
(1985) 10 KL CK 0007

In the High Court Of Kerala

Case No : Income-tax Reference No"s. 346 to 348 of 1980

Travancore Rayons Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 30-10-1985

Acts Referred:

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

Citation : (1986) 55 CTR 141 : (1986) 162 ITR 732

Hon'ble Judges : T. Kochu Thommen, J;K.P. Radhakrishna Menon, J

Bench : Division Bench

Advocate : K.A. Nayar, for the Appellant; P.K. Ravindranatha Menon, for the Respondent

Judgement

T. Kochu Thommen, J.—The following questions have been, at the instance of the assessee, referred to us by the Income Tax Appellate Tribunal, Cochin Bench:

"(1) Whether, on the facts and in the circumstances of the case, for the assessment year 1972-73, the Tribunal was right in holding that the salary, bonus, commission and perquisites payable to the managing director were allowable only to the extent permitted u/s 40A(5) and that the provisions of Section 40(c) were not attracted and consequently the amount to be disallowed was Rs. 24,938 and not Rs. 18,417 ?

(2) Whether, on the facts and in the circumstances of the case, for the assessment year 1973-74, the Tribunal was right in holding that the provisions of Section 40A(5) were the provisions which were to be invoked and not the provisions of Section 40(c) ?

(3) Whether, OB the facts and in the circumstances of the case, for the assessment year 1974-75, the Tribunal was right in holding that the provisions of Section 40A(5) were the provisions which were to be invoked and not the provisions of Section 40(c) ? "

2. The answers to these questions depend on the construction of sections 40(c)

and 40A(5) of the Income Tax Act, 1961. The fundamental question is whether, in computing the income of a company chargeable under the head "Profits and gains of business or profession", the expenditure arising or incurred in respect of its director, who was also its employee during the relevant year, has to be deducted solely with reference to Section 40A(5) and without regard to Section 40(c) ? This is in fact the proposition canvassed on behalf of the Revenue, while it is contended on behalf of the assessee that Section 40(c) alone would apply in such a case, and recourse to Section 40A(5) is not required in view of the specific provisions contained in Section 40(c) which are applicable as much to a director as to a director-employee.

3. We may at the outset point out that these two sections specify the amounts which are not allowed to be deducted in computing the income chargeable under the head " Profits and gains of business or profession ". Section 40(c) refers to the non-deductible expenditure of a company incurred in respect of its director or a person having a substantial interest in the company or a relative of either of them. Section 40A(5) refers to the non-deductible expenditure of an employer, whether or not a company, incurred in respect of an employee or a director-employee, as the case may be. The Tribunal held that in respect of the period during which a person was both a director and an employee of a company, the computation has to be made solely with reference to Section 40A(5) and Section 40(c), as contended by the assessee, has no application.

4. We shall read these two sections in so far as they are material. Section 40(c) reads:

" 40. 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 therefrom, 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:....."

5. This section is non obstante the deductions permitted under Sections 30 - 39 in so far as they provide to the contrary. Clause (c) of this section says that, in the case of a company, the Income Tax Officer is empowered to disallow any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or to a person having a substantial interest in the company or to a relative of either of them, or any expenditure or allowance in respect of any assets of the company used by such a person, if in the opinion of the Income Tax Officer such expenditure or allowance, having regard to the legitimate business needs of the company and the benefit derived by it, is excessive or unreasonable. However, in respect of any such person, the deduction of the aggregate of such expenditure and allowance must not in any case exceed the amounts specified under Sub-clauses (A) and (B), dependent upon the period to which such expenditure or allowance related. Where the expenditure or allowance related to a period exceeding eleven months comprised in the previous year, the deductible amount is limited to Rs. 72,000. On the other hand, where it related to a shorter period comprised in the previous year, the maximum deductible amount is Rs. 6,000 per month or part thereof comprised in that period.

