(1993) 07 CAL CK 0008

Calcutta High Court

Case No: IT Reference No. 9 of 1988

Union Carbide India Ltd.	APPELLANT
Vs	
Commissioner of Income Tax	RESPONDENT

Date of Decision: July 2, 1993

Acts Referred:

- Income Tax Act, 1961 - Section 17(3)(ii), 256(1), 37(3), 40(c), 40(c)(i)

Citation: (1994) 72 TAXMAN 63

Hon'ble Judges: Shyamal Kumar Sen, J; Ajit K. Sengupta, J

Bench: Division Bench

Judgement

Ajit K. Sengupta, J.

In this reference u/s 256(1) of the income tax Act, 1961 (''the Act'') for the assessment year 1980-81, the following questions of law have been referred to this Court:

1. Whether, on the facts and in the circumstances of the case, the Tribunal erred in holding that the provisions of section 40(c) of the income tax Act, 1961, are applicable to the expenditure on remuneration payable or benefits or amenities provided to the wholetime directors of the assessee-company when there is no finding that such expenditure is excessive or unreasonable having regard to the legitimate business need of the company ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that cash payment on account of reimbursement of medical expenses of the directors could be included in the value of benefit or amenity for the purpose of disallowance of amounts in excess of the limits laid down under the provision of the income tax Act, 1961?

3. Whether, on the facts and in the circumstances of the case, Tribunal erred in holding that the excess payment of Rs. 7,753 made on account of fluctuations in the

exchange rate of dollars, at the time of repayment of the dollar loan, raised from ICICI for purchasing machinery from abroad, was a capital expenditure and not an allowable revenue expenditure ?

4. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the commission paid to the wholetime directors is covered by the term ''remuneration'' as envisaged in section 40(c) of the Act?

5. Whether, on facts and in the circumstances of the case, the Tribunal erred in holding that the expenditure incurred during the stay of the employees or other persons outside the headquarters for the purpose of the business of the assessee is expenditure on travelling subject to the provisions of section 37(3), read with rule 6D, of the income tax Rules, 1962 ?

It is not in dispute that some of these questions are concluded by the decisions of this Court and, accordingly, it is not necessary to set out in detail the facts and circumstances relating to those questions.

In view of the decision of this Court in the case of Bilaspur Spinning Mills and Industries Ltd. Vs. Commissioner of Income Tax, the first question is answered in the negative and in favour of the revenue.

2. The second question relates to the medical reimbursement paid to the wholetime directors. The question was as to whether such medical reimbursement should be taken as a perquisite allowed by the assessee to its directors for the purpose of computing the disallowance u/s 40(c) of the Act. Both the ITO and the Commissioner (Appeals) held that the reimbursement of medical expenses formed part of benefit or amenity allowed to the wholetime directors. The Tribunal relying on the Special Bench decision in the case of Glaxo Laboratories (India) Ltd. v. Second ITO [1986] 18 ITR 226 (Bom.) upheld the decision of the revenue authorities.

3. There are, in fact, some decisions which lay down that the reimbursement of medical expenses by the assessee-company to its directors being a cash payment has to be treated as part of the salary for the purpose of computing the disallowance u/s 40(c) /40A(5) of the Act. There are a number of decisions holding that cash payment cannot be comprehended by the word ''perquisite'' because the definition of perquisite in Explanation 2 below section 40A(5) admits of only non-monetary benefits being construed as perquisites. Any cash payment cannot come within the meaning of that word in view of that definition. This Court has taken this view in Commissioner of Income Tax Vs. Kanan Devan Hills Produce Company Ltd., Commissioner of Income Tax Vs. Tecalemit (Hind) Ltd., and Indian Leaf Tobacco Development Co. Ltd. Vs. Commissioner of Income Tax, . However, in those decisions this question was not raised whether such cash payment is cash allowance and includible in the. quantum of remuneration or value of benefit or amenity or salary.

