(1992) 11 BOM CK 0097

Bombay High Court

Case No: Income-tax Reference No. 20 of 1978

Commissioner of Income Tax		APPELLANT
	Vs	
Hico Products (P.) Ltd.		RESPONDENT

Date of Decision: Nov. 17, 1992

Acts Referred:

- Income Tax Act, 1961 - Section 32(1), 35, 35(1), 35(2)(ia), 40

Citation: (1993) 201 ITR 567

Hon'ble Judges: U.T. Shah, J; B.P. Saraf, J

Bench: Division Bench

Advocate: G.S. Jetley, for the Appellant; Arun Sathe, for the Respondent

Judgement

DR. B.P. Saraf, J.
This is a consolidated reference u/s 256(1) of the Income Tax Act, 1961, made at the instance of the Commissioner of Income Tax. By this reference, the Income Tax Appellate Tribunal has referred the following two questions to this court for opinion :

"(1) Whether the Tribunal was right in law in holding that, in the case of directors who were the employees of the company, the provisions of section 40A(5)(a) and the ceiling or limit contemplated therein under clause (c) would not apply but only the ceiling of Rs. 72,000 contained in the provision to section 40A(5)(a) would be attracted and consequently, the limit would be Rs. 72,000 and not Rs. 60,000 as stated by the Income Tax Officer ?

(2) Whether, on the fact and in the circumstances of the case, the Tribunal was right in holding that depreciation allowance given u/s 32(1)(iv)/35(2)(ia) of the Act are disjunctive and cumulative and not alternative and, accordingly, upholding the grant of the depreciation allowance on items of building, plant and machinery used for scientific research in the relevant accounting year and on which appropriate deductions in the earlier year have been allowed u/s 35(1)(iv)/35(2)(ia) of the Act ?"

2. The first question relates to the assessment years 1972-73 and 1973-74 only whereas the second question relates to the assessment years 1972-73, 1973-74 and 1974-75.

3. Before we proceed to state the facts and deal with the controversy raised by question No. 1, it may be expedient to answer question No. 2 as it is stated at the Bar that the controversy raised therein stands concluded in favour of the Revenue by a recent decision of the Supreme Court in the case of Escorts Limited and Others Vs. Union of India and others, . Following the same, question No. 2 has to be answered in the negative and in favour of the Revenue. We answer the same accordingly.

4. We may now turn to question No. 1. The relevant facts are follows the assessee is a private limited company. The assessment year involved are 1972-73 and 1973-74. The legal dispute raised in respect of both these assessment years is identical. In the assessment for the year 1972-73, a sum of Rs. 1,04,942 was claimed as a deduction by the assessee company in respect of the salary of the managing director. The Income Tax Officer restricted the deduction to Rs. 60,000 by invoking the limit prescribed in clause (c) of section 40A(5) on individual items specified in clause (c) in respect of the expenditure referred to in clause 5 (a) (i). Thus an amount of Rs. 44,942 was disallowed. Similarly, in the assessment for the assessment year 1973-74, out of the claim on account of salary paid the assessment to an employee-director, a sum of Rs. 60,020 was disallowed confining the allowance to Rs. 60,000 only. The case of the assessee was that the individual ceiling specified in clause (c) was not applicable to a case governed by the first proviso to section 40A(5)(a) of the Act. Accordingly to him, it was only the aggregate ceiling specified in the first proviso which was applicable in respect of all the four items mentioned therein. Aggrieved by the order of the Income Tax Officer, the assessee preferred an appeal before the Appellant Assistant Commissioner who agreed with the assessee''s contention and held that since the disallowance was in respect of the managing director''s and director''s remuneration, the first proviso to section 40A(5)(a) was attracted which only provided a ceiling of Rs. 72,000 on the aggregate expenditure incurred under all the four heads together. The Revenue appealed to the Tribunal which failed. The Tribunal confirmed the order of the Appellant Assistant Commissioner. The Commissioner thereupon sought for a reference u/s 256(1) of the Act. Hence, this reference.

