IN THE INCOME TAX APPELLATE TRIBUNAL,
ALLAHABAD BENCH, ALLAHABAD
(THROUGH VIRTUAL COURT)

BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER

ITA Nos.249 & 261/ALLD/2018
(Assessment Years: 2013-14 & 2014-15)

Rajesh Bajaj, Allahabad 36 Chak, Zero Road, Allahabd	v.	**DCIT, Circle-1, Allahabad**
TAN/PAN:**AAMPB9894P**		
(Appellant)		(Respondent)

Appellant by:	Shri Abinav Mehrotra, CA
Respondent by:	Shri A. K. Singh,Sr. DR
Date of hearing:	26. 11. 2020
Date of pronouncement:	27.11. 2020

O R D E R

PER SHRI VIJAY PAL RAO, JUDICIAL MEMBER:

These two appeals by the assessee are directed against two separate orders dated 14.03.2018 & 10.05.2018 passed by Commissioner of Income Tax (Appeals), Allahabad for the assessment years 2013-14 & 2014-15.The assessee has raised common grounds in these two appeals. The grounds raised for the assessment year 2013-14 are as under:

> *"1.BECAUSE, on the facts and in the circumstances of the case, the impugned order passed by the Ld. CIT (A), confirming the illegal addition made by the AO for Rs. 6,26,811/-, by disallowing expenditure incurred by the assessee under the head "Rent" is patently illegal and bad in law. The expenditure incurred by the assessee is purely for the purpose of business and payment of Rent has not been found to be excessive or unreasonable by the authorities below by citing any comparable rates.*
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> *2. BECAUSE, on the facts and in the circumstances of the case, the impugned order passed by the Ld. CIT (A), confirming the illegal addition made by the AO for Rs. 6,26,811/-, is further unsustainable in law since there is no material cited or brought on record by any of the authorities below that the expenditure incurred by the assessee is not for the purpose of his*

business. It is judicially settled that Revenue authorities cannot sit in judgment over the business acumen of an assessee s as to decide upon the commercial/business expediency or relevancy of expenditure. The observations made by the AO, as confirmed by the Ld. CIT{A), to the effect that enhanced Rent expenditure is without business expediency and constituting the foundation for the instant addition are extraneous to record, without material and wholly unwarranted.

3. RECAUSE, on the facts and in the Circumstances of the case, the impugned order passed by the Ld. CIT (A), confirming the illegal addition made by the AO for Rs. 6,26,811/-, is further unsustainable in law since the Revenue has itself accepted expenditure under the head "Rent" in the previous assessment year and the business turnover of the instant assessee has increased from Rs.5.90,76,404/- to 14,69,28,769/- during the current assessment year and hence there is enough evidence to demonstrate the business expediency in incurring the additional rent. Further, the authorities have not considered the explanation furnished by the assessee, i.e.

1. The proximity of the shop from home.

2. The need for a nearby bank and food establishment

3. The nearness of the target market, the cost of delivering the goods, the nature of product traded by the appellant, availability of transport and service infrastructure, easy accessibility to godowns by different modes of transport, transportation cost, availability of labour for unloading and loading of paper , safety of goods from fire, flood and moisture etc., location convenient for key employees, sales potential; accessibility; pedestrian traffic; the terms of occupancy; and above all the cordial relationship with the landlords were the important factors in deciding the location of godowns and the amount of rent paid for space taken on rent.

4. BECAUSE, on the facts and in the circumstances of the case, the impugned order passed by the Ld. CIT (A), confirming the illegal addition made by the AO for Rs. 6,26,811/-, is further unsustainable in law since the determination of Rate of Rent by applying an Average Rent Rate is patently illegal and unknown to Law. Rent is determined upon negotiations between the transacting parties and is based on evidence in the shape of Rent Agreement/Contract. It is judicially settled that suspicion, no matter how strong it maybe, cannot substitute evidence. The authorities are hence not justified in ignoring evidence and substituting the same with some hypothetical calculations.

5. BECAUSE, on the facts and in the Circumstances of the case, the impugned order passed by the Ld. CIT (A), confirming the illegal addition made by the AO for Rs. 6,26,811/-, is plain arbitrary and purely based on conjectures.

