
(1987) 11 AP CK 0019
In the Andhra Pradesh High Court
Case No : R.C. No. 234 of 1982

Commissioner of Income Tax

APPELLANT

Vs

D.B.R. Mills

RESPONDENT

Date of Decision : 20-11-1987

Acts Referred:

Income Tax Act, 1961 — Section 40, 40A, 40A(5)

Citation : (1988) 172 ITR 366

Hon'ble Judges : Upendralal Waghray, J; B.P. Jeevan Reddy, J

Bench : Division Bench

Advocate : M. Suryanarayana Murthy, for the Appellant; Y. Ratnakar, for the Respondent

Judgement

B.P. Jeevan Reddy, J.—The Income Tax Appellate Tribunal, Hyderabad, has referred the following question u/s 256(1) of the Income Tax Act, 1961 :

"Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is correct in holding that the remuneration to the joint managing directors should not be restricted by applying the provisions of Section 40A(5) of the Income Tax Act, 1961 ?"

2. The assessee is a company. During the accounting years relevant to the assessment years 1974-75, 1975-76 and 1976-77, the assessee paid certain remuneration to two of its joint managing directors and claimed the same as deduction. The Income Tax Officer disallowed a portion of the amounts paid, applying the provisions contained in Sub-section (5) of Section 40A(5). On appeal, the Commissioner of Income Tax (Appeals) held that the correct provision applicable is Section 40(c)(i) and not Section 40A(5). Accordingly, he reduced the amount disallowed by the Income Tax Officer. The matter was then carried to the Tribunal. The Tribunal agreed with the opinion of the Commissioner of Income Tax (Appeals) that the correct provision applicable is Section 40(c)(i) and not Section 40A(5). (There was also an appeal by the assessee, with which we are not concerned herein, and, therefore, it is not necessary to set out the

facts relating to, or the contentions urged in, the said appeal). The question is ; where the directors are also employees, whether it is Section 40A(5) that applies or Section 40(c) ?

3. At the relevant time, the two provisions read as follows:

"40. Notwithstanding anything to the contrary in Sections 30 - 39, the following amounts shall not be deducted in computing the income chargeable under the head " Profits and gains of business or profession",--...

(c) in the case of any company-

(i) any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or to a person who has a substantial interest in the company or to a relative of the director or of such person, as the case may be;

(ii) any expenditure or allowance in respect of any assets of the company used by any person referred to in Sub-clause (i) either wholly or partly for his own purposes or benefit,

if in the opinion of the Income Tax Officer any such expenditure or allowance as is mentioned in Sub-clauses (i) and (ii) is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom, so, however, that the deduction in respect of the aggregate of such expenditure and allowance in respect of any one person referred to in Sub-clause (i) shall, in no case, exceed-

(A) where such expenditure or allowance relates to a period exceeding eleven months comprised in the previous year, the amount of seventy-two thousand rupees;

(B) where such expenditure or allowance relates to a period not exceeding eleven months comprised in the previous year, an amount calculated at the rate of six thousand rupees for each month or part thereof comprised in that period :

Provided that in a case where such person is also an employee of the company for any period comprised in the previous year, expenditure of the nature referred to in Clauses (i), (ii), (iii) and (iv) of the second proviso to Clause (a) of Sub-section (5) of Section 40A shall not be taken into account for the purposes of Sub-clause (A) or Sub-clause (B), as the case may be.

Explanation.--The provisions of this clause shall apply notwithstanding that any amount not to be allowed under this clause is included in the total income of any person referred to in Sub-clause (i)."

"40A. (I) The provisions of this section shall have effect notwithstanding anything to the Contrary contained in any other provision of this Act relating to the computation of income under the head " Profits and gains of business or profession"

(5) (a) Where the assessee-

(i) incurs any expenditure which results directly or indirectly in the payment of any salary to an employee or a former employee, or

(ii) incurs; any expenditure which- results directly or indirectly in the provision of any perquisite (whether convertible into money or not) to an employee or incurs directly or indirectly any expenditure or is entitled to any allowance in respect of any assets of the assessee used by an employee either wholly or partly for his own purposes or benefit,

then, subject to the provisions of Clause (b), so much of such expenditure or allowance as is in excess of the limit specified in respect thereof in Clause (c) shall not be allowed as a deduction :

4. Provided that where the assessee is a company, so much of the aggregate of-

(a) the expenditure and allowance referred to in sub-clauses (i) and (ii) of this clause ; and

(b) the expenditure and allowance referred to in Sub-clauses (i) and (ii) of Clause (c) of Section 40,

in respect of an employee or a former employee, being a director or a person who has a substantial interest in the company or a relative of the director or of such person, as is in excess of the sum of seventy-two thousand rupees, shall in no case be allowed as a deduction :

5. Provided further that in computing the expenditure referred to in Sub-clause (i) or the expenditure or allowance referred to in Sub-clause (ii) of this clause or the aggregate referred to in the foregoing proviso, the following shall not be taken into account, namely :--

(i) the value of any travel concession or assistance referred to in Clause (5) of Section 10;

(ii) passage moneys or the value of any free or concessional passage referred to in Sub-clause (i) of Clause (6) of Section 10 ;

(iii) any payment referred to in Clause (iv) or Clause (v) of Sub-section (1) of Section 36 ;

(iv) any expenditure referred to in Clause (ix) of Sub-section (1) of Section 36 ;

(b) Nothing in Clause (a) shall apply to any expenditure or allowance in relation to-

(i) any employee in respect of any period of his employment outside India ;

(ii) any employee being an individual referred to in Sub- Clause (vii) or Sub-clause (viiia) of Clause (6) of Section 10 in respect of any period during which he is entitled to the exemption under Sub-clause (vii) or, as the case may be, Sub-

clause (viia) aforesaid ;

