

(1998) 08 MAD CK 0092

In the Madras High Court

Case No : Tax Case No"s. 1554 to 1556 of 1985 and 1136 and 1137 of 1986
(Reference No"s. 1014 and 1016 of 1985 and 724 and 725 of 1986)

Commissioner of Income Tax

APPELLANT

Vs

India Cements Ltd.

RESPONDENT

Date of Decision : 17-08-1998

Acts Referred:

Companies Act, 1956 — Section 348, 349
Income Tax Act, 1961 — Section 154, 37

Citation : (2000) 241 ITR 62

Hon'ble Judges : R. Jayasimha Babu, J;A. Subbulakshmy, J

Bench : Division Bench

Advocate : C.V. Rajan, for the Appellant; P.P.S. Janarthana Raja, for the Respondent

Judgement

R. Jayasimha Babu, J.—The substantive question requiring our answer is, as to whether the infraction by the assessee-company of the provisions of Section 349 of the Companies Act, 1956, in not deducting the interest on the borrowings while computing the net profits a percentage of which was paid to the managing agents as remuneration, was required to be ignored, and the amount of remuneration paid by the assessee allowed in full as an item of expenditure u/s 37 of the Income Tax Act, 1961, even after that amount of interest admittedly paid by the assessee-company, and which had been ignored while calculating the net profit for determining the remuneration of the managing agent, had been claimed as a deduction and allowed as such in the assessment of the company's income in these assessment years. The assessment years are 1967-68, 1968-69, 1969-70, 1970-71 and 1971-72. With regard to the assessment year 1967-68, the tenability of the reopening of the assessment u/s 154 of the Income Tax Act is an additional question, which also requires our answer.

2. The facts are not in dispute. The assessee is a public limited company, which, during the relevant assessment years, was managed by a managing agent. Remuneration payable to the managing agent was a percentage of the net profits

of the company, such net profits being computed in accordance with the provisions of the Companies Act. The manner of computing the net profits is laid down in Section 349 of the Companies Act. Interest on debentures issued by the company, interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets, interest on unsecured loans and advances are required to be deducted under Clauses (f), (g) and (h) of Section 349(4) of the Companies Act, while determining the net profits of the company. The remuneration payable to the managing agent is subject to a ceiling of 10 per cent. of the net profits of the company for that financial year, as provided by Section 348 of the Companies Act. That section provides that the company shall not pay to its managing agent, in respect of any financial year beginning at or after the commencement of this Act, by way of remuneration, whether in respect of his services as managing agent or in any other capacity, any sum in excess of 10 per cent. of the net profits of the company for that financial year. The language of Section 348 of the Act is emphatic. It provides that the company "shall not pay" the amount in excess of that specified in the section. The percentage referred to in Section 348 of the Act is a percentage of the net profits, which is required to be calculated in accordance with Section 349 of the Act.

3. In all these assessment years, it is admitted that the company had paid interest on its borrowings and the entire amount of interest so paid had been claimed as a deduction in the Income Tax assessment for the relevant years and such claim had also been allowed. It is also not in dispute that in all these years, while calculating the remuneration payable to the managing agent, the interest paid on borrowings for acquisition of machinery had not been deducted while calculating the net profits and as a consequence, the amount paid to the managing agent as remuneration was much in excess of what would have been payable had the net profits been calculated strictly in the manner provided in Section 349 of the Act. The Assessing Officer had disallowed that excess amount while the Tribunal had held that such excess is also to be allowed as a deduction, ignoring the infraction of the provisions of the Companies Act, solely on the ground that the payment had been made and that the books of account disclosed such payments having been made to the managing agent.

4. In reaching the conclusion that it did, the Tribunal relied upon the decision of this court in the case of Commissioner of Income Tax, Madras Vs. Ramkrishnan Mills (Coimbatore) Ltd., and in the case of Commissioner of Income Tax Vs. Sree Rajendra Mills Ltd., . The court, in these decisions, observed that payment made in violation of Section 348 of the Act would not amount to the payments becoming illegal. The court dissented from the decision of the Bombay High Court speaking through Chagla C. J., in the case of Ramaben A. Thanawala v. Jyoti Limited [1957] 27 Comp Cas 105, holding that payment made to a partner in a managing agency for services rendered to the company is not affected by Section 348 of the Companies Act.

