

M/s. Mund and Samont Co. (P) Ltd.

Vs.

C. I. T., Bihar, Orissa and Patna

Civil Appeal No. 138 of 1967,

(J. C. Shah, K. S. Hegde, A. N. Grover JJ)

06.05.1970

JUDGMENT

SHAH, J. -

1. This appeal is filed with certificate under Section 66-A(2) of the Indian Income-tax Act, 1922.
2. The assessee is a private limited company carrying on business in "Mica Mining". Under Article 42 of its Articles of Association, remuneration payable to the Managing Director and the Deputy Managing Director of the assessee was fixed at 30% of the annual net profits subject to the minimum of Rs. 5,000/-. In the year of account ending June 30, 1958, the assessee debited an amount of Rupees 66,106/- paid to the Managing Director and the Deputy Managing Director. For the assessment year 1959-60 the Income-tax Officer while computing the taxable income in exercise of his power under Section 10(4-A) of the Income-tax Act allowed only Rs. 54,670/- as remuneration for the Managing Director and the Deputy Managing Director, and disallowed the balance of Rs. 11,436/-. He was of the view that the allowance paid to the two Directors was excessive or unreasonable having regard to the legitimate business needs of the Company and the benefit derived by or accruing to it therefrom. The Appellate Assistant Commissioner confirmed the order. In second appeal, the Tribunal held that the Income-tax Officer had jurisdiction under Section 10(4-A) to determine the reasonableness of the claim for remuneration paid to the two Directors and on the materials on the record he was justified in disallowing the amount of Rs. 11,436/-.
3. The Tribunal referred the following question to the High Court of Patna for opinion :

"Whether in the facts and circumstances of the case, the Tribunal was correct in applying the provisions of Section 10(4-A) of the Income-tax Act to the case of the assessee and in disallowing Rupees 11,436/- out of the remunerations paid to the Managing Director and Deputy Managing Director in accordance with the provisions of the Articles of Association of the Company ?"

The High Court held that the Income-tax officer had jurisdiction under Section 10(4-A) to disallow a part of the remuneration, and that the disallowance of a part of the claim cannot be said "to be unjustifiable or illegally disallowed by the authorities".

4. In an application filed by the assessee the High Court certified the case under Section 66-A(2) stating that "as regards the value and nature of the cases, it fulfils the requirements under Section 66-A(2) of the Income-tax Act, 1922, and is a fit for appeal to the Supreme Court."

5. In this appeal the Solicitor-General has contended that the certificate was defective in that it did not set out the substantial question of law which, in the view of the High Court, fell to be determined by this Court. For reasons which we have stated in Civil Appeal No. 376 of 1967 (SC) : Indian Machinery Store (P) Ltd. v. C. I. T., Bihar, we are of the view that the certificate is defective.

6. Mr. Chagla appearing on behalf of the assessee has offered to file a petition for special leave in this case. We have accepted the undertaking given by the Advocate on record to file a special leave petition.

7. We have heard counsel on the merits of the appeal. Section 10(4-A) of the Indian Income-tax Act which was added by the Finance Act of 1956 with effect from April 1, 1956, provides, insofar as it is material :

"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 provisions 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 (6-C) of Section 2, or

##(b) ... ..##

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."

Under the Article of Association, the rate of remuneration to be paid to the Managing Director and the Deputy Managing Director was fixed. The case was clearly covered by the terms of Section 10(4A), and the Income-tax Officer had jurisdiction to consider whether the allowance was excessive or unreasonable having regard to the legitimate business needs of the Company and the benefit derived by or accruing to it therefrom. Counsel for the assessee submits that the decision of the taxing authorities and the Tribunal that in the circumstances of the case the allowance was excessive or unreasonable having regard to the legitimate business needs of the Company and the benefit derived by or accruing to it therefrom is erroneous.

8. It appears that the Income-tax Officer had, for the assessment years 1957-58 and 1958-59 disallowed a part of the remuneration paid to the Directors. The matter was carried to the Tribunal. For the assessment year 1957-58 the Tribunal allowed the claim in full : in respect of the year 1958-59 the Tribunal allowed an amount of Rs. 48,000/- as against the claim for Rs. 74,190/-. The assessment orders of the years 1957-58 and 1958-59 are not before the Court. In his order relating to the assessment years 1959-60 the Income-tax Officer adopted the reasons recorded in his previous order relating to the earlier years, and held that the remuneration paid to the Directors was excessive or unreasonable having regard to the legitimate business needs of the Company and the benefit derived by and accruing to it therefrom. The Appellate Assistant Commissioner agreed with that view. He rejected the contention of the Company that the Managing Director and the Deputy Managing Director "had practically built up the business and it was due to their whole-time service and effort that large profits were earned by the Company." Apparently there was no evidence in support of such a case. He agreed with the Income-tax Officer that the remuneration allowed to the

Directors should be at an average rate of the last three years. The Tribunal held that even though it was not proved that the remuneration was "influenced by extracommercial consideration" the Income-tax Officer had determined the appropriate allowance by striking an average of remuneration charged in the account for the immediate preceding three years.

9. Mr. Chagla contends that in striking an average for three years the Tribunal erred. Counsel contended that under Section 10(4-A) of the Act the Income-tax Office must reach a conclusion that the allowance was excessive or unreasonable having regard to the legitimate business needs of the Company and the benefit derived by or accruing to it therefrom. It is however for the tax-payer to establish by evidence that a particular allowance is justifiable. Apparently evidence was tendered by the assessee relating to the duties of the Managing Director and the Deputy Managing Director, the service rendered by them, the manner in which the profits earned by the assessee were enhanced by reason of their special attitude or qualification, the legitimate business needs of their special aptitude or qualifications, the legitimate business needs of the assessee and the benefit derived by or accruing to the assessee in consequence of the service rendered by the Managing Director and the Deputy Managing Director. In the absence of any such evidence, the finding recorded by the Income-tax Officer and confirmed by the Appellate Assistant Commissioner and the Tribunal must be accepted. We are unable to agree with counsel for the assessee that even if the tax-payer does not produce any evidence in support of the claim for allowance, the Income-tax officer must independently collect evidence that the allowance claimed is excessive or unreasonable having regard to the legitimate business needs of the assessee before the power under Section 10(4-A) may be exercised.

10. The appeal therefore fails and is dismissed.

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