

*Before G. C. Mital and S. S. Sothi, JJ.*

COMMISSIONER OF INCOME TAX, (CENTRAL) LUDHIANA,—  
*Applicant.*

*versus*

M/S. SANDIKA P. LTD., LUDHIANA,—*Respondent.*

*Income Tax Reference No. 225 of 1980.*

January 18, 1989.

*Income Tax Act (XLIII of 1963)—S. 40-A(2) and 40-A(8) (Omitted with effect from 1st April, 1986)—Expenditure—Deduction—S. 40-A(8) whether excludes or overrides S. 40(A)(2)—Whether both provisions can co-exist.*

*Held*, that the distinction between S. 40-A(8) and S. 40-A(2) is that 15 per cent is disallowable out of the expenditure incurred under S. 40-A(8); whereas under S. 40-A(2) only that part of the expenditure is disallowable which is found to be excessive and unreasonable. The other distinction is more vital and conclusive. For the applicability of S. 40-A(8) it makes no distinction whether payment of interest is made to a director of the company or his relation or strangers totally unconnected with the company or their relatives. S. 40-A(2) is applicable only when payments are made to relatives of an individual assessee, a director of the Company, partner of the firm, member of the association of family or any relative or any such director, partner, or member. Therefore, it is clear that these provisions have different objects to be achieved and can co-exist in the statute book and one does not exclude the other.

(Paras 8 and 9).

*Held*, that the Tribunal might be justified in disallowing 15 per cent under S. 40A(8) and the unreasonable or excessive amount under S. 40-A(2) and on another set of facts it might consider to include 15 per cent to be disallowed under S. 40-A(8) in the disallowance to be made under S. 40-A (2). Therefore, in spite of our opinion that both the provisions can stand together, there may be little overlapping to a limited extent when on peculiar facts it may be concluded that 15 per cent amount disallowable under S. 40-A(8) should be include in the disallowance to be made under S. 40-A(2).

(Para 10).

*Reference under Section 256(1) of the Income Tax Act, 1961 by the Income Tax Appellate Tribunal, Chandigarh Bench, Chandigarh to the Hon'ble High Court of Punjab and Haryana for opinion of the following questions of law arising out of the Tribunal's order dated*

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6th September, 1978 in R.A. No. 127 of 1978-79, in I.T.A. No. 207 of 1977-78, Assessment Year 1976-77:—

*“Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was right in restricting the disallowance of interest paid by the assessee company to its directors and their relations to 15 per cent only of the expenditure under section 40-A(8) regardless of the specific provisions made by the Income tax Act, 1961 in section 40(c) and 40(A) (2) ?*

Ashok Bhan, Sr. Advocate with Ajay Mittal, Advocate, for the Petitioner.

D. K. Gupta, Advocate, for the respondent.

#### JUDGMENT

Gokal Chand Mital, J.

(1) The assessee is a private limited company. The company paid total amount of Rs. 57,941 by way of interest to its depositors in the period relevant to assessment year 1976-77. In assessment proceedings, the company claimed deduction of the interest paid but the Income Tax Officer disallowed 15 per cent in view of Section 40-A (8) of the Income Tax Act, 1961 (hereinafter called the Act) which was on the statute book during the relevant assessment year. That provision was as follows :—

*“(8) Where the assessee, being a company (other than a banking company or a financial company), incurs any expenditure by way of interest in respect of any deposit received by it, fifteen per cent of such expenditure shall not be allowed as a deduction.”*

2. The Income Tax Officer also found that the interest was paid at the rate of 24 per cent per annum on the deposits made by the Directors of the company and their relations and consequently proceeded to consider under section 40-A (2)(a) read with subsection (b)(ii) of the Act whether the payment of interest on the deposits was excessive or unreasonable. He came to the conclusion that payment of interest to the extent of 6 per cent per annum out of 24 per cent per annum was unreasonable and disallowed payment of interest to this extent under section 40-A(2)(a)

read with sub-section (b) (ii) of the Act. Some other matters were also decided. The assessee went up in appeal before the Appellate Assistant Commissioner. The Appellate Assistant Commissioner agreed with the Income Tax Officer that 15 per cent has to be disallowed under Section 40-A (8) of the Act. He also agreed that the payment of interest at the rate of 18 per cent per annum was reasonable and the balance was considered as disallowable under Section 40(c) of the Act. In spite of this, he made the following observation :—

“Taking into consideration the fact that the total disallowance is in excess of 15 per cent disallowance of Rs. 14,425 is considered as inclusive of the disallowance required to be made under section 40-A (8).”

3. Against the aforesaid appellate order, the assessee as well as the department went up in separate appeals before the Income Tax Appellate Tribunal, Amritsar.