4. ''Salary'' as such is not defined in Explanation 2. The definition that appears therein is merely inclusive. Therefore, the meaning of the word ''salary'' in its popular acceptation is to be taken to be the meaning of ''salary''. But certain species of cash payments have merely been Included in the definition, some of which could not have been taken as salary unless so included. Therefore, the definition is inclusive and, that way, an expensive one. It particularly includes ''profit in lieu of salary''. But ''profit in lieu of salary'' is also defined in an inclusive manner in its definition u/s 17(3)(ii) of the Act. It can include any payment received by an assessee from an employer including the payment received by an employee on termination of service with certain exceptions as specially referred to in the definition. Now in common parlance, salary is normally meant to be a payment by the employer to the employee arising from the employment relation and the rate of payment is commonly understood to be periodic and at a weekly or monthly or annual rate. That way, the medical reimbursement may not perhaps be strictly understood as salary in its popular connotation. It is exactly for the purpose of roping in other non-recurring or non-periodic payments by the employer to the employee strictly arising from their jural relation of employer and employee that the special addition has been made to the definition by including in the meaning of salary, the expression ''profit in lieu of salary''. Such non-periodic cash payments would be embraced by the expression ''profit in lieu of salary'' if not by salary simpliciter. Now the words ''remuneration as the value of benefit or amenity'' are words of wider connotation and, therefore, can include in it the benefit of cash payment towards medical reimbursement. The second question is answered in the negative and against the assessee.

5. The third question relates to the excess payment made on account of fluctuation in the exchange rate of dollars at the time of repayment of the dollar loan received from ICICI for purchasing machinery from abroad. The issue is whether such excess expenditure was to be treated as a capital expenditure and, therefore, not to be allowed as revenue expenditure. This issue is already covered by the decision of this Court in the case of Bharat General and Textile Industries Ltd. Vs. Commissioner of Income Tax, against the assessee. We see no reason for departing from such decision which in turn followed some earlier decision on the same line. The third question is answered in the negative and against the assessee.

6. The fifth question relates to the issue whether the expenditure incurred during the stay of the employee or other persons outside the headquarters for the purpose of the assessee''s business is subject to the provisions of section 37(3), read with rule 6D, of the income tax Rules, 1962 (''the Rules''). This issue is also covered by the decision of this Court in CIT v. Vidyut Metallics Ltd. [IT Reference No. 94 of 1987, dated 25-10-1990]. In this case also the assessee claimed that the expenditure incurred during the stay of the employees or other persons while on tour outside the headquarters could not form a part of the travelling expenses and, thus, could not attract the ceiling laid down under rule 6D, ibid. The ITO disallowed the

expenditure by applying the ceiling in rule 6D(2). The Commissioner (Appeals), however, allowed the claim. The Tribunal reversed the decision of the Commissioner (Appeals) following a Special Bench decision of the Tribunal in (1984) 7 ITD 845 Thus, the order of the ITO applying the ceiling prescribed by rule 6D(2) for the purpose of disallowance was restored. We have, however, held that the rule 6D, read with section 37(3), of the Act seeks to limit the expenditure incurred on travelling to the extent of stay in hotel and confines it to the ceiling limits to daily allowance referred to in rule 6D and does not extend to any other expenditure incurred provided the expenditure is wholly and exclusively laid out for the purpose of the business. It has not been the revenue''s case that the expenditure disallowed was not incidental to the business or was of a personal nature. That being so, the same principle laid down by this Court in the aforesaid case shall apply and the question is, therefore, answered in the affirmative and in favour of the assessee.

7. As for the facts relating to the fourth question, i.e., the question of the disallowance of commission, the Tribunal merely stated that the ITO did not accept the assessee''s claim that the ''commission'' paid to its wholetime director was not covered by the term ''remuneration'' for the purpose of section 40(c). The ITO included the said commission in the remuneration for determining the disallowance u/s 40(c). The Commissioner (Appeals), however, accepted the claim of the assessee and directed the ITO to recompute the disallowance u/s 40(c) without including therein the commission as part of remuneration. On an appeal by the department, the Tribunal, relying on the decision of the Special Bench of the Tribunal in the case of (1983) 3 ITD 612 allowed the ground of the department and reversed the decision of the Commissioner (Appeals). Thus, the ITO''s disallowance was restored. The question is whether the assessee''s stand that the word ''remuneration'' does not include ''commission'' is correct or not.

