**IN THE INCOME TAX APPELLATE TRIBUNAL**
**"K" Bench, Mumbai**

**Before Shri B. Ramakotaiah, Accountant Member**
**& Shri Vijay Pal Rao, Judicial Member**

**ITA No.8868/Mum/2010**
(Assessment year: 2007-08)

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| Gujarat Reclaim & Rubber Products Ltd.,<br>Kohinoor City Commercial-1,<br>510, 5th Floor, Wing, Kirol Road<br>Kamani, Off LBS Marg,<br>Kurla(W), Mumbai 400070<br>PAN: AAACG 1890 M | Vs. | Additional CIT, 10(2)<br>Aayakar Bhavan, MK Road,<br>Mumbai 400020 |
| **(Appellant)** | | **(Respondent)** |

**ITA No.8789/Mum/2011**
(Assessment year: 2008-09)

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| Gujarat Reclaim & Rubber Products Ltd.,<br>Kohinoor City Commercial-1,<br>510, 5th Floor, Wing, Kirol Road<br>Kamani, Off LBS Marg,<br>Kurla(W), Mumbai 400070<br>PAN: AAACG 1890 M | Vs. | Dy. CIT, 10(2)<br>Aayakar Bhavan, MK Road,<br>Mumbai 400020 |
| **(Appellant)** | | **(Respondent)** |

**ITA No.169/Mum/2012**
(Assessment year: 2008-09)

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| Dy. CIT, 10(2)<br>Aayakar Bhavan, MK Road,<br>Mumbai 400020 | Vs. | Gujarat Reclaim & Rubber Products Ltd.,<br>Kohinoor City Commercial-1,<br>510, 5th Floor, Wing, Kirol Road Kamani, Off LBS Marg,<br>Kurla(W), Mumbai 400070<br>PAN: AAACG 1890 M |
| **(Appellant)** | | **(Respondent)** |

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| Assessee by: | Shri B.V.Jhhaveri & Ms.Manju Sisodia |
| Department by: | Shri Deepak K. Sinha, DR |
| Date of Hearing: | 20/03/2013 |
| Date of Pronouncement: | 19/04/2013 |

**O R D E R**

**Per Bench.**

These are appeals by assessee and Revenue in AY 2007-08 and 2008-09. The appeal in 2007-08 is by assessee against the orders of the CIT (A-22 Mumbai dated 25.10.2010, whereas the cross appeals for the AY 2008-09 are against the order of the CIT (A)-21 Mumbai dated 10.10.2011. Since the issues are common in all the appeals, these are considered together. Grounds raised by assessee in AY 2007-08 are as under:

**ITA No.8868/Mum/2010 – AY 2007-08:**

1) *"On the facts and circumstances of the case and in law, the Commissioner of Income Tax (A) erred in directing the Assessing Officer to carry out the rectification u/s.154 of the Act instead of deciding on merit in respect of additions of Rs.14,24,448/- being Excise Duty on Opening Stock on the mistaken presumption that the said amount is claimed twice in the return, though the full facts in respect of the same were available before the CIT(A). The CIT(A) ought to have decided the matter on the merit.*

2) *Without prejudice to above, AO has wrongly made addition of Rs.14,24,448/- being excise duty on opening stock on the presumption that the same has been claimed twice.*

3) *On the facts and circumstances of the case and in law, the Commissioner of Income Tax (A) erred in confirming addition on account of Commission payments of Rs.17,29,389/- under section 40(a)(i) without considering the fact that the said payments are not covered u/s. 40(a)(i) of the Act and 1 or no tax was required to be deducted.*

4) *On the facts and circumstances of the case and in law, the Commissioner of Income Tax (A) erred in confirming addition on account of Ocean Freight expenses of RS.58,82,475/- under section 40(a)(i) without considering the fact that the said payments are not covered u/s. 40(a)(i) of the Act and 1 or no tax*

*was required to be deducted.*

5) *Without prejudice to above and on the facts and circumstances of the case and in law, the CIT(A) erred in relying on circular nO.7 of 2009, which has come in to effect only prospectively and hence question of disallowance u/s.40(a)(i) does not arise.*

6) *On the facts and circumstances of the case and in law, the Commissioner of Income Tax(A) erred in confirming addition of Legal & Professional Expenses of Rs.6,00,0001- though these expenses were of revenue nature and not of capital nature.*

7) *On the facts and circumstances of the case and in law, the CIT(A) erred in directing the Assessing Officer to carry out the rectification u/s.1S4 of the Act instead of deciding on merit in respect of Repair & Maintenance (Computer Software Expenses) of Rs.9,85,864/- though these expenses were not claimed in Profit and Loss Account and were in fact been capitalised and therefore there was no question of disallowing the said expenses. In fact, though the CIT(A) decided on the merit, it was wrongly directed to carry rectification u/s.154 of the Act instead of allowing the same.*

8) *On the facts and circumstances of the case and in law, the CIT(A) erred in directing the Assessing Officer to carry out the rectification u/s.154 of the Act instead of deciding on merit in respect of Repair & Maintenance (Office Renovation Expenses) of Rs.3,60,845/- though these expenses were not claimed in Profit & Loss Account and were in fact been capitalised and therefore there was no question of disallowing the said expenses. In fact, though the CIT(A) decided on the merit, it was wrongly directed to carry rectification u/s.154 of the Act instead of allowing the same.*

9) *On the facts and circumstances of the case and in law, the Commissioner of Income Tax(A) erred in confirming addition on account of interest expenses of Rs.3,18,6001-, without considering that:*

a) *No borrowed funds were utilised for Investments/ Advances.*
b) *Most of the amounts were given for strategic investment and not by way of loan.*

c) *The Investments were made on various dates and not on the first day of the year for working out interest".*

2. In the course of the appellate proceedings the Ground Nos.1, 2, 7 & 8 were not pressed as AO rectified the order under section 154.