(iii) any employee whose income chargeable under the head Salaries is seven thousand and five hundred rupees or less;

(c) The limits referred to in Clause (a) are the following, namely :--(i) in respect of the expenditure referred to in Sub-clause (i) of Clause (a), in the case of an employee, an amount calculated at the rate of five thousand rupees for each month or part thereof comprised in the period of his employment in India during the previous year, and in the case of a former employee, being an individual who ceases or ceased to be the employee of the assessee during the previous year or any earlier previous year, sixty thousand rupees :

6. Provided that where the expenditure is incurred on payment of any salary to an employee or a former employee engaged in scientific research during any one or more of the three years immediately preceding the commencement of the business and such expenditure is deemed under the Explanation to Clause (i) of Sub-section (1) of Section 35 to have been laid out or expended in the previous year in which the business is commenced, the limit referred to in this sub-clause shall, in relation to the previous year in which the business is commenced, be an amount calculated at the rate of five thousand rupees for each month or part thereof comprised in the period of his employment in India during the previous year in which such business is commenced and in the period of his employment in India during which he was engaged in scientific research during the three years immediately preceding that previous year.

(ii) in respect of the aggregate of the expenditure and the allowance referred to in Sub-clause (ii) of Clause (a), one-fifth of the amount of the salary payable to the employee or an amount calculated at the rate of one thousand rupees for each month or part thereof comprised in the period of employment in India of the employee during the previous year, whichever is less....."

7. A reading of the two provisions discloses that while Section 40(c) imposes a ceiling upon expenditure incurred on its directors by a company, Section 40A(5) prescribes certain limits on the remuneration payable to the employees, including the employees of a company. Where, therefore, a director is not an employee, all that one has to look to is Section 40(c); similarly, where an employee is an employee simpliciter, it is only Sub-section (5) of Section 40A which has to be looked into in this behalf. The difficulty arises only where the director also happens to be an employee of the company. In such a case, both these provisions have to be looked into and applied while fixing the ceiling upon the expenditure incurred upon him or the remuneration payable to him, as the case may be. To be more precise, in the case of a director-employee while determining the expenditure incurred upon him for the purpose of applying the ceiling prescribed in Section 40(c),--

(i) the expenditure of the nature referred to in Clauses (i), (ii), (iii) and (iv) of the second proviso to Clause (a) of Sub-section (5) of Section 40A shall not be

taken into account;

(ii) the aggregate of the expenditure and the allowance referred to in Sub-clauses (i) and (ii) of Clause (a) of Sub-section (5) and the expenditure and allowance referred to in Sub-clauses (i) and (ii) of Clause (c) of Section 40 shall not exceed Rs. 72,000.

8. It is necessary to point out that while Section 40(c) deals with the expenditure incurred upon the directors of a company alone, Sub-section (5) of Section 40A is not confined to companies; only certain provisions of Sub-section (5) are applicable to the employees of companies where they also happen to be the directors.

9. It would thus be evident that it would be too simplistic to ask which of the provisions among the aforesaid two provisions are applicable to directors-employees. The primary provisions applicable to them are those contained in Section 40(c); but some of the provisions contained in Section 40A(5) also apply to them. We have already set out the true position in the preceding paragraph. Accordingly, we answer the question referred to us in the following manner, viz., while applying the ceiling on the expenditure incurred upon and the remuneration paid to and perquisites provided to a director-employee, (1) the expenditure of the nature referred to in Clauses (i), (ii), (iii) and (iv) of the second proviso to Clause (a) of Sub-section (5) of Section 40A shall not be taken into account; and (2) the aggregate of the expenditure and allowance referred to in Sub-clauses (i) and (ii) of Clause (a) of Sub-section (5) and the expenditure and allowance referred to in Sub-clauses (i) and (ii) of Clause (c) of Section 40 shall not exceed Rs. 72,000. In all other respects, it is Section 40(c) that applies to directors-employees.

10. Before we conclude, we think it appropriate to refer to a few decisions brought to our notice by counsel. The first decision cited is of the Gujarat High Court in Additional Commissioner of Income Tax, Gujarat Vs. Tarun Commercial Mills Ltd., . The question was whether Section 40(c)(i) (as it then stood) is not applicable to directors of a company who are also its employees, and that only the provisions of Section 40(c) will be applicable. (Section 40(a)(v), it may be noted, was omitted by the Finance (No. 2) Act, 1971, with effect from April 1, 1972. Sub-section (5) of Section 40A practically corresponds to the said provision). The court expressed the opinion that while Section 40(a)(v) was a general provision applicable to all employees, whether employed by the company or not, Section 40(a)(v) is a special provision applicable only to directors of a company. Since a special provision prevails over a general provision, it was held Section 40(a) alone is applicable to director-employees of a company. The assessment year concerned therein was 1969-70 and the said opinion was expressed having regard to the provisions as they then stood and were considered by the court. The said decision cannot be taken as an authority on the provisions which fall for our consideration.

11. The Punjab and Haryana High Court considered the said aspect in Commissioner of Income Tax Vs. Patiala Flour Mills Co. (P.) Ltd., . The conclusion arrived at by them broadly accords with the view taken by us.

12. International Instruments (P.) Ltd. Vs. Commissioner of Income Tax, Karnataka, is a decision of the Karnataka High Court. In this case too, both the provisions were read together in the case of a director-employee and the maximum permissible deduction both on account of expenditure and salary was held to be Rs. 72,000.

13. Another decision cited is that of the Kerala High Court in Travancore Rayons Ltd. Vs. Commissioner of Income Tax, . In this case too, it was held that in the case of a director-employee, the total amount expended upon him, as also the salary paid to him, cannot exceed the maximum of Rs. 72,000.

14. There shall be no order as to costs.