

(1971) 06 CAL CK 0005

In the Calcutta High Court

Case No : Income-tax Reference No. 85 of 1963

Commissioner of Income Tax

APPELLANT

Vs

Edward Keventer (Private) Ltd.

RESPONDENT

Date of Decision : 22-06-1971

Acts Referred:

Income Tax Act, 1922 — Section 10(2), 10(4A)

Citation : (1972) 86 ITR 370

Hon'ble Judges : Sankar Prasad Mitra, J;A.N. Sen, J

Bench : Division Bench

Advocate : B.L. Pal and Chandan Banerjee, for the Appellant;Ashoke Sen, S.K. Acharya, P.K. Pal and S.K. Gupta, for the Respondent

Judgement

A.N. Sen, J.—This reference u/s 66(1) of the Indian Income Tax Act, 1922, raises the question of applicability of the provisions of Section 10(4A) of the said Act to the remuneration paid to the directors of Edward Keventer Pvt. Ltd. which happens to be the assessee in the instant case.

2. The assessee is a private limited company of which at the material times there were only 5 members, all of whom, except Sri K.A. Dikshit, were also directors of the company. They are :

- (1) Rani Jagadamba Kumari Devi who holds 65% of the total shares.
- (2) Sri A.C. Roy Chowdhury who holds 10.5% of the total shares.
- (3) Sri J.C. Chowdhury who holds 10.5% of the total shares.
- (4) Sri S. Das Gupta who holds 10.5% of the total shares.
- (5) Sri K.A. Dikshit who holds 3.5% of the total shares.

3. It may be noted that the assessee was originally a Swedish concern which was taken over in 1949. Lt. Genl. Madan Shumshere Jung Bahadur Rana of Nepal, since deceased, made the largest investment and purchased the majority of

shares. The Rana during his lifetime had been a director of the company and the chairman of the board of directors. Rani Jagadamba Kumari Devi is the widow of the late Rana and upon the death of the Rana she inherited the shares and succeeded to the office of the chairman of the board of directors of the company.

4. The articles of association of the company at the material times, inter alia, provided :

Article 109.

"Sri Animesh Chandra Roy Chowdhury, Sri Jagadish Chandra Chowdhury and Sri Sukhomoy Das Gupta or their nominees or successors in the board, as the case may be, each, shall successively by rotation, become managing director of the company, each to hold office for a maximum of two years at a stretch."

Article 110.

"The remuneration of the directors shall be as follows :

The board of directors shall from time to time fix the remuneration of the directors, but in no case shall be less than Rs. 4,000 per month as office allowance and an amount equivalent to 10% of the net profit of the company earned in the previous year. This amount shall be distributed as follows :

(1) Lt. Genl. Madan Shumshere Jung Bahadur Rana or his nominee or successor in the board, 40%.

(2) Sri Animesh Chandra Roy Chowdhury or his nominee or successor in the board, 20%.

(3) Sri Jagadish Chandra Chowdhury or his nominee or successor in the board, 20%.

(4) Sri Sukhomoy Das Gupta or his nominee or successor, 20%.

Besides the above remuneration the directors who will be in the active management of the company shall be entitled to such conveyance allowances as may be fixed by the directors from time to time."

Article 111.

"The directors may, from time to time, confer upon a managing director for the time being such of the powers exercisable under these presents by the directors as they may think fit and may confer such powers for such time and to be exercised for, such objects and for the purposes, and upon such terms and conditions and with such restrictions as they think expedient, and they may confer such powers either collaterally with or to the exclusion of and in substitution for all or any of the powers of the directors in that behalf, and may from time to time revoke, withdraw, alter or vary-all or any of such powers."

Article 120.

"If any director being willing shall be called upon to perform extra service or to make any special exertion in going or residing away from Calcutta for any of the purposes of the company or in giving special attendance to the business of the company as a member of the committee of directors, the company may remunerate the director so, doing either by a fixed sum or by a percentage of profits or otherwise as may be determined by the directors, and such remuneration may be either in addition to or in substitution for his or Her share in the remuneration above provided for the directors."

