

आयकर अपीलीय अधिकरण "F" न्यायपीठ मुंबई में।

IN THE INCOME TAX APPELLATE TRIBUNAL "F" BENCH, MUMBAI

श्री महावीर सिंह, न्यायिक सदस्य एवं श्री श्री एम बालगणेश, लेखा सदस्य के समक्ष ।

BEFORE SRI MAHAVIR SINGH, JM AND SRI M BALAGANESH, AM

आयकर अपील सं./ ITA No. 972/Mum/2018

(निर्धारण वर्ष / Assessment Year 2013-14)

आयकर अपील सं./ ITA No. 2557/Mum/2018

(निर्धारण वर्ष / Assessment Year 2014-15)

Jay Precision Products (India) Private Limited 12A, Colopen Compound, Old Nagardas Road, Andheri (East), Mumbai-400 059	बनाम/ Vs.	The Asst. Commissioner of Income Tax, Circle 10(2)(1), Room No. 209, 2 nd Floor, Aayakar Bhavan, Mumbai-400 020
(अपीलार्थी / Appellant)		(प्रत्यर्थी/ Respondent)
स्थायी लेखा सं./PAN No. AABCJ3642D		

अपीलार्थी की ओर से / Appellant by	:	Shri Dharmesh Shah, AR
प्रत्यर्थी की ओर से / Respondent by	:	Shri Rajeev Gubgotra, DR

सुनवाई की तारीख / Date of hearing:	17.07.2019
घोषणा की तारीख / Date of pronouncement :	14.10.2019

आदेश / ORDER

महावीर सिंह, न्यायिक सदस्य/
PER MAHAVIR SINGH, JM:

These appeals by assessee are arising out of orders of the Commissioner of Income Tax (Appeals)-17, Mumbai [in short CIT(A)], in Appeals Nos. CIT(A)-17/IT-506/15-16, CIT(A)-17/IT-13/10831/2017-18 vide dated 03.03.2017 & 23.02.2018. The



Assessments were framed by the Asst. Commissioner of Income Tax, Mumbai (in short ACIT/ ITO/ AO) for the A.Ys. 2013-14 & 2014-15 vide order dated 21.03.2016 & 10.12.2016 under section 143(3) of the Income-tax Act, 1961 (hereinafter 'the Act').

2. The only issue in these appeals of assessee is against the orders of CIT(A) disallowing commission payment made to directors by invoking the provisions of section 36(1)(ii) of the Act by holding that payment of commissions paid to directors and shareholders is not allowable reason having substantial interest in the company. Facts and circumstances are identical in both the years and even the orders of the lower authorities are identically worded. Hence, we will take the facts from AY 2013-14 in ITA No. 972/Mum/2018 and will decide the issue. The grounds raised read as under: -

"1. The Ld. Commissioner of Income-Tax (Appeals) has erred in law and facts passing order u/s 250 of the Act and determining the total income at Z 19,8068,900/-

2. The Ld. Commissioner of Income-Tax (Appeals) has erred in law and facts in passing an order without complying with the principles of natural justice.

3. The Ld. Commissioner of Income-Tax (Appeals) has erred in law and in facts in confirming the disallowance of commission paid to Mr. Xerxes K. Rao amounting to Z 2,35,00,000/- u/s 36(i)(ii) of the Act."

3. Brief facts are that the assessee is engaged in the business of manufacturing of pharmaceutical devices and allied plastic articles. During the course of assessment proceeding, the AO noted that the assessee company has paid a sum of Rs. 2,35,00,000/- as commission to Mr. Xeres Krishna Rao, apart from separate payment of managerial remuneration of Rs. 12,00,000/-. Accordingly, show cause notice was issued on this issue. The assessee company stated that the Managing Director Mr. Xeres Krishna Rao is a qualified Engineer and founder of the company. Because of his competence, the company had achieved greater heights. It is also contended that Mr. Rao had been paid commission after deducting the TDS and such sums were therefore not in lieu of profits or dividends. The AO did not accept the contention of the assessee company and examined the entire facts and circumstances of the case under the provisions of Section 36(1)(ii) and also Section 40A(2b) of the Act. The AO observed that Mr. Rio, holds 80% of the shares of the company and he is also one of the Directors of the company. He also analyzed the financial statement of the relevant previous year and has observed that had commission

