COMMISSIONER OF INCOME TAX, BOMBAY CITY-III, BOMBAY A

*v.*

BRITISH BANK OF MIDDLE EAST

AUGUST 30, 2001

[S.P. BHARUCHA, Y.K. SABHARWAL AND ASHOK BHAN, JJ.] B

*Income Tax Act, 1961/Income Tax Rules, 1962—Section 40A(5)/Rule 3(c)—Free cars provided by employer to employees for private use where actual expenditure is not ascertainable—Perquisite value—Amount of disallowance under the Section in the hands of employer—Applicability of the Rule in fixing the disallowance—Held, Rule 3(c) is applicable to determine income from salary in the hands of employee—As regards the employer, perquisite value for disallowance should be estimated under Section 40A(5).* C

**In respect of respondent-assessee, for assessment years 1975-76 and 1976-77 Revenue estimated the value of perquisite of free cars provided to the employees at 50% of the actual expenses of running and maintenance of cars and disallowed the same under Section 40A(5) of the Income Tax Act, 1961. On appeal by the assessee, CIT (Appeals) held that the value of the perquisite should be fixed as per Rule 3(c) of the Income Tax Rules, 1962 and the same value should be considered for the purpose of making the disallowance under Section 40A(5) of the Act. On appeal by Revenue, Tribunal upheld the order of the CIT (Appeals) relying on the decision of the Calcutta High Court in the case** *Commissioner of Income Tax, West Bengal* **v.** *Britannia Industries Co. Limited,* **[135 ITR 35 (Cal)]. On reference by Revenue, the High Court held in favour of the Revenue relying on the decision in** *Geoffrey Manners & Co. Ltd.* **v.** *Commissioner of Income Tax,* **[221 ITR 695 (Bom)].** D E F

**In appeal to this Court, Revenue contended that Rule 3 of the Income Tax Rules, 1962 can be invoked only for computing the value of perquisite in hands of employee as income from salary; that Rule 3 is not applicable for determining the amount of expenditure to be disallowed to employer-assessee under Section 40A(5) of the Act; and that where the actual expenditure incurred by an employer on providing the facility of a car to the employee for private use is not ascertainable, the disallowance under section 40A(5) should be worked out on estimated basis.** G

H

A Allowing the appeal, the Court

HELD : 1.1. Section 40A(5) of the Income Tax Act, 1961 and Rule 3 of the Income Tax Rules, 1962 deal with different situations and different set of assessees-one dealing with the employer-assessee and the other the employee-assessee. Rule 3 deals with valuation for the purposes of computing the income
B of the employees chargeable under the head "Salaries" whereas Section 40A(5) deals with computation of the income under the head "Profits and Gains of business or profession". The object of enacting Section 40A(5) was to discourage the assessees from incurring expenditure which resulted directly or indirectly in the provision of any benefit, amenity or perquisite to their
C employees beyond a particular limit and any expenditure incurred beyond the prescribed limit was liable to be disallowed. The said provision constitutes a composite scheme and the purpose of prescribing a ceiling on expenditure in connection with directors and employees is to discourage the employer from paying excessive salaries, remuneration, perquisites etc. to its employees and directors, and if paid, the employer would not be able to claim the entire
D expenditure as deduction. It will be able to claim deduction of expenditure upto the ceiling limit provided in the said section. This provision was enacted to curb extravagant expenditure. It does not contemplate deduction of notional value of perquisite assessed in the hands of employees. In contemplates the deduction of actual expenditure or on estimate basis where the details of the
E actual expenditure are not furnished. [331-D-G]

1.2. The employer has incurred the expenditure on the car and should be able to provide its figures. If he cannot, it is fair that the expenditure should be assessed on a realistic basis and not on the basis of Rule 3 which applies qua the employees, who cannot provide the figures of actual expenditure since
F it is not he who has incurred it. [331-H; 332-A]

1.3. Section 40A(5) of the Act was enacted to provide for a ceiling on expenditure on employees. The object of Rule 3 is to give relief to the employees. Applying Rule 3 for the purpose of determining the deduction in relation to the assessment of the employer would be doing violence to and
G ignoring the legislative intent evident in Section 40A(5) of the Act. There is no anomaly in applying Section 40A(5) while making assessment of the assesee-employer and it will clearly be wrong to apply Rule 3. That cannot be done in the teeth of the language of the Section. [332-B-C]

*Commissioner of Income Tax* v. *Rajesh Textiles Mills Ltd.*, [173 ITR 179
H (Guj)], approved.

