Ahmedabad Manufacturing and Calico Printing Co. Ltd.

Vs

Commissioner of Excess Profits Tax Bombay North Kutch and Saurashtra

Civil Appeal No. 72 of 1956

(CJI S. R. Dass, N. H. Bhagwati, M. Hidayatullah JJ)

14.05.1959

JUDGMENT

HIDAYATULLAH, J. –

This appeal by special leave of this court has been against the judgment and order of the Bombay High Court dated August 27, 1954, by the Ahmedabad Manufacturing and Calico Printing Co. Ltd., Ahmedabad, hereinafter called the assessee company. By that judgment, the High Court of Bombay answered the first of the two following questions referred to it by the Income-tax Appellate Tribunal, Bombay, in the negative, and declined too answer the second question, inasmuch as, in its opinion, that question did not arise in view of the answer too the first question :

> "1. Whether in law, if there is an obligation on the employer to any a certain bonus, the Excess Profits Tax Officer is bound to allow it as a deduction and is precluded from exercising his discretion under rule 10(1) of the First Schedule of the Excess Profits Tax Act.
>
> (2) If the answer to the first question is in the formative whether on a true construction of the agreement between the assessee and its employees and the provident Fund Rules, the assessee company is under obligation to pay the bonus without deducting the excess profits tax."

The facts out of which the reference arose were as follows : The assessee company is a limited is a limited liability company, and is one of the will known manufacturers of textile goods. We are concerned with three chargeable accounting periods corresponding to the calendar years 1943, 1944 and 1945. While making the assessment of the assessee company, the Excess Profits Tax Office found that large payments had been made to five of the employees of the company during the chargeable accounting periods. He also found that in the case of 53 employees of the assessee company, excessive contributions had been made by the company to their provident funds. These payments and contributions were not the basis of a percentage of the profits of the assessee company made in the years of account. In determining the profits on which the said percentage was to be calculated, the assessee company did not first deduct either the income-tax or the excess profits tax. The Income-tax Officer upheld the action of the assessee c

The Appellate Tribunal also upheld the Excess Profits Tax Officer's decision. It, however, declined to state a case to the High Court of Bombay, and the assessee company moved and obtained from the Bombay High Court a rule nisi, by which the High Court asked the Department to show cause why it should not state a case on the following two questions :

"I. Whether on a true and proper construction of the Provident Fund Rules and of the five agreements with the five officer employees, the amounts of excess profits tax determined to be payable should be deducted in the first instance for the purposes of determining the amount of bonus or commission payable to the said employees and the five officer employees.

2. Whether in the circumstances of the case the finding of the Tribunal that the full amount of commissioner or bonus paid to the employees of the petitioners under the Provident Fund Rules and Fund rules and to the five office employees under their respective agreements is not an allowable deduction in computing the taxable profits of the petitioners for the purpose of excess profits tax is justifiable in law."

It appears that when the fuel nisi came to the heard, the High Court of Bombay accepted the contentions of counsel for the Department, and modified the questions to those which have been stated at the commencement of this judgment. We mention this fact, because in the hearing before us, it was contended that the proper questions which arose forms he order of the Appellate Tribunal were the questions which were formulated by the High Court in the rule nisi and not the ones which were subsequently set down when the rule was made absolute.

A few further facts are necessary to indicate what exactly was the arrangement between the assessee company and the five employees with regard to payment of bonus to them and also what the existing rules were under which the company's contribution to the provident fund came to be made. The Tribunal in stating the case has forwarded five agreements entered into with the said employees. Of these, four agreements are between the years 1933 and 1935 and the fifth agreement is of 1944. In all these agreements, it is provided that the employees in question would receive in addition to the salary, if any, bonus or remuneration calculated at a certain percentage of the profit in accordance with the following formula :

#X per cent. of the profit of Block value Rs...........the company for the year x - -Block for the year for which bonus orremuneration payable.##

The percentage of the block value is shown differently under different agreements, but that is not much to the purpose. There was, however, a condition which was common to all the agreements, by which it was provided that profits meant the company's profit for each complete official year of the company as shown in the balance - sheet for the year before providing for depreciation and income-tax and super-tax.

In respect of the provident fund, it may be stated that the Provident Fund Regulations were framed with effect from June 30, 1935, and were recognised by the Commissioner of Income-tax, as required by the Rules regarding Recognised Provident Funds framed by the governor General in council on March 15, 1930. The amount payable by the company was determined in accordance with regulation 12(b), which reads as follows :

"If the profits of the company come to 4% and over on the cost value of the block as shown in the balance - sheet in a particular year, then the amount payable by the company as bonus in respect of an employee will be equal to Profit for a year "X - - X 100 Block value for that year

Where 'R' is a certain pre - assigned constant corresponding to each appointment."

