

आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई  
**IN THE INCOME TAX APPELLATE TRIBUNAL**  
'D' BENCH, CHENNAI

श्री महावीर सिंह, उपाध्यक्ष एवं श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष  
**BEFORE SHRI MAHAVIR SINGH, VICE PRESIDENT AND**  
**SHRI MANOJ KUMAR AGGARWAL, ACCOUNTANT MEMBER**

आयकर अपील सं./ITA No.: 724/CHNY/2018  
निर्धारण वर्ष /Assessment Year:2012-13

**Carmel Softech Pvt. Ltd.,**  
Plot No.1050, 2<sup>nd</sup> Floor,  
I Block, 18<sup>th</sup> Main Road,  
Anna Nagar West,  
Chennai – 600 040.

**The Income Tax Officer,**  
v. Corporate Ward 1(3),  
Chennai.

**PAN: AABCC 5177A**

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by  
प्रत्यर्थी की ओर से/Respondent by

: Shri D. Anand, Advocate  
: Shri G. Johnson, Addl.CIT

सुनवाई की तारीख/Date of Hearing : 12.05.2022

घोषणा की तारीख/Date of Pronouncement : 18.05.2022

**आदेश /O R D E R**

**PER MAHAVIR SINGH, VP:**

This appeal by the assessee is arising out of the order of Commissioner of Income Tax (Appeals)-3, Chennai in ITA No.49/2015-16/A-1 dated 29.12.2017. The assessment was framed by the ITO, Corporate Ward 1(3), Chennai for the assessment year

2012-13 u/s.143(3) of the Income Tax Act, 1961 (hereinafter the 'Act') vide order dated 25.03.2015.

2. The only issue in this appeal of assessee is as regards to the order of CIT(A) and that of the AO in holding that the directors remuneration is excessive and thereby disallowing excess directors remuneration amounting to Rs.58,19,376/-. For this, assessee has raised various grounds which are argumentative and hence need not be reproduced.

3. Brief facts are that the assessee is a resident domestic company involved in software development and engineering designs. During the course of assessment proceedings, the AO required the assessee to reconcile the income declared in profit & loss account and the amount credited as per Form No.26AS. The AO noted that the assessee company has paid a sum of Rs.75,07,380/- towards directors remuneration and that is to the extent of 80% of the net profit. The AO noted that the directors remuneration are to the extent of Rs.75,07,380/- as against the net profit declared at Rs.84,40,020/-. The assessee's turnover is at Rs.1,42,13,393/-. The AO also brought out a comparative remuneration of last year which is 'nil' as against the profit of

Rs.1,28,55,033/- on a total turnover of Rs.1,85,54,513/-. The AO taking help of Companies Act, 1956, Schedule XIV which prescribes maximum remuneration payable to the directors i.e., managerial personnels which cannot exceed 11% of net profit, restricted the allowance of remuneration at 20% of the net profit that comes to Rs.16,88,004/- and disallowed the differential amount of Rs.58,19,376/-. The CIT(A) also confirmed the action of AO exactly on identical ground that the AO has rightly adopted remuneration fixed for managerial of the company fixed for public limited companies as per the Companies Act and that should be taken as the base for private limited companies also. The CIT(A) also invoked the provisions of Section 40A(2)(b) of the Act. Aggrieved, assessee came in appeal before the Tribunal.

4. Before us, the Id.counsel for the assessee stated that the assessee has made payment to three directors of Rs.25,02,460/- each and the total comes to Rs.75,07,380/-, who are actively involved in the affairs of the company. The AO and CIT(A) firstly have wrongly invoked the provisions of section 40A(2)(b) of the Act on the ground that only 20% of the net profit is allowable as expenditure and further, drawing inference from the provisions of section 198 of the Companies Act, which is applicable only to the

public limited companies. The Id.counsel for the assessee referred to the provisions of section 198(1) of the Companies Act. The Id.counsel stated that the provision is applicable in the event of inadequacy of profits and only then remunerations paid to directors by Schedule XIII of the Companies Act, will apply and the provisions of section 198 of the Companies Act has laid down the manner in section 349 & 350 of the Companies Act for computation of net profit. The Id.counsel stated that the above provision will not apply to a private limited company unless it is a subsidiary of a public limited company. The Id.counsel contended that the assessee is a private limited company and it is not subsidiary of any public limited company. Further, it was contended that all the three directors are tax assesseees and have included the remuneration in the respective returns of income filed by them and paid the taxes at the maximum margin and hence, there is no revenue loss to the Department. The Id.counsel for the assessee also stated that these three directors are main directors and they are actively participating in the day to day business of the company. The Id.counsel also relied on the decision of Mumbai Bench of this Tribunal in the case of Benninger India Private Limited vs. DCIT in ITA No.2360/Mum/2017, order dated 28.09.2018, wherein the Tribunal after considering the facts of the case held as under:-

“9. After hearing rival contentions and going through the facts and circumstances of the case narrated in detail above, we are of the view that there is no tax evasion and there is reasonableness of managerial remuneration. Now no approval is required from the Central Government for making payment of higher remuneration even in case of loss in the case of unlisted public company. In view of these facts, we are of the view that this is allowable expenditure and we allow the same accordingly. Orders of the lower authorities are reversed and this issue of assessee's appeal is allowed.”

4.1 The Id.counsel also relied on another decision of the Mumbai Bench of the Tribunal in the case of The Bombay Samachar Pvt. Ltd., vs. ACIT in ITA No.7171/Mum/2010 & others, order dated 24.10.2018 and the relevant findings in para 8 reads as under:-

“8.....

