



TCA NO.151 OF 2012

**IN THE HIGH COURT OF JUDICATURE AT MADRAS**

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**JUDGMENT RESERVED ON : 10 / 03 / 2026**

**JUDGMENT PRONOUNCED ON : 18 / 03 / 2026**

**CORAM**

**THE HONOURABLE DR. JUSTICE G.JAYACHANDRAN**

**AND**

**THE HONOURABLE MR. JUSTICE R.SAKTHIVEL**

**TCA NO.151 OF 2012**

M/s.Karpaga Vinayagar Papers  
# 49, North Car Street,  
Sivakasi.

... Appellant / Respondent

*Versus*

The Assistant Commissioner of Income Tax  
Circle – I  
Virudhunagar.

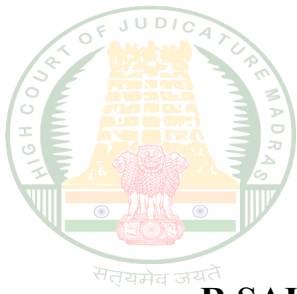
... Respondent / Appellant

**PRAYER:** Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961, against the Order dated February 25, 2011 passed in I.T.A.No.1397/Mds/2010 for the Assessment Year 2001-2002, by the Income Tax Appellate Tribunal, 'A' Bench, Chennai.

For Appellant : Mr.Dinesh  
for M/s.Philip George

For Respondent : Mr.V.Mahalingam  
Senior Standing Counsel

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## JUDGMENT

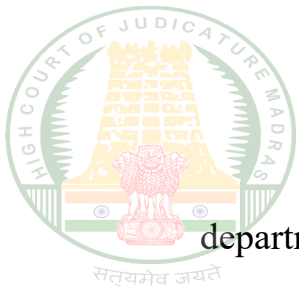
R.SAKTHIVEL, J.

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Aggrieved by the Order dated February 25, 2011 passed in I.T.A. No. 1397/Mds/2010 for the Assessment Year 2001-2002, by 'the Income Tax Appellate Tribunal, 'A' Bench, Chennai' ['Tribunal' for short], the assessee namely M/s.Karpaga Vinayagar Papers has preferred this Appeal.

2.Short facts shorn of elaboration are that 'M/s.Karpaga Vinayagar Papers' ['assessee' for short] is a partnership firm consisting of two partners namely Alamelu Aachi, wife of V.Valliappan and N.P.Selvaraj, brother-in-law of V.Valliappan. V.Valliappan who is not a partner was looking after the entire business.

2.1.The assessee is a dealer in paper and boards. In the income-tax return for the Assessment Year 2001-2002 filed on October 31, 2001, admitting a total income of Rs.7,49,290/-. The same was processed under Section 143 (1) of 'the Income Tax Act, 1961' ['I.T. Act' for short] and the assessment was completed under Section 143 (3) of I.T. Act on February 20, 2004 and an additional demand of Rs.15,036/- was raised. Subsequently, while going through the assessment details, the income-tax



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department noticed that the assessee had shown Rs.11,35,879/- as

commission / misappropriation paid to 31 identified persons in its profit

and loss account. Hence, the department initiated proceedings under

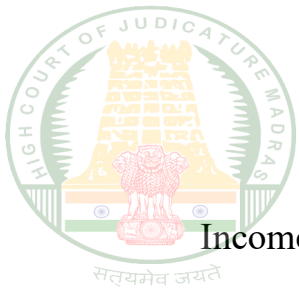
Section 147 of I.T.Act and issued notice dated November 5, 2007 under

Section 148 of the I.T. Act.

**2.2.**According to the assessee, the aforementioned sum along with some more amount was misappropriated by V.Valliappan and shown as an income in his individual income-tax assessment. When the same was explained to the assessing officer, he/she concluded that the alleged misappropriation by V.Valliappan would not reduce the liability of the assessee. The assessing officer further found that even if the misappropriation is true, the V.Valliappan being the husband of one of the partner - Alamelu Aachi, Section 40A(2) of the I.T. Act is applicable. Accordingly, the assessing officer disallowed the claim and ordered the assessee to pay an additional income-tax of Rs.7,03,476/- and also ordered to initiate penalty proceedings under Section 271 (1) (c) of I.T. Act, for the aforementioned amount of Rs.11,35,879/-.