5. On the basis of the articles, the directors have been receiving their shares of the remuneration. The said Articles 109, 110 and 111 along with various other articles of the company came to be amended later on. The amended articles, however, were not in force during the relevant years.

6. The assessment years in question are 1956-57 to 1959-60, the relevant previous years being the financial years which ended on 31st March, 1956, 31st March, 1957, 31st March, 1958, and 31st March, 1959, respectively.

7. During the relevant years, the following sums were paid on account of remuneration and commission :

Names Remuneration (Rupees)

Commission (Rupees)

Total (Rupees)

1956-57.

Rani Jagadamba Kumari Devi 19,200 3,998 23,198

Sri A. C. Roy Chowdhury 8,800 1,832 10,632

Sri S. Das Gupta 8,800 1,832 10,632

Sri J. C. Chowdhury 7,600 1,832 9,432

Sri K. A. Dikshit 2,400

500

2,900

46,800

9,994

56,794

1957-58.

Rani Jagadamba Kumari Devi 19,200 4,589 23,789

Sri A. C. Roy Chowdhury 8,800 2,103 10,903

Sri S. Das Gupta 8,800 2,103 10,903

Sri J. C. Chowdhury 7,600 2,103 8,703

Sri K. A. Dikshit 2,400

575

2,975

46,800

11,473

58,273

1958-59.

Rani Jagadamba Kumari Devi 19,200 1,845 21,045

Sri A. C. Roy Chowdhury 8,800 846 9,646

Sri S. Das Gupta 8,800 846 9,646

Sri J. C. Chowdhury 7,600 846 8,446

Sri K. A. Dikshit 2,400

230

2,630

46,800

4,613

51,413

1959-60.

Rani Jagadamba Kumari Devi 19,200 4,119 23,319

Sri A. C. Roy Chowdhury 8,800 1,888 10,688

Sri S. Das Gupta 8,800 1,888 10,668

Sri J. C. Chowdhury 7,600 1,888 9,488

Sri K. A. Dikshit 2,400

515

2,915

46,800

10,298

57,098

8. Out of the total remuneration of Rs. 56,794 inclusive of commission paid during the year 1956-57, the Income Tax Officer disallowed a sum of Rs. 46,162, For the year 1957-58, out of the total amount of Rs. 58,273 paid on account of remuneration and commission, the Income Tax Officer disallowed Rs. 45,753. Similarly, for the year 1958-59, out of the total amount of Rs. 51,413 paid on account of remuneration and commission, the Income Tax Officer disallowed Rs. 42,967 and for the year 1959-60 out of the total amount of Rs. 57,098 paid on account of such remuneration and commission, the Income Tax Officer disallowed a sum of Rs. 46,720.

9. It may be noted that prior to the incorporation of Section 10(4A) which was inserted by Section 7 of the Finance Act, 1956, with effect from the 1st April, 1956, the entire amount of remuneration and commission so paid in any and every year was being allowed and during the relevant years the Income Tax Officer applying the provisions of Section 10(4A) which had come into existence, disallowed the sums earlier mentioned.

10. The material portion of Section 10(4A) reads :

"Nothing in Sub-section (2) shall, in the computation of the profits and gains of a company, be deemed to authorise the making of--

(a) any allowance in respect of any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or a person who has a substantial interest in the company within the meaning of Sub-clause (iii) of Clause (6C) of Section 2, or.

if in the opinion of the Income Tax Officer any such allowance is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it there from"