3. The issue in Ground Nos. 3 & 5 is on the disallowance of an amount of ₹.17,29,389 under section 40(a)(ia) of the Act of commission paid to non resident agents. This ground is similar to Ground Nos. 1 & 2 raised by the Revenue in AY 2008-09 in ITA No.169/Mum/2012 as the CIT (A) therein has held against the Revenue on similar facts. Therefore, all the grounds are considered together for the sake of convenience.

4. Briefly stated, assessee paid an amount of ₹.17,29,389 as commission payment to non-resident agents for the services provided in foreign country. As they do not have any business connection in India, assessee has not deducted any tax when the amounts were remitted. On the reason that assessee should have remitted the amount after deducting the tax, AO invoked provisions of section 40(a)(ia) and disallowed the amount. The learned CIT (A) in AY 2007-08 rejected assessee's contentions and confirmed the disallowance. Therefore, assessee is in appeal.

4.1 In AY 2008-09 assessee paid an amount of ₹.32,73,538 to non residents for services provided in foreign countries. For the same reasons, AO disallowed the above amount invoking the provisions of section 40(a)(i). The learned CIT (A) after elaborate discussion deleted the said addition. Therefore, the Revenue is aggrieved in that year.

4.2 Before us the learned Counsel submitted that during the AY 2007-08 assessee paid commission to five non resident agents for rendering services in respect of procuring export orders from various countries. Copies of commission agreements, copies of credit notes and payment advices are at pages 20 to 63 of the Paper Book. It was stated that the non residents agents were operating in their own respective countries and they procured the orders for assessee from the parties outside India and the commission was paid to them outside India directly in foreign currency. In India, neither these agents have any business connection nor do they have any place of business. Therefore, commission income earned by the non resident agents outside India has not deemed to accrue or arise in India and hence the said commission income of the non resident agents are not taxable in India.

4.3 It was further submitted that the assessee company appointed aforesaid agents for marketing and distribution of various grades of reclaim rubber in the respective countries for a commission of 5% of the FOB value of the shipment of the products to the clients. The terms & conditions of sales of the products by the principal including price, delivery schedule, packing, payment terms, product grades and specifications is to be mutually decided between the Principal, Agents and the Customers which is confirmed by a purchase order from the agent or from the customer. In other words, assessee reserves the right of execution of order and/or cancel the order procured by the agent. The agent is not authorized to market the products of third party which are competing with those of the assessee company.

4.4 Assessee relied on the Board Circular No.23 and 786 which was subsequently withdrawn by the Circular No.7 issued on 22.10.2009. The learned Counsel relied on the decision of the Hon'ble Bombay High Court in the case of BASF (India) Ltd. v. W. Hasan, CIT, 280 ITR 136 that the circular which are in force during the relevant AYs are to be applied. It was further relied on the Hon'ble Bombay High Court decision in the case of Unit Trust of

India v. Income Tax Officer, 249 ITR 612 to submit that the subsequent withdrawal of the circular will have no effect on the circular issued and applicable in the relevant AY. On merits the learned Counsel relied on the decision of the Coordinate Bench in the case of Armayesh Global v. ACIT, 50 SOT 564 (Mum.) to submit that the commission amounts paid does not arise or accrue in India as the services are rendered outside India. Therefore, provisions of section 195 does not apply and consequently cannot be disallowed under section 40(a)(ia). He also relied on the judgment of the Hon'ble Delhi High Court in the case of CIT vs. EON Technologies, 203 Taxman 266 to submit that the payment of commission paid by the Indian Exporters to non resident agents cannot be disallowed under section 40(a)(ia).

4.5 The learned DR however, relied on the orders of the CIT (A) in AY 2007-08 to submit that having withdrawn the Board Circular and is applicable for the proceedings pending, AO has rightly disallowed the amount and so the amount has to be disallowed under section 40(a)(ia) and the order of the CIT (A) in AY 2008-09 is not correct. Therefore, that has to be reversed and the order of the CIT (A) in AY 2007-08 should be confirmed.

4.6 We have considered the issue. There is no dispute with reference to the fact that assessee paid commission at 5% on FOB value of the shipment of the product to the foreign agents and is also not in dispute that the agent is not authorized to market the products to any third party and it does not have any business connection in India. Their services are also not utilized in India. Therefore, respectfully following the decision of the Hon'ble Delhi High Court in the case of CIT v. EON Technology (supra) and also the Coordinate bench decision in the case of Armayesh Global v. ACIT (supra), the income of the non resident cannot be considered as accrued or arisen or deemed to accrue or arise in India as the services of the said agents were rendered/utilized outside India and the commission was also payable/paid outside India. Further, in the absence of permanent establishment in India, the income of the said agents cannot be subjected to tax in India and hence assessee was not liable to deduct tax on payments made to the said agents. Therefore, provisions of section 40(a)(ia) have no application on the given facts. This issue was very elaborately discussed by the CIT (A) in AY 2008-09 which we consider as worth extracting for completeness of the order. The order of the CIT (A) in Para 4.3 in AY 2008-09 is as under:

> *"4.3 I have considered the facts of the case. The appellant made payment of commission to three non-resident commissions agents aggregating to Rs.32,73,538/- for procuring the orders for export of reclaimed rubber manufactured by the appellant. It was admitted fact that firstly the non- resident commission agents procured orders outside India, secondly rendered services outside India and thirdly the payment to such non- resident commission agents were made by appellant in foreign currency and outside India. It was also an admitted fact that the said non-resident commission agents had no permanent establishment in India. The A.O. disallowed such payment of commission holding that firstly no documentary evidence was furnished to substantiate as to how the above payments were not liable for TDS except the mere statement that services were not rendered in India, secondly there were various provisions under the Act in which even services were performed outside India but if services were utilized in India the payments were liable to Indian Taxation Laws and thirdly the sec.195 mandates that if any sum which is chargeable to tax in India, tax at source needs to be deducted. The A.O. also held that if the appellant was believing that such payment was not liable for TDS, the appellant should have approached the IT Authorities for a certificate for Nil deduction of tax. I have considered the A.O's observation for making the disallowance of commission payment ujs.40(a)(i) of the Act. I am not in agreement with the A.O's observation. It is not understood as to what more evidence should*