**2.3.**Feeling aggrieved by the Order of the assessment officer, the assessee preferred an appeal before the Office of the Commissioner of

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Income-Tax (Appeals)-II, Madurai, who concluded that the aforementioned amount of Rs.11,35,879/- is not covered under Section 40A (2) (b) of the I.T. Act and hence, the additional income-tax liability of Rs.7,03,476/- was set aside. Accordingly, the appeal was partly allowed.

2.4. Feeling aggrieved by the Commissioner's Order, the respondent herein representing the income-tax department preferred an appeal before the Tribunal. The Tribunal held that even if the aforementioned amount of Rs.11,35,879/- is considered as commission payment *i.e.*, as a business expense, as per Section 40A (2) (a) of the I.T. Act, the said amount is excessive and hence, the assessing officer is entitled to disallow the claim. Further it was held that the assessee could not show anything regarding the nature of service rendered by V.Valliappan explaining his capacity to make the alleged commission payment to 31 people. It is an admitted proposition that the aforementioned amount of Rs.11,35,879/- was drawn by V.Valliappan without the knowledge of the partners. Hence, it cannot be considered as business expenditures. The said V.Valliappan in his individual income-tax assessment for the Assessment Year 2001-2002 has shown as if he drew majority of his income from the assessee - firm. The assessee has neither taken any steps to recover the amount nor pursued any

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legal remedy. Hence the aforementioned amount of Rs.11,35,879/- cannot be treated as expenses or loss incurred in the business of the assessee.

Upon these findings, the Tribunal allowed the appeal filed by the respondent herein.

**2.5.** Feeling aggrieved by the same, the assessee - firm has preferred the instant appeal under Section 260A of the I.T. Act.

**2.6.** On June 25, 2012, this Court admitted the instant appeal on the following substantial questions of law:

*'1. Whether on the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in holding that the loss incurred due to embezzlement by Mr.V. Valliappan will not be allowed as expenditure incurred for the purpose of business of the assessee?*

*2. Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in holding that 40A(2)(a) is applicable to the facts of the case and upholding the disallowance?'*

**3.** Mr.Dinesh, learned Counsel appearing for the appellant / assessee would argue that the employee - V.Valliappan being the manager of the appellant had inflated the expenses and withdrew money without any



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authorisation. Hence, the said money ought to be treated as a business expenditure. Further V.Valliappan declared the misappropriated amount in his individual income-tax assessment and hence, the disallowance made in the hands of the appellant would amount to double taxation. Further, he would contend that the assessment under Section 147 of the I.T. Act is barred by limitation as per the proviso thereto. The Tribunal failed to appreciate the facts of the case in a proper manner. Accordingly, he would pray to allow the appeal and uphold the Commissioner's Order.

4.Mr.V.Mahalingam, learned Senior Standing Counsel appearing for the respondent herein would argue that it is not satisfactorily established that the aforementioned amount of Rs.11,35,879/- was paid as commission to 31 people. Hence, it cannot be considered as a business expenditure. Further he would contend that no action was taken to recover the alleged misappropriated amount and in such circumstances, merely because V.Valliappan has shown the amount as an income in his individual assessment and paid income-tax, it cannot be treated as a case of double taxation. The Tribunal only after considering the factual aspects in detail, set aside the Commissioner's Order and there is no need to interfere with

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the same. Accordingly, he would pray to dismiss the appeal and sustain the Tribunal's Order.

5. This Court has considered the rival submissions and also perused the records.

6. The assessee in its profit and loss account for the Assessment Year 2001-2002 has shown Rs.11,35,879/- as commission / misappropriation paid to more than 30 identified persons. The assessee - firm has taken a contradictory stand. It is claiming that the amount of Rs.11,35,879/- is a business expense paid as a commission and at the same time, it is claiming that the said amount was misappropriated by V.Valliappan and hence, it is also to be considered as a business expense.

7. If this Court is to look at the aforementioned amount of Rs.11,35,879/- as a commission paid in the course of business, the same can be considered as valid business expenditures only on production of valid documentary evidence. Admittedly, there is no documentary evidence available on record to substantiate that the aforementioned amount of Rs.11,35,879/- was paid as a commission to more than 30 identified persons. No business agreement, bill of supply, or any particulars was



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produced on the side of the appellant in this regard. It is true that as per

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Section 40A (2) of the I.T. Act, any payment towards a partners, member or relative of a partner, shall be considered as a business expense for the purpose of income-tax assessment. However, such a payment or expenditure shall reflect fair market price of the goods, services or facilities for which the payment is made or shall be for the legitimate needs of the business or shall be for the benefit or in the interest of the business. Further, the assessing officer has every power to evaluate whether the payment or expenditure is a reasonable one as per Section 40A (2) of the I.T. Act. In this case, there is no evidence to show that the aforementioned amount of Rs.11,35,879/- is a reasonable expense as contemplated under Section 40A (2) of the I.T. Act. Hence the assessing officer is justifiable in disallowing the expenditure as excessive or unreasonable.