11. Before the Income Tax Officer it was contended on behalf of the assessee that considering the gross profit and the net profit accruing during the 4 years in question, the payment of remuneration and commission to the board of directors was reasonable. It was also submitted that such payments were covered by Article 110 of the articles of association of the company. The Income Tax Officer, for reasons given in his order, held that the remuneration drawn by the directors was far in excess of the amount justified by the rendering of services. He, accordingly, took recourse to Section 10(4A) of the Income Tax Act, 1922, and disallowed the above-mentioned amounts out of the total remuneration and commission paid during each year. The reasons which weighed with the Income Tax Officer appear to be that so far as Rani Jagadamba Kumari Devi was concerned, she was interested in the company merely as a custodian of the investments made in the said company by her deceased husband and services alleged to have been rendered by her did not justify the payment of the remuneration ; and so far as J.C. Chowdhury and S. Das Gupta were concerned, they were not devoting their full time and attention to the affairs of the assessee-company, being directors of two other companies also, and so far as A.C. Roy

Chowdhury was concerned, he was not at all looking after the affairs of the company and so far as K.A. Dikshit was concerned he was serving the Rani and not the assessee-company. With regard to the commission paid, the Income Tax Officer said that it was only an allocation of profits.

12. As against the orders of the Income Tax Officer disallowing the amounts mentioned in his orders for the relevant years, the assessee appealed to the Appellate Assistant Commissioner. The Appellate Assistant Commissioner made a consolidated order in all the 4 appeals and confirmed the orders passed by the Income Tax Officer, maintaining the, disallowance of the bulk of the remuneration and commission by recourse to Section 10(4A) of the Act. It may be noted that the assessee filed before the Appellate Assistant Commissioner an affidavit dated the 8th of April, 1961, sworn by A.C. Roy Chowdhury and also certain letters signed by Sri K.A. Dikshit, in view of the comments and criticisms made by the Income Tax Officer of the directors, to show that the criticisms made by the Income Tax Officer were wrong on the facts. The Appellate Assistant Commissioner while confirming the order of the Income Tax Officer had further observed that the business centres of the assessee were being looked after by highly qualified European personnel and, therefore, the work at the head office as well as the business centres required mere supervision for which the service of one of the directors was sufficient. The assessee preferred further appeals to the Appellate Tribunal. The Tribunal allowed the appeals preferred by the assessee. According to the Tribunal, the only factors relevant for the purpose of judging whether the remuneration was excessive or unreasonable by which the provisions of Section 10(4A) could be applied, were (i) the legitimate business needs of the company, and (ii) the benefit derived by the company by making such expenditure and these two factors had to be viewed with the eye of the businessman himself. The Tribunal held that the entire approach of the department to the case for justifying the applicability of the provisions of Section 10(4A) was wrong. The department had not viewed the legitimacy or reasonableness of the assessee's claim from the point of view of the businessman and the factors taken into consideration by the Income Tax authorities did not substantiate a case for disallowing any portion of the remuneration by application of Section 10(4A) of the Act. The Tribunal had accordingly deleted the addition on account of disallowance out of directors' remuneration and allowed the appeals.

13. On the application of the department the Tribunal on the aforesaid facts referred the following question u/s 66(1) of the Income Tax Act :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the disallowance of the amounts of Rs. 46,162, Rs. 45,753, Rs. 42,967 and Rs. 46,720 for the assessment years 1956-57, 1957-58, 1958-59 and 1959-60, respectively, out of the remuneration and commission paid to the 4 directors of the company and to Sri K.A. Dikshit by recourse to Section 10(4A) of the Indian Income Tax Act, 1922, was justified and in deleting the said

additions ?"