8. The provisions of section 40(c) are clear to this extent that 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, is disallowable where the expenditure is considered excessive or unreasonable by the Assessing Officer having regard to the legitimate business needs of the company. It is, over and above, subject to the prescribed ceiling. The excess over the ceiling is disallowable even if the payment is neither excessive nor unreasonable. The question has arisen before us whether the commission paid by the company to its directors shall form part of the remuneration referred to in section 40(c). The Punjab High Court has consistently taken the view that the word ''remuneration'' in its ordinary meaning connotes ''reward, recompense, pay, wages or salary for service rendered'', but commission is treated by the Legislature as something different from the genus ''remuneration''. Commission throughout the Act has been treated as a distinct category separate from remuneration. In this regard reference may be made to Commissioner of Income Tax Vs. Avon Cycles (P.) Ltd., There the said High

Court held that the word "remuneration" in section 40(c)(i) did not include commission. There commission was paid to a firm by the company. The firm had for its partners some of the directors of the assessee-company or their relatives. It acted as sole selling agent of the assessee-company. The disallowance made treating such commission as remuneration referred to in section 40(c) was reversed by the High Court. The Punjab and Haryana High Court even in subsequent decisions, viz., Hemco Industries Private Ltd. Vs. Commissioner of Income Tax, Commissioner of Income Tax Vs. Maltex Malsters Ltd., and Saraswati Industrial Syndicate Ltd. v. CIT [1990] 183 ITR 120, has consistently taken this view that commission is not to be equated with remuneration.

9. We cannot, however, visualise such a clear-cut separation between remuneration and commission. It largely depends on the relation wherefrom entitlement to the commission arises. Where the "commission" becomes due for the reason that the payee though a director or a person substantially interested in the payer-company, undertook a contractual liability, the commission paid to him may be treated distinctly from common remuneration. Such was the situation in CIT v. Sudarsan Chits (India) Ltd. [1990] 182 ITR 94 (Ker.). There the amount paid by the assessee-subsidiary company to the holding-company under an agreement for the use of services of officers of the holding-company including the managing director was held to be a payment not attracting the provisions of section 40(c), because the payment in question was made on contractual basis and it was incurred on account of the business expediency. Moreover, the payment under the contract was not found nor challenged as colourable or otherwise suspect.

10. There is one decision of this Court, viz., India Jute Co. Ltd. Vs. Commissioner of Income Tax, where guarantee commission was paid to a relative of a director. This Court held that the payment was not hit by the overall ceiling limit prescribed by section 40(c) as it does not fall within the ambit of the phrase remuneration or benefit or amenity and, therefore, could not attract the provisions of section 40(c). Here the commission was received by the relative of the director as a guarantor and his liability as such is co-extensive with that of the debtor. If the company fails to pay the loans, his personal assets and properties may be attached and held in execution of any decree that might be passed in respect of the loan. Therefore, by giving guarantee the person, concerned has exposed himself to a liability. It is for his undertaking the liability that he is being paid the commission. This cannot be described as a benefit either.

11. The decision gives one more clue, that is, the view taken by the Punjab High Court in the abstract proposition that remuneration cannot comprehend commission is not correct. What was lost sight of in the Punjab High Court"s view is that expression is not merely "remuneration", the expression is "remuneration or benefit or amenity". Therefore, commission cannot go outside this spectrum of benefit even if it goes out of the scope of the word "remuneration". So, the

commission to be out of the mischief of section 40(c) has also to avoid being embraced by the expression ''benefit or amenity''. The decision of this Court in Indian Jute Co. Ltd.''s case (supra) furnishes a clue to this construction of section 40(c). There is also a decision of the Karnataka High Court in T.T. Pvt. Ltd. Vs. Income Tax Officer, Company Circle-III, Bangalore, which held that the language of section 40(c)(i) refers to expenditure that is incurred by way of periodical payments to a person mentioned therein. Therefore, the payments intended to be brought within the scope of that provision are payments for personal services rendered by the payee. So, it could not have any reference to payments made by a company for all kinds of services or facilities. In that view of the matter commission paid to a selling agent even where the payee falls within the category of vulnerable persons in terms of section 40(c) would not fall within its mischief.

12. But the ultimate decision would depend on the nature of the service rendered. If services rendered are of a contractual origin and nature and involves such liability as exposed the payee to the likelihood of special jeopardy, de hors the relation with the company as director, the conclusion will be that the commission paid therefor could not be equated with remuneration for services.

13. It does not appear to us that the authorities below have looked into the matter from the point of view from which the payment of commission is to be adjudged. There are no facts available to come to a finding. We, therefore, decline to answer the fourth question and remand it to the Tribunal with direction to examine the whole matter afresh in the light of our observations, after giving to the parties due opportunity to lead evidence, if necessary. There will be no order as to costs.

Sen, J.

I agree.