DR. SARMUKH SINGH and CO. (PRIVATE) LTD. Vs COMMISSIONER OF Income Tax, SIMLA.

Court: High Court Of Punjab And Haryana At Chandigarh

Date of Decision: Feb. 1, 1961

Acts Referred: Income Tax Act, 1961 â€" Section 10(4A)

Citation: (1962) 45 ITR 311

Hon'ble Judges: Mehar Singh, J; Grover, J

Bench: Full Bench

Judgement

MEHAR SINGH J. - In 1946 two private companies came into existence, one under the name of the Narain Cold Storage Co. Ltd. and the other

under the name of Dr. Sarmukh Singh and Co. Private Ltd. The last named company is the assessee company, which is the managing agents of the

first company. According to the managing agency agreement between the two companies the assessee company receives remuneration of Rs.

1,000 per mensem from the managed company. Again, according to the assessee companys articles of association, it is to pay to its director-in-

charge a remuneration of Rs. 1,000 per mensem. The capital of the assessee company is 200 shares of Rs. 100 each; out of those shares, half, that

is to say, 100 shares, are held by Dr. Sarmukh Singh and the remaining 100 shares are equally held between his two sons, Bhupal Singh and

Harpal Singh. All the three are directors of the assessee company with Dr. Sarmukh Singh as director-in-charge. The assessee company has, in the

terms of its articles of association, in the accounting year ending November 30, 1955, paid to its director-in-charge a salary of Rs. 1,000 per

mensem. In its return for the assessment year 1956-57 the assessee company has shown an income of Rs. 12,275 out of which Rs. 275 is interest

earned on certain investment and Rs. 12,000 is the amount received under the managing agency agreement from the managed company, and it is

shown as paid out to the director-in-charge as his salary. This amount has been claimed as deduction by the assessee company because of having

been laid out or expended wholly or exclusively for the purposes of its business.

The Income Tax Officer has reached the conclusion that the arrangement between the two companies and the director-in-charge of the assessee

company in regard to this amount is that for all practical purposes it reduces the assessee company to the position of a conduit pipe which passes

on its entire business receipts to its director-in-charge and the arrangement has been devised with a view to escape the corporate tax. He has

applied section 10(4A) of the Indian Income Tax Act to the case and allowed only salary or remuneration to the director-in-charge at Rs. 200 per

mensem, disallowing the balance as excessive or unreasonable. The Appellate Assistant Commissioner of Income Tax has agreed with the Income

Tax Officer in this respect and so has the Income Tax Appellate Tribunal by its order of October 16, 1957, but raising the allowance from Rs. 200

to 500 per mensem as salary or remuneration of the director-in-charge.

On an application of the assessee company u/s 66(1) of the Income Tax Act the Tribunal has stated the case and referred for opinion this question

:

Whether on the facts and in the circumstances of this case the salary of Rs. 1,000 per mensem paid to S. Sarmukh Singh, director-in-charge of

the assessee company, is any allowance in respect of any expenditure within the meaning of clause (a) of section 10(4A) of the Indian Income Tax

Act ?

The Finance Act of 1956, section 7, adds sub-section (4A) to section 10 of the Indian Income Tax Act, which provides :

(4A). Nothing in sub-section (2) shall, in the computation of the profits and gains of a company, be deemed to authorise the making of -

(a) any allowance in respect of any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a

director or a person who has a substantial interest in the company within the meaning of sub-clause (iii) of clause (6C) of section 2, or

(b) any allowance in respect of any assets of the company used by any person referred to in clause (a) either wholly or partly for his own purposes

or benefit,

if in the opinion of the Income Tax Officer any such allowance is excessive or unreasonable having regard to the legitimate business needs of the

company and the benefit derived by or accruing to it therefrom.

There is an Explanation to the sub-section but that is not material here. There are seven sub-clauses in clause (6C) of section 2 of the Indian

Income Tax Act and out of those sub-clauses (ii) and (iii) are -

Section 2 (6C). Income includes -....

(ii) the value of any perquisite or profits in lieu of salary taxable u/s 7;

(iii) the value of any benefit or perquisite whether convertible into money or not, obtained from a company either by a director or by any other

person who has a substantial interest in the company (that is to say, who is concerned in the management of the business of the company, being the

beneficial owner of shares, not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits, carrying not

less than twenty per cent. of the voting power), and any sum paid by any such company in respect of any obligation which but for such payment

would have been payable by the director or other person aforesaid;.....

It is at once clear that the director-in-charge of the assessee company has a substantial interest in the assessee company within the meaning of sub-

clause (iii) of clause (6C) of section 2 inasmuch as he is concerned in the management of the business of the assessee company, and is the

beneficial owner of half of its total share capital, which shares are not entitled to a fixed rate of dividend, and carries thus more than twenty per

cent. of the voting power. The assessee company seeks allowance of Rs. 12,000 as expenditure by it in payment of a salary of Rs. 1,000 per

mensem to its director-in-charge, which obviously is directly a provision of remuneration to the director-in-charge. Thus clause (a) of section

10(4A) squarely applies to the allowance sought by the assessee company in respect of this expenditure, and the Income Tax authorities have

exercised their power under that provision to disallow half of the amount as excessive and unreasonable allowance claimed by the assessee

company having regard to the legitimate needs of its business and the benefit derived by or accruing to it therefrom.

The learned counsel for the assessee company contends that in section 2(6C), sub-clause (ii) particularly relates to salary, and in the application of

section 10(4A) what is to be taken into consideration is sub-clause (iii) of section 2(6C), in which latter sub-clause there is no reference to salary,

and thus salary having been excluded from that sub-clause it is also excluded from sub-section (4A) of section 10. The argument is not tenable

because sub-clause (ii) of section 2(6C) has no bearing on any provision of sub-section (4A) of section 10, and because reference in sub-section

(4A) (a) of section 10 to sub-clause (iii) of section 2(6C) is only for the purpose of the definition of the expression ""substantial interest in the

company"", and for no other purpose. The reference to that sub-clause is to find whether a director or any other person has or has not substantial

interest in the company as that is explained in brackets in that sub-clause. No other part of that sub-clause has any reference to clause (a) of sub-

section (4A) of section 10. The learned counsel for the assessee firm contends that the word ""allowance"" in clause (a) of sub-section (4A) of

section 10 has reference to an allowance made by a company, as in the present case, to the director-in-charge, and such an allowance being in the

shape of a salary is not within that clause because of its coming directly under sub-clause (ii) of section 2(6C). This is mere repetition of the

previous argument and it proceeds, to my mind, on a wrong meaning attached to the word ""allowance"" in clause (a) of sub-section (4A) of section

10. The word allowance in that clause is used in the meaning of the deduction allowable by the Income Tax authorities and not an expenditure

incurred by a company, because the allowance has to be in respect of any expenditure by the company. It is with reference to deduction claimed

by the company in respect of any expenditure by it that the expression is used. It is used in the same meaning in clause (b) and if in clause (b) the

meaning of the word were as contended by the learned counsel that clause would not make sense, and it cannot be that in the two clauses the

word has been used with different meanings. In fact the meaning of the word is plain in the context and it is not used in the sense of expenditure by

a company but in the sense of a deduction claimed in respect of expenditure by a company.

In the result the answer to the question referred is in the affirmative. In this reference the assessee company will bear the costs of the opposite

party.

GROVER J. - I agree.

Question answered in the affirmative.