COMMISSIONER OF INCOME TAX, BOMBAY ETC

v.

M/S. MAFATLAL GANGABHAI AND CO. (P) LTD. ETC.

MARCH 12, 1996

[B.P. JEEVAN REDDY AND M.K. MUKHERJEE, JJ.]

Income Tax Act, 1961—Sections 40(a)(V) and 40-A(5)—Amounts not deductible in computing the income chargeable under the head 'Profits and Gains of Business of Profession'—Payments made in cash by an assessee to its employees—Whether fall within the mischief of Sec. 40(a)(v) and Sec. 40-A(5) of the Act—Held, No.

During the accounting year relevant to the Assessment Year 1982-83, the assessee, a limited company made payments in cash to its employees on account of house rent allowance, conveyance allowance and medical reimbursement and claimed deduction. The Income Tax Officer disallowed these holding that the payments fall within mischief of section 40-A(5) of the Income Tax Act, 1961. On appeal, the Commissioner of Income Tax (Appeals) upheld the assessee's claim that cash payments cannot be treated as 'perquisites' for the purpose of and within the meaning of Section 40-A(5). Revenue's appeal to the Tribunal was dismissed. Applications U/S 256(1) filed by the Revenue was also dismissed by the Tribunal. Applications under s. 256(2) were rejected by the High Courts. These appeals had been filed against orders of the High Courts rejecting the Revenue's applications U/S 256(2) of the Act.

The assessee contended that such cash payments made was not within the mischief of sub-clause (v) of Section 40(a) as what is within the mischief of the sub-clause is an expenditure incurred for providing benefit, amenity or perquisite to an employee and that a cash payment to the employee is not an 'expenditure' contemplated by the cash sub-clause and that the use of the qualifying words 'whether convertible into money or not' puts the matter beyond doubt. According to the Revenue, whether the assessee takes a house on rent and provides it to the employee or pays a cash amount directly to the employee asking him to find a house on rent himself should make no difference.

Dismissing the appeals, this Court

A HELD : 1.1. The language employed in sub-clause (v) of clause (a) of Section 40 of the Income Tax Act, 1961, is not capable of taking within its ambit cash payments made to the employees by the assessee. These cash payments will, of course, be treated as salary paid to the employees and will be subject to the limits/ceiling, if any, in that behalf. But they cannot be brought within the purview of the words "any expenditure which results directly or indirectly in the provision of any benefit or amenity or perquisite" - more so because of the following words "whether convertible into money or not". [237-B-C]

1.2. Except for certain structural changes, Section 40- A(5)(a)(ii) and C Section 40(a)(v) are similar in all material aspects. [237-H]

1.3. The words "including any sum paid by the assessee in respect of any obligation which but for such payment would have been payable by such employee" in Section 40(a)(v) as well as in Section 40-A(5)(A)(ii) contemplate a situation where the assessee makes a payment (in cash) in D respect of an obligation - obligation of the employee - which would have been payable by the employee if it is not paid by the assessee. The payment by the assessee contemplated by these words is not evidently a payment to the employee but to a third party, no doubt, on account of the employee. Sub-clause (v) of the definition of "perquisite" in clause (b) of Explanation E (2) to sub-section (5) also refers to cash payment but that too is not to the employee, though undoubtedly for his benefit. Therefore cash payments by an assessee to his its employees do not fall within the ambit of Section 40(a)(v) or Section 40-A(5)(a)(ii), as the case may be. [238-B-D]

Commissioner of Income Tax v. *Commonwealth Trust Limited,* (1982) F 135 ITR 19 Ker (FB), overruled.

