(1989) 01 P&H CK 0011

In the Punjab And Haryana At Chandigarh

Case No : Income-tax Reference No''s. 1 and 2 of 1980

Hemco Industries Private Ltd. APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 09-01-1989

Acts Referred:
Income Tax Act, 1961 — Section 40

Citation : (1989) 178 ITR 200

Hon'ble Judges : S.S. Sodhi, J;Gokal Chand Mital, J

Bench : Division Bench

Advocate : S.C. Sibal, for the Appellant; L.K. Sood, for the Respondent

Judgement

Gokal Chand Mital, J.—Hemco Industries (P.) Ltd. Company, the assessee, carried on the business of manufacture of nuts and bolts. The company appointed Bharat Sales Corporation as its sole selling agent and during the period relevant to the assessment years 1968-69 and 1969-70, the assessee paid commission to the sole selling agent amounting to Rs. 42,476 and Rs. 48,498, respectively. During the assessment proceedings, the Income Tax Officer found that one of the partners of Bharat Sales Corporation was a director of the assessee-company and other partners were related to the shareholders of the assessee-company. In view of this, he applied Section 40(c) of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), and for the first year disallowed the commission to the extent of Rs. 22,694 and for the next year disallowed Rs. 29,000. On the assessee''s appeal, the Appellate Assistant Commissioner restricted the disallowance for the first year to Rs. 11,984 and maintained the disallowance for the subsequent year. The order of the Appellate Assistant Commissioner was confirmed by the Income Tax Appellate Tribunal, Amritsar.

2. At the instance of the assessee, the following two common questions have been referred for the opinion of this court:

"(1) Whether, on the facts and in the circumstances of the case, the Tribunal has erred in law in upholding the order of the Appellate Assistant Commissioner disallowing part of the commission to the assessee for the assessment years 1968-69 and 1969-70 on estimate basis ?

(2) Whether, on the facts and in the circumstances of the case, there was any material to hold that the commission paid by the assessee to the Bharat Sales Corporation was excessive or unreasonable having regard to the legitimate business needs of the assessee-company ?"

3. The sole point for consideration is whether Section 40(c) of the Act applies to the facts of the case and if it does, the Income Tax Officer had the jurisdiction to consider whether the expenditure was excessive or unreasonable and in case it was so, to disallow the unreasonable part, but in case Section 40(c) of the Act does not apply, the Income Tax Officer will have no jurisdiction to disallow any part of the commission as excessive or unreasonable. On this matter, probably, there can be no dispute.

4. In order to appreciate it, it will be necessary to reproduce the relevant portion of Section 40(c) contained in Sub-clause (i) which reads as under :

"40(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,... "

5. A reading of the aforesaid provisions would show that this provision gets attracted only when any payment is made by way of 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, and not otherwise. Here, the partnership concern, namely, Bharat Sales Corporation, which is a separate legal entity was appointed as the sole selling agent of the assessee-company. It is true that in the partnership concern one of the partners is also the director of the assessee-company and other partners are relatives of the shareholders of the company. The payment of commission to the partnership concern by way of commission as a sole selling agent does not amount to directly or indirectly giving remuneration or benefit or amenity to a director or relative of the shareholders of a company. Precisely this matter came up for consideration before the Division Bench of this court in Commissioner of Income Tax Vs. Avon Cycles (P.) Ltd., and the following rule was laid down (head-note) :

"Section 40(c) will apply only if the expenditure by a company results directly or indirectly in the provision of 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 such other person, as the case may be. Where a company pays commission to a firm as its sole selling agent and the partners of the firm are directors of the company and their relatives, there is no nexus between the services rendered by the partners of the firm and the payment of commission by the company to the firm. The firm which takes the responsibility for sale of the products of the company enters into a business activity. The selling agent firm has to incur expenditure on many items for performing the duties entrusted to it under the agreement between the company and the firm. The activity of the firm is in the nature of business. The directors of the company or their relatives who are partners of the firm if they get shares from the profits of the firm get the same as partners of the firm and this money cannot be said to be remuneration paid by the company to the directors or their relatives directly or indirectly."

6. We are in agreement with the aforesaid view and hold that Section 40(c) of the Act is not attracted to the facts of the case. The matter may have been different if a finding had been recorded that there was no firm or partnership concern in existence and in fact no payment was made but payment was shown in the account books of the company. On those facts, the entire amount could be disallowed as not having been expended but not by virtue of Section 40(c) of the Act. On the facts of the case, the existence of the sole selling agent firm has been accepted because only part of the commission has been disallowed in exercise of the discretion contained in Section 40(c) and the remaining part has been accepted as good payment.

7. For the reasons recorded above, we answer the first question in favour of the assessee, i.e., in the affirmative, and opine that the case is not covered by Section 40(c) of the Act and no part of the commission could be disallowed for the two assessment years in question. In view of our decision on question No. 1, question No. 2 does not arise and the same is returned unanswered. No costs.