14. Mr. B.L. Pal, learned counsel, appearing on behalf of the department, has submitted that the order of the Income Tax Officer disallowing the bulk of remuneration paid to the directors by applying "the provisions of Section 10(4A) is proper and perfectly justified. He contends that Section 10(4A) is a special provision which controls the operation and effect of all the clauses in section"10(2) including section 10(2)(xv) and, therefore, even if the conditions of section 10(2)(xv) are fulfilled, an expenditure may still not be allowed, if it comes within the mischief of Section 10(4A). It is the argument of Mr. Pal that Section 10(4A) confers upon the Income Tax Officer an overriding power over the decision of the businessman concerned in testing the excessiveness or unreasonableness of any expenditure in the light of two guiding factors, namely : "(i)" legitimate business needs of the company, and (ii) benefit derived by the company or accruing to it by the expenditure in question. He contends that the Income Tax Officer has the power to question both the aspects, namely : (i) whether the business needs were legitimate, and (ii) whether the benefits derived are commensurate with the expenditure. Mr. Pal has submitted that the onus rests on the assessee to produce proper evidence to establish the duties of directors and services rendered by them and to satisfy whether and to what extent the profits have been increased by any special aptitude of any of the directors. The learned counsel has commented that the Income Tax Officer has considered at length the relevant materials "and has exhaustively dealt with the evidence. The learned counsel points out that, the remuneration paid accounts for a major portion of the profits to the company, about 33% of the gross profits and about, 50% of the net profits. The learned counsel has submitted that the Income Tax Officer after having considered all the relevant materials has rightly applied the provisions of Section 10(4A) in disallowing the bulk of remuneration paid. Mr. Pal has also drawn our attention to the order of the Appellate Assistant Commissioner who confirmed the orders of the Income Tax Officer and he has pointed out that the Appellate Assistant Commissioner has also exhaustively discussed the matter. Mr. Pal complains that the Tribunal has not discussed any of these findings of the taxing authorities and has proceeded on an erroneous approach to the question. Mr, Pal has referred to the following decisions : Natesan and Co. Private Ltd. v.: Commissioner of Income Tax [1964] 51 ITR 386, NUND AND SAMONTA COMPANY PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BIHAR AND ORISSA., Nund and Samont Company (P.) Ltd. v. Commissioner of Income Tax [1970] 78 ITR 208, Commissioner of Income Tax, Madras Vs. Raman and Raman Ltd., , COMMISSIONER OF Income Tax, UTTAR PRADESH Vs. MOTOR AND GENERAL SALES (P.) LTD., , MERCANTILE EXPRESS CO. (PRIVATE) LTD. Vs. COMMISSIONER OF Income Tax, CALCUTTA, AND OTHERS., and The Newton Studios Ltd., Madras Vs. The Commr. of Income Tax, Madras, .

15. Mr. A.K. Sen, learned counsel appearing on behalf of the assessee has submitted that the entire approach to the problem by the taxing authorities was wrong and the Tribunal has rightly pointed out the same in its order. Mr. Sen has

contended that the provision contained in Section 10(4A) is more or less by way of clarification of the provision contained in Section 10(2)(xv) and is in the nature of a statutory instruction. Mr. Sen contends that the legitimate business needs of the company and the benefit derived or accruing to the company from any allowance made, have to be considered from the view-point of the businessmen and the Income Tax Officer cannot substitute his own views on these matters ignoring the viewpoint of the businessmen. It is the contention of Mr. Sen that, in applying the provisions of Section 10(4A), the Income Tax Officer must not act capriciously or arbitrarily. He must act judiciously and form his opinion by considering the relevant factors, namely, (i) legitimate business needs of the company, and (ii) the benefit derived by or accruing to the company and these factors he must consider from the standpoint of the businessmen. Mr. Sen argues that the legitimacy of the business needs of a company may differ from company to company and the question -will have to be decided on the facts of each particular case. Mr. Sen submits, that similarly the question, whether any benefit has been derived and, if so, the nature and extent thereof, will depend on the facts of the case. Mr. Sen has argued that in the instant case the Income Tax Officer has ignored the basic facts and has proceeded entirely on a wrong basis. It is the argument of Mr. Sen that the company is a private limited company which is in the nature of a partnership. The articles of association of the company emphasise this aspect and reiterate this principle. The rotation provided in Article 109 relating to appointment of managing director provides for equality in the participation in the management and the provision in Article 110 of the articles with regard to the remuneration of directors makes it clear that the remuneration is a collective earning and the earning is that of a lump-sum which is distributed amongst the directors according to the articles. Mr. Sen contends that applying the principles of partnership it is essential that the members continue to function in accordance with the articles which constitute the agreement between the members including the directors and also between the members and the company ; and the smooth working of the company on the basis of the articles is an essential business need of the company. Mr. Sen points out that the provision in the articles relating to the remuneration of the director has been in existence long before Section 10(4A) came to be introduced in the statute and he comments that it can never be said that this article was introduced as a device to escape the provision of Section 10(4A). Mr. Sen has submitted that taking into consideration the nature of business, the volume of work done and the profits earned, the total amount spent on the directors' remuneration in the years in question can never be said to be excessive or unreasonable, Mr. Sen has drawn our attention to the fact that the company has two producing centres at Fattabad and Ghoom and other branches which are distributing centres and the turnover ran into several lakhs. Mr. Sen has pointed out that for a company of this type the head office expense, apart from what is paid to the directors, does not exceed Rs. 500 per month. Mr. Sen argues that this fact alone goes to show the amount of work which the directors had to do for themselves for the company and it is the submission of Mr. Sen that under such circumstances the total