Commissioner of Income Tax, Kemataka v. *Mysore Commercial Union Limited,* (1980) 126 I.T.R. 340; *Commissioner of Income Tax* v. *Shriram Refrigeration Industries Limited,* (1992) 197 I.T.R. 431 (Delhi); *Commissioner of Income Tax* v. *Kanan Devan Hills Produce Company Limited,* G (1979) 119 I.T.R. 431 (Calcutta); *Commissioner of Income Tax* v. *Indokem Private Limited,* (1981) 132 I.T.R. 125 (Bombay); *Commissioner of Income Tax* v. *Warner Hindustan Limited,* (1984) 145 I.T.R. 24 (Andhra Pradesh); *Instalment Supply Private Limited* v. *Commissioner of Income Tax,* (1984) 149 I.T.R. 458 (Delhi); *Commissioner of Income Tax* v. *Manjushree Planta-* H *tions Limited,* (1980) 125 I.T.R. 150 (Madras) and *Commissioner of Income*

Tax v. *New India Industries Limited* **(1993) 201 ITR 208 (Gujarat), affirmed.** A

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2215 of 1978 Etc. Etc.

From the Judgment and Order dated 14.11.1978 of the Bombay High Court in I.T. Application No. 281 of 1977. B

Ranbir Chandra and S.N. Terdol for the Appellants.

G.C. Sharma, Mrs. A.K. Verma, Santosh K. Aggarwal and Vinay Vaish for the Respondents. C

The Judgment of the Court was delivered by

B.P. JEEVAN REDDY, J. Leave granted in the Special Leave Petition.

The only question in this batch of appeals is whether the payments D made in cash by an assessee to its employees are within the mischief of Section 40(a)(v) and Section 40-A(5). Sub-clause (v) was inserted in clause (a) of Section 40 by the Finance Act, 1968 with effect from April 1, 1969. Section 40(a)(v) reads as follows :

> S.40. *Amounts not deductible.*— Notwithstanding anything to the E contrary in (sections 30 to 38), the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business of profession",-
>
> (a) in the case of any assessee- F
>
> (v) any expenditure which results directly or indirectly in the provision of any benefit or amenity or perquisite, whether convertible into money or not, to any employee (including any sum paid by the assessee in respect of any obligation which but for such payment would have been payable by such employee) or any G expenditure or allowance in respect of any assets of the assessee used by such employee either wholly or partly for his own purposes or benefit, to the extent such expenditure or allowance exceeds one-fifth of the amount of salary payable to the employee, or an amount calculated at the rate of one thousand rupees for each H

month or part thereof comprised in the period of his employment during the previous year, whichever is less :

Provided that in computing the aforesaid expenditure or allowance, the following shall not be taken into account, namely :

(a) any payment by way of gratuity;

(b) the value of any travel concession or assistance referred to in clause (5) of section 10;

(c) passage moneys or the value of any free or concessional passage referred to in sub-clause (i) of clause (6) of section 10;

(d) any payment of tax referred to in sub-clause (vii) or sub-clause (vii-a) of clause (6) of section 10;

(e) any sum referred to in sub-clause (vii) of clause (1) of section 17;

(f) any sum referred to in sub-clause (v) of clause (2) of section 17;

(g) the amount of any compensation referred to in sub-clause (i) or any payment referred to in sub-clause (ii) of clause (3) of section 17;

(h) any payment referred to in clause (vi) or clause (v) of sub-section (1) of section 36; and

(i) any expenditure referred to in clause (ix) of sub-section (1) of section 36 :

Provided further that nothing in this sub-clause shall apply to any expenditure which results directly or indirectly in the provision of any benefit or amenity or perquisite to an employee whose income chargeable under the head "Salaries" is seven thousand five hundred rupees or less.

Explanation 1. — The Provisions of this sub-clause shall apply notwithstanding that any amount not to be allowed under this

sub-clause is included in the total income of the employee. A

Explanation 2. — In this sub-clause, the word 'salary' shall have the meaning assigned to it in clause (h) of rule 2 of Part A of the Fourth Schedule."

