

IN THE INCOME TAX APPELLATE TRIBUNAL

"D" BENCH, MUMBAI

BEFORE SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER AND

SHRI SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA no.3414/Mum./2023
(Assessment Year : 2015-16)

Micropoint Computers Pvt. Ltd.
17/18, Navketan Industrial Estate
Mahakali Caves Road, Opp. Onida House
Andheri (East), Mumbai 400 093
PAN – AACCM8590Q

..... Appellant

v/s

Dy. Commissioner of Income Tax
Circle-10(2)(2), Mumbai

..... Respondent

Assessee by : Shri Bhupendra Shah
Revenue by : Smt. Mahita Nair

Date of Hearing -05/02/2024

Date of Order -22/04/2024

ORDER

PER SANDEEP SINGH KARHAIL, J.M.

The present appeal has been filed by the assessee challenging the impugned order dated 05/09/2023, passed u/s 250 of the Income Tax Act, 1961 (*"the Act"*) by the learned Commissioner of Income Tax (Appeals), National Faceless Appeal Centre, Delhi, [*"learned CIT(A)"*], for the assessment year 2015-16.

2. In its appeal, the assessee has raised the following grounds: –

"1. In the facts and circumstances of the case and in law, the Assessing Officer erred in disallowing bonus of Rs. 1,92,00,000/- paid to 2 Directors under

section 36(1)(ii) of the Income tax Act, 1961 by arbitrarily rejecting the fact that

a. Directors have already paid taxes on the said bonus and thus this disallowance tantamount double taxation of same amounts, which is contrary to settled law

b. The said addition is against the decide cases of jurisdictional ITAT and others

c. Without issuing a show cause notice of proposed disallowance u/s 36[1][ii]

2. In the facts and circumstances of the case and in law, the Assessing Officer erred in not following the instructions No.20/2015 dated 29.12.2015 issued by the Central Board of Direct Taxes in connection with scope of scrutiny assessment by

a. Wrongly converting the limited scrutiny into a full scrutiny without appropriate approval.

b. Wrongly making disallowance u/s 36[1][ii] even though Limited scrutiny was pertaining to payments u/s 40A[2][b]

c. Wrongly exceeding scope of Limited Scrutiny

3. In the facts and circumstances of the case and in law, the Assessing Officer erred in initiating penalty u/s 271(1)(c) and also charging interest under section 234A, 234B, 234C and 234D.

4. In the facts of the case and in Law, the learned CIT(A) erred in confirming the disallowance of bonus of Rs. 1,92,00,000/-/- by rejecting the above said submissions without granting a physical hearing through Video Conferencing."

3. The issue arising in ground no.1 pertains to the disallowance of bonus paid to directors u/s 36(1)(ii) of the Act.

4. The brief facts of the case pertaining to this issue are that the assessee is engaged in the business of dealing in computers, networking solutions, and providing maintenance and facility management services. For the year under consideration, the assessee filed its return of income on 30/09/2015 declaring a total income of Rs.3,23,05,088/-. The return filed by the assessee was selected for verification of payment made to parties u/s 40A(2)(b) of the Act

and for verification of TDS deducted or collected but not deposited with the Government. During the assessment proceedings, on perusal of the details filed by the assessee, it was observed that during the year under consideration, the assessee not only paid higher remuneration to its directors, i.e. Shri Amul D Mahale and Shri Chetan R Goyani, but in addition to the same also paid a bonus of Rs.96 lakh each to both of them. Accordingly, the assessee was asked to justify the allowability of bonus paid of Rs.1,92,00,000, as per provisions of section 36(1)(ii) of the Act. In response thereto, the assessee submitted that both the aforesaid directors are the promoter directors holding 49.77% and 47.23% of equity shares of the assessee. It was further submitted that both the directors are engineers by qualification and are actively involved in day to day affairs of the company. It was submitted that the directors have been regularly paying withholding taxes on remuneration and bonus amounts received. It was further submitted that during the year under consideration, there has been an increase of 44% in total turnover and 55% in sales turnover as compared to the preceding year, and therefore, the bonus of Rs.1,92,00,000 was paid to the directors. The assessee also submitted that the bonus to the directors has been paid purely due to improvement in the sales performance and not as dividends or distributions of profits. Accordingly, the assessee claimed that the payment of bonus of Rs.1,92,00,000 to two promoter directors is allowable as an expenditure u/s 36(1)(ii) of the Act.