*have been submitted by appellant to substantiate that the payments were not liable for TDS except claiming that the services were not rendered in India. The A.O. also incorrectly observed that the TDS provisions were applicable if services are rendered outside India but if services are utilized in India. In the case under consideration though the services were rendered outside India but the services were not utilized in India and, therefore, the A.O's observation was not relevant. The A.O's observation was also irrelevant that the appellant should have approached the IT authorities for obtaining the certificate of Nil deduction of tax. When the appellant was claiming that such payment of commission to non-resident agents was not liable for TDS therefore, there was no need for approaching the IT authorities for obtaining such certificate. In the assessment order the A.O. also considered CBDT's Circular No.23 of 1969 and 786 of 2000 and withdrawal of such Circulars by CBDT vide Circular No.7 of 2009. The A.O. held that payment of commission by appellant to the non-resident commission agents was attracting the provisions of sec.195 of the Act and hence the appellant should have deducted TDS thereon.*

*I have considered the facts of the case. The question under consideration is as to whether the payment of commission to the non- resident commission agents was covered by the provisions of sec.195 of the Act. As per provisions of sec.195, any person responsible for paying to a non-resident any interest or any other sum chargeable under the provisions of this Act deducted income-tax thereon at the rates enforced. The payment made by appellant was admittedly not on account of any interest payment. Consequently it has to be examined whether the commission paid by appellant is covered by the term "any other sum chargeable under the provision of this Act" as provided in sec.195 of the Act. It is worth to mention here that for the purpose of applicability of sec.195 any other sum must be chargeable under the provisions of the I. T. Act. Sec. 5 of the I.T. Act deals with the "scope of total income". As per sub-sec.(2) of sec.5, the total income of a person who is not resident includes all income from whatever sources derived which is received or deemed to be received in India in such year by or on behalf of such person or accrue or arise or is deemed to accrue or arise to him in*

*India during such year. Sec.7 explains the income deemed to be received. Sec.9 further explained/ defined the income deemed to accrue or arise in India. As per sub-sec.(I) of sec.9, the income shall be deemed to accrue or arise in India in case of all income accruing or arising whether directly or indirectly, through or from any business connection in India, or through any property in India, or from any asset or sources of income in India, or through the transfer of capital asset situated in India. In the case of payment of commission by appellant to its non-resident commission agents, such commission income to such non-resident commission agents was not received in India or was not accruing or arising in India whether directly or indirectly. Such income was also not accruing or arising to non-resident through or from any business connection in India since these commission agents were rendering services outside India and the payments were also made outside India. In the facts and circumstances it could not be said that these commission agents were having any business connection in India particularly when these non-resident commission agents were having no permanent establishment in India. Income (in the form of commission paid by appellant) was also not arise or accrued to those non-resident through or from any asset or sources of income in India or through transfer of capital asset situated in India. In the facts and circumstances, I am of considered view that provisions of sub-sec.(I)(i) of sec.9 were not applicable in the case of payment of commission to those non-resident commission agents. The ITAT, Mumbai in the case of DeIT vs. Ardeshi B. Cursetjee & Sons Ltd. 115 ITJ 916 has held that commission paid to non-resident agents outside India for services rendered outside India were not chargeable to tax in India. In the facts and circumstances, in my considered opinion, commission paid by appellant to the non resident commission agent was not chargeable under the provisions of 1. T. Act. Such payment of commission was not chargeable to tax as the conditions specified in sub-clause (i) of sec.9(1) were not attracted. Sub Clause (iii) , (iv) , (v), (vi) & (vii) of sec.9(1) were also not applicable in the case under consideration. The Explanation to sec.9(2) inserted by Finance Act, 2010 with retrospective effect (01.06.1996) was also not applicable since the said explanation was not applicable to sub clause (i) of sec.9(1) of the Act.*

*The next question for consideration is the effect of withdrawal of Circular No.23 of 1969 and 786 of 2000 by the CBDT vide Circular No.7 of 2009.*

*I have considered the facts of the case. In the Circular No.23 of 1969 dtd.23.09.1969 some illustration instances of non-resident having business connection in India had been given as under:*

- *Maintaining a branch office in India for the purchase or sale of goods or transacting other business.*
- *Appointing an agent in India for the systematic and regular purchase of raw materials or other commodities, or for sale of the non-resident's goods, or for other business purposes*
- *Erecting factory in India where the raw produce purchased locally is worked out into a form suitable for export abroad.*
- *Forming a local subsidiary company to sell the products of the non- resident parent company.*
- *Having financial association between a resident and a non-resident company.*

*In the said circular CBDT have given clarification regarding the applicability of provisions of sec.9 in the certain specific situations as under:*

*(1) Non-resident exporter selling goods from abroad to Indian importer*

*(2) Non-resident company selling goods from abroad to its Indian subsidiary*

*(3) Sale of plant & machinery to an Indian importer on installment basis.*

*(4) Foreign agents of Indian exporters - a foreign agent of Indian exporter operates in his own country and no part of his income arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. Such an agent is not liable to income-tax in India on the commission.*

*(5) Non-resident persons purchasing goods in India.*

*(6) Sale by a non-resident to Indian customer either directly or through agents.*

*(7) Extent of the profit assessable u/ s.9.*

*In the above Circular relevant para is No.4 dealing with the subject of foreign agents of Indian exporters.*

