
(1980) 03 AHC CK 0043

In the Allahabad High Court

Case No : Income-tax Reference No's. 865 of 1977 and 86, 87 and 88 of 1978

Shervani Sugar Syndicate (P.) Ltd. and Marketing Services
Agency (P.) Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 26-03-1980

Acts Referred:

Income Tax Act, 1961 — Section 40

Citation : (1980) 18 CTR 262 : (1980) 125 ITR 158 : (1980) 4 TAXMAN 202

Hon'ble Judges : Satish Chandra, C.J;H.N. Seth, J

Bench : Division Bench

Advocate : G.L. Tripathi and S.P. Gupta, for the Appellant; R.K. Gulati and A. Gupta, for the Respondent

Final Decision : Disposed Of

Judgement

H.N. Seth, J.—These four references, made u/s 256(2) of the I.T. Act, 1961, can be conveniently disposed of by a common judgment.

2. The assessee in ITR No. 865 of 1977 and ITR No. 88 of 1978, M/s. Shervani Sugar Syndicate (P.) Ltd., Allahabad, is a company registered under the Indian Companies Act. During the previous years, relevant to assessment years 1970-71 and 1973-74, the company paid the following amounts as annual remuneration to its directors, other than the managing directors:

1. Rs. 6,000 for the assessment year 1970-71.

2. Rs. 13,500, for the assessment year 1973-74.

3. The assessee in ITR No. 86 of 1978 and 87 of 1978 is M/s. Marketing Services Agency (P.) Ltd., which too is a company registered under the Indian Companies Act. During the previous years relevant to the assessment years 1971-72, 1972-73 and 1973-74, this assessee also paid a sum of Rs, 3,069, Rs, 6,684 and Rs. 6,257, as annual remuneration to its directors.

4. Both the assesseees claimed that the amount of annual remuneration paid by them to their directors should be deducted while computing their income under the head, "Profits and gains of business or profession". The ITO disallowed the claim of the assesseees on the finding that payment of the remuneration in each of three cases was not justified and they appeared to have been paid for consideration other than that of business of the company. The assesseees took the matter up before the AAC and the Income Tax Appellate Tribunal. Both the authorities upheld the disallowance of the annual remuneration paid to the directors in each of the three cases.

5. Eventually, at the instance of the assesseees this court required the Appellate Tribunal to state the case in respect of the following questions of law for the opinion of the court :

For the year 1970-71 (Reference No. 865 of 1977):

" Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was correct in law in holding that the sum of Rs. 6,000 paid by the assessee as annual remuneration to the directors of the company was not eligible for deduction from the income of the assessee ? "

For the assessment years 1971-72 and 1972-73 (Reference No. 86 of 1978):

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was correct in law in holding that the sum of Rs. 3,069 paid by the assessee as annual remuneration to the directors of the company was not eligible for deduction u/s 40(c) of the Income Tax Act, 1961 ?

Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was correct in law in holding that the sum of Rs. 6,684 paid by the assessee as annual remuneration to the directors of the company was not eligible for deduction u/s 40(c) of the Income Tax Act, 1961?"

For the year 1973-74 (Reference No. 87 of 1978):

"Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was correct in law in holding that the sum of Rs. 6,257 paid by the assessee as annual remuneration to the directors of the company was not eligible for deduction from the income of the assessee ? "

For the year 1973-74 (Reference No. 88 of 1978) :

"Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was correct in law in holding that the sum of Rs. 13,500 paid by the assessee as annual remuneration to the directors of the company was not eligible in whole or in part for deduction from the income of the assessee ? "

6. Parties are agreed that the aforementioned question in the case of M/s. Marketing Services Agency (P). Ltd. (References Nos. 86 and 87 of 1978) has arisen in exactly the same circumstances in which the aforementioned questions

have arisen in the case of M/s. Shervani Sugar Syndicate (P.) Ltd. (References Nos. 865 of 1977 & 88 of 1978) and that the answer in the two cases of M/s. Shervani Sugar Syndicate (P.) Ltd. would govern the ITR Nos. 86 & 87 of 1978 as well. Accordingly, we proceed to state the facts of the two cases of M/s. Shervani Syndicate only.

7. It is not disputed that the directors of the company have been paid separate fees for attending the meetings of the board of directors and the amount so paid by the company has been deducted in computing the assessee's income. In addition, a sum of Rs. 1,000 was paid to each of the six directors of the company for the assessment year 1970-71 under a resolution of the company dated December 4, 1954. Likewise a sum of Rs. 1,500 was paid to each of the nine directors of the company for the years 1973-74 as authorised by the resolution of the company dated December 6, 1971. Relevant portion of Section 40 runs thus :

" Notwithstanding anything to the contrary in sections 30 to 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,...

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 therefrom..."

8. Accordingly, while computing the income of a company chargeable to tax under the head " Profits and gains of business or profession ", any deduction in respect of remuneration paid to its directors has to be disallowed, if the ITO feels that such expenditure is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom. The I.T. authorities, therefore, called upon the assessee to indicate the circumstances justifying payment of the annual remuneration to their directors. Before the Appellate Tribunal the assessee attempted to justify the reasonableness of payment of annual remuneration to the directors by contending that, under the articles of association, the entire responsibility of the working of the companies rested on the members of the board of directors who were to discharge those functions not merely when they assemble in the directors' meeting for which they were being separately paid, but also beyond such meetings. The directors thus guided the running of the company, passed resolution by circulation, attended to any other work assigned to individual directors outside the board meeting, like execution of documents, operation of

the bank account, etc. The assessee claimed that having regard to the amount of profits made by them in the years relevant to the assessment year in question, payment of total remuneration of Rs. 6,000 and Rs. 13,500 paid to the directors in these cases could not be said to be unreasonable.