*Commissioner of Income Tax, West Bengal* **v.** *Britannia Industries Co. Limited,* **[135 ITR 35 (Cal)] and** *Geoffrey Manners & Co. Ltd.* **v.** *Commissioner of Income Tax,* **[221 ITR 695 (Bom)], overruled.** A

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 95 of 1998.

From the Judgment and Order dated 21.3.97 of the Bombay High Court in I.T.R. No. 305/88 in R.A. No. 115-116/Bom/1983. B

Harish N. Salve, Solicitor General and R.P. Bhatt, K.C. Kaushik, Nikhil Sakhardande, Rajiv Nanda, B.V. Balram Das and Ms. Sushma Suri for the Appellant. C

B. Sen (A.C.) for the Respondent

The Judgment of the Court was delivered by

**Y.K. SABHARWAL, J.** The assessee is a non-resident banking company. In respect of assessment years 1975-76 and 1976-77 the assessing officer, for the purpose of working of the disallowance under Section 40A(5) of the Income Tax Act, 1961, estimated the value of the perquisite of free cars provided to the employees at 50% of the expenses of running and maintenance of the cars. On appeal the Commissioner of Income-tax (Appeals) held that the value of perquisite of free cars provided to the employees is fixed by Rule 3(c) of the Income-Tax Rules, 1962 and the same value should be taken to be the value of the perquisite of the free cars provided to the employees for the purpose of making the disallowance under Section 40A(5). In further appeal the Income-Tax Appellate Tribunal upheld the order of Commissioner of Income-tax (Appeals), in view of the decision of Calcutta High Court in the case of *Commissioner of Income-tax, West Bengal* v. *Britannia Industries Co. Limited,* (135 ITR 35). D E F

At the instance of the Revenue, the question that was referred to the High Court for its opinion was as follows: G

> "Whether, on the facts and in the circumstances, and on a correct interpretation of Section 40A(5) of the Income Tax Act, 1961 and Rule 3(c) of the Income Tax Rules, 1962, the Appellate Tribunal was justified in law in holding that the value of the free car provided to the employees for the purpose of working out the disallowance case of the employer i.e. the assessee company should be the same as H

A prescribed by Rule 3(c) of the Income Tax Rules, 1962 in the case of the employee.?"

The High Court by impugned judgment and order answered the question in favour of the assessee, relying upon its earlier decision in the case of *Geoffrey Manners and Co. Ltd.* v. *Commissioner of Income-tax,* (221 ITR B 695).

The Revenue is in appeal before this court on grant of leave.

The question for determination is that where the actual expenditure incurred by an employer on providing the facility of a car to the employee C for private use is not ascertainable, is the disallowance under Section 40A(5) to be worked out on an estimated basis or by following the provision of Rule 3. According to Revenue, Rule 3 has no applicability since that rule can be invoked for computing the value of perquisite in the context of income of the employee from salary and has no relevance for determining the amount of D expenditure to be disallowed to an employer-assessee under Section 40A(5).

On the point in issue, there is divergence of opinion between the High Courts. The opinion of Calcutta High Court which is earliest in point of time is in favour of the assessee. That has been followed by some High Courts, including Bombay High Court. According to this opinion, for determining E the amount of expenditure under Section 40A(5), Rule 3 can be invoked. The contrary opinion, which is in favour of the Revenue has been expressed by the High Court of Gujarat and that has also been followed by some other High Courts, including Madras High Court. Which of these opinions lays down the correct law is the question before us.

F Section 40A(5) and Rule 3, to the extent relevant and as those provisions stood at the material time, read as under:

"40A. 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 G relating to the computation of income under the head 'Profits and gains of business or profession'....

(5) (a) Where the assessee,

(i) incurs any expenditure which results directly or indirectly in H 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,

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 :

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

(a) the expenditure and allowance referred to in sub-clauses (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.

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 seventy two thousand rupees, shall in no case be allowed as a deduction:.....

(c) The limits referred to in clause (a) are the following, namely:-

.....