6. The humble assessee, craves for leave add/ amend any other ground with the prior permission of the Hon'ble Tribunal."

2. The assessee is an individual and dealing in paper in the name and style of M/s Bajaj Pratisthan. The assessee filed its return of income for the assessment year under consideration u/s 139(1) of the Income Tax Act on 30.09.2013 declaring total income of Rs.23,10,440/-. During the course of scrutiny assessment, the AO noted that the assessee has paid rent for various godowns/shops amounting to

Rs.21,00,000/- to the persons specified u/s 40A(2) of the Income Tax Act. The AO has made a disallowance of Rs.6,26,811/- on account of the excess rent paid to the related party by invoking the provision of section 40A(2)(b) of the of the Income Tax Act. The AO has compared the rent paid by the assessee in the preceding year and found that the rent paid by the assessee for the year under consideration which is more than the reasonable enhancement of 10% is not allowable being excess payment in comparison to the fair market price. The assessee challenged the action of the AO before the CIT(A) but could not succeed.

3. Before the Tribunal, the ld. AR of the assessee has submitted that the details of the rent paid by the assessee during the year are reproduced by the AO in the assessment order and therefore, the recipient at Serial no.(i) and (iii) i.e. Alka Bajaj, sister-in-law and Preeti Bajaj, sister-in-law do not fall in the definition of relative as provided u/s 2(41) of the Income Tax Act and hence the provision of section 40A(2) cannot be invoked in respect of the rent paid by the assessee to these two parties. The ld. AR has further submitted that the AO has not taken up the matter to determine the fair market rent of the properties in question so as the arrive at the conclusion that the rent paid by the assessee to the related parties falling under the provisions of section 40A(2)(b) is more than the fair market rent. Thus the disallowance made by the AO is highly arbitrary and in contravention of the provisions of section 40A(2) read with section 2(41) of the Income Tax Act. He has submitted that once the AO has not given a finding that the rent paid by the assessee is excessive or unreasonable having regard to the fair market price, the disallowance made by the AO is not permissible and the same to be deleted. In support of his contention, he relied upon the decision of the Hon'ble Jurisdictional High Court in the case of CIT vs. Modi Xerox reported in 344 ITR 411(All) as well as the following decisions of the Tribunal:

(i) DCIT vs. M/s MGS Hospitalities in ITA Nos.2415&2416/Del/2010 dated 19.11.2010 of ITAT, Delhi.

(ii) Motilal Laxmichand Sanghavi vs. ACIT ITA No.3110,3111& 3112/Mum/2018 dated 26.07.2019 of ITAT, Mumbai

(iii) S.K. Engineering vs. JCIT reported in (2006) 286 ITR 210 (Bang) dated 02.08.2005 of ITAT, Bangalore

3.1 Hence the ld. AR submitted that the disallowance made by the AO by invoking the provisions of section 40A(2)(b) of the Income Tax Act is illegal and liable to be set aside.

4. On the other hand, the ld. DR has submitted that the AO has given the details of the area taken on rent by the assessee and the rent paid to each individual which shows that there is no uniformity of rate of rent paid by the assessee but it varies from person to person which is not justified for paying the higher rent for lesser area. Further the AO has already considered the fair market rent by giving a 10% hike for the year under consideration and thereafter the excess and unreasonable rent paid by the assessee to the persons specified u/s 40A(2) is disallowed by the AO. Thus the ld. DR has submitted that the AO has carried out the necessary verification regarding the fair market rent of the properties in question and the disallowance made by the AO after giving a 10% hike for the year under consideration which is very reasonable and justified. He has relied upon the orders of the authorities below.

5. Having considered the rival submissions as well as the relevant materials on record, it is noted that during the year under consideration the assessee has paid rent to various persons as under:

S. No.	*of the Land Lord*	*Address of thebuilding[Proof w.r.t.Ownership annexed]*	*Use ofspace in the business*	*Amount*	*TDSdeducted TDSreturns Annexed]*	*Relation*	*Area inSq. Feet (approx.)*
1	*Alka Bajaj*	*1172/1/778, Mutthiganj, Allahabad*	*Godown*	*3,00,000 =00*	*30,000=00*	*Sister-in-law*	*1920*
2	*Kamla Devi Bajaj*	*34-A (Old)/ 36/46 (New), Chak, ZeroRoad, Allahabad*	*Shop andcontrollin goffice*	*4,50,000 =00*	*45,000=00*	*Mother*	*2393*
3	*Preeti Bajaj*	*667/525, Nai Basti, Kydganj, Allahabad*	*Godown*	*4,50,000 ==00*	*45,000= 00*	*Sister-in law*	*3744*
4	*Rajeev Bajaj*	*61/32, Ram Bagh, Allahabad*	*Godown*	*4,50,000 =00*	*45,000=00*	*Brother*	*2981*
5	*Varsha Bajaj*	*658/517, Nai Basti, Allahabad*	*Godown*	*4,50,000 =00*	*45,000=00*	*Wife*	*2926*

