

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH 'A', HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUH RAHMAN, ACCOUNTANT MEMBER**

ITA No. 323/Hyd/2017
Assessment Year: 2005-06

Dy. Commissioner of Income-tax, Circle – 3(1) Hyd. vs. RKS Motors Pvt. Ltd., Hyderabad.

PAN – AAACR9764P

Appellant

Respondent

Revenue by: Shri Balakrishna
Assessee by: Shri Siddharth Toshnival

Date of hearing: 16/01/2018
Date of pronouncement: 24/01/2018

ORDER

PER S. RIFAUH RAHMAN, AM:

This appeal is filed by the revenue against the order of CIT(A) - III, Hyderabad, dated 16/12/2016 relates to the AY 2005-06.

2. In this appeal, the revenue is contesting against the commission paid to the Directors, which was allowed by the CIT(A) as allowable expenditure u/s 36(1)(ii) of the Income-tax Act, 1961 (in short 'the Act').

3. Briefly the facts relating to the case are, during the course of scrutiny assessment, the AO noticed that assessee has paid commission to Shri Vinay Saboo & Smt. Madhumathi Saboo of Rs. 21,00,000/- and Rs. 12,00,000/- respectively on the basis of sale of cars during the year as per the slab authorised by the Board of Directors. According to AO, the

above commissions are not allowable u/s 36(1)(ii) as the Directors have interest in the business as they are shareholders of the company. Accordingly, he disallowed the commission paid to such Directors. Aggrieved with this order, the assessee preferred an appeal before the CIT(A).

4. Before the CIT(A), the assessee submitted as under:

(a) The section 36(1)(ii) prohibits payment of profit or dividend in the guise of commission. In this case the commission paid is purely for the services rendered and linked to the sales made, unlike dividend or profit which is linked to the investment. The commission was never paid as percentage of profit.

(b) The commission was paid and also was allowed in the earlier years consistently.

(c) Both the directors Sri Vinay Saboo & Smt. Madhumathi Saboo are taxed at highest slab. If the commission is disallowed in the hands of appellant, that would amount to double taxation as it would suffer tax in the company as well as in the hands of directors.

(d) As per the Board circular No.551 dated 23.1.1990, the bonus or commission paid to the employees will be allowed without any restriction.

(e) If the payments are unreasonably excessive, such payments can be disallowed u/s 40A(2).

5. After considering the submissions of the assessee, the CIT(A) allowed the appeal of the assessee by observing as under:

First of all this provision is applicable to workers and employees who are covered by the Bonus Act, 1975 and is not applicable to the shareholders who are entitled to dividends. As per the I.T. Act, 1961 the excessive payments to directors or to the person who have substantial interest in the company could be reduced or disallowed u/s 40C. However this section is omitted w.e.f. 104.1989.

With reference to A.Y.2005-06, the payments made to directors / persons having substantial interest can be disallowed u/s 40A(2)(b). Another relevant section would be Sec.43B where such payments should be allowed only when such amounts are actually paid;

In the instant case the commission paid to Sri Vinay Saboo of Rs. 21,00,000/- & Smt. Madhumathi Saboo of Rs.12,00,000/- was accepted as their income in their Income Tax returns filed for A.Y.2005-06 which are placed on record. It is also pertinent to mention that the company M/s RKS Motors Pvt Ltd and its directors Sri Vinay Saboo & Smt. Madhumathi Saboo and taxed at higher rates, therefore whether they taxed in the hands of company or in the hands of directors the tax effect would be same. Since the directors have already admitted the commission received as their income, there is no need to make disallowance in the hands of the company. In result both the grounds of appeals are allowed."

6. Aggrieved with the above order, the revenue is in appeal before us raising the following grounds of appeal:

1. The Ld. CIT (A) erred both in law and on facts of the case.

2. The Ld. CIT (A) erred in deleting the disallowance of commission paid to the directors of the company of Rs.33,00,000/-.

3. The Ld. CIT (A) erred in not considering the fact that the commission paid to the directors of the company is not an allowable expenditure 36(1)(ii) of the Act.

4. The Ld. CIT (A) erred in allowing the relief on the ground that there is no tax effect since the income was assessed in the hands of the directors of the company.

