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***IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ ITA Nos. 69/2011, 536/2011, 611/2011 & 1298/2011

CIT

..... Appellant

Through Mr. Anupam Tripathi, Sr.
Standing Counsel & Ms. Anusha Singh,
Advocate for the appellant in ITA No.
1298/2011.

Ms. Suruchi Aggarwal, Sr. Standing
Counsel for the appellant in ITA Nos.
69/2011, 536/2011 & 611/2011.

Versus

BONY POLYMERS PVT LTD.

..... Respondent

Through Dr. Rakesh Gupta & Ms. Rani
Kiyala, Advocates.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE R.V.EASWAR

ORDER

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18.01.2012

CM Nos. 22916-22917/2011 in ITA No. 1298/2011

These are applications by the Revenue for condonation of
delay of 13 days in filing and 102 days in re-filing the appeal.
Learned counsel for the respondent assessee states that the
delay may be condoned. The applications are accordingly

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allowed and the delay in filing and re-filing are condoned.

The applications are disposed of.

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These appeals by the Revenue pertain to disallowance under Section 36(1)(ii) of the Income Tax Act, 1961 (Act, for short) on commission paid by the respondent assessee-Bony Polymers Private Limited to the two directors, Mr. Raj Bhatia and Ms. Kavita Bhatia.

2. These appeals pertain to assessment year 2003-04 (wrongly mentioned in the assessment orders and appellate proceedings as assessment year 2004-05), 2005-06, 2006-07 and 2007-08. As a similar issue arises for consideration, these appeals are being disposed of by this common order.

3. At the very outset, we may record and notice that the Assessing Officer has not invoked Section 40A(2) of the Act and held that the commission payments made to the two directors were unreasonable or excessive having regard to the fair market value of the services rendered.

4. We are only concerned with Section 36(1)(ii) of the Act and whether commission paid to the directors was rightly disallowed.

5. The respondent assessee has eight shareholders. Mr. Raj Bhatia, the Managing Director is a qualified Mechanical

Engineer having more than twenty five years of experience. Ms. Kavita Bhatia is an MBA with over twenty years experience and is a director. In addition to the fixed amount, the two directors are entitled to remuneration in the form of commission fixed by the Annual General Meeting(AGM) of the shareholders of the respondent assessee. The Revenue is not disputing or denying the fact that as per the resolution passed in the AGM, the respondent assessee is liable to pay the said commission to the two directors for services rendered. The Assessing Officer has not held that the two directors did not render services to the respondent assessee.

6. The term "salary" under Section 17(1)(iv) of the Act includes commission in lieu of or in addition to the salary or wages. The two directors were paying maximum marginal tax in their capacity as individual assessees in the assessment years in question. No claim or allegation has been made by the shareholders of the respondent assessee that excessive, exorbitant or unjustified commission has been paid to the two directors.

7. A shareholder of a company makes an investment when he purchases shares and is entitled to dividend on the said

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investment. Dividend is payable as per and in accordance with the provisions of the Companies Act, 1956. The Board proposes payment of dividend and the rate thereof and thereafter it is approved by the shareholders. It is not mandatory and the Companies Act, 1956 does not stipulate that dividend must be paid. Payment of salary to the directors is for the work and services rendered by them to the company. It is contractual but can be regulated by law. The nature of the two payments, i.e., "dividend" and "salary" is entirely different.

8. The question whether Section 36(1)(ii) should be applied and payment of commission should be disallowed as an expense in the hands of the company was considered by us in ITA No. 1283/2011, **CIT versus Creative Travel Private Limited**, decided on 15th December, 2011. In the said case, we dismissed the appeal filed by the Revenue recording as under:-

"4. During the period relevant to the assessment year, the respondent declared income of Rs.1,85,42,920/- in the return filed on 27th November, 2006. The respondent company had earned profit of Rs.1,98,98,286/-. Dividend of Rs.20,00,000/- was proposed and was distributed/paid to the shareholders. The total paid-up capital of the company was Rs.20,00,000/- and, therefore, 100% dividend was declared. The Managing Director and the two Directors of the respondent company were paid bonus and commission of Rs.77,37,965/-. The aforesaid amount as per the provisions of