amount spent for the head office including the remuneration of the directors did not exceed Rs. 5,500 per month and the said amount can never be considered to be unreasonable or excessive. Mr. Sen has argued that the value of services rendered or of the benefits which accrue to a company cannot be properly judged by reference to the number of hours of work put in by any of them and the said question will necessarily depend on various other factors. He contends that Rani J. K. Devi as chairman of the board of directors was advising on all important matters and her advice was considered to be of the greatest possible importance from the view-point of the benefit of the company and also of the business need of the company.

16. Section 10(4A) casts a duty and confers the power on the Income Tax Officer not to allow any deduction in respect of any remuneration or benefit or amenity to any director or any person who has a substantial interest in the company, as contemplated in the said section, if the Income Tax Officer is of the opinion that any such allowance is excessive or unreasonable, having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom. It is to be noted, as the section itself expressly mentions, that this power can be exercised by the Income Tax Officer, in the matter of computation of the profits and gains of the company, notwithstanding the provisions contained in Section 10(2), which must necessarily include Section 10(2) (xv). This section contains substantive provision and is not merely clarificatory in nature. This section clearly contemplates that even if the requirements of Section 10(2) including the necessary requirements u/s 10(2)(xv) are satisfied, the Income Tax Officer is enjoined not to make any allowance in respect of any expenditure which may come within the mischief of Section 10(4A). In other words, even if the qualitative characteristics of Section 10(2)(xv) justify any item of expenditure as wholly and exclusively laid for the business of the company, the Income Tax Officer is enjoined and empowered to consider the reasonableness or otherwise of the quantum or the amount expended on the item, if the item of expenditure comes within the purview of Section 10(4A) and the Income Tax Officer is not to allow the entire amount so spent, if the provisions of Section 10(4A) are attracted and the sum spent comes within the mischief of the said provisions. The Income Tax Officer must, however, consider the entire position dispassionately and objectively and from the view-point of a prudent businessman. The Income Tax Officer must appreciate that Section 10(4A) is not to be applied capriciously as a matter of routine and he must realise that the said section is to be applied judiciously and can only be applied, if the necessary conditions of the said section are satisfied. The opinion of the Income Tax Officer as to the reasonableness or otherwise of the amount spent must not be arbitrary and is not to be the subjective and prejudiced opinion of an officer interested in collecting more revenue. The opinion as to reasonableness or otherwise of the amount spent must be formed, having regard to the legitimate business needs of the company and the benefit derived by the company or accruing to the company from the said sum expended. The said Section 10(4A) itself, while conferring the