not paid to Mr. Rao, it would have been distributable as dividend to the shareholders, including Mr. Rao. But instead of paying higher dividend the director has opted to appropriate the profits for himself in the form of commission and hence, commission paid to the director falls under the mischief of exception provided by Section 36(1)(ii) of the Act. The AO further concluded that the reason behind the distribution of profit in the form of commission is also quite apparent, if the entire amount of Rs. 2,35,00,000/. had been distributed as dividend then the assessee income would have gone up by this amount and the company would have been paid tax @ 30%. After this, if this amount of ₹ 2,35,00,000/- would have been paid as dividend to the shareholders, the company would have paid a dividend distribution tax @ 15% of the entire amount. Mr. Rao being the director of the company was in a position to take any decision regarding either payment of dividend or payment of commission. He opted for payment of commission instead of distributing the profit to the shareholders in the form of dividend in order to evade aforesaid tax. Thus, he disallowed the claim of commission to the extent of Rs. 2,35,00,000/- by invoking the provision of Section 36(1)(ii) of the Act and added to the total income. Aggrieved by this, the assessee preferred appeal before CIT(A).

4. The CIT(A) confirmed the action of the AO and observed as under: -

"4.2 In the background of the above, the facts of the appellant's case is examined:

a) Mr. Xerex Krishna Rao having 80% of the shares of the company (Rest 20% has been held by his wife Mrs. Sinita Xerex Rao) has been - commission of Rs. 2,35,00,000 in addition to his managerial remuneration of Its. 12,00,000/-. It Is important to mention that Board's Resolution for such commission payment dated 30.09.2013 was approved' by husband and wife la. Mr. and Mrs. Rae. And this so called resolution bas been passed much after end of the financial year.

b) The company is closely held company where husband and wife are having total shareholding and thus having total control over the company. From, the Board Resolution itself, it is clear that they have decided to appropriate Rs. 2,35,00,000/- in the garb of commission, in order to avoid dividend distribution.

c) The AO has clearly made out a case that the commission payment is part of a

design to evade tax by receiving the otherwise distributable dividend in the garb of the commission. Under Para 4.6 of the Assessment Order, the AO analyzed that profit was available before paying commission and this amount along with balance brought forward has been credited to reserve and surplus. This huge profit was very much distributable among the shareholders i.e. Husband and Wife. However, they have chosen to appropriate through the path of commission because had it not been taken in the garb of commission, then the company would have paid tax on this together with 15% Dividend Distribution Tax once this amounts were distributed as a dividend.

d) The financial analyses of the AO clearly makes a case that it was distributable dividend which has been appropriated in the garb of commission. Thus, the provisions of 36(1)(ii) is clearly attracted.

e) During assessment year, in order to justify such high commission payment, it has been claimed that Mr. Rao is a

Qualified Engineer, Founder of the company and Self Certified Extra Ordinary Technical Talent having all round knack of the business and totally involved in the affairs of the company.

f) During appellate proceedings, the role performed by Mr. Rao has been submitted in the tabular form which is quoted in the preceding paras. A simple perusal of this para will make it clear that even if a person works for 24 x 7 x 365, still, it will be impossible to accomplish the task which has been assigned to Mr. Rao. He is credited to shoulder almost all the responsibility of the company. Almost all the areas have been claimed to be handled by Mr. Rao such as Research and Development, Planning, Co-ordination for Administration, Day to Day Management, Recruitment and Retrenchment i.e. HRD, Cost Management and Price Negotiation, Sales Co-ordination and Price.