*The CBDT vide Circular No.7 of 2009 dtd.22.10.2009 has withdrawn the Circular No.23/ 1969 with retrospective effect. In the Circular No.23 of 1969, CBDT clarified that the payment made to non-resident commission agents was not liable to income-tax in India. Such clarification of CBDT was based on the provisions of section 5, 7, 9, 195 and other relevant provisions of the Act. The question for consideration is when there is no relevant change in sections 5, 7, 9, 195 then as to how the withdrawal of Circular No.23 of 1969 of CBDT will make the commission paid to such non-resident commission agents taxable in India. I am of considered view that even after the withdrawal of Circular No.23 of 1969, the position will remain the same i.e. the commission paid to non-resident agents is not liable to tax under the provisions of LT. Act when the services were rendered outside India, services were used outside India, payments were made outside India and there was no permanent establishment or business' connection in India. It cannot be accepted that by virtue of CBDT Circular No.23/ 1969, the commission paid to non-resident agents become not liable to income-tax in India and on such withdrawal of Circular by the CBDT, such commission paid to non-resident agents become liable to income-tax in India. Irrespective of Circular issued by CBDT, the question of taxability of such commission to income-tax has to be decided as per the provisions of section 9(1) of the Act. I am of considered view that the provisions of sec.9(1) are not applicable to the commission paid to such non-resident agents. Such income (commission) in the hands of non-resident commission agents did not accrue or arise directly or indirectly, through or from any business connection in India. Such income to the non-resident commission agents did not accrue or arise in India through or from any property in India or through the transfer of capital asset situated in India. In the facts and circumstances the provisions of sec.9(1) were not applicable to such payment of commission by appellant to non-resident agents.*

*The year under consideration is A.Y.2008-09 covering* *the previous year period 01.4.2007 to 31.03.2008. The CBDT issued Circular No.7 of 2009 in the year 2009. In the above mentioned case, the Bench of ITAT have held that withdrawal of such Circular is not having retrospective effect and will be applicable prospectively. In the facts and circumstances, even if it is assumed that the withdrawal of Circular No.23 of 1969 by the CBDT's Circular No.7 of 2009 is having any effect on taxability of commission paid to non-resident agents, such withdrawal of Circular will not be applicable in the year under consideration. In the facts and circumstances the Circular No.23 of 1969 will be clearly applicable in the year under consideration making such commission payment not liable to tax in India.*

*In view of the above discussion, it is held that the payment of commission aggregating to rs.32,73,538/- by appellant to the non-resident commission agents was not attracting the provisions of sec.195 and sec.40(a)(i) of the Act. While holding so, the undersigned has considered the appeal order of CIT(A)-22, Mumbai dtd.20.01.2010 for A.Y.2007-08 in the case of appellant company on the identical issue. The disallowance made by A.O. is therefore, deleted. This ground of appeal is allowed.*

4.7 In view of the elaborate discussion made by the CIT (A) in AY 2008-09 with which we fully concur as it is correct both on facts and on law, we uphold the same and dismiss the Revenue ground on this issue in AY 2008-09 and allow assessee's grounds in AY 2007-08. AO is directed to delete the addition so made.

5. In the result the grounds raised by assessee in AY 2007-08 are allowed.

6. Ground Nos. 4. The issue in this ground is with reference to disallowance of Ocean Freight Expenses paid by the assessee company to a non resident shipping company M/s Transmode Overseas Partners, Germany during the year AY 2007-08 aggregating to ₹.58,82,475, invoking section 40(a)(ia) of the Act. Similar disallowance was also made by AO in later year on payment

of ocean Freight Expenses of ₹.84,12,764 paid to M/s. MSE Agency India (P) Ltd which was a general agent of M/s. Mediterranean Shipping Co. SA Geneva on the reason that TDS was not made. Assessee submitted that shipping incomes are taxable under section 172 which itself is a self contained code and therefore, as per the Board Circular No.723, provisions of section 194(C) and 195 shall not apply as provisions of section 172 applies. Assessee also relied on the decision of the Coordinate Bench in the case of Income Tax Officer vs. Freight Systems India Pvt. Ltd, 6 SOT 473 for the same proposition and other decisions. The learned CIT (A) in AY 2007-08 confirmed the action of AO rejecting assessee's contentions, whereas the learned CIT (A) in AY 2008-09 following the CBDT Circular allowed assessee's contentions. It is to be noted that Revenue has accepted the decision of the CIT (A) in AY 2008-09 and has not preferred any appeal on the issue. The learned DR however, relied on the orders of AO and the CIT (A) in AY 2007-08.

7. After considering the rival contentions, we are of the opinion that AO without assigning any specific reasons disallowed Ocean Freight Expenses under section 40(a)(ia) as he has clubbed the same along with commission payments discussed in the above grounds. There is no dispute with reference to the fact that the Ocean freight was paid to foreign shipping companies. The Board Circular No.723 dated 19.09.1995 reads as under:

> *“"2. Section 172 deals with shipping business of non-resident. Section 172(1) provides the mode of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-residents, which carries passengers, live- stock, mail or goods shipped at a port in India. An analysis of the provision of section 172 would show that these provisions have to be applied to every journey a ship, belonging to or chartered by a non-resident, undertakes from any port in India. Section 172 is a self-contained code for the levy and recovery of the tax, ship-wise and journey-wise, and requires the filing of the return within a maximum time of thirty days from the date of*

*departure of the ship.*

*"3. The provisions of section 172 are to apply, notwithstanding anything contained in other provision of the Act. Therefore, in such cases, the provisions of section 194C and 195 relating- to tax deduction at source are not applicable. The recovery of tax is to be regulated, for a voyage undertaken from any port in India by a ship under the provisions of section 172.*

*"4. Section 194C deals with work contracts including carriage of goods and passengers by any mode of transport other than railways. This section applies to payments made by a person referred to in clauses (a) to U) of sub-section (1) to any "resident". (termed as contractor). It is clear from the section that the area of operation of TDS is confined to payments made to any "resident". On the other hand, section 172 operates in the area of computation of profits from shipping business of non-resident ship-owner or characterer, he steps into the shoes of the principal. Accordingly, provisions of section 172 shall apply and those of Sections 194 C and 195 will not apply."*

7.1 In view of the aforesaid Circular of the Board, the assessee company is not required to deduct tax at source from the ocean freight paid by it of ₹58,82,475/- to M/s. Transmode Overseas Partners, Germany, because the said company is liable to tax *u/s.* 172 of the Act.

