwise been shown was reduced and consequently it leads to undisclosed income. This is limited only to supervisory charges. The other disallowances including depreciation, building repairs, cash payment would not be valid in making block assessment.

7. From the above finding, it is clear that the authorities were of the view that the expenditure claimed in respect of supervisory charges, is not a legitimate expenditure. Hence, in the absence of a finding that the said expenditure is bogus or false, the Revenue cannot treat the same as undisclosed income. The order of the block assessment was passed before the amendment, but when the Tribunal passed the order, the definition of undisclosed income was amended by the Finance Act of 2002 with effect from 01.07.1995. Unfortunately, the Tribunal did not give any factual finding whether the claim of supervisory charges is a bogus one or not. Even taking into account the amended provision, mere disallowance made under Section 40A(2) could not be treated as undisclosed income. The scope of Section 40A(2) is to disallow only unreasonable or excessive payments in computing the income of the assessee.

8. In view of the foregoing reasons, we answer the second question in favour of the assessee and against the Revenue. No costs.