6. The ld. counsel for the assessee has contended that the recipient at Serial No.(1) and (3) namely Alka Bajaj and Preeti Bajaj are sister-in-law of the assessee and therefore do not fall in the definition of relative as provided u/s 2(41). This fact is not disputed by the Revenue and therefore, the payment to these two persons would not fall in the ambit of provisions of section 40A(2) when the transaction is not with the relative of the assessee as provided u/s 40A(2)(b)(i) of the Act. There is no dispute that the definition of the term "relative" provided u/s 2(41) of the Income Tax Act. Therefore the sister-in-laws of the assessee are not included in the said definition of relative u/s 2(41) of the Income Tax Act. There is also a definition of "relative" provided u/s 56(2) of the Act as under:

> ***"Amendment of section 56.***
>
> ***13.*** *In section 56 of the Income-tax Act, in sub-section (2), after clause (iv), the following clause shall be inserted at the end, with effect from the 1st day of April, 2005, namely:—*

'(v) where any sum of money exceeding twenty-five thousand rupees is received without consideration by an individual or a Hindu undivided family from any person on or after the 1st day of September, 2004, the whole of such sum :

***Provided** that this clause shall not apply to any sum of money received—*

(a) from any relative; or

(b) on the occasion of the marriage of the individual; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer.

Explanation. — For the purposes of this clause, "relative" means—

(i) spouse of the individual;

(ii) brother or sister of the individual;

(iii) brother or sister of the spouse of the individual;

(iv) brother or sister of either of the parents of the individual;

(v) any lineal ascendant or descendant of the individual;

(vi) any lineal ascendant or descendant of the spouse of the individual;

(vii) spouse of the person referred to in clauses (ii) to (vi).'.

7. Since this definition provided u/s 56(2) is only for the said clause of section 56(2) therefore, the same cannot be applied in respect of provisions of section 40A(2) of the Income Tax Act when a general definition of term "relative" is provided u/s 2(41) of the Act. Hence, the provisions of section 40A(2) cannot be invoked in respect of transaction of payment of rent to Alka Bajaj and Preeti Bajaj who are not falling in the definition in term of 'relative' provided u/s 2(41) of the Income Tax Act.

8. As regards the issue of excess /unreasonable payment to the specified person, it is evident from the assessment order that the AO has made a disallowance on the basis of comparative rent paid by the assessee in the preceding year and in the year under consideration without determining the fair market rent of the properties in question. It is settled proposition of law that in order to make a disallowance u/s 40A(2)(b), the AO has to first determine the fair market value/price and then compare the same with the actual expenditure incurred and payment made by the assessee to the specified person. In case, the payment made by the assessee to the

specified person is excessive and unreasonable having regard to the fair market value/price, the amount found to be excess or unreasonable is liable to be disallowed u/s 40A(2) of the Income Tax Act. Therefore it is pre-condition for making the disallowance u/s 40A(2) that the AO has to arrive to the conclusion that the amount paid by the assessee is excessive or unreasonable in comparison to the fair market value/price. In the case in hand, the AO has not carried out such exercise to first determine the fair market rent of the properties in question by bringing any comparable instance/case but the AO has just compared the quantum of the rent paid by the assessee in the preceding year and the rent paid during the year under consideration. Further the quantum of rent cannot be considered in absolute terms as to whether it is excess or unreasonable without considering the rate of rent paid by the assessee in terms of per square feet or per square meter. Further the comparison of the rent paid by the assessee is also depends upon various factors being the locality of the each property if the same are not situated at one place and therefore there cannot be a standard criteria of fair market rent to be applied for all the properties without considering the criteria such as locality, nature of property and other advantage or disadvantage attached to a particular property. Hence, the fair market rent required to be determined by considering all these factors and by bringing on record the comparable cases for each of the property as per their location, category and advantage or disadvantage attached to them. The AO failed to conduct the minimum enquiry to ascertain the fair market rent of these properties. The Hon'ble Jurisdictional High Court in the case of CIT vs. Modi Xerox (supra) has considered this issue in para 17 to 19 as under:

> ***"17.*** *Section 40A(2)(a) of the Income-tax Act 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."