6. The proviso to Clause (c) of Section 40 says that expenditure incurred, in respect of a director or a person having a substantial interest in the company or a relative of either of them and who was also an employee of the company for any period comprised in the previous year, as travel concession or assistance or passage moneys or other benefits referred to in Section 10(5) and (6) or Section 36(1)(iv), (v) and (ix), must be excluded from the computation of the aforesaid maximum allowable deduction of Rs. 72,000 per year or Rs. 6,000 per month, as the case may be. The second proviso to Section 40A(5)(a) contains a similar provision in regard to these items. We shall now read Section 40A :

" 40A. (1) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head " Profits and gains of business or profession ".

(5) (a) Where the assessee-

(i) incurs any expenditure which results directly or indirectly in the payment of any salary to an employee or a former employee, or

(ii) incurs any expenditure which results directly or indirectly in the provision of any perquisite (whether convertible into money or not) to an employee or incurs directly or indirectly any expenditure or is entitled to any allowance in respect of any assets of the assessee used by an employee either wholly or partly for his own purposes or benefit,

then, subject to the provisions of Clause (b), so much of such expenditure or allowance as is in excess of the limit specified in respect thereof in Clause (c) shall not be allowed as a deduction :

Provided that where the assessee is a company, so much of the aggregate of-

(a) the expenditure and allowance referred to in Sub-clauses (i) and (ii) of this clause; and

(b) the expenditure and allowance referred to in Sub-clauses (i) and (ii) of Clause (c) of Section 40,

in respect of an employee or a former employee, being a director or a person who has a substantial interest in the company or a relative of the director or of such person, as is in excess of the sum of seventy-two thousand rupees, shall in no case be allowed as a deduction:

Provided further that in computing the expenditure referred to in Sub-clause (i) or the expenditure or allowance referred to in Sub-clause (ii) of this Clause or the aggregate referred to in the foregoing proviso, the following shall not be taken into account, namely :--

(i) the value of any travel concession or assistance referred to in Clause (5) of Section 10;

(ii) passage moneys or the value of any free or concessional passage referred to in Sub-clause (i) of Clause (6) of Section 10 ;

(iii) any payment referred to in Clause (iv) or Clause (v) of Subsection (1) of Section 36;

(iv) any expenditure referred to in Clause (ix) of Sub-section (1) of Section 36.

(b) Nothing in Clause (a) shall apply to any expenditure or allowance in relation to-

(i) any employee in respect of any period of his employment outside India;

(ii) any employee being an individual referred to in Sub-clause (vii) or Sub-clause (viii) of Clause (6) of Section 10 in respect of any period during which he is entitled to the exemption under Sub-clause (vii) or, as the case may be, Sub-clause (viii) aforesaid ;

(iii) any employee whose income chargeable under the head "Salaries" is seven thousand and five hundred rupees or less.

(c) The limits referred to in Clause (a) are the following, namely :--

(i) in respect of the expenditure referred to in Sub-clause (i) of Clause (a), in the case of an employee, an amount calculated at the rate of five thousand rupees for each month or part thereof comprised in the period of his employment in India during the previous year, and in the case of a former employee, being an individual who ceases or ceased to be the employee of the assessee during the previous year or any earlier previous year, sixty thousand rupees ...

(ii) in respect of the aggregate of the expenditure and the allowance referred to in Sub-clause (ii) of Clause (a), one-fifth of the amount of the salary payable to the employee or an amount calculated at the rate of one thousand rupees for each month or part thereof comprised in the period of employment in India of the employee during the previous year, whichever is less. "

7. This section, in the computation of income under the head "Profits and gains of business or profession" operates non obstante any other provision of the Act to the contrary. The operation of Section 40A is thus controlled by this section. Sub-section (5) of Section 40A specifically deals with deductions in respect of payments to an employee.