Negotiation, Market Strategy, Quality Control, Floor Management, Banking activity, Finance and Fund Management, Asset Management, Agreement and

Contract. Only a super Human being will be able to handle all the above responsibility of a large company like appellant company having turnover of more than Rs. 79 Crore. It is very important to point out that all these claims are without any shred of evidence. This humongous claim has been made in order to justify extra ordinary payment of commission in the background of proposition that adequacy of services rendered have no relevance u/s.36(1)(ji) except for exceptions provided therein.

g) The case laws such as AMD Meta Plast (Supra) and Carrier Launcher 358 ITR 179, relied by the appellant company are distinguishable. Later one is based on the earlier one. The facts of the AMD Plast has been discussed in the preceding paras. It is clear that recipient of the commission was not having the total control on the company rather had a shareholding of 19.89% only. The return was filed at Nil, and it was not clear that whether there was distributable profit for dividend or not. Most important aspect is



Board's resolution] agreement of the recipient with the company was from 01.04.1997 itself, whereas the commission was received during financial year 2004-05. The agreement was for a specific service and receipt of commission on percentage basis. Hon'ble Delhi High Court held that payment of commission was part of salary package in terms of employment. Whereas the facts are totally different in the ease under reference. As mentioned earlier, the Board Resolution is much after the end of the financial year, entire control is in the family i.e. Mr. Rao and Mrs. Rao are having 80% and 20% shareholdings respectively. There is a distributable profit for distribution of dividend clearly establishing that commission has been received in lieu of dividend.

In view of the above, it is clear that the closely held company having husband and wife as a shareholders has appropriated profit in the garb of commission without distributing the profit as a dividend in order to evade dividend distribution tax.

the facts of the appellant's case is clearly covered by the decision of M/s. Dalal and Broacha Stock Broking Pvt. Ltd. (Supra) and by the judgement of Jurisdictional High Court Loyal Motors Service Company Ltd Vs CIT (Supra). Thus, it is held that the commission of Its. 2,35,00,000/- paid to Mr. Rio is hit by mischief of Sec.36(1)(ii) of the Act and the AO has justifiably disallowed the same. Hence disallowance made by the AO is, therefore upheld and appeal filed by the Appellant Company is dismissed."

Aggrieved, assessee preferred appeal before Tribunal.

5. We have heard the rival contentions and gone through the facts and circumstances of the case. We noted from the facts of the case that Shri Xerxes Krishna Rao is the founder of the company and also a qualified engineer having experience for more than 25 years. He has been devoting his full time and energy to the business of the company. He provides his engineering expertise for product development and research and development activities for the company. He also looks after all day to day activities and also takes all the strategic decision of the company. This was explained by Ld Counsel of the assessee that for all the services rendered by him to the company, an overall salary package has been designed and

agreed to be paid to him comprising of remuneration and commission. The quantum of commission therein, is determined on the basis of yearly performance of the company. Thus, even though no separate commission payment is made for services rendered by him, the salary package is designed in such a manner so as to subsume commission payment for all the services to be rendered by him in toto. The commission was part and parcel of the overall package of salary agreed to be paid by company. Such a structure of salary has been agreed and paid since the first year of the company. We also noted from the argument that such salary packages are not designed for others director or employees because of the limited scope of work designated to them. The assessee had filed a complete chart of the services performed by Sh Rao. The following chart shows the nature of services performed by Shri Rao vis a vis other officials of the company in various fields: -

Sr. No.	Name of service	Role performed by Shri Xerxes Rao	Role performed by Smt Smita Rao (other director)	Role performed by other employees
1.	Product development	<ul style="list-style-type: none"> • Research, development and product innovation • Developing product from research and development stage into final product. • Ensuring timely completion of product development. 		<ul style="list-style-type: none"> • Quality Control • Control on actual production vis a vis budgeted production
2.	Planning/ Budgeting	<ul style="list-style-type: none"> • Overall business planning • Defining Strategy as per the market conditions 	<ul style="list-style-type: none"> • Defining budget for planning 	<ul style="list-style-type: none"> • Overview of target achievement
3.	Administrative Services	<ul style="list-style-type: none"> • Overview and coordination for administration • Manage and ensure smooth running of day to day operations 	<ul style="list-style-type: none"> • Ensuring effective information flow throughout the organization 	<ul style="list-style-type: none"> • Execution of work as defined by the management