necessary powers on the Income Tax Officer, places two limitations in the matter of exercise of the power and the said sections enjoin the Income Tax Officer to take into consideration in exercising the power, (1) the legitimate business needs of the company, and (2) the benefit derived by or accruing to the company in forming any opinion as to the reasonableness or otherwise of the amount spent. The legitimate business needs of the company must be judged from the view-point of the company itself and must be viewed from the point of view of a prudent businessman. It is not for the Income Tax Officer to dictate what the business needs of the company should be and he is only to judge the legitimacy of the business needs of the company from the point of view of a prudent businessman. The benefit derived or accruing to the company must also be considered from the angle of a prudent businessman. The term "benefit" to a company in relation to its business, it must be remembered, has a very wide connotation and may not necessarily be capable of being accurately measured in terms of pound, shillings and pence in all cases. Both these aspects have to be considered judiciously, dispassionately without any bias of any kind from the view-point of a reasonable and honest person in business.

17. In an unreported decision of this court in the case of Ghanga Saran and Sons Pvt. Ltd. v. Commissioner of Income Tax (I. T. Reference No. 11 of 1961), this court observed :

"Dr. Paul appearing for the assessee has urged that it is true that the decisions in Eastern Investments Ltd. Vs. Commissioner of Income Tax, West Bengal, and Newtowne Studios Ltd. v. Commissioner of Income Tax, as referred to before, have been modified by incorporation of Section 10(4A) of the Indian Income Tax Act, but he has contended that such wide powers as are given under this section must be exercised within cautious limitations as it does not envisage that the tax authorities should have absolute discretion and should exercise their own judgment without reference to reasonableness and commercial expediency. The Income Tax Officer should have considered the case from the point of view of the businessman and not as an outsider. He should have placed himself in the position of a person in business. We are of opinion that the argument as advanced by Dr. Paul is based on sound reasons."

18. The Madras High Court in the case of Natesan and Co. Private Ltd. v. Commissioner of Income Tax, while dealing with Section 10(4A), observed at pages 391-392 :

"This provision was inserted by the Finance Act of 1956. The object of the legislature was to prevent avoidance of tax by companies allowing remuneration or other benefits to directors or persons substantially interested in the company extravagantly without a due sense of commercial propriety or without balancing it with the adequacy of the benefit obtained by their services. Prior to 1956, before the amendment, an assessee-company could claim deduction of allowance to directors u/s 10(2)(xv). But the department was forbidden to sit in the armchair of the management of the company and decide what would be the

proper remuneration. (See N.M. Rayaloo Iyer and Sons, Mathurai Vs. Commr. of Income Tax Excess Profits Tax, Madras,). The company was, therefore, free to be lavish in the matter of payment of such remuneration, though the department was always inclined to frown upon even a little liberality. Now the question is what is the scope of Section 10(4A). The Income Tax Officer is not authorised or empowered to grant any allowance resulting in any remuneration, benefit, or amenity to a director or a person having any substantial interest in the company if in the opinion of the officer such allowance would be excessive or unreasonable. The officer cannot of course be arbitrary or capricious. He cannot make a guess-work relying on his instinct. He must form an opinion having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom. He must say that the business of the company is such that it does not need a highly remunerated director, Or he may after an analysis of the work done by the director reach the conclusion. that the company does not derive benefits corresponding to the remuneration paid. It is obvious that the Income Tax Officer must apply his mind to the nature of the business of the company, the actual work done by the directors, the quantum of income earned by the company, the necessity to pay remuneration to the director and to other allied considerations, to form an opinion whether or not the payment is reasonable or excessive. The mere ipse dixit of the officer unrelated to the criteria laid down in the statute would not be a considered opinion but. dogmatic assertion. We have no doubt that the statute does not permit the department to adopt such a course."

19. The following observations of the Madras High Court in the case of Commissioner of Income Tax v. Reman and Raman Ltd., may also be usefully noted :

"Further, we are not satisfied that Sub-section (4A) was merely clarificatory of Section 10(2)(xv). This is because Sub-section (4A) will come into play even where there is an expenditure wholly and exclusively laid out for the purpose of the business. Where it is a case of a closed company, discretion, of course, is given to the revenue to see whether the allowance is excessive or unreasonable. But, that discretion is not given to the revenue u/s 10(2)(xv). Under that provision, once it is shown that a certain amount is expended wholly and exclusively for the purpose of the business, there is no option for the department but to make the allowance."