5. Section 40A of the Act deals with expenses or payments not deductible in certain circumstances in company income under the head "Profits and gains of business or profession." Sub-section (5) thereof deals with expenditure incurred on payments made to the employees or former employees by way of salary, etc. The first proviso to clause (a) thereof deals with the case of an employee or a former employees who is a director a person who has a substantial interest in the company or a relative of the director or such other persons. A special provision for disallowance has been

made for this category of employees. Sub-sections (5) (a) and (c) of section 40A, so far as relevant, are set out below :

"(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 asset 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 : .....

(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 months or part thereof comprised in the period of his employment in India during the previous year or any earlier previous year, sixty thousand rupees :

Provided that, where the expenditure is incurred on payment of any salary to an employee or a former employee engaged in scientific research during any one or more of the three years immediately preceding the commencement of the business and such expenditure is deemed under the Explanation to clause (i) of sub-section (1) of section 35 to have been laid out or expended in the previous year in which the business is commenced the limit referred to this sub-clause shall, in relation to the previous year in which the business is commenced, be 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 pervious year in which such business is commenced and in the period of his employment in India during which was

engaged in scientific research during the three years immediately preceding that previous year;

(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, which ever is less...."

6. From the plain reading of these provisions, it is clear that the main provision of clause (a) of sub-section (5) refers to all employees or formers employees of a company and puts a ceiling on certain expenditure incurred on payment of salary, etc., to such persons. Clause (a) has two sub-clauses. Sub-clause (i) deals with expenditure incurred by a company which results directly or indirectly in the payments of salary to an employees or a former employee; sub-clause (ii) deals with expenditure which results directly or indirectly in the provision of any perquisite to an employee or any expenditure or allowance in respect of any asset of the assessee used by an employee either wholly or partly for his own purposes or benefits. If such expenditure referred to in the aforesaid two sub-clauses is incurred by an company, then subject to the provisions of clause (b) with which we are not concerned in the present case, so much of such expenditure are allowance as is in excess of the limit specified in respect thereof in clause (c) would not be allowed as a deduction. In clause (c), the limit of expenditure for allowability of expenditure referred to in clause (a) have been specified. Separate limits have been fixed for expenditure mentioned in sub-clause (i) and sub-clause (ii) of clause (a). These limits apply to payments made to all persons covered by clause (a). The substantive provision of clause (a) clearly takes with its ambit all persons employed by the company. Had there been no proviso to this clause, this provision and all the limits and ceiling specified in clause (c) would have applied to payments of the nature prescribed in sub-clauses (i) and (ii) of clause (a) made to the employee-directors also. But the proviso has carved out the particular category of persons mentioned therein from the substantive provision of clause (a) and has dealt with them differently. It provides a separate ceiling in respect of such persons and that is a ceiling of Rs. 72,000 on the aggregate expenditure and allowance. This aggregate ceiling applies not only to the expenditure mentioned in sub-clauses (i) and (ii) of clause (a) but also to expenditure and allowance referred to in sub-clauses (i) and (ii) of clause (c) of section 40. It is the aggregate of all these four items which cannot exceed Rs. 72,000. No individual ceiling has been put on any of these items of expenditure for the purposes of allowability as has been done in clause (c) in the case of persons other than those falling under the proviso to clause (a). The limit of expenditure referred to in sub-clause (i) of clause (a) is Rs. 60,000 and the limit in respect of expenditure referred to in sub-clause (ii) is Rs. 1,000 per month. But, in the case of the employee-directors and such other persons who are covered by the proviso to clause (a), an aggregate ceiling of Rs. 72,000 has been fixed not only in

respect of the expenditure referred to in the aforesaid two sub-clauses but also those referred to in sub-clauses (i) and (ii) of clause (c) of section 40(5) of the Act. From this, it is evident that the legislative intention is to treat the employee-directors and other persons mentioned in the proviso differently, from other employees in the matter of allowability of expenditure incurred on them. By the proviso it carved out of clause (a) somethings which otherwise would have fallen within it. The determination of the controversy in this case, therefore, hinges upon the interpretation of the proviso to clause (a) of sub-section (5) of section 40A.