Sub-clause (v) of Section 40(a) was omitted by the Finance (No. 2) Act. 1971. which simultaneously introduced sub-section (5) in Section 40-A. Sub-section (5) of Section 40-A, omitting unnecessary clauses, reads thus : B

"S.40-A. *Expenses or payments not deductible in certain circumstances.* - (1) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head 'Profits and gains of business or profession' - C

(5)(a) Where the assessee — D

(i) incurs any expenditure which results directly or indirectly in the payment of any salary to an employee or a former employee, or

(ii) incurs any expenditure which results directly or indirectly in the provision of any perquisite (whether convertible into money or not) to an employee or incurs directly or indirectly any expenditure or is entitled to any allowance in respect of any assets of the assessee used by an employee either wholly or partly for his own purposes or benefit, E

then, subject to the provisions of clause (b), so much of such expenditure or allowance as is in excess of the limit specified in respect thereof in clause (c) shall not be allowed as a deduction : F

Provided that where the assessee is a company, so much of the aggregate of - G

(a) the expenditure and allowance referred to in sub-clause (i) and (ii) of this clause; and

(b) the expenditure and allowance referred to in sub-clauses (i) and (ii) of clause (c) of section 40, H

A in respect of an employee or a former employee, being a director or a person who has a substantial interest in the company or a relative of the director or of such person, as is in excess of the sum of one hundred and two thousand rupees, shall in no case be allowed as a deduction :

B *Explanation 2.* - In this sub-section, -

(a) 'salary' has the meaning assigned to it in clause (1) read with clause (3) of section 17 subject to the following modifications, namely :

C (1) in the said clause (1), the word 'perquisites' occurring in sub-clause (iv) and the whole of sub-clause (vii) shall be omitted;

(2) in the said clause (3), the reference to 'assessee' shall be construed as reference to 'employee or former employee' and the references to 'his employer or former employer' and 'an employer D or a former employer' shall be construed as references to 'the assessee';

(b) 'Perquisite' means -

E (i) rent-free accommodation provided to the employee by the assessee;

(ii) any concession in the matter of rent respecting any accommodation provided to the employee by the assessee;

F (iii) any benefit or amenity granted or provided free of cost or at concessional rate to the employee by the assessee;

(iv) payment by the assessee of any sum in respect of any obligation which, but for such payment, would have been payable by the employee; and

G

(v) payment by the assessee of any sum, whether directly or indirectly or through a fund, other than a recognised provident fund or an approved superannuation fund, to effect an assurance on the life of the employee or to effect a contract for an annuity."

H Section 40(a)(v) was introduced with a view to check the deductible

expenditure incurred by assessees (including companies) in providing amenities, benefits and perquisites to their higher paid employees. This sub-clause is indeed an improvement upon Section 40(c)(iii) which preceded it. Under sub-clause (v), the deduction in respect of expenditure which results directly or indirectly in the provision of benefits etc. to an employee is limited to an amount equal to one-fifth of salary paid to such employee during the relevant year or to an amount calculated at the rate of Rupees one thousand per month, whichever is less. Further, any expenditure incurred upon and any allowance admissible to the assessee/employer in respect of any assets provided by him to the employee free of charge or at a concessional rate is also brought within the purview of the limits prescribed by the sub-clause. Payment of any sum in respect of any obligation, which, but for such payment, would have been payable by the employee is also brought within the ambit of the sub-clause. Section 40-A(5) is an yet further improvement on Section 40(a)(v). Under sub-section (5) of section 40-A, the following restrictions/limits have been placed; (1) any expenditure incurred by the assessee on payment of salary to an employee in respect of his period of employment in India during the relevant year will not be allowed as a deduction in computing the taxable profits to the extent it exceeds the amount calculated at the rate of Rupees five thousand per month. (Similar restriction is placed on salary paid to an ex-employee as well.) For this purpose, the expression "salary " is defined in clause (a) of Explanation (2) to the sub-section (5). (2) Any expenditure incurred by the assessee in providing whether directly or indirectly any perquisite (whether convertible into money or not) to an employee and the amount of expenditure or allowance (e.g., depreciation allowance) in respect of assets of the assessee used by the employee for his own purposes, whether wholly or partly, will not be allowed as deduction in computing the profits of the business or profession, to the extent it exceeds twenty percent of the salary payable to the employee or an amount calculated at the rate of Rupees one thousand per month, whichever is less. The expression "perquisite" is defined in clause (b) of Explanation (2) to the sub-section as including not only any benefit or amenity but also "payment by the assessee of any sum in respect of any obligation which, but for such payment, would have been payable by the employee".