5. **The Assessing Officer ("AO")** vide order dated 28.11.2017 passed u/s 143(3) of the Act did not agree with the submission of the assessee and held

that both the directors are full-time directors of the assessee company and have been appointed to the said post considering their qualifications, experience, and expertise. Hence, all out efforts are anyway expected from them to achieve higher growth for the company and even if no bonus is paid, they cannot be absolved of their responsibility of being the directors of the assessee company, for which they are duly compensated by way of remuneration, which during the year has increased to Rs.60 lakh each, as against Rs.54 lakh each during the preceding year. The AO further held that the assessee was having profits to the tune of Rs.12,30,21,565/- including the bonus paid to the directors of Rs.1.92 crore, which could have been distributed among the shareholders in the form of dividends. Thus, the AO held that the bonus paid to the directors of Rs.1.92 crore, if had not been paid as a bonus, was clearly payable as a dividend to the shareholder directors. The AO further held that if the entire amount of Rs.1.92 crore had been distributed as a **dividend, then the assessee's income could have gone up by this amount and** hence the assessee would have paid tax on this amount at 30%. Further, if the amount of Rs.1.92 crore would have been paid as a dividend to the shareholders, the assessee would be also liable to pay dividend distribution tax at 15% of the entire amount. Thus, the AO concluded that the payment of bonus of Rs. 1.92 crore is nothing but a colourable device, which is prohibited by the provision of section 36(1)(ii) of the Act. Accordingly, the AO disallowed the amount of Rs.1.92 crore u/s 36(1)(ii) of the Act.

6. The learned CIT(A), vide impugned order, dismissed the appeal filed by the assessee and upheld disallowance made u/s 36(1)(ii) of the Act. Being aggrieved, the assessee is an appeal before us.

7. We have considered the submissions of both sides and perused the material available on records. In the present case, the assessee paid a bonus in addition to the remuneration to two of its directors, i.e. Shri Amul D Mahale and Shri Chetan R Goyani, during the year under consideration. It is undisputed that Shri Amul D Mahale and Shri Chetan R Goyani are holding 49.77% and 47.23%, respectively, of the equity shares of the assessee. Since the payment was made to the directors of the company, it is evident from the records that the AO initially made verification of the payments u/s 40A(2)(b) of the Act. However, after considering the details filed by the assessee, the AO examined the allowability of bonus paid to the aforesaid two directors u/s 36(1)(ii) of the Act. In the present case, it is the plea of the assessee that both the directors are promoter directors of the company having a diploma in electronic engineering with 35 years of experience in the IT Industry. It is further the claim of the assessee that both the directors are actively involved in the day-to-day affairs of the company and a bonus of Rs.96 lakh each was paid for the services rendered by them and also because during the year under consideration, total turnover and sales turnover increased by 44% and 55%, respectively, as compared to the preceding year. However, the AO rejected the claim of the assessee u/s 36(1)(ii) of the Act and treated the payment of bonus to both the directors as a colourable device in order to avoid payment of tax. As per the AO, the assessee was having profits which could have been

distributed amongst the shareholders in the form of dividends instead of payments as bonus, and therefore, the claim of the assessee u/s 36(1)(ii) of the Act is not maintainable.

8. In order to decide the issue at hand, it is firstly relevant to analyse the provisions of section 36(1)(ii) of the Act under which the claim of the assessee has been denied in the present case. Section 36(1)(ii) of the Act reads as under: -

"(ii) 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 commission;"

9. Therefore, for the allowability of deduction claimed u/s 36(1)(ii) of the Act, it is necessary that the sum is paid to an employee as a bonus or commission for services rendered. However, section 36(1)(ii) of the Act also carves out an exception to the allowability of the amount paid as bonus or commission and further provides that if such sum has not been paid as bonus or commission then, in that case, such sums would not have been payable to the employee as profits or dividend. Therefore, as per section 36(1)(ii) of the Act, payment of bonus or commission to an employee is allowable subject to the condition that the payment is not made in lieu dividend. Upon reading the provisions of section 36(1)(ii) of the Act in its entirety, it cannot be disputed that the shareholder-employee is also covered within its ambit. Ostensibly, in the present case, a sum of Rs.96 lakh each has been paid as a bonus to both directors, who are also holding 49.77% and 47.23% equity shares of the assessee. Therefore, now the question arises that if such a sum, i.e. Rs.1.92 crore in total, is not paid as a bonus by the assessee whether the same would

be payable as profits or dividend to the shareholder directors. In order to answer this question, at the outset, it is pertinent to note that the distribution of dividend depends on various factors. Therefore, even assuming that during the year under consideration, the dividend was payable by the assessee company to its shareholders, in the facts of the present case and in the light of the provision of section 36(1)(ii) of the Act it needs to be examined whether the sum so received by the shareholder directors as bonus would have been payable as profits or dividend if not paid as bonus. The aforesaid analysis is **relevant as the provisions of section 36(1)(ii) of the Act use the term "any sum" in the first part and "such sum" in the second part** of the section.

