

(1996) 08 KL CK 0028

In the High Court Of Kerala

Case No : Income-tax Reference No. 54 of 1991

Khaders International Constructions Ltd.

APPELLANT

Vs

Commissioner of Income Tax (No. 2)

RESPONDENT

Date of Decision : 05-08-1996

Acts Referred:

Income Tax Act, 1961 — Section 35B(1), 40

Citation : (1997) 1 ILR (Ker) 654 : (1998) 229 ITR 452

Hon'ble Judges : V.V. Kamat, J; P.A. Mohammed, J

Bench : Division Bench

Advocate : C.M. Devan and C.N. Ramachandran, for the Appellant; P.K.R. Menon and N.R.K. Nair, for the Respondent

Judgement

P.A. Mohammed, J.—This Income Tax reference came up before us at the instance of the assessee known as "The Khaders International Constructions Ltd." The questions referred to us for answer are the following :

"(1) Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the remuneration paid to the managing director in Libyan dinars for services rendered in Libya and as approved by the Central Government is covered by Section 40(c)(i) of the Income Tax Act, 1961, and the rupee equivalent of the payment of remuneration in foreign currency in excess of Rs. 72,000 is to be disallowed ?

(2) Whether the Income Tax Appellate Tribunal was right in having held that the rupee equivalent of the remuneration paid to the managing director in Libyan dinars and incorporated in the accounts of the company is to be disallowed to the extent it is in excess of Rs. 72,000 even if there is no finding that such remuneration was excessive ?

(3) Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the appellant was not entitled for weighted deduction u/s 35B of the Act for the following expenses incurred :

(Rs.)

(a) Expenditure on travel outside India

1,16,551.68

(b) Expenditure for travel of employees from Libya to India (repatriation expenses)

9,34,916.81

(c) Mobilisation expenses for travel of employees from India to Libya

1,40,073.01

(d) Postage expenses at the branch office outside India

1,84,846.39

(e) Revenue and court fee at the branch office outside India

19,260.14

(f) Printing and stationery "

44,563.68

(g) Translation charges "

1,49,380.92

(h) Registration charges "

46,522.64

(i) Service charges "

3,12,533.89

(j) Allowance at B. O. outside India

39,275.95 ?"

2. The assessee is a company in which the public are not substantially interested. It is engaged in construction work in Libya. In respect of the assessment year 1983-84, the assessee filed a return on September 23, 1983, declaring a loss of Rs. 66,03,647 inclusive of carried forward losses. It claimed an amount of Rs. 4,67,124 as remuneration paid to the managing director who was posted at Libya. With regard to this claim, the Income Tax Officer found the allowable amount of remuneration was only Rs. 72,000 for the whole year. Therefore, the claim for balance salary of Rs. 3,93,430 paid to the managing director was disallowed. As far as the weighted deduction u/s 35B of the Income Tax Act was concerned, the Income Tax Officer rejected the said claim of the assessee on the ground that the expenses are strictly related to the construction work undertaken in Libya, and, therefore, not of the nature described in Section 35B(1)(b)(i) or

(iv) or (viii). In appeal the Commissioner of Income Tax (Appeals) fixed the correct amount of disallowance of salary at Rs. 5,60,919 instead of Rs. 3,93,430 fixed by the officer. He further confirmed the action of the Income Tax Officer with regard to the claim u/s 35B. In further appeal by the assessee, the Tribunal allowed the claim of the assessee only in respect of the office rent and rejected the other claims u/s 35B. As far as the payment of salary to the managing director was concerned, the view taken by the assessing authority had been confirmed by the Tribunal.

3. The main dispute in this reference is with regard to the remuneration paid to the managing director. From the assessment order it is revealed that the assessee was paying a salary of Rs. 4,69,430 to the managing director. The Income Tax Officer found that the maximum salary payable u/s 40(c)(i) to a managing director is Rs. 76,000 (?) and, therefore, he disallowed the balance salary of Rs. 3,93,430. According to the Commissioner of Income Tax (Appeals) the provision which would be applicable is Section 40(a)(iii). Anyway, the assessee has no such case and before the Tribunal, on behalf of the assessee it was contended that the managing director who received the salary has been assessed in the status of non-resident since he was living outside India and salary has been paid in the foreign currency outside India. The consequence of this contention is that Section 40(a)(iii) has no application in this case.

4. The next question required to be considered is whether the order of the Tribunal can be justified in view of the provisions contained in Section 40(c)(i) of the Income Tax Act. The relevant portion of the said provision is as follows :

"40. Amounts not deductible--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 there from, 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)."

5. There is no dispute that the assessee is a company and it paid remuneration to the managing director and therefore Section 40(c)(i) will apply in the present case. The above provision empowers the Assessing Officer to disallow the payment of remuneration paid to a director which is excessive or unreasonable. It also places a limit on the allowable amount of remuneration at Rs. 72,000 for the whole year. However, counsel for the assessee reiterated the contention that inasmuch as the Income Tax Officer has not recorded a finding that the salary paid to the managing director is excessive or unreasonable, the whole of the expenditure claimed is allowable. This contention was negated by the Tribunal. We also do not find our way to countenance it. A similar argument was advanced on behalf of an assessee before the Calcutta High Court in *Bilaspur Spinning Mills and Industries Ltd. Vs. Commissioner of Income Tax*, . After interpreting the relevant provisions and taking note of the Notes on Clauses of the relevant Finance Bill, the Division Bench of the said court ultimately held (page 500) :

"In that background of the matter, it appears to us that there were two conditions independently to be fulfilled, i.e., that the Income Tax Officer might disallow if he found that the remuneration was excessive or unreasonable and further even in cases where he arrives at no such finding, if the expenditure or allowance exceeded Rs. 72,000 then no such expenditure or allowance was allowable."

6. We are perfectly in agreement with the aforesaid decision of the Calcutta High Court. In view of the above situation, the disallowance of Rs. 3,93,430 balance salary paid to the managing director is totally justified in this case.

7. Now, we will advert to the claim of weighted deduction u/s 35B for the expenditure incurred which is specified in question No. (3) above. It was argued by counsel for the assessee that the expenses specified as items (a) to (j) are allowable either under Sub-clause (iv) or sub-Clause (vii) of Section 35B(1)(b). The assessee has incurred above expenses in the course of carrying out its

business activities in Libya. Since these expenditures have been actually incurred in relation to the construction work in Libya, they are not expenditures for "promotion of sale" as contemplated in the aforesaid Sub-clauses of Section 35B(1)(b). There is no dispute in this reference regarding the expenditure incurred by way of payment of rent for office room and of its maintenance. That has been allowed by the Tribunal. From the nature of the expenses claimed by the assessee, we feel that there is no nexus between the expenditure incurred and sales promotion outside India. Therefore, the disallowance of the aforesaid expenditures by the Tribunal is perfectly in order.

8. In view of the aforesaid discussion, all the questions are answered in the affirmative, that is to say, against the assessee and in favour of the Revenue.

9. A copy of this judgment under the seal of the court and the signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench, as required by law.