5. Any other ground that may be urged at the time of hearing."

7. Before us, Id. DR submitted that assessee has paid commission to Directors in order to avoid payment of tax on dividend as the payment is nothing but dividend paid to the Directors. He submitted that CIT(A) has erred in deleting the

commission paid to the Directors since it is not allowable expenditure u/s 36(1)(ii) of the Act. Further, he relied on the special bench decision of ITAT, Mumbai in the case of M/s Dalal Broacha Stock Broking Pvt. Ltd., (ITA No. 5792/Mum/2009, order dated 26/11/2011.).

8. On the other hand, Id. AR submitted that assessee is making this payment of commission to its directors consistently over the years. In support of his claim, he submitted a statement at page 2 of paper book, as per which, assessee has paid commission to the directors from AY 2003-04 to 2012-13. He submitted that the department has accepted such payment of commission in other AYs in which scrutiny assessments were completed in AY 2003-04 and 2006-07 to 2012-13, but, only in the current AY, this commission was disallowed. He submitted that the assessee is following payment of commission consistently, by following rule of consistency, therefore, this expenditure should be allowed as in the earlier years. He further submitted that the case relied upon by the Id. DR is distinguishable to the facts of the assessee's case, as the directors in the said case were holding 100% shares and also received commission whereas in assessee's case, directors who are in receipt of commission were holding only 82% of the shares. Moreover, this commission was paid to the directors on the basis of sales of cars not on the basis of profits and these two directors actively involved in running of the business. He relied on the decision of the Hon'ble Delhi High Court in the case of Controls and Switchgear Contractors Ltd. Vs. DCIT, [2014] 365 ITR 32 (Del.).

9. Considered the rival submissions and material on record. It is noticed that assessee has paid commission to the

two directors on the basis of sales of cars achieved by the company as per the slab approved by the Board of Directors. To this effect, the slab approved by the company is filed by the assessee which is at page 21 of the paper book. As per the information brought on record by the assessee, it is also noticed that assessee is paying commission to its directors over the years and consistently claiming the above payment of commission u/s 36(1)(ii) and the same was accepted by the department in 143(3)/(1) assessments over the years, but, only in the current AY this issue was disputed. However, CIT(A) has allowed the above payment of commission not only on the basis of allowability under the Act, but, also noticed that assessee as well as the directors are falling under the highest rate of tax under the Act. Therefore, there is no loss to the revenue considering the fact that directors have shown the above income as income for the same AY and paid taxes due thereon. The Hon'ble Delhi High Court has come across similar issue in the Controls and Switchgear Contractors Ltd. (supra) and held as under:

"8. It is also apparent from the reading of the aforesaid provision that bonus or commission paid to an employee is expressly allowed as deduction. The only exception is where the bonus or commission paid to the employee would otherwise be payable to him as profits or dividends, in the event the same had not been paid as commission. It is clear that the exception would be applicable only where an employee would be entitled to receive the amount paid as commission, as profits or dividends. In the present case, the directors would not be entitled to receive the amount paid to them as commission, as dividends because even if it is assumed that non-payment of commission would add to the kitty of distributable profits the same would have to be distributed pro rata to all the shareholders and not selectively to the said directors. Dividend is paid by a company as distribution of profits to its shareholders in the ratio of their shareholding in the company. In the present case, the directors were not the only shareholders of the company and, therefore, in the event the commission had not been paid by the

assessee it could not have been distributed to them as dividends.

9. *This court in the case of AMD Metplast (supra) also pointed out this distinction between distribution of dividends and payment for services in the following words (page 569 of 341 ITR.) :*

"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 commissioner which was paid to Ashok Gupta was for services rendered by him as per the terms of appointment as a man aging director."

10. *Thus, in our view, the Tribunal and the income-tax authorities below erred in holding that the payments of commission to the directors fell within the exclusionary limb of section of 36(1)(ii) of the Act."*

Respectfully following the above decision, we hold that the payment of commission is allowable u/s 36(1)(ii) of the Act and accordingly, we uphold the order of CIT(A) and dismiss the grounds raised by the revenue in this regard.

10. In the result, appeal of the revenue is dismissed.

Pronounced in the open court on 24th January, 2018.

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER

Hyderabad, dated 24th January, 2018

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Copy forwarded to:

1. DCIT, Circle – 3(1), Room No. 714, 7th Floor, Signature Towers, Opp. Botanical Garden, Kondapur, Hyd.
2. M/s RKS Motors Pvt. Ltd., 6-3-905, Saboo Towers, Raj Bhavan Road, Somajiguda, Hyderabad.
3. CIT(A) - 3, Hyderabad
4. Pr. CIT - 3, Hyderabad
5. The DR, ITAT, Hyderabad
6. Guard File