

IN THE INCOME TAX APPELLATE TRIBUNAL “H” BENCH, MUMBAI
BEFORE SRI MAHAVIR SINGH, JM AND SRI RAJESH KUMAR, AM

ITA No.5542/Mum/2016
(A.Y:2012-13)

Dy. Commissioner of Income Tax, Circle 9(1)(1) Room No. 260A, 2 nd Floor, Aayakar Bhavan, M.K. Marg, Mumbai-20	Vs.	Adsun Offshore Diving Contractors Pvt. Ltd. D-251, Solaris 1, Saki Vihar Road, Opp. L&T Gate No.6 Andheri East, Mumbai-400 072
Appellant	..	Respondent
PAN No. AACCA9673L		
Revenue by	..	Shri M.C. Omi Ningshen, DR
Assessee by	..	Shri Ajay Singh, AR
Date of hearing	..	15-03-2017
Date of pronouncement	..	15-03-2017

ORDER

PER MAHAVIR SINGH, JM:

This appeal by the Revenue is arising out of the order of CIT(A)-16, Mumbai, in appeal No CIT(A)-16/DCIT-9(1)(1)/IT-286/2014-15 dated 24-06-2016. The Assessment was framed by DCIT Circle-9(1)(1), Mumbai for the A.Y. 2012-13 vide order dated 16-02-2015 under section 143(3) of the Income Tax Act, 1961 (hereinafter ‘the Act’).

2. The only issue in this appeal of Revenue is against the order of CIT(A) deleting the disallowance of non-contractual payment /gratuitous payment for the purpose of business under section 37 of the Act. For this Revenue has raised following ground: -

“Whether in the facts and circumstances of the case and in law non-obligatory, gratuitous, non-contracted payments made wholly for altruistic reasons is in the nature of application of income not deductible under section 37 of the income Tax Act, 1961.”

3. Briefly stated facts are that the assessee company is in the business of sub-sea diving, job work and equipment hiring. The AO after seeking details noted that the payment of compensation for an accident claimed as business expenditure/loss is not allowable because there is no specific clause in the agreement with free-lance divers to provide for compensation in the event of damage or loss of life because of such marine accident. The AO recorded the following reasons for making disallowance: -

“a) The divers who lost their lives were free-lance divers who entered into a contract with the assessee company. These divers were recruited on a contractual basis on a day rate. From the perusal of the contract entered with these divers, it is seen that as per clause 13 of the said contract, the following has been stated

"The freelancer will not be entitled to any other benefits except for those as stated in the agreement"

There is no specific clause in the agreement with free-lance divers to provide for compensation in the event of damages or loss of life because of such marine accident. This leads us to the inevitable conclusion that the assessee has made a claim of an expense which was not the assessee's liability in the first place.

(b) The above fact gets further strengthened as out of the total amount of Rs.6,89,26,965/- which has been paid as compensation, the assessee company has borne an expense of Rs.94.50 lakhs and the rest was borne by Adsun Middle East FZE. Moreover, the assessee in his submission has stated that:

"After detailed discussions, keeping in mind the reputation and goodwill of the Company arrived at the understanding with the families of the

deceased to make part payments immediately, pending the settlement of Insurance claim. Accordingly, the Company Paid Rs. 94.50 lacs immediately to three such Divers and the balance amount was promised to be arranged through the Principal employer on whose ship the divers were deputed to work and through the personal contacts of the Directors of the company."

Thus, even the assessee admits that this was not the liability of the assessee company per se, yet it chose to make a payment to these divers and is now making a claim that the said expense made be allowed under section 37. Such a claim is not tenable as the assessee cannot take upon itself someone else's liability and make a claim of such expenditure when the same was not its liability in the first place. This was precisely the reason because of which the major compensation has been paid by Adsun Middle East FZE."

And finally, added this sum of Rs. 94.50 lakhs to the return of income. Aggrieved, Assessee preferred appeal before CIT(A).

4. CIT(A) deleted the disallowance of Rs.1,16,460/-made by AO by observing as under: -

"6.2.8 Since the expenditure was incurred by the appellant with a intention to protect its business interest it was purely a commercial decision to avoid further litigation in the international court where the legal cost must have exceeded the compensation paid. Therefore, respectfully following judgements of Hon'ble jurisdictional High Court in the case of CIT vs. Sinnar Bidi Udyog Ltd. (supra) and Gujarat High Court in the case of CIT vs. UTI Bank Ltd. (supra), appeal of the

*appellant is allowed and disallowance of Rs. 1,16,460/-
made by the AO is deleted.”*