7. It is well-settled that a proviso is added to a principal clause primarily with the object of taking out of the scope of that principal clause what is included in it and what the Legislature desires should be excluded. The proper function of the proviso is to except or quality somethings enacted in the substantive clause, which but for the proviso would be within that clause, unless the context, setting and purpose of the provision warrants a different construction. Reading the proviso to clause (a) in the instant case with reference to the scheme of sub-section (5), it is clear that its object is to take out of the scope of clause (a) of sub-section (5) certain categories of employees referred to therein for a different treatment in the matter of disallowance of expenditure. Any other interpretation will lead to anomalous situations. If we read this proviso with clause (c), it is evident that it is difficult to give effect to the various limit specified therein on different items separately in addition to the aggregate limit of Rs. 72,000 put in the proviso. In clause (a), there is no aggregate ceiling. Only the limits specified in clause (c) on individual items of expenditure are applicable. But in the proviso, an aggregate ceiling has been put on the expenditure without laying down any ceiling on individual items of expenditure mentioned therein. In our opinion, by the incorporating the proviso, the Legislature has taken out the case of employee-directors and other persons referred to therein from the substantive provision contained in clause (a) and has laid down a separate aggregate ceiling on expenditure under different heads. This view of our gets full support from the fact that, in addition to the two items mentioned in the substantive part of clause (a), two more items of expenditure have also been added in the proviso for the purpose of considering the aggregate. We are, therefore, of the clear opinion that the individual ceiling on different items of expenditure specified in clause (c) of section 40A(5) are not applicable to cases covered by the first proviso to clause (a) of section 40A(5) of the Act. On a true and proper interpretation of section 40A(5), the only limit applicable to such cases is the aggregate, i.e., Rs. 72,000 specified in the proviso itself and the items which are to be taken into account for this purpose are the four items mentioned therein.

8. Learned counsel for the Revenue placed reliance on the decision of the Kerala High Court in the case of Travancore Rayons Ltd. Vs. Commissioner of Income Tax, and the decision of the Punjab and Haryana High Court in the case of Commissioner of Income Tax Vs. Amritsar Rayon and Silk Mills (P.) Ltd., wherein the Kerala High Court view has followed. Learned counsel also relied upon the case of Ganga Saran

and Sons P. Ltd. Vs. Income Tax Officer and Others, which has also been referred to in a decision of this court in the case of Lubrizol India Ltd. v. CIT [1991] 187 ITR 25.

9. The High Court of Kerala and Punjab have taken the view that the ceiling on the individual items of expenditure incorporated in clause (c) should be brought in by reference also to cases covered by the first proviso to clause (a). In other words, the view of these courts is that, in addition to the aggregate ceiling, the ceilings on allowability of individual items specified in clause (c) should also be applied to ceases governed by the first proviso to clause (a).

10. A contrary view has been taken by the Gujarat High Court. The decision of the Gujarat High Court is in Additional Commissioner of Income Tax, Gujarat Vs. Tarun Commercial Mills Ltd., . A view similar to that to of the Gujarat High Court has also been taken by the Calcutta High Court in the case of Commissioner of Income Tax Vs. Indian Molasses Co. (P.) Ltd., . We have carefully gone through the decision of the High Courts of Kerala and Punjab but, in view of the reasons given by us in the foregoing paragraphs, we find it difficult to accept the same. We find ourselves in agreement with the view expressed by the Gujarat High Court. The Gujarat High Court, in our opinion, has rightly taken the view that the Legislature has laid down an upper limit or ceiling of Rs. 72,000 on the permissible expenditure which may comprise with the view expressed by the Gujarat High Court that the ceiling is on the aggregate expenditure as contemplated by the general scheme of section 40A(5)(a) read with clause (c) thereof. In our opinion, any other interpretation will mean adding words to the proviso which are not there. Needless to say such an interpretations is impermissible.

11. In view of the foregoing discussion, we answer the first question referred to us in the affirmative and in favour of the assessee. Question No. 2 is answered in the negative and in favour of the Revenue. Under the facts and circumstances of the case, we make no order as to costs.