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the Act was treated as salary paid and TDS was deducted. As per the findings recorded by the tribunal, the said Directors have paid tax in the highest tax bracket. The tribunal has rightly noticed that dividend has to be paid to all shareholders equally as per the provisions of the Companies Act, 1956. The said position cannot be disputed by the Revenue. The respondent company is a closely held company and it is accepted that all shareholders are not directors in the respondent company. It may be also noted that the directors in question, were working directors and had contributed to the earnings/profit earned by the company respondent. A non-working director or a mere shareholder does not contribute and put in efforts or labour towards earning of profits. A shareholder merely makes an investment and contributes to the share capital. It is not the number of shareholders, but the principle which matters.

5. The tribunal has further recorded that the respondent company has been paying commission/bonus to the directors for last 30 years. It is submitted by the Revenue that with regard to the assessment years 2002-03, 2005-06 and 2007-08, the Revenue had raised objections and disallowed commission/bonus payments made. The tribunal has decided the issue in favour of the assessee in the aforesaid assessment years. The Revenue preferred an appeal before the High Court for the assessment year 2005-06 in ITA No.1672/2010, which has been dismissed by this Court."

9. This issue again came up before us in ITA No. 650/2011,

AMD Metplast Private Limited versus Deputy Commissioner of

Income Tax, decided on 16th December, 2011. In the said case also, we noticed the decision of the Bombay High Court in **Loyal Motor Service Company Limited versus Commissioner of Income Tax**, (1946) 14 ITR 647 (Bom.). The relevant portions of the judgment of Stone, C.J. and Kania, J. were reproduced. For the sake of convenience, we reproduce the reasoning of Stone, C.J., who had interpreted Section 10(2)(x) of the Income Tax Act, 1922 and observed:-

"3. Now the facts as shown by the reference are that this company was formed by fourteen persons, thirteen of whom were originally owner drivers of motor vehicles, the fourteenth member contributing in money. The thirteen not only contributed their motor vehicles but also their services and accordingly became employees of this company. Besides the thirteen there are twenty-eight other employees making a total of forty-one. In the year in question the company granted a bonus at the rate of two months' salary to its forty-one employees and the total sum required to pay this bonus was Rs.6,084, of which Rs.1,954 went to the twenty-eight other employees and Rs.4,130 to the thirteen shareholder employees. It is to be noted that the quantum of bonus paid to each of the shareholder employees was by reference to their salaries and not to their stakes in the company. A tabulated result is set out in the application for this reference and is printed on page 12 of the record. It is there shown that of the thirteen shareholders employees six employees got less bonus than they would have got as dividends if the

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sum of Rs.4,130 had been distributed by way of additional dividends. Five of them got more bonus than such dividends and in the case of two of them the figure works out the same. That is an accident in the sense that the bonus payments being referential to their wages and the dividends being referential to their shares have no relation to each other. Now the answer to the question referred to us depends on the construction that is to be placed upon para (x) of sub-s. (2) of s. 10. It should be noted that the body of this sub-section provides an allowance and the qualifying part of it is by way of exception to that allowance. What is to be allowed is "any sum" paid to an employee as bonus or commission for services rendered and the exception is, where "such sum" would not have been paid to him as profits or dividends if it had not been paid as bonus or commission. In the exception the words "such sum can, in my opinion, only refer to the last and the only antecedent, which is "any sum" paid as commission or bonus. Therefore unless the commission or bonus would be paid to the assessee as profits or dividends the exception to the allowance does not operate. Mr. Setalvad on behalf of the CIT has pointed out with considerable force that strictly construed there can hardly ever be a case which comes within the ambit of the exception. Sir Jamshedji Kanga on behalf of the assessee-company suggests two such cases, viz., in the case of what is generally called a one-man-company which is not unlawful under the Indian Companies Act, and also in a case in which a company, in declaring a dividend, or a partnership, in declaring division of their profits, say that instead of distributing their profits by way of dividends, or shares of profits, they will distribute the amount to themselves, as

salaries employees in their own company or partnership, as bonus. We are construing a taxation statute and the subject is entitled to have such a statute strictly construed in his favour. In my opinion in placing a strict construction on this sub-section, the sum excepted under the expression "such sum" must be the same sum as is described by the expression "any sum paid as bonus or commission", and that an equivalent sum even in the two cases where by accident the bonus and the prospective dividend are the same, is not included in that construction. If that is the construction which is to be placed upon this sub-section, then the answer to the question is, that the whole of the sum of Rs.4,130 paid as bonus to the shareholder employees is allowable as deduction under the provisions of s. 10(2)(x). I answer the question referred to us in the affirmative. The CIT must pay the costs of this reference."