Here we want to make it clear that the CIT(A) by mistake has deleted this disallowance of Rs. 1,16,460/-. We have noticed from the order of CIT(A) that this addition was confirmed by CIT(A) at para 6.1.2 page 8. Further, the CIT(A) in view of rectification application of the assessee dated 16-09-2016, passed an order dated 19-10-2016 whereby the disallowance was deleted at Rs. 94.50 lakhs and for this he passed an corrigendum stating as under: -

“Since the expenditure was incurred by the appellant with a intention to protect its business interest it was purely a commercial decision to avoid further litigation in the international court where the legal cost must have exceeded the compensation paid. Therefore, respectfully following judgments of Hon’ble jurisdictional High Court in the case of CIT vs. Sinnar Bidi Udyog Ltd. (supra) and Gujarat High Court in the case of CIT vs. UTI Bank Ltd. (supra), appeal of the appeals is allowed and disallowance of Rs. 94,50,000/- made by the AO is deleted.”

Aggrieved Revenue is in second appeal before Tribunal.

5. We have heard the rival contentions and gone through the facts and circumstances of the case. We find from the facts of the case that the assessee during the year, while executing the work of diving support services for Simakoosh Offshore for Free Span rectification work of Phase 12 in South Pars Field in Persian Gulf Ship DP II DSV "Khoosha 1" sunk due to bad weather. The Pressure Chambers mounted on the said diving support vessel also was sunk along with the said ship/vessel. In this marine accident, the vessel/ship sunk in about 4 minutes. 7 Divers working for the Company who were part of the team on board on DP if DSV "Khoosha 1" who were trapped in that pressure chamber at that time had died in the accident. News report about the accident is enclosed at pages: 105-106 of the assessee paper book. Death certificates of divers issued

by Embassy are enclosed at pages: 130-142 of assessee's paper book. The copy of the contract for diving support services with Simakoosh offshore is enclosed at pages: 60-62 of the assessee's paper book. Copies of sub- contract agreements with divers are at pages: 63 -104 of the assessee's paper book. It was claimed by the assessee that these free lance divers were regularly being engaged by the Adsun group for various projects being undertaken by them under Adsun Middle East FZE, Fujairah UAE and Adsun Offshore Diving Contractors Pvt. Ltd, the assessee. Thus these divers had a long association with Adsun group.

6. The assessee narrated the facts that the deceased Divers were sole bread earners for their family and also high net worth individuals who were undertaking risky work and thus were earning good income. Their family was to be deprived off the good amount of income due to death of these divers. The directors were under tremendous pressure from the family members of the deceased divers to provide for monetary compensation. Some of them had also threatened to file legal cases against the assessee. The directors of the assessee company were of the view that the Adsun group has always been dependent on free lance divers' fraternity to support them in executing the projects bid by them and awarded to them. They assessed the situation and they thought it fit and prudent to maintain their goodwill and reputation amongst diving community and in the overall business interest of the company to provide the monetary compensation to the family of the deceased divers. The assessee was starving of funds and did not have adequate resources and these divers in the past worked for their group company Adsun Middle East and also assessee and hence keeping in mind the availability of the funds, it was decided to pay the compensation partly from the assessee and partly from their company in UAE. In fact major part of compensation was paid from UAE company and only small part of the compensation was paid from assessee, even though the mishap had happened while the job was being executed by the assessee.

7. Accordingly, the assessee Paid Rs. 94.50 lakhs immediately to families of these such Divers. The said expenditure was debited to "Compensation for Accident" under Project Expenses. Balance of the compensation amount was

paid from the other group company. The assessee had entered in to settlement agreement with the family members of the deceased whereby the compensation amount was decided. The expenditure was incurred wholly or exclusively for the purpose of the business for smooth continuity of its business operations. The expenditure was incurred for commercial considerations and for facilitating smooth business operations from point of view of business prudence. It was claimed that all the conditions of the Section 37(1) are fulfilled to claim the aforesaid expenses. We find that the AO declined to allow the above Expenditure as Business Expenditure merely because he did not find specific clause in the agreement entered into by the assessee with the said freelance divers for providing compensation in the event of damages of loss of life in a marine accident. Further, the learned AO also disallowed Compensation paid for accident Rs. 94,50,000/- treating it as "application of income" of the appellant company.

8. We find from the above facts that the expenses incurred was in the course of business, and in order to safe guard the business interest and avoid unwanted litigation, We find that the decision to settle the matter and pay compensation was a commercial decision taken by the company to safe guard the business interest of the assessee. It was with view to maintain co-ordial relations and goodwill amongst free lance divers who were regularly being employed by Adsun group companies for execution of the sub-sea projects. Without the support of these free lance divers it would not be possible for the assessee to execute contracts it signs up and honour its commercial commitments. Hence, it as a need of the business to maintain good relations and gain the confidence amongst diving community.