7.2 In the Coordinate Bench decision of the Appellate Tribunal, Delhi Bench in the case of Income Tax Officer vs. Freight Systems India Pvt. Ltd, 6 SOT 473, the Tribunal held as under:

*"The provisions of section* 172 *constitute a code in itself with regard to the mode of levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident. By virtue of sub-section* (8) *of section* 172 *'the demurrage charge or handling charge or any other amount of similar nature' are treated at par with carriage paid or payable to such owner or charter. Thus, even as the amounts in the nature of demurrage etc. may not end up being paid to non-residents, these are treated as amounts falling within special provisions of section* 172. *This stands*

*clarified in CBDT Circular No. 723, dated* 19-9-1995 *wherein these amounts have been taken outside the purview of section 194C. This Circular has made it further clear that where payments are made to shipping agents of non resident ship owners or charter ship at a port in India provisions of section 172 will apply because the agent steps into the shoes of the principal. However, the problem arises only when restrictive interpretation is placed on the Board's circular referred to hereinabove when AO has sought to draw distinction on the basis of the status of the agents. We would like to mention that even if the agent is to be treated as resident, by virtue of his acting on behalf of non-resident shippers or charters, he receives payments primarily on behalf of his principal i.e., non-resident ship owners or ships charters shipped at a port in India. In our opinion, even if these amounts are inclusive of small element of the amounts that ultimately may be going into his own pocket or any of resident on account of demurrage or handling charge or any amount of similar nature, it will be covered by sub-section* (8) *of section* 172 *inasmuch as the circular does not draw any distinction between a dry port and a sea port. Thus, as per provisions of section 172(8) the inland haulage charges are also covered under this provision of law and, hence, no deduction of tax is called under section 194C of the Act. We are further of the opinion that such an interpretation is also fair because the dry ports or ICD's are treated at par with the regular ports. Hence, the contradictory stand taken by the Assessing Officer i.e., when he included certain charges in freight in respect of movement of goods by road at the destination contrary by the slipping line such charges are deemed to be covered under section* 172, *but when the same shipping line or their agents take charges for transportation from ICD, where goods have been handed over to them by an exporter, then these amounts are not deemed to be covered under section 172.*

*"For the reasons stated above, in our opinion, in the existing facts and circumstances of the case of the assessee, the assessee cannot be treated as an assessee in default, so, the CIT (Appeals) after properly considering the submissions of the assessee and properly analyzing the provisions of law, has rightly cancelled the impugned orders of the Assessing Officer by passing a well-reasoned and well-discussed consolidated*

*order. Accordingly, the impugned order of the CIT (Appeals) is upheld and the grounds of appeal taken by the revenue in the respective appeals under consideration before us are rejected. "*

7.3 Further, the following decisions also support the same view:

(i) Subhash Chand Gupta vs. Income Tax Officer (ITA No.898, 899 & 731/JP/2010, Jaipur dated 23.09.2011).

(ii) Hindustan M-1 Swaco Ltd, Bharuch vs. Income Tax Officer (ITA No.1004/Ahd/2010, dated 7th September, 2012).

7.4 It is to be noted that the learned CIT (A) followed the same Board Circular in AY 2008-09 to delete the disallowances so made by AO by stating as under:

*"5.3 I have considered the facts of the case. The CBDT in Circular No.723 dtd. 19.09.1996 has stated that section 172 is a self contained code for the levy and recovery of tax, ship-wise and journey wise and required the filing of return within the maximum time of 30 days from the date of departure of the ship. The CBDT further clarified that the provisions of section 194-C and 195 relating to tax deduction at source will not be applicable. In view of the CBDT Circular, the disallowance made by AO at ₹84,12,764 is deleted. This ground of appeal is allowed".*

7.5 The Revenue has accepted the above decision and has not even contested in AY 2008-09. In view of this, we cannot uphold the order of the CIT (A) confirming the action of AO. Since the Board circular is binding on the authorities and since the incomes are being taxed under section 172 of the Income Tax Act separately, we are of the opinion that there is no need for deducting any tax under the provisions of the TDS and therefore, disallowance under section 40(a)(ia) does not arise. Therefore, assessee's ground No.4 is allowed.

8. Ground No.6. This ground pertains to the disallowance of an amount of ₹.6.00 lakhs claimed as legal expenses. Assessee claimed the following amounts under the head legal and professional fee:

| Name of the party | Description | Amount |
|---|---|---|
| Ruchira Pillai | Fees for net security solution | 2,50,000 |
| Sangeeta Telang | Fees for ERP feasibility study report | 50,000 |
| Shalin Pandey | For acquiring land | 35,000 |
| SYSSOFT | Software Development | 3,00,000 |
| Total | | 6,35,000 |

8.1 AO disallowed the above amount by stating as under:

> *"6.2 Bills of above parties were perused and examined. It is noticed that assessee has got enduring benefit from above expenses. The sum of ₹.6,00,000 was spent for development of ERO software systems in the company. It results into creation of assets. Remainder amount of ₹.35,000 was spent for acquiring land. It is not related to revenue expenditure. Therefore, sum of ₹.6,35,000 is disallowed and added back to the total income of assessee. However, depreciation of ₹.3,60,000 is allowed @ 60% on ₹.6,00,000 being intangible assets came into existence by way of ERP system developed by assessee".*

8.2 The learned CIT (A) after considering the facts of the case deleted the disallowance of ₹.35,000 stating that the same pertains to revenue expenditure for rendering professional services and to that extent he has allowed, whereas the balance amount was sustained hence, assessee is aggrieved. It was submitted that the amount of ₹.2,50,000 was paid to Ms. Ruchira Patil for providing consultancy services in respect of Network Solution Services at Mumbai office for smooth working of Networking system and connectivity solution and services for the Mumbai office and the branch at Ankleshwar. The expenses were of recurring in nature and there was no acquisition of an asset or advantage for enduring benefits.