Certain types of expenditure are excluded from the purview of both Section 40(a)(v) as well as Section 40-A(5)(a)(ii). For the sake of completion, it may also be stated that though Section 40(a)(v) does not place any

A restriction upon the amount of salary payable to the employee, such a restriction was implicit in clause (c) of Secrion 40. Clause (c) of Section 40 continued to be in force till March 31, 1989. It was omitted by Direct Tax Laws (Amendment) Act, 1987 along with sub-section (5) for Section 40-A.

B Inasmuch as the main arguments have been urged in Civil Appeal No. 5946 of 1994 and Civil Appeal No. 2215 of 1978, we shall state the facts of these two appeals alone to bring out the question. The assessee in Civil Appeal No. 5946 of 1994 is a limited company and the assessment year concerned is 1982-83. This appeal is preferred against an order of the Delhi C High Court rejecting an application under Section 256(2) of the Income Tax Act filed by the Revenue. The question which the Revenue sought to raise is the following :

> "Whether on the facts and in the circumstances of the case, the ITAT is correct in law in holding that the payment in cash of House D Rent Allowance, conveyance allowance, medical reimbursement etc. should not be treated as perquisite u/s 40A(5) of the I.T. Act."

During the accounting year relevant to the Assessment Year 1982-83, the assessee made payments in cash to its employees on account of E house rent allowance, conveyance allowance and medical reimbursement. The Income Tax Officer disallowed the same holding that the said payments fall within the mischief of Section 40.A(5). On Appeal, the Commissioner of Income Tax (Appeals) upheld the assessee's contention that cash payments cannot be treated as "perquisites" for the purpose of and within the meaning of Section 40-A(5). Revenue's appeal to the Tribunal was F dismissed. An application under Section 256(1) was also dismissed by the Tribunal whereupon it approached the High Court which too rejected its application under Section 256(2), as stated above.

Civil Appeal No. 2215 of 1978 is preferred against an order of the G Bombay High Court rejecting the Revenue's application under Section 256(2) insofar as Questions (1) and (3) are concerned. This Court granted leave insofar as question No. 1 is concerned, which reads :

> "Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the cash payments made H by the assessee to its Directors, such as house rent allowance,

conveyance allowance, furniture allowance etc. should not be considered 'perquisites' within the meaning of section 40(a)(v) of the Income Tax Act, 1961 ?" A

Leave was granted by this Court for the reason that there is a conflict of opinion on the said question between the High Courts in the country. The assessment year concerned in this appeal is 1971-72 and, therefore, the relevant provision is Section 40(a)(v). B

We shall first take up Section 40(a)(v). According to Section 40, which opens with a *non-obstante* clause, "notwithstanding anything to the contrary in sections 30 to 38", the amounts mentioned in several clauses C therein shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession". Clause (a) contains several sub-clauses. We are concerned with sub-clause (v) alone. The main limb of sub-clause (v) places, a limit upon two kinds of expenditure, viz., (a) any expenditure which results directly or indirectly in the provision of D any benefit or amenity or perquisite whether convertible into money or not, to an employee (including any sum paid by the assessee in respect of any obligation which but for such payment would have been payable by such employee) *or* (b) any expenditure or allowance in respect of any assets of the assessee used by such employee either wholly or partly for his own purposes or benefit. The limit prescribed - or ceiling provided, as it may E be called - is one-fifth of the amount of salary payable to the employee or an amount calculated at the rate of one thousand rupees for each month or part thereof comprised in the period of his employment during the previous year or whichever is less. Any expenditure over and above the said limit/ceiling has to be disallowed. It is the first part to the sub-clause we are concerned with in Civil Appeal No. 2215 of 1978. Now, what does the F sub-clause say ? The opening words are "any expenditure which results directly or indirectly in the provision or any benefit or amenity or perquisite, whether convertible into money or not, to an employee". It is clear from the above words that it is not any and every expenditure that is attracted by the sub-clause but only such expenditure which results directly G or indirectly in the provision of any benefit, amenity or perquisite to an employee. Once this is so, it is immaterial whether such benefit, amenity or perquisite is convertible into money or not. The words "directly or indirectly" are equally significant. While the expressions "benefit" and amenity are not defined by the Act, the expression "perquisite" is defined in sub-section (2) Section 17. While it is not necessary to set out the entire H