8. The provisions of Section 40A(5)(a)(i) and (ii) say that where the asses-see incurs any expenditure resulting directly or indirectly in the payment of any salary to an employee or a former employee, or in the provision of any perquisites to an employee, or incurs any expenditure or is entitled to any allowance in respect of assets of the assessee used by an employee, then so much of such expenditure or allowance as is in excess of the limit prescribed under Clause (c) of Sub-section (5) will not be allowed as a deduction in computing the profits and gains of business or profession. This provision is, however, subject to Clause (b) which provides that the ceiling limit prescribed under Clause (c) is not applicable to the expenditure or allowance in relation to (i) any employee in respect of any period of his employment outside India; (ii) any employee being a foreign technician who is entitled to exemption from tax on his remuneration u/s 10(6)(vii) or Section 10(6)(viii); and, (iii) any employee whose income chargeable under the head "Salaries" does not exceed Rs. 7,500.

9. The limit prescribed under Clause (c)(i) with reference to Clause (a)(i) regarding salary is an amount calculated at the rate of Rs. 5,000 for each month comprised in the period of his employment in India during the previous year, and in the case of a former employee, Rs. 60,000. The limit prescribed under Clause (c)(ii) with reference to Clause (a){ii} regarding perquisite, etc., is one-fifth of the amount of the salary payable to the employee or an amount calculated at the rate of Rs. 1,000 for each month or part thereof comprised in the period of his employment in India during the previous year, whichever is less. The "expenditure" and "perquisite" mentioned u/s 40A(5)(a) must be understood as

those expressions are defined under Explanation 2(a) and (b) to the Sub-section.

10. The first proviso to Sub-section (5)(a) of Section 40A specifically deals with an assessee which is a company. It says that so much of the aggregate of the expenditure and allowance falling under Sub-section (5)(a)(i) and (ii) and the expenditure and allowance referred to in Section 40(c)(i) and (ii), in respect of an employee or a former employee, being a director or a person having a substantial interest in the company or a relative of either of them, as is in excess of the sum of Rs. 72,000 will not be allowed as a deduction. In other words, the maximum limit of allowable expenditure incurred by a company in respect of an employee or a former employee, being a director, etc., is Rs. 72,000.

11. The second proviso to Sub-section (5)(a), as stated earlier, refers to the amounts mentioned u/s 10(5) and (6) and Section 36(1)(iv), (v) and (ix). These amounts, paid or payable, in respect of an employee, whether or not a director, are excluded in computing the non-deductible expenditure incurred by his employer.

12. Having thus understood these two sections, we pose the question again, i. e., whether in computing the chargeable income of a company under the head " Profits and gains of business or profession ", the non-deductible expenditure in relation to a director, who was also an employee, must be, as contended by the Revenue, determined solely with reference to the limits prescribed u/s 40A(5)(a) and (c), or whether, as contended by the assessee, it is solely Section 40(c) which is applicable in such cases.

13. Section 40A, in relation to the computation of profits and gains of business, is, as already stated, non obstante any other provision to the contrary. The maximum allowable deduction of Rs. 72,000 as provided u/s 40(c) must, therefore, be understood, in respect of a director who was also an employee during the relevant year, as restricted by the words of limitation contained in Section 40A(5)(a) and (c). This means that the permissible deduction in respect of salary and perquisite referred to in Sub-section (5)(a)(i) and (ii) of Section 40A is limited to the respective amounts mentioned under Sub-clauses (i) and (ii) of Clause (c) of Sub-section (5). Nevertheless, any expenditure resulting in any provision of remuneration or benefit or amenity or allowance mentioned u/s 40(c), but which does not partake of the character of salary or perquisite referred to in Section 40A(5)(c)(i) and (ii) read with Explanation 2(a) and (b) of that Sub-section, can be deducted in addition to salary and perquisite, in respect of a director-employee, provided the aggregate deduction under these heads in terms of Section 40(c)(i), (ii)(A) and (B) and Section 40A(5)(a)(i) and (ii) does not exceed the maximum of Rs, 72,000, as stipulated in the first proviso to Section 40A(5)(a).

