
(1999) 07 BOM CK 0040

In the Bombay High Court

Case No : Income-tax Reference No. 1 of 1989

Commissioner of Income Tax

APPELLANT

Vs

Melauto Industries P. Ltd.

RESPONDENT

Date of Decision : 26-07-1999

Acts Referred:

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

Citation : (1999) 240 ITR 74

Hon'ble Judges : Ranjana Desai, J;B.P. Saraf, J

Bench : Division Bench

Advocate : R.V. Desai and P.S. Jetley, for the Appellant;

Judgement

Ranjana Desai, J.—By this reference u/s 256(1) of the Income Tax Act, 1961, the Income Tax Appellate Tribunal has referred the following question of law to this court for opinion :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the commission of Rs. 1,24,969 paid by the assessee to Parekh and Co., would fall to be considered u/s 40A(5), or Section 40(c), as the case may be ?"

2. The controversy in this case pertains to the assessment year 1978-79. The material facts giving rise to the present reference is as under ;

3. The assessee is a private limited company. It is manufacturing various types of forgings, industrial fasteners and automobile spare parts including general engineering goods. Shri Pradeep H. Shah is the managing director of the assessee. He is paid a salary of Rs. 5,400 per annum and perquisites, viz., leave travel allowance of Rs. 540 and medical expenses of Rs. 1,500. He is also the proprietor of a concern called Parekh and Company. Parekh and Co., is the selling agent of the products of the assessee under an agreement dated August 23, 1974.

4. During the assessment year 1974-75 (1978-79 ?), the assessee had paid Rs. 5,400 as salary to Shri Pradeep Shah. It had also paid commission of Rs. 1,24,969 to Parekh and Co. The Income Tax Officer applied Section 40A(5) of the Income Tax Act for finding out the allowable salary. Following the earlier orders of the Income Tax Appellate Tribunal in the case of the assessee for the years 1975-76 to 1977-78, in appeal the Commissioner of Income Tax (Appeals) held that the amount paid to Parekh and Co., is not covered by Section 40A(5) of the Income Tax Act.

5. The matter was carried to the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal held that the amount paid as commission to Parekh and Co., cannot be included in the salary and allowances paid to Pradeep H. Shah, working director of the assessee for the purposes of disallowance u/s 40A(5) of the Income Tax Act. The Tribunal further observed that it would have been necessary for the Tribunal to see whether the amount paid by the assessee as commission can reasonably be brought u/s 40(c) of the Income Tax Act. After going through the profit and loss account of Parekh and Co., for the relevant years and having regard to the figures contained therein, the Income Tax Appellate Tribunal was of the view that it was not a fit case for remitting the matter to the authorities below for being processed u/s 40(c) of the Income Tax Act. The Income Tax Appellate Tribunal held that there is prima facie evidence to show that the commission paid is not excessive or unreasonable having regard to the business of the assessee. In this view of the matter, the Income Tax Appellate Tribunal dismissed the appeal filed by the Department and hence the reference.

6. Mr. V. B. Patel, learned counsel for the assessee, submits that the controversy in this case is covered by the decision of this court in *Pai Paper and Allied Industries Pvt. Ltd. Vs. Commissioner of Income Tax*, .

7. We have perused the above decision. In that case, this court has followed the ratio of the Supreme Court decision in *Bharat Beedi Works (Pvt.) Ltd. and another etc. Vs. Commissioner of Income Tax*, . The High Court quoted the following observations of the Supreme Court in *Bharat Beedi Works (Pvt.) Ltd. and another etc. Vs. Commissioner of Income Tax*, :

"We assume for the purpose of this argument that, in this case, payments to the firm were payments to partners. Even so, we think that the said payments did not fall within Clause (c). The payments were made in consideration of a valuable right parted with by the firm/partners/directors of the assessee-company in favour of the assessee. So long as the agreement whereunder the said payments were made is not held to be a mere device or a mere screen, the said payments cannot be treated as payments made to the directors as directors (qua directors). The payments were made by way of consideration for allowing the assessee to use a valuable right belonging to them, viz., the brand name. Such a payment may be liable to be scrutinised under Sub-section (2) of Section 40A, but it certainly did not fall within the four corners of Section 40(c)."

8. The High Court then observed (page 417) :

"We are of the clear opinion that the above decision of the Supreme Court is a clear answer to the controversy sought to be raised in regard to the scope and ambit of Section 40(c) of the Act. It stands concluded now that only payments made to directors as directors (qua director) fall within Section 40(c). Payments made in consideration of a valuable right parted with by the directors of the assessee-company in favour of the assessee-company are outside the scope of the said section."

9. In the facts of this case, there is no controversy in regard to the factum of genuineness of the payment or the reasonableness thereof having regard to the legitimate business needs of the assessee. Since the dispute in regard to the scope and ambit of Section 40(c) of the Income Tax Act is put to rest by the above decision of the Supreme Court which is followed by this court in *Pai Paper and Allied Industries Pvt. Ltd. Vs. Commissioner of Income Tax*, we answer the question referred to us in the aforesaid terms, i.e., the commission of Rs. 1,24,969 paid by the assessee to Parekh and Co., would neither be covered u/s 40A(5) nor u/s 40(c).

10. The reference is disposed of accordingly with no order as to costs.