4.	Human Resource Management	<ul style="list-style-type: none">• Recruitment of new employees• Retrenchment of employees	-	<ul style="list-style-type: none">• Salary and Wages payment• Resolving various issues of employees
5.	Purchase Management	<ul style="list-style-type: none">• Defining cost required for purchase of goods• Price negotiation for purchase of products	-	<ul style="list-style-type: none">• Ensuring timely payment to creditors
6.	Sales development	<ul style="list-style-type: none">• Defining sale consideration for the product• Price negotiation for sale of products	-	-
7.	Sales Management	<ul style="list-style-type: none">• Devising Marketing strategy• Overview of operational activities• Ensuring that the products are adhering to quality standards	-	<ul style="list-style-type: none">• Ensuring safety of product• Ensuring recovery from Debtors
8.	Supervising	<ul style="list-style-type: none">• Overall management of the company• Working of Manpower• Wear and tear of Fixed Assets	-	<ul style="list-style-type: none">• Working of Manpower
9.	Accounting	<ul style="list-style-type: none">• Overview of Banking transactions• Executing Agreements/ Contracts	-	<ul style="list-style-type: none">• Overview of banking transactions• Regularly prepare accounts
10.	Finance	<ul style="list-style-type: none">• Strategize funds requirements for the company• Obtained funds from various sources as per company requirements	-	-

6. From the above chart, it can be seen that Shri Rao has been performing most of the work in all the key areas as compared to other director and employees of the company. From the above, we noted that it is for this reason that salary by way of commission is paid to him. Thus, it can be said that the payments to Shri Rao were for services rendered by him and not in lieu of profits or dividend as alleged by the Assessing

Officer. We also noted that Shri Rao has been providing these services since the incorporation of the company and similar salary package including commission, has been paid to him since incorporation. The same has also been accepted by the department in assessment proceedings for earlier years. The assessee also filed the details in regard to his engineering expertise and full time involvement with the company, he has managed to increase the profitability of the company and led the company to newer heights in last many years. This can be seen from the following table file by the assessee: -

AY	Sales Turnover	Gross profit	Net Profit	--
2006-07	23,00,35,158	11,12,87,037	8,35,40,516	1,50,00,000
2007-08	27,69,32,695	129577717	85061028	1,50,00,000
2008-09	365402184	185836157	106003688	1,50,00,000
2009-10	427751878	213186110	149506098	1,50,00,000
2010-11	426625751	224514557	159738226	23500000
2011-12	623715807	286552475	216044044	23500000
2012-13	594194121	240630183	140589867	23500000
2013-14	746921747	306182614	186480364	23500000

It can be seen that considering the turnover and profit of the company, salary paid (including commission) was highly reasonable. We also noted that the payment of commission to the director, Shri Xerxes Rao, was for the services rendered by him and not in lieu of profit or dividend.

7. We also noted that the AO has examined the facts of the case in the back ground of decision of the Hon'ble Special Bench in the case of M/s Dalal and Broacha stock Broking Pvt. Ltd. 11 taxmann.com 426 (Mumbai) (SB), Loyal Motor Service Co. Ltd. vs. Commissioner of Income Tax, 14 ITR 647, and categorically

concluded that this was a part of design not to pay dividend and payment of commission to the major shareholders in lieu of dividend were made, in order to avoid dividend distribution tax and higher tax of the company. The same was affirmed by the CIT(A).

8. We have gone through the documents filed by the assessee i.e. computation of total income of the assessee for AY 2011-12, Profit and Loss A/c and balance sheet for the year ending 31.03.2011. Even the assessment order dated 25.02.2014 passed under section 143(3) of the Act for AY 2011-12 was filed by the assessee. From this, it is seen that even this commission payment to managing director was accepted and no disallowance was made even in scrutiny assessment. Further, we have gone through the computation of total income for AY 2012-13 including profit and loss account and balance sheet for the year ending 31.03.2012 and also the assessment order for AY 2012-13 passed under section 143(3) of the Act dated 19.03.2015, wherein the similar commission paid to managing director was allowed. We also noted that the Form 16 issued by the assessee to Mr. Krishna Rao, the Managing Director, this commission is already included in the income and this is tax neutral. Even, the taxable income of the managing director is in highest bracket/ slab of tax rates. Hence, there is no question of evasion of tax.

