



THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 21.05.2014

+ **W.P.(C) 2845/2014 & CM APPL. 5898/2014**

**CONTROLS & SWITCHGEAR CONTACTORS
LIMITED**

..... Petitioner

versus

**DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE 3(1) NEW DELHI**

..... Respondent

Advocates who appeared in this case:

For the Petitioner : Mr Piyush Kaushik.

For the Respondent: Mr N.P. Sahni, Sr. Standing Counsel
with Mr Nitin Gulati, Jr Standing Counsel.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE VIBHU BAKHRU

JUDGMENT

VIBHU BAKHRU, J (ORAL)

1. This is a petition under Article 226/227 of the Constitution of India, whereby the petitioner impugns an order dated 31.10.2013 passed by the Income Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal'), rejecting the petitioner's application under Section 254(2) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act'), for rectification of the order dated 20.04.2012 passed by the Tribunal in ITA No. 1642/Del/2010. By the said order dated 20.04.2012, the Tribunal had rejected the petitioner's appeal against the orders passed by the CIT (Appeals), affirming the disallowance of commission paid (by the petitioner) to its



Managing Director and another Director (hereinafter referred to as the 'Directors').

2. The petitioner's grievance is that the Assessing Officer has disallowed the commission paid by it to its Directors in consideration of the personal guarantees furnished by them to a bank for facilitating the loan provided to the petitioner. The petitioner's contention that the said commission is allowable as an expenditure having been incurred wholly and exclusively for the business of the company, was rejected by the Assessing Officer by holding that the commission paid by the assessee was not allowable by virtue of Section 36(1)(ii) of the Act.

3. Briefly stated the relevant facts are as under:-

3.1 The petitioner is a listed company and had filed its return of income for the assessment year 2006-07 claiming deduction on account of guarantee commission aggregating to ₹48,75,000/- paid to the Directors of the company. It is stated that the petitioner required certain credit facilities from State Bank of India for its business purposes, and the said bankers had insisted on a personal guarantee of directors as a pre-condition for providing the financial assistance sought by it. It is asserted by the petitioner that a sum of ₹24,37,500/- each was paid to the Directors as commission, computed at the rate of 1.5% of the principal sum in respect of which personal guarantees had been furnished by the said Directors to the State Bank of India.

3.2 The Directors were employees of the assessee and were drawing a salary from the assessee. The assessee had passed the necessary resolution and obtained the corporate authority for paying the commission in question



to the Directors. The assessee had also deducted tax at source at the applicable rates. The commission received by the Directors was duly reflected as income in their respective returns.

3.3 The Assessing Officer's order, for the Assessment Year 2006-07, on 31.12.2008 held that by virtue of Sections 36(1)(ii) of the Act, bonus or commission paid to an employee was allowable as deduction, provided the same would not have been payable as profits or dividends had such commission not been paid. The Assessing Officer further concluded that in the event such commission had not been paid by the petitioner, it would have been distributable as dividends. The Assessing Officer further observed that by paying commission to the Directors, the assessee was avoiding 15% dividend distribution tax under Section 115O of the Act.

3.4 The assessee preferred an appeal before CIT (Appeals) challenging the Assessment, which was unsuccessful. The decision of CIT (Appeals) was also challenged by way of an appeal to the Tribunal. The Tribunal rejected the contention of the assessee and confirmed the decision of the CIT (Appeals), by an order dated 20.04.2012.

3.5 The assessee filed an application under Section 254(2) of the Act before the Tribunal for rectification of the order bringing to the notice of the Tribunal, the decision of this Court in AMD Metplast Pvt. Ltd. v. DCIT: 341 ITR 563. According to the assessee the said decision clearly settled the question involved in favour of the assessee and as the Tribunal had not considered the same, the order dated 20.04.2012 was liable to be rectified. The said application filed by the assessee under Section 254(2) of the Act was also rejected by the Tribunal by an order dated 31.10.2013



whereby the Tribunal held that the facts referred in the case of *AMD Metplast Pvt. Ltd.* (supra) were different from the facts in the present case. Aggrieved by the said order dated 31.10.2013, the petitioner has filed the present petition, *inter alia*, praying that the said order be set aside and the matter be remitted back to the Tribunal for passing a speaking order with respect to the question of disallowance of commission paid to the Directors.

4. We have heard the learned counsel for the parties. Since there is no dispute as to the facts and the controversy is limited to the question whether the commission paid to the Directors as consideration for standing as a surety is allowable as an expense under the Act, we deem it appropriate to consider the question in these proceedings.

5. It is not in dispute that the requisite resolution was passed by the assessee for paying the guarantee commissions to the Directors. It is also not in dispute that the Directors provided the personal guarantees and stood as surety for the financial assistance availed of by the assessee. The contention that personal guarantees of the Directors were insisted upon by the State Bank of India and were necessary for availing of the facilities, is also not contested. In view of the aforesaid factual background we find that the issues that needs to be addressed is whether the Directors have rendered any service to the assessee and whether by virtue of Section 36(1)(ii) of the Act such payments of commission are liable to be disallowed.

6. The Directors to whom the commission had been paid are, admittedly, employees of the assessee and are entitled to remuneration for their services as employees. The assessee has passed the requisite resolution confirming the remuneration payable to the Directors. The



assessee has also passed a resolution resolving that the Directors be paid the commission on account of providing their personal guarantees for the financial assistance availed by the assessee from the State Bank of India. This act of the Directors in providing their personal guarantees and undertaking the attendant risks is clearly beyond the scope of their services as employees of the assessee. In this view, it can hardly be disputed that the transactions in consideration for which commissions were paid by the assessee to its Directors are real. Undisputedly, the Directors having provided their personal guarantee have acted beyond the call of duty as employees of the assessee. The fact that the assessee in its commercial wisdom has agreed to pay a commission for the furnishing of such guarantees cannot be flawed, as it is well settled that it is assessee's discretion as to which expenditure is necessary and to what extent. And, it is not within the jurisdiction of the Assessing Officer to impose his views with regard to the necessity or the quantum of the expenditure undertaken by an assessee. The Assessing Officer has only to determine whether the transactions are genuine and real. In the given circumstances, in our view it cannot be contended that the transactions involving payment of commissions to the Directors are unreal or not genuine.

7. The next aspect that has to be considered is whether payment of such commissions are liable to be disallowed as an expense by virtue of Section 36(1)(ii) of the Act. At this stage it is necessary to refer the Section 36(1)(ii) of the Act, which reads as under:-

“any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as



bonus or commissioner.”

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:-

“.....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 terms of appointment as a managing 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.

11. In view of the above, the writ petition is allowed and the impugned order dated 31.10.2013 is set aside. We direct that the order dated 20.04.2012 passed by the Tribunal in ITA No. 1642/Del/2010 be rectified to the limited extent that it upholds the disallowance of expense of ₹48,75,000/-, paid as commission to the Directors. The said disallowance and the additions made on this count are set aside. The impugned matter is remitted to the Tribunal to pass consequential orders.

VIBHU BAKHRU, J

S. RAVINDRA BHAT, J

MAY 21, 2014
RK/MK