(ii) in respect of the aggregate of the expenditure and the allowance referred to in sub-clause (ii) of clause (a), one-fifth of the amount of the 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 employment in India of the employee during the previous year whichever is less .....

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

(b) 'perquisite' means,-

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

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

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

B (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

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

Rule 3. Valuation of perquisites.-For the purpose of computing the income chargeable under the head 'Salaries' the value of the perquisites (not provided for by way of monetary payment to the assessee) mentioned below D shall be determined in accordance with the following clauses, namely :-

(c) (i) The value of a motor car provided by the employer for use by the assessee exclusively for his private or personal purposes shall be determined as the sum actually expended by the employer on the maintenance and running of the motor car during the relevant previous year (including remuneration, E if any, paid by the employer to the chauffeur) and, where the motor car is owned by the employer, as the aggregate of such sum and the amount representing the normal wear and tear of the motor car:

(ii) the value of a motor car provided by the employer for use by the assessee partly in the performance of his duties and partly for his private or F personal purposes shall be determined to be a sum equal to that part of the amount actually expended by the employer on the maintenance and running of the motor car during the relevant previous year (including remuneration, if any, paid by the employer to the chauffeur) which can reasonably be attributed to the user of the motor car by the assessee for his private or G personal purposes or, where the motor car is owned by the employer, the aggregate of such sum and a sum equal to that part of the amount representing the normal wear and tear of the motor car which can reasonably be attributed to the user of the motor car by the assessee for his private or personal purposes; so, however, that where a determination on the basis mentioned above presents difficulty, the value of the perquisite may be determined on H the basis provided in the Table below:

TABLE

| Value of perquisite per calendar month | | |
|---|---|---|
| 1 | 2 | 3 |
| | Where the h.p. rating of the car does not exceed 16 or the cubic capacity of the engine does not exceed 1.88 litres. | Where the h.p. rating of the car exceeds 16 or the cubic capacity of the engine exceeds 1.88 litres |
| 1.Where the motor car is owned or hired by the employer and all the expenses on maintenance and running are met or reimbursed to the assessee by the employer. | Rs. 300 | Rs. 400 |
| 2. Where the motor car is owned or hired by the employer but the expenses on maintenance and running for the assessee's private or personal purposes are met by the assessee. | Rs. 100 | Rs. 150 |

Provided that where a chauffeur is also provided to run the motor car, the value of the perquisite as calculated in accordance with this Table shall be increased by a sum of Rs.150 per month:

(iii) where one or more motor cars are owned or hired by the employer of the assessee and the assessee is allowed the use of such motor car, or all or any of such motor cars (otherwise than wholly and exclusively in the performance of his duties), an amount calculated in accordance with the Table under sub-clause (ii) and the proviso thereto, as if the assessee had been provided one motor car for use partly in the performance of his duties and partly for his private or personal purposes:

A Provided that where two or more motor cars are allowed to be so used and the h.p. rating of any one of such motor cars exceeds 16 or the cubic capacity of the engine of any one of such motor cars exceeds 1.88 litres, the assessee shall be deemed to have been provided by the employer with one motor car of h.p. rating exceeding 16 :

B Provided further that where two or more motor cars are allowed to be so used and a chauffeur is also provided to run any such motor car, the value of the perquisite as so calculated shall be increased by a sum of Rs.150 per month : ....."

In *Britannia Industries Ltd.,* the Calcutta High Court held that there C cannot be two different standards for assessment in respect of the employee and the employer and it would lead to a very anomalous situation if the value of the perquisite of the car provided by the assessee company to the employees was taken at one figure for the purpose of assessment of the employees under the head "salaries" and was taken at a different figures for the purpose of D working out a ceiling in the hands of the assessee company, which was the employer. It said that, "it is also equitable that what the payer gives is what the receiver receives". It accordingly said:

"...we hold that if the value of the perquisite of the car provided by the company to its employees is to be taken in the hands of the E employees for the purpose of assessment of the employees under the head 'Income from salaries' at Rs. 150 per month, the same value should be taken in the hands of the assessee-company which is the employer for the purpose of working out the ceiling under s.40(c)(iii)."