**8.** On considering the submission made by the appellant that the aforementioned amount of Rs.11,35,879/- as misappropriated amount. In this case, the alleged misappropriator is none other than the husband of one of the partner and the brother-in-law of the other. In view of such close nature of relationship between the partners and the alleged misappropriator, there is every chance of active collusion between them in

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order to evade income-tax. Further, no evidence has been let in to substantiate the alleged misappropriation nor has the mode of misappropriation been specifically explained by the appellant anywhere. Even the role of V.Valliappan in the assessee - firm and his monetary benefits were not explained. Further, the appellant does not seem to have taken steps or pursued any legal remedy to recover the alleged misappropriated amount from the misappropriator. Moreover, if the proposition that misappropriated amount shall be considered as business expenses is to be accepted, then anyone can easily allege misappropriation and evade income-tax. It would lead to gross misuse of law.

9. As regards the argument *qua* double taxation, as rightly held by the Tribunal, income in one person's hand need not necessarily be an expense in the other person's hand. V.Valliappan could have derived the aforementioned amount of Rs.11,35,879/- and even more from the assessee - firm which may be an income in his hand, but whether the assessee can claim the same as a valid expenditure or loss is a different question. As stated *supra*, misappropriation cannot be claimed as a valid expenditure or loss. In the absence of evidence to show the nature of payment to V.Valliappan from the assessee - firm or to show that the amount is a valid

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expenditure for the purpose of income-tax assessment, the argument that V.Valliappan has shown his income derived from the assessee in his individual assessment and paid income-tax, and therefore, taxing the aforementioned amount of Rs.11,35,879/- would lead to double taxation, does not hold water.

**10.** As regards the question of limitation, the contention of the learned Counsel for the appellant is that the re-assessment notice under Section 147 read with Section 148 of the I.T. Act was issued four years after the relevant assessment year and hence, the same is barred by limitation. As per the words contained in the bare provision of Section 147 of the I.T. Act, it is subject to Sections 148 to 153 of the I.T. Act. As per Section 149 (a)(ii)(iii) of the I.T. Act as it stood then, if the value of escaped assessment exceeds Rs.1,00,000/-, then the period of limitation for issuing re-assessment notice under Section 147 read with Section 148 of the I.T. Act is upto 10 years from the relevant assessment year. Subsequently, the Finance Act, 2001 (Act No.14 of 2001) reduced the same to 6 years with effect from June 1, 2001. In this case, the escaped assessment is Rs.11,35,879/- and the relevant assessment year is 2001-2002 corresponding to Financial Year 2000-2001 coming to end on March 31,



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2001. Hence, the income-tax department may issue notice within 10 years therefrom. In this case, the notice is dated November 5, 2007 and hence, it is not barred by limitation.

**11.** The appellant has not established its case in a satisfactory manner. In view of the foregoing narrative, the Tribunal is justifiable in holding that the alleged misappropriation cannot be a valid expenditure for the purpose of income tax assessment of the assessee and hence the assessing officer disallowing the same under Section 40A (2) of the I.T. Act is right. This Court finds no reason to interfere with the Tribunal's Order. The Substantial Questions of Law are answered accordingly. Hence, the instant appeal must fail.

**12.** In conclusion, the instant Tax Case Appeal is dismissed. In view of the facts and circumstances of this case, there shall be no order as to costs.

**[DR. G.JAYACHANDRAN, J.] [R.SAKTHIVEL, J.]**

**18 / 03 / 2026**

Index : Yes  
Speaking Order : Yes / No  
Neutral Citation : Yes / No  
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DR.G.JAYACHANDRAN, J.

AND

R.SAKTHIVEL, J.

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To

1.The Income Tax Appellate Tribunal  
'A' Bench  
Chennai.

2.The Assistant Commissioner of Income Tax  
Circle – I  
Virudhunagar.

PRE-DELIVERY JUDGMENT MADE IN  
TCA NO.151 OF 2012

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