A definition of "perquisite" in the said sub-section, it is sufficient to mention that it includes among others "the value of rent-free accommodation provided to the assessee by his employer". (The definition, it may be remembered, is worded from the point of view of and for the purposes of Section 17 which brings to tax income under the head "salaries". The said definition may not be strictly applicable to the expression "perquisites" in B Section 40(a)(v), yet it can be taken as broadly indicating the meaning of the said expression.) Now, take a case where the assessee provides a rent-free accommodation to its employee. It would be a "perquisite" within the meaning of sub-clause (v) and hence, the expenditure incurred by the assessee in providing such rent-free accommodation to its employee would C fall within the sub-clause. This would be so whether the accommodation provided belongs to the assessee or is taken on rent by the assessee. In the latter event, the rent paid by the assessee to the owner of the house will be an expenditure incurred by the assessee in providing a perquisite to its employee within the meaning of the sub-clause. Similarly, any expenditure incurred by the assessee in providing a benefit or amenity to its employee D will equally fall within the sub-clause. This much is not in dispute. Now, take another case where an assessee pays a cash amount of, say, Rupees five thousand to its employee asking him to find a house on rent himself instead of the assessee himself taking the house on rent and providing it to the employee. In this case, however, the assessees say, such cash payment made by the assessee is not within the mischief of the sub-clause while E the Revenue characterises the assessee's contention as ex-facie illogical and absurd. In principle, it should make no difference, the Revenue submits, whether the assessee takes a house on rent and provides it to the employee or pays a cash amount directly to the employee asking him to find a house on rent himself. The counsel for the Revenue commended the reasoning F and conclusion of the Full Bench of the Kerala High Court in *Commissioner of Income Tax* v. *Commonwealth Trust Limited,* (1982) 135 I.T.R. 19) for our acceptance. The counsel for the assessee, however lay stress upon the language of the sub-clause, to wit, upon the words any expenditure incurred for providing a benefit etc. to an employee. They also emphasise the words "whether convertible into money or not" following the words "any G benefit or amenity or perquisite". Their submission is that what is whithin the mischief of the sub-clause is an expenditure incurred for providing a benefit, amenity or perquisite to an employee and that a cash payment to the employee is not an "expenditure" contemplated by the sub-clause. They submit that the use of the qualifying words "whether convertible into money or not" puts the matter beyond doubt. They also submit that almost all the H

High Courts in the country have accepted this submission. A

On a consideration of both the points of view, we are inclined to agree with the submission of the learned counsel for the assessees. The language employed in the sub-clause v of clause (a) of section 40 of the Income tax Act 1961 is not capable of taking within its ambit cash payments made to the employees by the assessee. These cash payments will, of B course, be treated as salary paid to the employees and will be subject to the limits/ceiling, if any, in that behalf. But they cannot be brought within the purview of the words "any expenditure which results directly or indirectly in the provision of any benefit or amenity or perquisite" - more so because of the following words "whether convertible into money or not". C