The Bombay High Court in the judgment and order under appeal has F answered the question in favour of the assessee following its earlier decision in the case of Geoffrey Manners. In the said decision, the High Court held that though Rule 3 has been framed for determination of the value of a motor car provided by the employer to the employee for the purpose of computing the income chargeable under the head "Salaries", there is nothing wrong in applying the same for valuing the perquisites for the purpose of computing G the disallowance under Section 40A(5) of the Act because the rule has been framed by the Central Board of Revenue with a view to get over the difficulties that might arise in determining the value of the perquisite in respect of the use of the car owned and maintained by the employer of the employees. As already noticed, the Bombay High Court followed the opinion expressed by H the Calcutta High Court in the case of Britannia Industries Ltd.

In *Commissioner of Income Tax* v. *Rajesh Textiles Mills Ltd.* (173 ITR 179) the Gujarat High Court has analised the legal position for coming to the conclusion that the computation of monetary benefit of perquisites in the hands of the employees has to be on an entirely different footing and concerns entirely a different topic and the head of income as compared to the computation of expenses actually incurred by the employer-assessee from the point of view of their deductibility from the income of the employer under the head "Profit and Gain of business or profession". Dealing with the decision in the case of Britannia Industries Ltd., the Gujarat High Court attempted to distinguish it on facts and said that the general observations in that decision were made on an entirely different statute scheme as compared to the one with which that court was concerned. Those general observations of the Calcutta High Court were that there cannot be any two different standards for assessment in respect of employee and employer. We, however, do not think that the observations made in Calcutta case were on consideration of different scheme or there was any distinction on facts. There, Rule 3 was erroneously invoked for determining the deduction of expenditure in the assessment of assessee-employer.

It has to be borne in mind that Section 40A(5) and Rule 3 deal with different situations and different set of assessees — one dealing with the employer-assessee and the other the employee-assessee. Rule 3 deals with valuation for the purposes of computing the income of the employees chargeable under the head "Salaries" whereas Section 40A(5) deals with computation of the income under the head "Profits and Gains of business or profession". The object of enacting Section 40A(5) was to discourage the assessees from incurring expenditure which resulted directly or indirectly in the provision of any benefit, amenity or perquisite to their employees beyond a particular limit and any expenditure incurred beyond the prescribed limit was liable to be disallowed. The said provision constitutes a composite scheme and the purpose of prescribing a ceiling on expenditure in connection with directors and employees is to discourage the employer from paying excessive salaries, remuneration, perquisites etc. to its employees and directors, and if paid, the employer would not be able to claim the entire expenditure as deduction. It will be able to claim deduction of expenditure upto the ceiling limit provided in the said section. This provision was enacted to curb extravagant expenditure. It does not contemplate deduction of notional value of perquisite assessed in the hands of employees. It contemplates the deduction of actual expenditure or on estimate basis where the details of the actual expenditure are not furnished.

A The employer has incurred the expenditure on the car and should be able to provide its figures. If he cannot, it is fair that the expenditure should be assessed in a realistic basis and not on the basis of Rule 3 which applies qua the employee, who cannot provide the figures of actual expenditure since it is not he who has incurred it.

B The High Courts of Calcutta and Bombay have not properly considered that Section 40A(5) and Rule 3 operate in different fields and apply to different set of assessees. The provision of the Act was enacted to provide for ceiling on expenditure on employees. The object of the rule is to give relief to the employees. Applying Rule 3 for the purpose of determining the deduction in C relation to the assessment of the employer would be doing violence to and ignoring the legislative intent evident in Section 40A(5). The question is not whether there is anything wrong in applying Rule 3 or any anomalous situation arising on account of determining different values of the same perquisite in the hand of employee or employer-assessee. There is no anomaly in applying Section 40A(5) while making assessment of the assessee-employer and it will D clearly be wrong to apply Rule 3. That cannot be done in the teeth of the language of the section. In our opinion the law has been correctly laid down by Gujarat High Court and not by the Calcutta and Bombay High Courts.

Before parting we wish to place on record our sincere gratitude for the valuable assistance rendered by Mr. B. Sen, Senior Advocate who readily E acceded to our request to assist the court as an amicus curiae since the respondent did not appear in the matter despite being served. In the conclusion, setting aside the impugned judgment and order of the High Court, we allow the appeal and answer the question in the negative in favour of the Revenue. No costs.

F B.S. Appeal allowed.