5. Counsel for the assessee placed strong reliance on these judgments of this court to sustain the order of the Tribunal.

6. The aforementioned decisions can no longer be regarded as good law, in the light of the decision of the Supreme Court in the case of Maddi Venkataraman and Co. (P) Ltd. Vs. Commissioner of Income Tax, . We may notice here that this decision of the apex court was rendered in an appeal from the decision of the Andhra Pradesh High Court in the case of Commissioner of Income Tax, Andhra Pradesh Vs. Maddi Venkataratnam and Co. (P.) Ltd., . Jeevan Reddy. J (as he then was), speaking for the Bench of the Andhra Pradesh High Court referred to the decision of this court in the case of Commissioner of Income Tax, Madras Vs. Ramkrishnan Mills (Coimbatore) Ltd., , and expressly dissented from the view taken in the decision of this court, viz., that in considering the allowability of the expenditure, one cannot travel outside the provisions of the Income Tax Act and deny the benefit of deduction under that section on the ground that the payment is unauthorised or has been prohibited by some other statute.

7. The apex court in the case of Maddi Venkataraman and Co. (P) Ltd. Vs. Commissioner of Income Tax, , found that the assessee therein had indulged in transactions in violation of the provisions of the Foreign Exchange (Regulation) Act, and that the assessee's case that had it not violated the Act, it would have incurred a loss could not constitute a justification for contravention of the law. The court observed that the assessee was expected to carry on the business in accordance with law, and that the expenditure incurred for evading the provisions of the Act and also the penalty levied for such evasion could not be allowable as a deduction. The court further held (headnote) :

"Moreover, it would be against public policy to allow the benefit of deduction under one statute, of any expenditure incurred in violation of the provisions of another statute or any penalty imposed under another statute. If the deductions claimed by the assessee were allowed, the penal provisions of the Foreign Exchange (Regulation) Act would become mean-ingress. It has also to be borne in mind that evasion of law cannot be a trade pursuit. The expenditure in this case could not be allowed as wholly and exclusively laid out for the purpose of the assessee's business."

8. The assessee is expected to carry on its trade or business in accordance with law and not in violation of law. In making the assessment under the Income Tax Act, the authorities under the Act are not required to close their eyes to the infraction of other applicable laws by the assessee, and render such other laws and the penal provisions therein meaningless by allowing a trader or an owner of a business to reap the benefit of the violation of the law. The Income Tax Act does not require the authorities under that enactment to ignore the provisions of the other statutes, and the blatant violation thereof by the assessee who came forward with claims for deductions despite the patent violation of the other applicable laws with regard to the claim so made. The computation of the profits and gains of business or profession is not required to be made on the basis that

the business can be carried on only by ignoring or by violating the provisions of other applicable statutes and any and every outgoing allowed as a deduction even when such outgoing was in whole or in part a result of the violation of other applicable laws. The ascertainment of commercial profits permissible in certain contexts also does not require that the infraction of the law is to be wholly ignored and the profit as determined by the assessee in its balance-sheet or profit and loss account adopted without further question as the proper basis on which the Income Tax assessment should be made. As observed by the apex court, it would be "against public policy" to allow under one statute the benefit of deduction of expenditure incurred in violation of the provisions of another statute.

9. Learned counsel for the assessee contended that the payments having been made though admittedly in excess of what is properly payable u/s 348 of the Companies Act, and though admittedly in violation of Section 349 of the Act, the assessee-company has suffered an outgoing and, therefore, it is an item of expenditure from the point of view of the assessee and is required to be allowed u/s 37 of the Act. It was further submitted that the expenditure so incurred and the payments so made were bona fide. It was also submitted that violation of Section 348 of the Companies Act and the payments made in excess thereof cannot be characterised as unauthorised or prohibited.

10. None of the submissions so made for the assessee can be accepted. The mere fact that payment has been made by itself does not constitute a justification for allowing that payment as an item of deduction u/s 37 of the Act. The fact that payment has been reflected in the books of account does not also lead to the conclusion that such payment has been made bona fide. It cannot be held that payment made in violation of the express injunction contained in Section 348 of the Act is a payment which is not prohibited or which is not unauthorised. Section 348 of the Companies Act injuncts companies from making payments to the managing agent by way of remuneration, amounts in excess of that specified in that section and for the purpose of making the calculations relevant to the section, Section 349 of the Act must necessarily be complied with. No other mode of ascertaining the net profits is permissible. If, as contended by the assessee, the assessee had in its books of account capitalised the interest which has been claimed, and allowed as a revenue expenditure, that fact even if true, does not by itself entitle the assessee to adopt a mode of calculation different from the one provided in Section 349 of the Act for determining the net profits.

