

Subsidiary company is not a 'related person' for sec. 40A(2).

Summary – The Karnataka HC in a recent case of Raman Boards Ltd., (the Assessee) held that the subsidiary company of the assessee is not a related person within meaning of sub-clause (ii) of clause (b) of section 40A(2) and thus payment made by assessee to its subsidiary cannot be disallowed by invoking provisions of said section.

Facts

- The assessee-company entered into an agreement with its subsidiary company for manufacture of footwear soles.
- The manufacturing related jobs were to be done by the subsidiary company for which, the assessee was to pay management fee of Rs. 4 lakh per month. Accordingly, the assessee claimed Rs. 48 lakh payment made to the subsidiary company as expenditure.
- The Assessing Officer allowed 50 per cent of the claim of the assessee and disallowed remaining amount under section 40A(2)(b).
- The Tribunal noted that there was no finding that payment made by the assessee was excessive under section 40A(2)(b).
- The Tribunal thus allowed the appeal and permitted deletion of the impugned disallowance.

Held

- The HC held that to attract provisions of section 40A(2), assessee has to incur an expenditure by making payment to the person referred to in clause (b). The Assessee is a company and the person to whom they have to make payment in order to attract the said provision should be any director of the company or any relative of the director. Since in this case, payment is made to the subsidiary company and not to any director or any relative of the said director, the requirement of the section is not fulfilled.
- Another company, even if it is a subsidiary of the assessee is not a related person within the meaning of sub-clause (ii) of clause (b) of section 40A(2). While the holding company is a member of its subsidiary company, the subsidiary company is not a member of the holding company. As, the subsidiary company was not a member of the assessee, sub-clause (iv) of clause (b) of section 40A(2) is also not attracted.

- Further a reading of section 37(1) makes it clear any expenditure laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head 'Profits and gains of business or profession'.
- In the instant case, the agreement between the assessee and the subsidiary company is not in dispute. Payment of Rs. 48 lakh by the assessee to the subsidiary company is admitted. The material on record shows that the subsidiary company has incurred an expenditure of Rs. 21 lakh to perform the contract under the agreement.
- The material on record also discloses that there was labour unrest in the subsidiary company for nearly half of the year which contributed to the lower production, lower sales and poor profitability of the assessee-company.
- The undisputed facts show that the subsidiary company was not able to comply with or perform its part of the contract and merely because a subsidiary company did not fulfil its obligations it will not render the transaction illegal. Consequently, it cannot be held that the expenditure laid out or incurred is not wholly for the business of the assessee-company
- The HC held that facts have not been properly appreciated by the assessing authority as well as the lower appellate authority and thus the Tribunal was justified in directing the deletion of disallowance.
- The HC affirmed the ITAT order and accordingly, the revenue's appeal was dismissed.