9. We are of the view that the remark of the that AO that "liability of some other company" was taken up by assessee, which is not the fact. AO did not realise that entire compensation amount was a liability of assessee and even then only small amount was claimed as expenditure. The contract with divers was entered by the assessee company. And another aspect that the AO disallowed the said Compensation paid for accident Rs. 94,50,000/- treating it as "application of

income” of the assessee. As can be observed from the facts narrated above, the said expenditure was a genuine business expenditure of the assessee and it never formed part of the income of the assessee. Income is to be arrived at after deducting business expenditure from the gross revenue earned by the business. Hence, this payout never formed part of the income and was not the "application of the income" as treated by the AO. The concept of application of income is wrongly invoked by the AO. There is no diversion of income as alleged by AO.

10. We have gone through the case law relied on by the assessee of Mumbai ITAT in the case of *Urmila & Co. Ltd vs. DCIT (2013) 60 SOT 2 (Mumbai)* wherein the assessee claimed allowance of a sum being compensation paid to local fishermen in connection with construction of a temporary Jetty. The Assessing Officer was of view that the said expenditure was prohibited. The ITAT held that the payments were definitely not contractual, the fishermen having no vested or secured rights in the coastal line, so as to permit the assessee to build a temporary jetty thereat. At the same time, the commercial expediency of the payments is manifest inasmuch as the cooperation of the local fishermen had necessarily to be secured if the Jetty had to be constructed. It is not necessary that a payment to be allowable under section 37(1) has necessarily to be contractual, and neither do we consider it as opposed to public policy, which could be so said only if the construction of the jetty was either prohibited by law or if the required permission for the same had not been obtained.

11. The assessee further relies on the decision of Hon'ble Bombay High Court in the case of *CIT vs. Sinnar Bidi Udyog Ltd . (2001) 257 ITR 216 (Bom)*. Wherein the assessee, a beedi manufacturing company, claimed deduction of Rs. 3,70,755/- as revenue expenditure on account of compensation paid to several workers on retirement. This amount was paid towards the period of service rendered by these workers under another company for the period of service under that company, after the representations of the workers and they had initiated proceedings before the Labour Commissioner and the gratuity authority. For the assessment year 1989-90, it claimed that amount as revenue expenditure under section 37 of the Act. The AO disallowed the claim on the ground that

expenditure was voluntary in nature there being no legal liability. The ITAT took the view that since the expenditure had been incurred by the assessee for maintaining good relations with the employees and for the welfare of the employees. The Hon. Court held, that it was not a payment either towards or from a gratuity fund that was a payment in excess of the payment that would be required to be made under the Payment of Gratuity Act though made on basis of the legitimate expectations of the workmen in the facts of the case on the one hand and the commercial expediency of the employer on the other. The legitimate business needs of an assessee had to be judged from the point of view of business. It was for the assessee to consider the business expediency and whether a particular expenditure would be incurred for the business. Provision of gratuity to the employees for the continuous services rendered to the company taken over could not be said to be either unusual or unnecessary. The Tribunal was right in allowing the compensation paid as allowable revenue expenditure.

12. We are of the view that in the given facts of the present case that whatever test may be applied in deciding whether any expenditure is allowable as a deduction under section 37, the essential requirement must in every case be as to whether the expenditure was either in reality or as a measure of business expediency necessary either for the purpose of earning profit or for protecting and safeguarding the business assets of the assessee including goodwill or in connection with some transaction or activity which is directly and substantially connected with the running of the business of the assessee or is intimately connected with the assessee business activities. Such expense must necessarily pertain to the business itself and must not be an expenditure merely connected with any activity, however remote or ancillary. It has to be shown in every case that not only the expenditure was wholly and exclusively laid out, but it was so laid out for the purpose of the business of the assessee, that is, some purpose directly connected with or attributable to the assessee normal business activities or the protection of its business interest, in the instant case the expenses incurred in connection with the accident occurred in course of the business where 7 lives of divers were lost , thus the expenditure incurred was wholly and exclusively

for the purpose of the company's business. In view of the above legal and factual position we are of the view that compensation paid by the assessee to the family members of deceased divers was in course of the assessee business, and the assessee had rightly considered the business expediency and there after incurred the said legitimate business expenses. Accordingly, we confirm the order of CIT(A) and dismiss the appeal of the revenue

13. In the result, the appeal of Revenue is dismissed.

Order pronounced in the open court on 15-03-2017.

Sd/-
(RAJESH KUMAR)
ACCOUNTANT MEMBER

Sd/-
(MAHAVIR SINGH)
JUDICIAL MEMBER

Mumbai, Dated: 15-03-2017

Sudip Sarkar /Sr.PS

Copy of the Order forwarded to:

1. The Appellant
2. The Respondent.
3. The CIT (A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,
Assistant Registrar
ITAT, MUMBAI