10. We find that while interpreting the provisions of section 10(2)(x) of the Income Tax Act, 1922, which corresponds to the provisions of section 36(1)(ii) **of the Act, the Hon'ble jurisdictional High Court in Loyal Motors Service Co Ltd v/s CIT, [1946] 14 ITR 647 (Bom.) held that the term "such sum" only refers to the last and only antecedent, which is "any sum" paid as a commission or bonus, and therefore unless the commission or bonus would be paid as profits or dividends the exception to the allowance does not operate. Thus, it was held that the sum included under the expression "such sum" must be the same sum as is described by the expression "any sum paid as bonus or commission".**

11. In the present case, it is undisputed that the assessee had profits to the tune of Rs.12,30,21,565 during the year under consideration. If such profit is distributed amongst the two directors, i.e. Shri Amul D Mahale and Shri Chetan R Goyani, in the ratio of their shareholding, i.e. 49.77% and 47.23%, respectively, it is evident that the share of their profit during the year would

have been much higher than Rs.96 lakh received as a bonus by each of them. Therefore, we are of the considered view that submission of the Revenue is contrary to the ratio laid down by the **Hon'ble jurisdictional High Court in Loyal Motors Service Co Ltd (supra)** as the sum of Rs.1.92 crore paid as bonus to the directors is not payable to them as profit or dividend in the facts of the present case if it had not been paid to them as bonus or commission.

12. Further, from the perusal of the decision of the Special Bench of the Tribunal in *Dalal Broacha Stock Broking (P.) Ltd. v. Addl. CIT*, [2011] 11 taxmann.com 426 (Mumbai) (SB), relied upon by the AO, we find that in the facts of that case, it was noted that there is no evidence that the directors had rendered any extra services for payment of huge commission in addition to services rendered as an employee for which salary was paid. Further, the Special Bench noted that the commission was paid only in the years of exceptional profit and there was no continuous payment of commission every year to the directors. Accordingly, in the facts of the case, the Special Bench concluded that the dividend was payable and the same has been paid in the garb of commission, which is not allowable u/s 36(1)(ii) of the Act. However, in the present case, as per the assessee it had paid a bonus of Rs.35 lakh each to the aforesaid directors in the preceding year, which was increased to Rs.96 lakh in the year under consideration. From the perusal of the computation of income of both the directors, forming part of the paper book from pages 65-122 for the assessment year 2015-16, we find that the directors had declared a salary of Rs.60 lakh and a bonus of Rs.35 lakh received by them. Thus, it is not a case wherein the bonus was received by the directors only in one year.

Accordingly, we are of the considered view that the decision of the Special Bench of the Tribunal in Dalal Broacha Stock Broking (P.) Ltd. (supra) has been rendered in its own set of facts, which are completely different from the facts of the present case. Further from the financial statement of the assessee, forming part of the paper book on page 2, we find that the turnover from the sale of products increased from Rs.39.77 crore in the assessment year 2014-15 to Rs.61.61 crore in the assessment year 2015-16. The aforesaid facts also distinguish the present case from the facts in Dalal Broacha Stock Broking (P.) Ltd. (supra), as in that case, it was noted by the Special Bench that the steady rise in performance was due to improved market conditions as the taxpayer was a stockbroker who was getting commission on sale/purchase of shares by the investor/traders. However, in the line of business of the assessee, wherein it is engaged in dealing in computers, networking solutions, and providing maintenance and facility management services, it cannot be denied that without the dedicated efforts turnover from sales and services cannot increase. Thus, we are of the considered view that the aforesaid factors also support the case of the assessee that the bonus was a reward for the work of the promoter directors, who were actively involved in the day-to-day affairs of the company, in addition to the salary paid to them. Accordingly, in view of the aforesaid facts and circumstances, we are of the considered view that the assessee is entitled to claim deduction u/s 36(1)(ii) of the Act in respect of payment of bonus to its directors. Therefore, the impugned disallowance u/s 36(1)(ii) of the Act is deleted. **As a result, ground no.1 raised in assessee's appeal is allowed.**

13. During the hearing, the learned AR submitted that if the relief is granted to the assessee in respect of ground no.1 then ground no.2 raised in the appeal may be left open. Accordingly, in view of the submissions of the learned AR, ground no.2 is left open.

14. **Ground no.3 raised in assessee's appeal pertains to the levy of penalty u/s 271(1)(c) of the Act and charging of interest u/ss 234B and 234C of the Act.** Insofar as the levy of penalty is concerned, the same is premature in nature. Further, the charging of interest u/ss 234B and 234C of the Act is consequential in nature, and therefore, the same needs no separate adjudication.

15. Ground no.4 is rendered academic in view of our findings in respect of **ground no.1 raised in assessee's appeal.**

16. In the result, the appeal by the assessee is allowed.

Order pronounced in the open Court on 22/04/2024

Sd/-
PRASHANT MAHARISHI
ACCOUNTANT MEMBER

Sd/-
SANDEEP SINGH KARHAIL
JUDICIAL MEMBER

MUMBAI, DATED: 22/04/2024

Vijay Pal Singh, (Sr. PS)

Copy of the order forwarded to:

- (1) The Assessee;
- (2) The Revenue;
- (3) The PCIT / CIT (Judicial);
- (4) The DR, ITAT, Mumbai; and
- (5) Guard file.

True Copy

By Order

Assistant Registrar
ITAT, Mumbai