20. In the case of Nund and Samont Co. (P.) Ltd. v. Commissioner of Income Tax, the Supreme Court held, at pages 270-271 :

"Under the articles of association, the rate of remuneration to be paid to the managing director and the deputy managing director was fixed. The case was clearly covered by the terms of Section 10(4A), and the Income Tax Officer had jurisdiction to consider whether the allowance was excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it there from"

21. Whether in any particular case the Income Tax Officer has properly exercised his jurisdiction and power u/s 10(4A) or not, must necessarily depend on the facts of each particular case. The principles which should, however, govern the exercise of the power and jurisdiction by the Income Tax Officer have already been noted. Whether the Income- tax Officer has properly and correctly applied the principles underlying the said Section 10(4A) or not will have to be tested in the light of the facts of every particular case. The other cases which were cited from the Bar are not of any material assistance in the facets of the present case.

22. In the facts of the present case, we are of opinion that the Income Tax Officer did not properly exercise his jurisdiction and power u/s 10(4A) and the Income Tax Officer did not apply the correct principles in forming his opinion as to the reasonableness of the sums paid to the directors. The Income Tax Officer appears to have considered the entire matter essentially from the angle of a tax collector and he has not applied his mind to the basic questions dispassionately and objectively from the view-point of a prudent businessman. He has not given any proper consideration to the legitimate business needs of the company and, on the aspect of benefit, his view has been mainly influenced by applying his mind only to the kind of physical or hard labour done by the directors. Even on this aspect, the assessment of the Income Tax Officer is clearly wrong. Judging from the angle of the tax collector, the Income Tax Officer considers the sums paid to the directors to be unreasonable on the basis of percentage in relation to the profits of the company; ignoring the other relevant considerations. The Income Tax Officer does not appreciate that for a company of this kind, which has two producing centres and other distributing centres with a huge annual turnover ranging from over Rs. 23,66,000 to over Rs. 30,86,000 during the relevant years in question, total head office expenses of about Rs. 5,000 per month inclusive of all payments to directors both on account of remuneration and commission, cannot by any proper standard be said to be unreasonable, having regard to the legitimate business needs of such a company. There appears to be no justification for the finding that the payment of commission was by way of allocation of profits. The fact that, apart from payments made to directors, a nominal sum of Rs. 500 per month is paid by way of salaries to employees suggests clearly, in our opinion, that the directors must necessarily be doing substantial work. The affidavit of A. C. Roy Chowdhury dated the 8th of April, 1961, which was filed before the Appellate Assistant Commissioner clearly indicates the nature of duties of the directors and the work done by them. The particulars of work mentioned in the said affidavit are the normal and usual kinds of administrative duties which must be carried out to keep any company going and there can be no manner of doubt in the instant case that the said duties are done by the directors. The smooth running of the company and the steady increase in the profits except for one year, also indicates that the directors must be discharging their duties properly and are rendering proper services to the company. The fact that some of the directors also happen to be directors of some other companies does not establish that the directors are not discharging their

duties properly or are not rendering sufficient services to the company. The amounts paid to the directors, other than the Rani inclusive of remuneration and commission, appear to vary between "Rs. 750 and Rs. 850 per month for each of them. These amounts paid to these individual directors, excepting the Rani, cannot be considered to be excessive or unreasonable by any standard.