(emphasis supplied)

10. In the same decision, Kania, J. had observed:

"7. In my opinion, that construction of the clause is not correct. The word "such" must refer to what had been previously mentioned in the same clause in connection with the word "sum". To find that out we must look to the first part of the clause. That refers to "any" sum. Reading the clause in that way the plain meaning appears to be that when a particular amount was paid by way of bonus to any employee, if the same amount would have been paid to him as a shareholder as dividend or profit, the company cannot be allowed a deduction on the ground of payment of bonus. To put it in other words the clause is intended to prevent an escape from taxation by describing a payment as

bonus, when in fact ordinarily it should have reached the shareholder as profit or dividend. The argument would be equally applicable in the case of a partnership as in the case of a limited company. This construction leads to no hardship. It does not allow a wrong payment of bonus to escape taxation. In the first instance the bonus in the hands of the employee is liable to be taxed, unless exempted by a special notification. Moreover, the proviso contains conditions under which if a wrong claim is made, the same can be investigated and disallowed. An illustration will perhaps make the position clear. Five persons in a firm realizing that the profits of the year were Rs.50,000 and they had an equal share in the profits of the business decide that instead of receiving Rs.10,000 each as the share of profits each of them will be paid Rs.10,000 as bonus or commission. In such a case the firm, when sought to be assessed, may contend that Rs.10,000 were paid as bonus. The contention will be clearly rejected. But the safeguards do not end there. The firm will have to provide to the satisfaction of the taxing authority that the five partners were employees, in the first instance. Secondly, that the bonus was a reasonable amount having regard to the pay of the employee and the conditions of his service. Thirdly, that the profits of the business for the year in question made it reasonable to pay the amount granted as allowance, and lastly, the general practice in similar businesses or trade justified the payment of the amount as bonus. It seems to me that the plain reading of the clause means that the profits of a business will not be allowed to be dwindled by merely describing the payment as bonus, if the payment is in lieu of dividend or profit. I do

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not see any reason why any strained construction should be put on the plain meaning of the words of the clause. I therefore agree with the learned Chief Justice with regard to the answer to be given to the question referred to us."

(emphasis supplied)

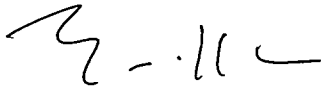
11. After referring to the aforesaid paragraphs, the appeal filed by the assessee was allowed in **AMD Metplast Private Limited** (supra), inter alia, recording as under:-

"11. We fail to understand how the aforesaid observations assist and help the Revenue in the factual matrix of the present case. Ashok Gupta is the Managing Director and in terms of the Board resolution is entitled to receive commission for services rendered to the company. It is a term of employment on the basis of which he had rendered service. Accordingly, he was entitled to the said amount. Commission was treated as a part and parcel of salary and TDS has been deducted. Ashok Gupta was liable to pay tax on both the salary component and the commission. Payment of dividend is made in terms of the Companies Act, 1956. Dividend has to be paid to all shareholders equally. This position cannot be disputed by the Revenue. Dividend is a return on investment and not salary or part thereof. Herein the consideration in the form of commission which was paid to Ashok Gupta was for services rendered by him as per terms of appointment as a Managing Director."

12. In view of the aforesaid reasoning and our decisions in the

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case of ***Creative Travel Private Limited*** (supra) and ***AMD Metplast Private Limited*** (supra), we dismiss the present appeals. In the facts of the case, there will be no order as to costs.


SANJIV KHANNA, J.


R.V. EASWAR, J.

JANUARY 18, 2012
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