11. The remuneration properly payable to the managing agent in accordance with the provisions of the Companies Act is the amount which can properly be claimed as deduction by the assessee u/s 37 of the Act. Where the infraction is patent, and the amount paid in excess is also ascertainable, it is the duty of the Assessing Officer to disallow the excess, and that having been done by the Assessing Officer, the Tribunal was clearly in error in rejecting the appeal of the Assessing Officer, that appeal having been filed against the order of the

Commissioner who had held in favour of the assessee.

12. The fact that businesses often violate the law, and also with equal frequency offer practical necessity as a justification for such infraction does not entitle them to claim the expenditure incurred, or the payments made while violating the applicable laws as expenditure which should be allowed for the purposes of computation of their income u/s 37 of the Act. The Income Tax Act does not stand in isolation. It is an enactment, which is to be enforced along with, and in the context of other laws which are currently in force, and an approach which seeks to isolate the Income Tax Act, and all actions taken thereunder in disregard of the surrounding environment of other current legislation is not an approach which is required to be made under any of the provisions of the Income Tax Act.

13. The Tribunal, therefore, was clearly in error in holding that the assessee is entitled to deduction of the entire amount paid as remuneration to the managing agent to the extent the remuneration so paid was in excess of what was permissible u/s 348 read with Section 349 of the Companies Act. Such excess amount having been paid in contravention of the provisions of Section 348 of the Act the Income Tax Officer was fully justified in disallowing such excess payment.

14. So far as the assessment year 1967-68 is concerned, the Assessing Officer had initially allowed the entire amount claimed as remuneration paid to the managing agent. Without any new facts having been brought to his notice he merely, by a change of his own opinion, initiated proceedings u/s 154 of the Act, and held that part of the amount paid as remuneration was in excess. At the time the order on the proceedings initiated u/s 154 of the Act was made, the decision of this court in the case of Commissioner of Income Tax, Madras Vs. Ramkrishnan Mills (Coimbatore) Ltd., , was available. In the state of the law as it then prevailed it could not be said that there was a mistake apparent on the face of the record, which could be set right by resorting to proceedings for rectification. The Tribunal therefore, was right in holding that the rectification proceedings were not warranted and in setting aside the same.

15. For all the assessment years excepting 1967-68, we hold that the assessee was not entitled to the deduction of the entire amount paid by it as remuneration to the managing agent and that the amounts so paid which are in excess of the amounts as computed u/s 348 read with Section 349 of the Companies Act, are required to be disallowed, and that the disallowance of such excess by the Assessing Officer was proper and correct.

16. Our answers to the first three questions, which read as under :

"1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the managing agent's remuneration should be allowed as per the profits arrived at by the assessee in the books before deduction of interest capitalised which, however, was allowed as a deduction in computing the assessee's income ?

2. Whether, the Appellate Tribunal's view that there can be two different methods for arriving at the profits for Income Tax purposes and for allowances of managing agent's remuneration is sustainable in law especially when the interest capitalised was clearly a revenue expenditure deductible ?

3. Whether, on the facts and in the circumstances of the case, and having regard to the provisions of Section 349(4) of the Companies Act, 1956, the Appellate Tribunal's view that the computation of profits for determining the managing agent's remuneration is in accordance with the Companies Act, 1956, is sustainable in law especially when the interest on loans and advances was not deducted in terms of Section 349(4) of the Companies Act while computing such profit ?"

are, therefore, in favour of the Revenue and against the assessee. Our answer to the fourth question,

"Whether, on the facts and in the circumstances of the case, the Income Tax Officer was not justified in invoking the provisions of Section 154 of the Income Tax Act, 1961, for withdrawing the excess managing agent's remuneration allowed by the assessee for the assessment year 1967-68 ?"

is in favour of the assessee and against the Revenue. The Revenue shall be entitled to costs in the sum of Rs. 1,000.