14. In our view, in so far as the relevant provisions of sections 40 and 40A are concerned, there is no clash or inconsistency. The non obstante Clause of Section 40A(5) are words of caution, and even without them, the provisions of these two

sections, in respect of a director-employee, can be read harmoniously. While the maximum permissible deduction in respect of remuneration and other benefits, in the case of a director, in relation to a period exceeding eleven months comprised in the previous year, is Rs. 72,000, such deduction, in the case of a director who was also an employee, it is subject to the further restriction that the allowable deduction in respect of salary and perquisite should not exceed Rs. 60,000 and Rs. 12,000, respectively. Where, for example, the expenditure incurred by a company for a director-employee during the relevant year as "salary" (as that expression is understood under Explanation 2(a) to Sub-section (5)(a)) is Rs. 50,000 and the "perquisite" provided for (within the meaning of Explanation 2(b) to Sub-section (5)(a)) is Rs. 10,000 being one-fifth of the salary, the company would still be entitled to claim deduction u/s 40(c) read with the first proviso to Section 40A(5)(a), in respect of remuneration or benefit or amenity other than "salary" or "perquisite", such as, for example, sitting fees up to a maximum of Rs. 12,000, if such expenditure had been incurred, so that the aggregate under all the heads of expenditure mentioned under these provisions is limited to Rs. 72,000. Where, on the other hand, the expenditure on account of "salary" and "perquisite" is claimed to be deducted at the maximum provided under Clause (c)(i) and (ii) of Section 40A(5), namely, Rs. 60,000 + Rs. 12,000 = Rs. 72,000, there would be no room for further recourse to Section 40(c). The same will be the result if, as in the present case, the expenditure incurred consisted of only salary and perquisite falling u/s 40A(5)(a) and no other amount. Likewise, as in the present case again, if the assessee paid salary in excess of the ceiling prescribed u/s 40A(5)(c)(i) and perquisite less than the limit prescribed under Sub-clause (ii) of Clause (c) of that Sub-section, the gap between the ceiling limit and what was actually paid as perquisite cannot be filled up by adding part of the excess salary paid, for such addition would violate the limit prescribed under Sub-clause (i) of Clause (c) in respect of salary.

15. We have been referred to the decision of the Gujarat High Court in Commissioner of Income Tax, Gujarat-I Vs. Bharat Vijay Mills Ltd., , where it was held that the head wise limit prescribed under Clause (c) in relation to salary and perquisite falling under Clause (a) of Sub-section (5) of Section 40A did not apply in respect of an employee who was also a director referred to in the first proviso to Sub-section (5)(a). We respectfully disagree. We do not read the first proviso to say that in respect of the director-employee the limit prescribed under Clause (c) has no application. The first proviso qualifies what is stated under Clause (a) by providing that where an employee happens to be also a director, etc., the company can claim deduction up to Rs. 72,000. The proviso must, however, be understood with reference to what follows in the subsequent provisions and not in isolation. There is nothing in the proviso to derogate from Clause (c) which has prescribed head wise limitation in respect of the expenditure referred to under Clause (a). This means that while in respect of a director-employee, the company can claim deduction up to Rs. 72,000, such claim is still subject to the limitation in respect of salary and perquisite as

provided under Clauses (a) and (c) of Sub-section (5).

16. In the present case, it is admitted that all the amounts paid to the managing director during the relevant accounting years were solely by way of salary and perquisite and no other amount was paid so as to attract the provisions of Section 40(c). In the circumstances, the expenditure could be allowed only with reference to Section 40A(5) and Section 40(c) had no application. Accordingly, we answer the questions referred to us? in the affirmative, that is, in favour of the Revenue and against the assessee.

17. We direct the parties to bear their respective costs in these tax referred cases.

18. A copy of this judgment under the seal of the High Court and the signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.