9. The claim by the assessee was refuted on behalf of the revenue on the ground that the business of the assessee was being looked after by the managing director alone and that there was absolutely no evidence to indicate that the other members of the board of directors did anything more than attending the board's meeting. It was pointed out that the assessee did not claim that the remuneration paid to the members of the board of directors for attending the meetings of the board was inadequate. There was thus no material to indicate that the members of the board of directors did anything for the benefit of the company to justify the payment of the additional remuneration to them. The said remuneration, not being justified by the legitimate business needs of the company and the benefit derived by it, was not eligible for deduction in computing the company's income.

10. The Income Tax Appellate Tribunal observed thus ?

" It cannot be denied that theoretically the directors of the company shoulder the entire responsibility for the conduct of the company's business. But this would not make them entitled to remuneration from the company. Unless they are actually rendering some service to the company, the power of general supervision and guidance is exercised through the directors' meeting, for which the directors have been paid separately. Even though the authorities below (sic) that the directors did something more than attending the board's meeting, no evidence whatsoever has been produced in support of this contention. The mere fact that the directors are authorised to do something would not be sufficient to justify a remuneration unless it is shown that they actually rendered any service as claimed. The fact that all the directors (including the three lady directors) have been uniformly paid this remuneration again shows that the remuneration was not linked with any particular service rendered by any of them. No doubt, similar remuneration claimed in earlier years was not disallowed but it is neither claimed nor it appears to be a fact that in those years the matter was examined and the remuneration was found to be paid for service rendered by the directors. Under the circumstances we hold that there is no evidence to show that the directors rendered any other service except attending the board's meetings and the remuneration paid to them was hit by Section 40(c) of the Income Tax Act. The disallowances are, therefore, confirmed."

11. In substance, the finding recorded by the Tribunal is that even though according to the articles of association it was possible for the directors of the company to render service for the benefit of the company on occasions other than at the time of the meeting of the board of directors, there was absolutely no material to show that the directors, in fact, rendered any such service to the company outside the board's meetings. There was thus good reason for the ITO

to think that the payment of annual remuneration was unreasonable, specially when the said annual remuneration was not in consideration of any benefit that the company derived from any service rendered by the directors to the company.

12. In the case of *Mund and Samont Co. (P) Ltd. Vs. Commissioner of Income Tax , Bihar, Orissa and Patna, ,* the Supreme Court expressed the view that it was for the taxpayer to establish by evidence that the particular amount was deductible. It held that, in the absence of evidence relating to the duties of the directors, the services rendered by them, the manner in which the profits were enhanced by reason of their special aptitude or qualifications, the legitimate business needs and the benefit derived by the company in consequence of such service rendered, the disallowance of the remuneration to the directors was to be upheld. Following the observation made by the Supreme Court in the aforementioned case, a Bench of the Delhi High Court has, in the case of *J.B. Bottling Co. (P.) Ltd. Vs. Commissioner of Income Tax, ,* held that in a case where benefit, if any, derived by a company could not be linked with any service rendered by the lady directors, the remuneration paid to such lady directors was liable to be disallowed u/s 40(c) of the I.T. Act.

13. In the instant case, the assessee has failed to adduce any evidence to link the payment of the annual remuneration to its directors with any specific activity which had been beneficial to the assessee. Learned counsel for the assessee has also failed to show that the resolution, authorising payment of annual remuneration to the members of the board of directors, had been passed in consideration of any activity of the members of the board of directors which was or which was expected to be beneficial for the assessee-company. In these circumstances, the finding of the I.T. authorities that the remuneration had been sanctioned for extra-commercial considerations does not appear to be unreasonable or unjustified.

14. Learned counsel appearing on behalf of the assessee cited before us the cases of *Commissioner of Income Tax Vs. Edward Keventer (Private) Ltd.,* and *J.K. Steel and Industries Ltd. Vs. Commissioner of Income Tax, .* Relying upon the observations made in these two cases, he urged that as the Tribunal had itself observed that theoretically the directors of the company shouldered the entire responsibility for conducting the company's business, this shouldering of responsibility by itself would constitute sufficient consideration for payment of the annual remuneration involved in these cases specially when the total remuneration paid to all the directors comes to less than two per cent. of the total profits earned by the company in the relevant previous years. It may, for the purposes of this case, be assumed that sharing of the responsibility for running of the business of the assessee-company could be a consideration for remunerating the directors. However, in the instant case, the assessee failed to adduce any evidence to show that the members of the board of directors discharged the aforementioned responsibility by doing something outside the meeting of the board of directors for which separate remuneration was paid to

them. As stated earlier, the assessee had, before the I.T. authorities, accepted that the remuneration paid by it to its directors for attending the meetings of the board was not inadequate. Accordingly, the annual remuneration paid by the company to its directors could not be linked with the responsibility undertaken by the members of the board either under the articles of association or other provisions of the Companies Act. So long as a particular remuneration is not linked or connected with any activity which is beneficial to the company, the payment of the same would be hit by Section 40(c) of the Act.

15. In the result, we answer the questions referred to us by the Tribunal in these references in the affirmative and in favour of the department. The Commissioner shall be entitled to one set of costs in these references, which are assessed at Rs. 200.