8.3 A fee of ₹.3,00,000 was paid to M/s Sys Soft towards attending the issues related to payroll system based on Foxpro software and modification for statutory and/or internal business. Before the SAP ERP System, the company was having FOXPRO program. M/s Sys Soft provided the consultancy in relation to FOXPRO and SAP related issues.

8.4 Similarly, an amount of ₹.50,000 was paid to M/s Sangeeta Telang, an ERP Consultant, for her consultancy services in respect of ERP facilities, which was already in existence and thus, there was no creation of any asset.

8.5 The learned Counsel referring to the paper book and particularly the orders placed on record at Page Nos.87, 295 referred to the nature of the services to submit that the expenditure is revenue in nature. He also relied on the decision in the case of DCIT vs. Mahindra Realty & Inf. Developers Ltd in ITA No.1160/Mum/2010 dated 28th January, 2011 and CIT v. Raychem RPG Ltd in ITXA No.4176 of 2009 dated 4th July, 2011 of the Hon'ble Bombay High Court.

8.6 We have considered the nature of the expenditure and the submissions of assessee. Even though the expenditure may be of enduring nature, the same cannot be considered as capital in nature always unless an asset was created. This issue was discussed elaborately by the Coordinate Bench in the case of DCIT vs. Mahindra Realty & Inf. Developers Ltd (wherein the AM is also a Member) in ITA No.1160/Mum/2010 dated 28.01.2011. In that case the expenditure was for development of Website and the discussion on the issue is as under:

*"6. Ground No. 2 is with reference to deleting the addition of ₹.8,02,139/-made on account of website development charges. The A.O. noticed that the assessee has debited an amount of `8,02,139/- under the head 'website development charges'. The A.O. asked why the same should not be treated as capital expenditure. It was submitted that the website offers the various details of the company's business and products it offers. Hence it is essentially an advertisement expenses and allowable as revenue in nature. The A.O. did not accept the contentions of the learned A.R. and treated the expenditure as capital in nature stating that the life span of the website is quite long and it is an asset in the cyber space. However, he allowed depreciation @ 25% on website development charges. Before the CIT(A) it was submitted that the website is a very cost effective tool of advertisement/marketing of the company's business. It is a medium of corporate communication and offers advantages over traditional mode of advertisement. Therefore it is essentially an advertisement expenditure allowable as revenue expenditure. After hearing the learned A.R. and considering the facts the CIT(A) deleted the addition by holding as under: -*

> *"9. I have carefully considered the above fact and do not find any merit in the observations and findings of the AO. Expenditure incurred on website development is although enduring in nature, the intent and purposes behind the development is not to create an asset but only to provide a means for disseminating the information about the assessee among its clients. In the case of CIT vs. Indian Visit.com P. Ltd. (2008) 219 CTR 603 (Del), on identical facts, such expenditure was held to be revenue expenditure akin to printing of pamphlets etc. It was stated that mere enduring benefit, de hors any accretion to fixed capital would not make an expenditure a capital one. In the light of such facts and the legal position emerging from the cited decision, such expenditure is held to be revenue in nature and the addition made is deleted. The AO is, however, directed to withdraw depreciation allowed to the appellant."*

> *7. We have considered the issue. In our view the CIT(A) has rightly considered the nature of expenditure as revenue in nature. Similar issue was considered by the Hon'ble Delhi High Court in the case of CIT vs. Indian Visit.com P. Ltd. (2008) 219 CTR 603 (Del), wherein it was held as under: -*
>
>> *"Just because a particular expenditure may result in an enduring benefit would not make such an expenditure of a capital nature. What is to be seen is what is the real intent and purpose of the expenditure and as to whether there is any accretion to the fixed capital of the assessee. In the case of expenditure on a website, there is no change in the fixed capital of the assessee. Although the website may provide an enduring benefit to an assessee, the intent and purpose behind development of a website is not to create an asset but only to provide a means for disseminating the information about the assessee. The same could very well have been achieved and, indeed, in the past, it was achieved by printing travel brochures and other published materials and pamphlets. The advance of technology and the wide spread use of the internet has provided a very powerful medium to companies to publicize their activities to a larger spectrum of people at a much lower cost. Websites enable companies to do what the printed brochures did but, in a much more efficient manner as well as in a much shorter period of time and covering a much large set of people worldwide. The Tribunal has correctly appreciated the facts as well as the law on the subject and has come to the conclusion that the expenditure on the website was of a revenue nature and not of a capital nature. No substantial question of law arises for consideration."*
>
> *Respectfully following the above decision we uphold the decision of the CIT(A). The expenditure is correctly allowed as revenue expenditure. Ground is rejected".*

8.7 In view of the above, since the same principles were also upheld by the Hon'ble Bombay High Court in the case of CIT vs.

Raychem RPG Ltd (supra), we modify the orders of AO and direct him to allow the expenditure as revenue in nature. Consequently depreciation, if any, allowed by AO can be withdrawn. With these directions, this ground is considered allowed.

9. Ground No.9 pertain to disallowance of interest expenses of.3,18,600. On perusal of details filed it is seen that assessee has paid interest and financial charges of Rs. 10,104,198/. It is also noticed that assessee has made investment amounting to Rs. 20,05,600/ and gave loan of Rs. 6,50,000/ to M/s Alpanso Netsecure Pvt. Ltd being associate company. Assessee was asked as to why the proportionate interest should not be disallowed. In response to such query, assessee has submitted note thereon as under:-

> « *The company has given* a *loan of Rs. 6,50,000/ to M/s Alphanso Netsecure Pvt. Ltd an associate concern in which company has an equity participation of Rs. 20,05,600/. The company has made investment in this company to increase its presence in the filed of software development. The different types of software are being developed by the said company. The some of the software may be useful for the company in manufacturing and security arrangement in different plants including networking.*
>
> *The investments being in the nature of strategic investments it is in the interest of the company to infuse the funds to get better results in the said company.*
>
> *It may be stated that the appellant company has sufficient interest free funds available to invest and/ or advances the money to the associate concern. The company has reserves and surplus of Rs.* 14,76, *24,043/ in the beginning of the year even the profit of the company was Rs. 15,91,72,009/.*
>
> *Considering the above facts, the loan and investments of Rs.26.55 Lacs* is *out of the said reserves and surplus and not out of borrowed funds.*
>
> *We would like to invite your attention to the judgment of S.A. Builders Ltd v. CIT (2007)* 288 *ITR* 1 *(SC) where it has been held that if the investment* is *for the commercial expediency , the same can not be disallowed even the same is made in the company under the same management.*