Now, coming to Section 40-A(5), the position is no different. It would, however, be appropriate to point out the distinction between Section 40(a)(v) and Section 40-A(5). We shall refer to the former provision as "sub-clause" and the latter provision as "sub-section". The provision of sec. 40A(5) is wider in its scope and application than the sub-clause. D Sub-clause (i) of clause (a) of sub-section (5) deals with "any expenditure which results directly or indirectly in the payment of any salary to an employee or a former employee". Sub-clause (i) of clause (c) of sub-section (5) sets out the limits/ceilings on such expenditure while clause (a) Of Explanation (2) appended to the sub-section defines the expression "salary" for the purposes of this sub-section. These features were absent in sub- E clause (v) of Section 40(a). Now, coming to sub-clause (ii) of clause (a) of sub-section (5) - which corresponds to Section 40(a)(v) - it uses only one expression "perquisite" as against Section 40(a)(v) which spoke of "benefit or amenity or perquisite", but this is no real distinction because the definition of "perquisite" in clause (b) of Explanation (2) to the sub-section F takes in both benefits and amenities. The said definition also include *inter alia* "payment by the assessee of any sum in respect of any obligation which but for such payment, would have been payable by the employee" - words which are found in the main limb of Section 40(a)(v) but which are missing in the main limb of sub-clause (ii) of clause (a) of sub-section (5). Thus, G except for certain structural changes, Section 40-A(5)(a)(ii) and Section 40(a)(v) are similar in all material aspects. It, therefore, follows that what we have said with respect to Section 40(a)(v) applies equally to Section 40-A(5)(a)(ii).

There still remain the words "including any sum paid by the assessee H

A in respect of any obligation which but for such payment would have been payable by such employee" in Section 40(a)(v) and similar words found in Section 40-A(5)(a)(ii) as well, i.e. in sub-clause (iv) of the definition of "perquisite" in clause (b) of Explanation (2) to sub-section (5). What do they mean ? The words "including any sum paid by the assessee in respect
B of any obligation which but for such payment would have been payable by such employee" in section 40(a)(v) as well as in section 40-A(5)(a)(ii) contemplate a situation where the assessee makes a payment (in cash) in respect of an obligation - obligation of the employee - which would have been payable by the employee if it is not paid by the assessee. The payment by the assessee contemplated by these wouds is not evidently a payment to
C the employee but to a third party, no doubt on account of the employee. Sub-clause (v) of the definition of "perquisite" in clause (b) of Explanation (2) to sub-section (5) also refers to cash payment but that too is not to the employee, though undoubtedly for his benefit.

D For the above. reasons, we hold that cash payments by an assessee to his/its employees do not fall within the ambit of Section 40(a)(v) or Section 40-A(5)(a)(ii), as the case may be. We disagree with the opinion of the Kerala High Court in *Commonwealth Trust Limited* (supra) and agree with the other High Courts which have taken a view according with
E our view, viz., *Commissioner of Income Tax, Karnataka* v. *Mysore Commercial Union Limited,* (1980) 126 I.T.R. 340 (Karnataka), *Commissioner of Income Tax* v. *Shriram Regrigeration Industries Limited,* (1992) 197 I.T.R. 431 (Delhi), *Commissioner of Income Tax* v. *Kanan Devan Hills Produce Company Limited* (1979) 119 I.T.R. 431 (Calcutta), *Commissioner of Income Tax* v. *Indokem Private Limited,* (1981) 132 I.T.R. 125 (Bombay),
F *Commissioner of Income Tax* v. *Warner Hindustan Limited,* (1984) 145 I.T.R. 24 (Andhra Pradesh), *Instalment Supply Private Limited* v. *Commissioner of Income Tax,* (1984) 149 I.T.R. 457 (Delhi), *Commissioner of Income Tax* v. *Manjushree Plantations Limited,* (1980) 125 I.T.R. 150 (Madras) and *Commissioner of Income Tax* v. *New India Industries Limited,*
G (1993) 201 I.T.R. 208 (Gujarat).

Accordingly, the appeals are dismissed. No costs.

H R.A. Appeals dismissed.