18. *A perusal of section 40A(2)(a) of the Act reveals that any expenditure incurred shall be disallowed in case if the payment is made to the persons referred to in clause (b) of section 40A(2) of the Act and the Assessing Officer 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 need of the business or profession of the assessee shall be disallowed.*

19. *In the present case, having regard to the facts and circumstances referred to hereinabove, the Tribunal has arrived to a conclusion that the Assessing Officer has failed to prove by any comparable case or comparison by market rate that the amount paid by the assessee was excessive or unreasonable. The finding of the Tribunal is finding of fact. On the enquiry the Inspector found that the premise was in occupation and use of the assessee and the claim of the rent was not false. The Tribunal found that the assessee has paid the actual rent and reimbursed the actual expenditure incurred by M/s. MRL. We are of the view that the finding of the Tribunal is finding of fact, based on material on record and cannot be said to be perverse. The order of the Tribunal, in this regard, is liable to be upheld."*

9. Thus once the transaction of payment of rent is not found to be bogus or ingenuine then the disallowance of the expenditure u/s 40A(2)(b) is not warranted in the absence of a definite finding that the payment made by the assessee is excessive or unreasonable in comparison to the fair market rent. In the case of Motilal Laxmichand Sanghavi vs. ACIT (supra) the Mumbai Benches of the Tribunal has considered and decided this issue para 9 as under:

"9. We have considered rival submissions and perused the material on record. A reading of the provision of section 40A(2) of the Act as a whole makes it clear that if in the opinion of the Assessing Officer, the expenditure claimed by the assessee in respect of payment made to any related party/associated concern is excessive or unreasonable having regard to the fair market value, disallowance has to be made under the said provision. Therefore, before making any disallowance under the said provision, two conditions have to be satisfied. Firstly, the payment in respect of which deduction has been claimed must have been made to a related party and secondly, such payment must be excessive and unreasonable having regard to the market rate. Therefore, the Assessing Officer must form an opinion objectively on the basis of material brought on record to demonstrate that the payment made by the assessee is excessive and unreasonable having regard to the market rate. No doubt, in the facts of the present case, the first condition of section 40A(2) of the Act has been fulfilled as the assessee has made the payment to the related parties. However, as regards the second condition relating to unreasonableness of the payment made, on a perusal of the impugned assessment order it is noticed that the Assessing Officer has not brought any material on record to demonstrate that the payment made is excessive and unreasonable having regard to the market rate. Simply stating that the rate of interest paid on unsecured loan is higher than the fixed deposit interest rate, the Assessing Officer has restricted the rate of interest on unsecured loans to 12% per annum. The Assessing

Officer has not brought any comparable case to demonstrate that the market rate of interest on unsecured loan is 12%. The Assessing Officer cannot equate the rate of interest on bank fixed deposit with unsecured loan as unsecured loans are without any security, hence, the lender always carries the risk of not being able to recover the money. Therefore, the rate of interest is always little higher compared to the rate of bank interest. The decisions cited by the learned Authorised Representative also support this view. Therefore, in the facts of the present case, in our considered opinion, the payment of interest @ 15% per annum on unsecured loans availed from related parties cannot be considered to be excessive on unreasonable to invoke the provisions of section 40A(2)(b) of the Act. Accordingly, we delete the disallowances made by the Assessing Officer in all the assessment years under appeal. Grounds are allowed.

10. A similar view has taken by this Tribunal in a series of decisions including the decision relied upon by the ld. AR of the assessee. No contrary decision has been brought to the notice of the Tribunal. Accordingly, in the facts and circumstances of the case, when the AO has not conducted any enquiry to determine the fair market rent so as to hold that the payment made by the assessee on account godown/shop rent is excessive or unreasonable, the disallowance made by the AO is contrary to the provisions of section 40A(2) of the Income Tax Act. Following the decision of the Hon'ble Jurisdictional High Court as well as the decisions of the Coordinate Benches of the Tribunal, this issue is decided in favour of the assessee and disallowance made by the AO is deleted.

11. Since, the facts and issue are common and identical in both the assessment years, therefore the finding for assessment year 2013-14 would also dispose of the issue for the assessment year 2014-15 in favour of the assessee.

12. In the result, both these appeals of the assessee are allowed.

Order pronounced in the open Court on 27/11/2020.

Sd/-
[VIJAY PAL RAO]
JUDICIAL MEMBER

DATED: 27/11/2020
RS

Copy forwarded to:

1. Appellant –Rajesh Bajaj, Allahabad
2. Respondent -DCIT, Circle-1, Allahabad
3. CIT(A) -
4. CIT
5. DR -

By order

Assistant Registrar