> *Similarly CIT v. Reliance Utilities & Power Ltd-* 313 *ITR 340 (Bom) (2009). it has been held that if the investments are more than interest free funds available with the assessee, no interest can be disallowed.*

9.1 AO however, did not agree. He disallowed the proportionate interest of ₹.3,18,600 at 12% of the interest. The learned CIT (A) confirmed the same by stating as under:

> *"7.3 I have gone through the assessment order perused the submissions made by the appellant and also discussed the case with the A/R of the appellant. AO disallowed ₹.3,18,600 out of interest and financial expenses stating that assessee had made investment in its sister concern M/s Alphanso Netsecure Pvt Ltd of ₹.20,05,600 and also gave loan of ₹.6,50,000 to it. AO noted that loans were used to invest in sister concern without any business consideration. The appellant before me stated that it has invested in the said company to increase its presence in the software development which was the business consideration and commercial expediency and hence interest is allowable as per the decision of the Hon'ble Supreme Court in case of SA Builders (Supra). However, I do not agree with the contention of the appellant since during the year, assessee had paid huge software charges to other concerns. Hence no business expediency is served by advancing loan to the sister concern. The appellant also claimed that it was having sufficient interest free fund to invest or advance to the associate concern. However, on perusal of balance sheet it is noticed that share capital and reserve and surplus in total amounted ₹.31.21 crores as against which the invest in fixed assets is ₹.37.21 crores. Thus, there were no interest free funds available with the appellant to make interest free advance/investment. Apparently these advances are out of the interest bearing funds only. Further, the provision of section 14A are also applicable since the appellant has made investment in shares. In view of these facts, I am of the considered opinion that AO has rightly made the disallowance of interest which is upheld".*

9.2 It was submitted that during the year ending 31.3.2007, the assessee company had given interest free advance of ₹.6,50,000 to M/s Alphanso Netsecure Pvt Ltd, a concern wherein assessee has an equity participation of ₹.20,05,600. A copy of the ledger account of M/s Alphanso Netsecure Pvt Ltd in the books of assessee (Page 97) shows that the loan of ₹.4,50,000 was given on 20th & 28th February, 2007 and further loan of ₹.2,00,000 was given on 27th March, 2007 i.e. at the fag end of the year. AO computed disallowance of interest @ 12% p.a. i.e. ₹.78,000 without taking into account that the loan was given at the fag end of the year. AO also computed disallowance of interest of ₹.2,40,600 in respect of investment in equity shares of M/s Alphanso Netsecure Pvt Ltd of ₹.20,05,600.

9.3 It is the case of the assessee company that it has interest free funds in the form of capital and reserves and surplus aggregating to ₹.16,09,57,373 at the beginning of the year. In the year under consideration the assessee company had earned profit after tax but before depreciation allowance of ₹.12,56,30,119. Thus, the assessee company had interest free fund many fold in comparison to interest free advance of ₹.6,50,000 given at the fag end of the year and investment in shares of the group company of ₹.20,05,600. It is therefore, submitted that the aforesaid interest free loan and investment in shares are out of its own funds and not out of the borrowed funds. Hence no portion of the interest paid on borrowing can be disallowed.

9.4 The learned Counsel referred to the decision of the ITAT in the case of DCIT vs. Mohit Diamonds Pvt Ltd in ITA No.2097/M/11 for AY 2007-08 dated 31,.7.2012 and also the decision in the case of Sheetal Manufacturing Co. vs. JCIT in ITA No.7107/M/11 for AY 2008-09 dated 28.09.2012. The learned DR however, relied on the orders of the CIT (A) as far as the facts are concerned.

9.5 We have considered the issue. There is no dispute with reference to the availability of the interest free fund in the form of capital and reserves aggregating to ₹.16.09 crores. In fact the income declared during the year itself was to the tune of ₹.7.29 crores. Further, as seen from the schedule III of the secured loans, assessee has a cash credits, bill discounting, loan for its working capital requirements to an extent of ₹.5.65 crores and term loan for Mumbai Office premises at Panoli Plant and captive power plant at Ankleshwar to the tune of ₹.1.16 crores, the details of which can be referred to Note 2 of the notes forming part of the account for the year ended on 31.03.2007. The interest charges and the finance charges as seen from the record are mostly paid for these loans and working capital requirements including discounting of bills. Therefore, we are of the opinion that no part of the interest could be disallowed on the reason that assessee had advanced interest free advances to its sister concern. It is also a fact that assessee has invested money in a sister concern and if any disallowance is required the same has to be considered under section 14A which is the case not here as assessee has not earned any exempt income. Since assessee's available capital is more than the borrowed funds, presumption as decided by the Hon'ble jurisdictional High Court in the case of Reliance Utilities and Power Ltd 313 ITR 340 (Bom.) equally apply. This aspect was elaborately discussed by the Coordinate Bench in the case of DCIT vs. Mohit Diamonds Pvt Ltd in ITA No.2097/M/11 for AY 2007-08 dated 31,.7.2012 as under:

> *"The Learned AR pointed out that the assessee had Shareholders' funds including Share capital along with Reserve and surplus to the tune of Rs. 72.19 crores at the end of the year and the corresponding figure for the preceding year stood at Rs. 67.85 lacs. The above referred figures are apparent from the copy of balance sheet available on record. When we consider the amount of average loan advanced by the assessee to its sister concern, as taken by the AO, at Rs. 7.41 crores, we observe that such interest free loan is far short of interest free funds available with the assessee in the form of Shareholders' funds. The Hon'ble jurisdictional High Court in the case of CIT vs. Reliance Utilities and*

> *Power Limited (2009) 313 ITR 340 (Bom.) has held that if there are interest free funds available to an assessee sufficiently in excess of its investment and at the same time the assessee has also raised a loan, it can be presumed that the investments were from interest free funds available. In view of the fact that the interest free funds advanced by the assessee to its subsidiary company are much less than the interest free funds available with it in the shape of Share capital along with Reserve and surplus, in our considered opinion there can be no question of sustaining any addition in this regard. We, therefore, uphold the impugned order but from a different angle. This ground is not allowed".*

9.5 Respectfully following the Coordinate Bench, both on facts and principles we are of the opinion that the amount of ₹.3,18,600 cannot be disallowed as it has no nexus to the other finance charges claimed by assessee as business expenditure. Accordingly the ground is allowed.