23. So far as the Rani is concerned she happens to be the chairman of the board of directors. It may be true that she does not participate in the day to day administration of the business of the company in the way the other directors do. It is, however, clear that she bears the largest amount of responsibility in the matter of taking all important decisions relating to the affairs of the company, its administration and business. It appears that any and every matter of importance is referred to the Rani and her advice and decision in all such matters are of vital consequence in guiding the affairs of the company and its smooth and efficient administration. In every company of any standing and status, there will necessarily be employees and their number and cadre and remuneration will depend on the nature of the company, its needs and capacity. There will be ordinary workers and there will be officers and amongst them there may again be gradation. The fact that there are employees and officers who may do most of the hard labour, cannot justify an argument that the remuneration paid to directors should not be allowed. Directors who are at the helm of the affairs of the company remain mainly responsible for managing the affairs of the company and the company may get larger benefit from their advice, guidance, supervision and effective and efficient manner of discharge of their responsibility of properly managing the affairs of the company. Among the directors again there may be a division of labour for the efficient administration of the affairs of the company and there may also be managing directors with larger powers and greater responsibility in the matter of management of the affairs of the company. The benefit of their services derived by or accruing to the company cannot be judged by considering the number of hours of work put in or the kind of physical or hard labour done by them. The benefit has to be considered from the point of view of the company as a prudent man of business by applying one's mind to all the relevant facts and circumstances. It is clearly established in the instant case that the Rani, although she was not participating actively in the day to day administration and was not attending to any regular office work like the other directors, was primarily and mainly responsible for taking decisions in all important matters. It is clear that the Rani's share of responsibility in deciding important matters relating to the company and its affairs was the largest and the value of her service to the company is to be judged in this background of her measure of responsibility and the manner of discharge thereof, and the benefit resulting to the company in consequence thereof. There can be no doubt in the facts of the instant case that the Rani's contribution to the smooth and efficient working of the company is very significant and material. The smooth and efficient working of the company is, undoubtedly, an important business need of the company and is one of the vital factors which enable the company to earn the

profits. Taking into consideration the legitimate business needs of the company and the benefit derived by the company the amounts paid to the Rani cannot, in our opinion, be considered to be excessive or unreasonable.

24. There is another aspect which, in our opinion, justifies the payments made to the Rani in the facts of the instant case. We have earlier observed that the total sum paid to the directors on account of remuneration and commission, including the payments made to the Rani, is justified and is not excessive or unreasonable. The amount of remuneration of directors and the manner of distribution thereof are both provided in the articles of association of the company. Payment of remuneration by virtue of any provision contained in the articles does not undoubtedly oust the jurisdiction of the Income Tax Officer u/s 10(4A) and, by itself, in the absence of other relevant materials, may not sufficiently justify an amount paid. In view, however, of the fact that the total amount paid to the directors on account of remuneration and commission in the instant case is not unreasonable or excessive and is justified, the manner of distribution of the said total amount amongst the directors on the basis of the articles which constitute a valid agreement between the members themselves who also happen to be the directors and between them and the company, results in the smooth and efficient working of the company and avoids all kinds of possible hitches amongst them. As the payment of the total amount of remuneration inclusive of commission to the directors is justified in the facts of the instant case, the payment to the Rani of a larger sum in the matter of distribution of the total amount by agreement between the parties cannot be considered to be unjustified, particularly as such payment results in smooth working of the company on the basis of the articles. We, however, wish to make it clear that we are not allowing the amounts paid to the directors including the Rani, merely because such payments are made on the basis of the provisions contained in the articles. We have earlier observed, and the Supreme Court makes it clear in the case of *Nund and Samont Co. Private Ltd. v. Commissioner of Income Tax*, that payment of any remuneration to a director only on the basis of the provisions contained in the articles does not constitute sufficient justification and does not bar the jurisdiction of the Income Tax Officer u/s 10(4A). In the facts of the present case, payments made to the directors are, however, justified and the Tribunal, in our opinion, was right in holding that the disallowance of the amounts paid to the directors by recourse to Section 10(4A) was unjustified. We have to observe that Sri K.A. Dikshit is not a director of the company and he is also not a person who has any substantial interest in the company. Section 10(4A) has, therefore, no application to Sri Dikshit.

25. We, therefore, answer the question raised in the affirmative, in favour of the assessee and against the department. The respondent-assessee will be entitled to the costs from/the applicant.

Sankar Prasad Mitra, J.

26. I agree.