Further, while invoking the provisions of section 40A(2)(a) of the Act, the Assessing Officer must bring material on record to demonstrate that the payment made by the assessee is excessive or unreasonable having regard to the market rate for the goods, services, facilities availed or the business needs of the assessee or commensurate with the benefit derived by the assessee. On scanning through the assessment order passed for the impugned assessment year, we do not find any material brought on record by the Assessing Officer to demonstrate that the payment made by the assessee is excessive and unreasonable having regard to the market rate or business needs or benefit derived by the assessee. As could be seen, the Assessing Officer by simply taking the remuneration paid in assessment year 2003-04 as a base has determined the reasonable remuneration payable to directors. This, in our view, is purely on estimate basis without having any relevance to the actual facts on record including the fact that in the immediately preceding assessment year the assessee has not only paid remuneration of Rs.1.56 crore to the concerned directors but the Assessing Officer has also allowed such payment in scrutiny assessment. As regards the observations of the Assessing Officer that to avoid the mischief of section 2(22)(e) of the Act, the assessee has camouflaged loan / advances to the directors as remuneration, we do not find any substance in such allegation. Undisputedly, the assessee had been paying remuneration to the

concerned directors from past several years. Moreover, from the shareholding pattern of the company, it appears that the total share holding of the aforesaid three directors combined together constitutes only 15%. Therefore, it cannot be said that for escaping the rigors of section 2(22)(e) of the Act the assessee has paid remuneration to the directors. The object behind introduction of section 40A(2) of the Act is for preventing evasion of tax through shifting of profit by making payment to related parties. Therefore, it is of paramount importance to examine whether the assessee has made payment for evading tax through shifting of profit. In the facts of the present case, it is evident that the assessee had been showing loss continuously for past several years and the Assessing Officer has also accepted loss shown by the assessee. That being the case, there cannot be any intention on the part of the assessee to evade tax by shifting profit. It is equally important to note that the remuneration paid to the directors have been offered by them to tax while filing their individual tax returns for the respective assessment years. This fact is evident from the copies of the income tax returns of the concerned directors filed before us by the learned Sr. Counsel. It is also not disputed that the concerned directors are assessed to tax at the maximum rate of 30%. In the aforesaid facts and circumstances, we are of the considered view that the provisions of section 40A(2) of the Act are not attracted to the payment made to the directors. The decisions relied upon by the learned Sr. Counsel also support our aforesaid view. Whereas, the decisions cited by the learned Departmental Representative are factually distinguishable. Thus, on overall consideration of facts and circumstances of the case, we are of the view that the disallowance made under section 40A(2)(a) of the Act in the impugned assessment years are unsustainable. Accordingly, we deleted the disallowances made in all the assessment years under appeal. Grounds raised are allowed.”

5. On the other hand, the Id. Senior DR relied on the assessment order and that of the CIT(A) and argued that in earlier year when there was comparatively more profit than this year, no remunerations were paid to these three directors. Even the turnover was more than this year and this year there is decrease in

turnover. According to him, the CIT(A) as well as the AO has rightly invoked the provisions of section 40A(2)(b) of the Act and also the provisions of Companies Act, whereby maximum remuneration payable to managerial personnel is restricted. In these lines, he requested the Bench to confirm the order of CIT(A).

6. We have heard rival contentions and gone through facts and circumstances of the case. We noted that the Tribunal in the case of The Bombay Samachar Pvt. Ltd., *supra*, has considered the issue of applicability of provisions of section 40A(2)(b) of the Act to the directors remuneration and held that this provision will not apply to the directors payment for holding that the payment is excessive or unreasonable in the absence of any material brought on record to demonstrate that the payment is actually excessive or unreasonable having regard to market rate for the goods, services or facilities availed or the business need of the assessee or commensurate with the benefit derived by the assessee. In the present case before us also the AO has not carried out any exercise for holding the payment of remuneration to the directors that the same is unreasonable or not in consonance with the payment of directors or remuneration. We note that in this year the turnover is at Rs.1,42,13,393/- and profit earned is at Rs.84,40,020/- and

remuneration paid to these three directors are at Rs.75,07,380/-. Even it is accepted position that the directors have paid taxes on these remunerations on maximum margin rate and there is no revenue loss to the Department. In view of the above, we are of the view that in the absence of any findings by the AO that the directors remunerations are excessive and unreasonable, we reverse the orders of lower authorities and allow the appeal of assessee.

7. In the result, the appeal filed by the assessee is allowed.

Order pronounced in the court on 18<sup>th</sup> May, 2022 at Chennai.

Sd/-

(मनोज कुमार अग्रवाल)

**(MANOJ KUMAR AGGARWAL)**  
लेखा सदस्य /ACCOUNTANT MEMBER

Sd/-

(महावीर सिंह)

**(MAHAVIR SINGH)**  
उपाध्यक्ष /VICE PRESIDENT

चेन्नई/Chennai,  
दिनांक/Dated, the 18<sup>th</sup> May, 2022

**RSR**

आदेश की प्रतिलिपि अग्रेषित/Copy to:

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|------------------------|--------------------------|------------------------------|
| 1. अपीलार्थी/Appellant | 2. प्रत्यर्थी/Respondent | 3. आयकर आयुक्त (अपील)/CIT(A) |
| 4. आयकर आयुक्त /CIT    | 5. विभागीय प्रतिनिधि/DR  | 6. गार्ड फाईल/GF.            |