9.6 In the result, the appeal is allowed.

**ITA No.169/Mum/2012 – AY 2008-09:**

10. This appeal is filed by the Revenue and the grounds raised are as under:

> *"1. On the facts and in the circumstances of the case and in law, the learned CIT (A) erred in holding that payment of commission to a non resident commission agents was not attracting the provisions of section 195 and section 40(a)(ia) of the Act.*
>
> *2. On the facts and in the circumstances of the case and in law, the learned CIT (A) erred in holding that Circular No.7 of 2009 dated 22.10.2009 is not applicable for AY 2008-09 even though the assessment was completed on 08.12.2010.*
>
> *3. The appellant prays that the order of CIT (A) on the above ground be set aside and that of AO be restored".*

10.1 This issue of disallowance under section 40(a)(ia) raised in the above two grounds was discussed elaborately along with assessee's ground Nos. 3 & 5 in the appeal for AY 2007-08 (Supra). For the reasons stated therein, the Revenue grounds are rejected.

10.2 In the Result the appeal filed by the Revenue is dismissed.

**ITA No.8789/Mum/2011 – AY 2008-09:**

11. Assessee in this appeal has raised the following grounds:

> *"1. On the facts and in the circumstances of the case and in law, the learned CIT (A) erred in confirming addition on account of interest expenses of ₹.4,56,672 without considering that:*
>
> *(a) No borrowed funds were utilized for investments/ advances*
>
> *(b) Most of the amounts were given for strategic investment and not by way of loan.*
>
> *(c) The investments were made on various dates and not on the first day of the year for working out interest.*
>
> *2. On the facts and in the circumstances of the case and in law, the learned CIT (A) erred in invoking the provisions of section 14A of the Act in respect of the investment in shares of associate concern, though the provisions of section 14A are not applicable to the facts of the case.*
>
> *3. On the facts and in the circumstances of the case and in law, the learned CIT (A) erred in invoking the provisions of section 14A of the Act as AO has considered total interest disallowance of ₹.4,56,672 after considering and including investments in shares of associate concern and therefore, would amount to double disallowance".*

11.1 Ground No.1 is similar to the Ground No.9 discussed in ITA No.8868/Mum/2010 in AY 2007-08. The learned CIT (A) confirmed the same for the reasons stated in AY 2007-08. Since in that year we have not upheld the order of the CIT (A), in this year also asthe facts and the legal principles being the same, we modify the order of the CIT (A) and allow assessee's grounds. An amount of ₹.4,56,672 disallowed in this year was deleted. Ground no1 is allowed.

11.2 Ground Nos. 2 & 3 pertains to invoking section 14A after disallowance of interest. The learned CIT (A) during the appellate proceedings asked assessee why disallowance could not be made on the investment made in shares of sister concern. Since no reply was furnished, he directed AO to invoke Rule 8D and make suitable disallowance under section 14A. The learned Counsel submitted that there is no proper opportunity given by the CIT (A) and without examining facts directed AO to invoke Rule 8D. It was his submission that even though Rule 8D is applicable from AY 2008-09 the same cannot be invoked unless AO is satisfied that the assessee claim of no expenditure cannot be verified from the books of account. It was further submitted that the learned AO did not give any effect to the order so far. The learned DR however, relied on the orders of the CIT (A).

11.3 We have considered the issue. The directions of the CIT (A) without examining the facts directing to invoke Rule 8D cannot be considered as appropriate in the given facts of the case. Since AO has not invoked Rule 14A, nor there is any evidence on record that assessee claimed any amount as exempt, we are not in a position to give any finding on the issue. Therefore, without prejudice to the respective claims of assessee and revenue, in the interest of justice, we restore the issue to the file of AO for fresh adjudication whether the provisions of section 14A are applicable and whether provisions of section 14A(2) can be invoked on the facts of the case and if so whether any disallowance is required. Since the facts are not available on record, AO is directed to examine the facts first, give opportunity to assessee and determine disallowance under section 14A if warranted. He should keep in mind the principles laid down by the judicial authorities on the issue, including the jurisdictional High Court/ Supreme Court orders. The grounds are allowed for statistical purposes and the issue is restored to the file of AO for fresh adjudication.

11.4 In the result the appeal filed by assessee is treated as allowed for statistical purposes.

12. In the result appeal in ITA No. 8868/Mum/2010 filed by assessee is allowed, while appeal in ITA No.169/Mum/2012 filed by the Revenue is dismissed and appeal in ITA No.8789/Mum./2011 is partly allowed for statistical purposes.

Order pronounced in the open court on 19th April, 2013

| Sd/- | Sd/- |
|---|---|
| **(Vijay Pal Rao)** | **(B. Ramakotaiah)** |
| **Judicial Member** | **Accountant Member** |

Mumbai, dated 19th April, 2013.

Vnodan/sps

*Copy to:*

1. *The Appellant*
2. *The Respondent*
3. *The concerned CIT(A)*
4. *The concerned CIT*
5. *The DR, "K " Bench, ITAT, Mumbai*

By Order

Assistant Registrar
Income Tax Appellate Tribunal,
Mumbai Benches, MUMBAI