4. On behalf of the assessee, it was contended that in view of specific provisions of Section 40-A (8) of the Act, disallowance of 15 per cent could be made and no further disallowance could be made either under Section 40(c) or under section 40-A(2) of the Act. It was also contended that a special provision overrides the general provision and, therefore, in face of section 40-A (8) the other provisions would not apply. On the other hand, counsel for the Revenue pleaded that under Section 40-A (8) of the Act, 15 per cent of the interest whether paid to a stranger or to a director of the company or any relative of such director was disallowable whereas under Section 40-A (2) payments made to a director of the company or any relative of such director, if found to be excessive or reasonable could be disallowed and in this manner it was urged that both the provisions were different and had different objects to be achieved and could stand at the same time and one provision did not exclude the other as was sought to be argued on behalf of the assessee. The Tribunal agreed with the contention of the assessee and held that disallowance of Rs. 8,691 only was justified with reference to the figures of interest payment of Rs. 57,941 and the disallowance was restricted to this figure. We are surprised to find on a reading of para 6 of the order of the Tribunal that the matter was remitted to the Income Tax Officer for fresh disposal to see whether section 40-A (2) of the Act was applicable or not. In

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the aforesaid background, we have to opine on the following question referred for opinion of this Court :—

“Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was right in restricting the disallowance of interest paid by the assessee company to its directors and their relations to 15 per cent only of the expenditure under section 40-A (8) regardless of the specific provisions made by the Income-tax Act, 1961 in sections 40(c) and 40-A (2) ?”

5. The learned counsel for the Revenue could not dispute that in view of *C. I. T. Patiala v. Avtar Cycle (P.) Ltd.*, (1), section 40(c) of the Act would not be applicable to the facts of the case. We have to see whether section 40-A (8) would exclude or override section 40-A (2) or both can stand. On a careful consideration of the two provisions and the objects sought to be achieved, we are of the opinion that both the provisions can co-exist and are applicable to the facts of the case. Section 40-A provides for expenses or payments not deductible in certain circumstances. Sub-section (8) was inserted with effect from 1st April, 1976 and has been omitted, with effect from 1st April, 1986.

6. Section 40-A (8) provides in regard to companies other than a banking or financial company and is not applicable to individual assessee, firms, association of persons or Hindu undivided families. Whenever such a company incurs expenditure by way of interest in respect of any deposit received by it, 15 per cent of such expenditure has to be disallowed in view of the aforesaid provision.

7. On the contrary, section 40-A(2) is applicable to all assesseees including individuals, company firm, association of persons or Hindu undivided family. This provision provides that where an assessee incurs expenditure in respect of which payment has been made or has to be made to any person referred to in clause (b) of the sub-section, and if the Income Tax Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the circumstances mentioned in the provision, such expenditure shall not be allowed as a deduction.

8. Therefore, one distinction between section 40-A (8) and Section 40-A (2) is that 15 per cent is disallowable out of the expenditure incurred under section 40-A (8); whereas under section 40-A (2) only that part of the expenditure is disallowable which is found to be excessive and unreasonable.

9. The other distinction is more vital and conclusive. For the applicability of section 40-A (8) it makes no distinction whether payment of interest is made to a director of the company or his relation or strangers totally unconnected with the company or their relatives. Section 40-A (2) is applicable only when payments are made to relatives of an individual assessee, a director of the company, partner of the firm, member of the association or family, or any relative or any such director, partner, or member. Therefore, it is clear that these provisions have different objects to be achieved and can co-exist in the statute book and one does not exclude the other. The Tribunal was in error in coming to the conclusion that section 40-A (8) excluded section 40-A (2) of the Act so far as company is concerned.

10. Since the Tribunal did not consider the effect of section 40-A (2) on the facts of the case, the matter will have to be sent back to the Tribunal in order to determine as to how much of interest paid by the assessee to its directors and their relations was excessive and unreasonable and whatever is found to be excessive and unreasonable, the same shall have to be disallowed. It will be open to the Tribunal to consider whether 15 per cent which is to be disallowed under section 40-A (8) would be included in the disallowance to be made under section 40-A (2) or would be in addition to this disallowance. In this behalf the matter can be looked at from different angles. While considering the matter under section 40-A (2) the Tribunal might come to the conclusion that payment of interest was reasonable to a figure between 15 per cent per annum to 23 per cent per annum (this is by way of illustration). The balance payment of interest would thus be unreasonable. If unreasonable part falls below 15 per cent of the amount paid, than 15 per cent will have to be disallowed by virtue of section 40-A (8), but if the amount to be disallowed is more than 15 per cent of the amount paid, would it be justifiable to disallow the excessive or unreasonable expenditure as also 15 per cent under section 40-A (8)? This matter will have to be considered by the Tribunal in the wake of what is excessive or unreasonable expenditure. On

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peculiar facts of a case, the Tribunal might be justified in disallowing 15 per cent under section 40-A (8) and the unreasonable or excessive amount under section 40-A (2) and on another set of facts it might consider to include 15 per cent to be disallowed under section 40-A (8) in the disallowance to be made under section 40-A (2). Therefore, in spite of our opinion that both the provisions can stand together, there may be little overlapping to a limited extent when on peculiar facts it may be concluded that 15 per cent amount disallowable under section 40-A (8) should be included in the disallowance to be made under section 40-A (2).

(11) Accordingly, we answer the question in favour of the Revenue, i.e. in the negative, but the matter is left open to be considered by the Tribunal under section 40-A (2) as to how much amount is unreasonable or excessive under section 40-A (2). There is no dispute that 15 per cent has to be disallowed under section 40-A (8) of the Act even if nothing is found excessive or unreasonable under section 40-A (2) of the Act. However, there will be no order as to costs.

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R. N. R.