9. We have gone through the case law referred by the learned Counsel for the assessee of Hon'ble Bombay High Court

in the case of CIT Vs. Indo Saudi Services (Travel) Pvt. Ltd. (2009) 310 ITR 306 (Bom.), wherein commission paid to sister concern was not held to be for evasion of tax and held to be allowable as reasonable. Hon'ble Bombay High Court in Para 4 & 5 held as under: -

"4. We have heard the learned advocates appearing for both sides. We have also perused the order passed by the Tribunal dated 21st Oct., 1999 which is impugned by the Revenue in the present appeals. We find that the following facts were established before the Tribunal and the same have been accepted by the Revenue even before us.

- (i) That the assessee apart from paying handling charges @ 9 1/2 per cent to its sister concern, have paid handling charges at the same rate to other agents viz., M/s A.K. Travels, M/s Om Travels and M/s Jet Age Travels.*
- (ii) For asst. yrs. 1986-87 and 1987-88 the assessee had paid the handling charges @ 10 per cent to the sister concern of the assessee and such charges paid were considered to be reasonable by the appellant.*
- (iii) For asst.yrs. 1989-90 and 1990-91 the assessee had reduced the payment of handling charges to 9 1/2*

per cent to its sister concern. The AO has considered the payment of commission to the sister concern in the asst. yr. 1989-90 and allowed the claim after due scrutiny. For asst. yr. 1990-91 also the claim of the assessee @ 9 1/2 per cent has been allowed though the same has not been dealt with by the AO specifically in the order.

- (iv) For asst. yrs. 1993-94 and 1994-95 the assessment has been made by the AO under section 143(3) and handling charges paid to the sister concern @ 9.5 per cent have been considered to be reasonable and allowed.*
- (v) The sister concern of the assessee M/s Middle East International is also assessed to tax and income assessed for the asst. yr. 1991-92 is Rs. 9,38,510 and for asst. yr. 1992-93 is Rs. 14,65,880 and the said assessment orders have been placed on record.*
- (vi) Under the CBDT Circular No. 6-P, dated 6th July, 1968 it is stated that no disallowance is to be made under section 40A(2) in respect of the payments made to the relatives and sister concerns where there is no attempt to evade tax.*

5. In view of the aforesaid admitted facts we are of the view that the Tribunal was correct in coming to the conclusion that

the CIT(A) was wrong in disallowing half per cent commission paid to the sister concern of the assessee during the asst. yrs.1991-92 and 1992-93. The learned advocate appearing for the appellant was also not in a position to point out how the assessee evaded payment of tax by alleged payment of higher commission to its sister concern since the sister concern was also paying tax at higher rate and copies of the assessment orders of the sister concern were taken on record by the Tribunal."

10. Further, this issue has been dealt in with by Hon'ble Delhi High Court in the case of AMD Metplast P. Ltd. vs. DCIT (2012) 341 ITR 563 (Delhi) wherein it is held that commission paid to managing director in addition to salary is not unreasonable or disallowable. Further, it is held that the payment of dividend was in term of Company's Act,1956 and paid to all the shareholders equally as a return on investments and not salary or part thereof. Hon'ble High Court has finally held as under: -

"10. Kania J. in his judgment had elucidated and interpreted section 10(2)(x) of the Indian Income-tax Act, 1922, and observed (page 652) :

"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 an 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 prove 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 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)

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.”



11. In view of the above facts and circumstances, we allow the commission paid to Mr. Krishna Rao amounting to ₹2.35 crores paid by assessee and the orders of the lower authorities are reversed on this issue. This issue of assessee's appeal is allowed.

12. Similar are the facts in AY 2014-15 in ITA No. 2557/Mum/2018, hence taking consistent view, we allow this issue of assessee's appeal in this year also.

13. **In the result, the appeal of the assessee is allowed.**

Order pronounced in the open court on 14.10.2019.

Sd/-

(एम बालगणेश / M BALAGANESH)

(लेखा सदस्य / ACCOUNTANT MEMBER)

मुंबई, दिनांक/ Mumbai, Dated: 14.10.2019

सुदीप सरकार, व.निजी सचिव / Sudip Sarkar, Sr.PS

Sd/-

(महावीर सिंह / MAHAVIR SINGH)

(न्यायिक सदस्य/ JUDICIAL MEMBER)

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Asstt. Registrar)

आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai