
(1987) 01 AP CK 0013
In the Andhra Pradesh High Court
Case No : R.C. No. 192 of 1982

Andhra Sugars Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 20-01-1987

Acts Referred:

Income Tax Act, 1961 — Section 40

Citation : (1987) 165 ITR 259

Hon'ble Judges : R. Rao, J;B.P. Jeevan Reddy, J

Bench : Division Bench

Advocate : S. Parvatha Rao, for the Appellant; M. Suryanarayana Murthy, for the Respondent

Judgement

Rama Rao, J.—The question referred u/s 256(1) of the Income Tax Act of 1961 is as follows :

"Whether, on the facts and in the circumstances of the case, the provision of section 40(c)(i)(A) of the Act of 1961 can be applied for making a disallowance of Rs. 98,673 paid to the whole-time directors of the company as remuneration pertaining to the assessment year 1971-72 and earlier and claimed in the assessment year 1972-73 after the sanction of the Company Law Board was received ?"

2. The assessee-company claimed deduction of an amount of Rs. 98,673 under the head "Expenditure not relating to the year" as the amount represented the remuneration and sitting fee payable to three of its directors in the accounting period relevant to the assessment year 1971-72. Though the amount was paid to the directors during the accounting year relevant to the assessment year 1971-72 as advances, the final adjustment could not be made in the absence of sanction from the Company Law Board for such payment to the directors. The sanction order of the Company Law Board was given on April 23, 1971, in the accounting period relevant to the assessment year 1972-73. Apart from the amount relatable to the assessment year 1971-72, the assessee claimed

deduction under the same head for Rs. 1,91,494 for the assessment year 1972-73. The Income Tax Officer applying the limitation prescribed u/s 40(c) of the Act disallowed the amount relatable to the assessment year 1971-72. On appeal, the Appellate Assistant Commissioner held that the ceiling u/s 40(c) does not apply as the deduction relates to the period prior to April 1, 1972, and the claim of the assessee should be allowed as the sanction of the Company Law Board was given and the final adjustments in the accounts were made during the accounting period relevant to the assessment year 1972-73. On appeal, at the instance of the Revenue, the Appellate Tribunal held that in view of the overall ceiling limit u/s 40(c) of the Act which came into force from April 1, 1972, the Income Tax Officer is justified in disallowing the deduction and in this view reversed the order of the Appellate Assistant Commissioner.

3. Sri Parvatha Rao, learned counsel for the assessee, contends that pursuant to the sanction given by the Company Law Board permitting the payment of remuneration to the directors, the accounts were adjusted in the assessment year 1972-73 and such payment is relatable to the assessment year 1971-72 and, therefore, the question of applying the ceiling limit as provided u/s 40(c) does not arise and the entirety of the amount has to be allowed as deduction. Learned standing council for the Revenue contends that the liability to pay the amount accrued on the day when the Company Law Board has given the sanction during the accounting year relevant to the assessment year 1972-73 and as such the ceiling limit u/s 40(c) is attracted.

4. Section 40(c)(i)(A) : of the Income Tax Act postulates a ceiling of . Rs.72,000 regarding remuneration payable to the directors. It cannot be gainsaid that if the entirety of the amount is considered as relatable to the assessment year 1972-73, the ceiling limit envisaged under the amended provision, 40(c)(i)(A), is attracted. But, however, the complexity is beset in view of the clearance given by the Company Law Board for the payment of the amount in question at a later point of time, i.e., during the accounting year relevant to the assessment year 1972-73. To get at the crucial controversy, it is necessary to have a detailed survey of facts and events. During the accounting year relevant to the assessment year 1971-72, the amount payable towards remuneration to the director was paid as advance as section 198 of the Companies Act bars payment of excess remuneration without clearance from the Company Law Board. Pursuant to the sanction retrospectively for such payments by the Company Law Board in the accounting year relevant to the assessment year 1972-73, final adjustment was made in the year relevant to 1972-73 and the amount was claimed as deduction. The contention of learned council for the assessee is that the liability to pay arose during the assessment year in question as the approval of the Company Law Board was given only on April 28, 1971, and the directors were holding the amount paid as advances in trust as provided u/s 309 of the Companies Act. Section 309(5A) and section 309(5A) of the Companies Act are as follows :

"Section 309(5A) : If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company.

Section 309(5A) : The company shall not waive the recovery of any sum refundable to it under sub-section (5A) unless permitted by the Central Government."

5. It may be recalled that the amounts which have been paid to the directors have been put in suspense account and they have been finally adjusted during the accounting year for present assessment year. Therefore, as and when the amounts were paid, they were held in trust. Sub-section (5A) envisages statutory trust whereby any amount that has been paid in excess of the limits prescribed by the section without prior sanction of the Central Government shall be refunded by the director and until they are refunded, the concerned director holds it in trust for the company. The question of waiver of the recovery of the said amount is precluded by sub-section (5B). The finality of the payments was suspended due to their treatment as advances coupled with the statutory trust envisaged u/s 309 of the Companies Act. Learned counsel for the assessee invited us to the decision of the Supreme Court in *Nonsuch Estate Ltd. Vs. The Commissioner of Income Tax, Madras*, . In this decision, the agreement was entered into by the company for appointment of the managing agents of the company for a period of 10 years on certain remuneration and in accordance with section 326 of the Companies Act. The agreement was sent to the Central Government for approval by an application dated August 3, 1957. On September 2, 1957, the approval was accorded by the Government. On receipt of the approval, by a resolution dated October 4, 1957, the company reappointed the managing agents on the terms set out in the new agreement, for the period April 1, 1956, to June 30, 1956, and the company credited a sum of Rs. 9,320 to the account of the managing agents as their remuneration in accordance with the terms of the proposed new agreement. For the purpose of assessment to Income Tax, however, the company added back the said sum of Rs. 9,320 to its taxable income. In the next accounting year also, the same procedure was followed. For the assessment year 1959-60 for which the previous year was July 1, 1957, to June 30, 1958, a total sum of Rs. 97,188 was shown as remuneration payable to the managing agents during that year. This amount was made up of the amounts paid during the past two years. Though this sum did not pertain to the previous year relevant to the assessment year 1959-60, the company claimed it as deductible expenditure on the ground that the sum became payable only during that year when the Government accorded approval. In the context of considering whether such deduction is allowable for the assessment year 1959-60, the Supreme Court held as follows (p. 193) :

"Section 326 prohibits the appointment or reappointment of a managing agent

unless the Central Government approved such appointment or reappointment. The Central Government would not accord its approval unless the requirements specified in clauses (a),(b) and (c) of sub-section (2) of the section have been fulfilled. Therefore, it cannot be assumed that the Central Government will approve every proposed appointment or reappointment of a managing agent. Thus, in the instant case, it is only when the Central Government conveyed its approval to the appointment of M/s. Harrisons and Crossfield Ltd., as managing agents by its letter dated September 2, 1957, that the appointment became effective and the company's liability to pay the remuneration of the managing agents accrued. The position here is not that the liability had arisen earlier and its quantification only depended on the approval of the Central Government. It is true that the liability became effective from April 1, 1956, a date anterior to the relevant previous year, but that is because the Central Government chose to give its approval with retrospective operation. The liability in these circumstances cannot be said to have arisen from any date prior to September 2, 1957, when the approval was given as section 326 contains an absolute prohibition against the appointment or reappointment of a managing agent before the approval of the Central Government was obtained. In our opinion, the position is quite clear from the terms of section 326 and we do not consider it necessary to refer to the authorities cited by the learned counsel for either side."

6. The Supreme Court held that it is only on the approval by the Central Government that the appointment of the managing agents became effective and the company's liability to pay the remuneration accrued and did not arise on any date prior to the date of approval, i.e., September 2, 1957. This decision squarely applies to the facts of this case. The remuneration paid during the assessments year 1971-72 did not become effective and, therefore, the payments were labelled as advance payments in anticipation of the clearance of the Company Law Board. Further, the payment of these amounts should be considered as having been held in trust by the directors and there is an embargo on waiver of repayment of such amounts as provided u/s 309 of the Companies Act. The bar to the payments is lifted by the Company Law Board with retroactivity and consequently the suspense and trust abated and the liability to payment accrued on and from the date of sanction by the Company Law Board for such payments. As the sanction was accorded during the accounting year relevant to the assessment year 1972-73, the liability to pay arose during the assessment year 1972-73, In view of the liability for the assessments year 1972-73, this amount should be added to other payments in the year for the purpose of ceiling, says learned standing counsel for the Revenue. This contention lacks realistic impress and statutory sanction. The liability to pay alone arose during the assessment year 1972-73 as a sequel to clearance by the Company Law Board but the amounts are relatable to the preceding assessment year and despite the factum of payment in the preceding year, they have become effective in the present year due to suspense account and statutory trust. When the amount is relatable to the preceding assessment year, the ceiling limit which

came into effect from April 1, 1972, cannot be relegated to the assessment year 1971-72. The occasion of liability to pay the amount pursuant to sanction by the Company Law Board should not be stretched to have full sway over all other incidents. The liability to pay the amount arose during the assessment year 1972-73 due to belated sanction by the Company Law Board but the sanction with retroactivity cleared the mist and as such the amounts have to be necessarily considered as pertaining to the precedings year and the ceiling limit which was not existing during the said year cannot be invoked. Hence, we are unable to endorse the conclusion and reasoning of the Appellate Tribunal and we agree with the conclusion of the Appellate Assistant Commissioner.

7. Learned counsel for the assessee seeking to sustain the order of the first appellate authority by a different approach contended that the ceiling limit is applicable to the expenditure during the period exceeding eleven months comprised in a previous year only but should not be extended to expenditure covering past years. The contention is untenable. The unit taken for the purpose of applicability of ceiling limit in a particular year is sought to be nullified in the event of expenditure spreading over years. This approach is obviously not in accord with the purport of the provision.

8. In the result, question is answered in the negative and in favour of the assessee. No costs.