It was also provided (regulation 13) that profits for a year meant profits as shown in the balance - sheet of the company for that year before providing for depreciation and income-tax charges but after providing for bonus.

The dispute naturally arose whether the term "income-tax and super- tax" could be said to include excess profits tax, which came into being in 1940. It was also a question whether the Excess Profits Tax, Officer could, under the powers conferred on him by rule 12(1) of First Schedule of the Excess Profits Tax Act, 1940, order that the deduction of excess profits tax should be made before applying the percentage. Rule 12(1) reads as follows :

> "In computing the profits of any chargeable accounting period no deduction shall be allowed in respect of expenses in excess of the amount which the Excess profits Tax Officer considers reasonable and necessary having regard to the requirements of the business and, in the case of directors' fees or other payments for services, to the actual services rendered by the person concerned :

Provided that no disallowance under this rule shall be made by the Excess Profits Tax Officer unless he has obtained the prior authority of the Commissioner of Excess Profits Tax."

In the assessment year 1944-45, which corresponded to the chargeable accounting period ending December 31, 1943, the Income-tax Officer had not allowed the claim of the assessee company with regard to excess profits tax in the income-tax assessment. In that year the excess profits Tax Officer also acting under rule 12 above quoted, disallowed the claim for excess profits tax assessment. In the two subsequent assessment years corresponding to the chargeable accounting periods ending December 31, 1944, and December 31, 1945, respectively, the Income-tax Officer computed the assessable profits by allowing bonus to the employees and contribution to the provident fund on the basis of net profits after deduction to the provident fund on the basis of net profits after deduction of e=excess profits tax. The Excess Profits Tax Officer also took the same action, but he did it not only on the acceptance of the assessment of the Income-tax Officer but also under special power conferred on him under Rule 12 above quoted.

> "1, whether in law, if there is an obligation on the employer to pay a certain bonus, the Excess Profits Tax Officer is bound to allow it as a deduction and is precluded from exercising his discretion under rule 12 (1) of the First Schedule of the Excess Profits tax Act.
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> 2. If the answer to the first question is in the affirmative, whether on a true construction of the agreement between the assessee and its employees and the Provident Fund Rules, the assessee company is under obligation to pay the bonus without deducting the excess profits tax."

Mr. Palkhivala who appeared for the assessee company contended that several maters were not in dispute in the present case. He argued that the genuineness of the agreements and the rule s were not at any stage questioned, and that these agreements had come into existence long before the passing of the Excess Profits Tax Act. He drew attention to the recognition granted by the Commissioner of Income-tax to the Provident Fund Regulations when they were enacted, and added that there was no dispute as to the meaning of the relevant conditions in the documents between the employer and the employees. He wound up this part of his argument by saying that the reasonableness of the percentage was also not questioned by the Department. He stated that the construction placed by the

assessee company upon the agreements and regulations to the effect that the excess profits tax should not be deducted before the percentage was calculated was reasonable, regard being had to several decisions, including the opinion of Viscoun

These cases were cited not merely as aids to the construction of the documents in question, but to show that the action of the assessee company in not deducting the excess profits tax before applying the percentage could not per se be unreasonable. The argument was really advanced to afford a step to the next argument, which was the main contention in the case. The assessee company's complaint was that the Excess profits Tax Officer's order did not disclose why he had considered the deduction of excess profits tax as necessary before the percentage could be applied. If the documents could be interpreted in a manner which would exclude excess profits tax from the list of deductions to be made before applying he percentage, counsel contended that three was nothing further in the case to show that the Excess Profits Tax Officer had any material or evidence on which the unreasonableness of the payments made could be rested. He therefore argued that the proper questions where the ones which were raised by the Hig

The order of the Excess profits Tax Officer was rested on a decision of the Bombay High court reported in Walchand & Co. Ltd. v. Hindustan construction Co. Ltd., excess profits tax was analysed by Chagla, C.J. Having quoted from the judgment of Chalga, C.J. J., the Excess Profits Tax Officer set down rule 12 of first Schedule of the Excess profits Tax Act, and observed as follows :

> "In the light of the observations of the Chief Justice in the case of Walchand & Co. Ltd. quoted above the payments of bonuses on the basis of net profits as per balance sheet without deducting excess profits tax is clearly both unreasonable and unnecessary with in the meaning of rule 12 of Schedule I of the Act. The employer and the employee cannot divide the profits including the item of excess profits tax payable which the employer himself is not allowed to retain. As required by proviso to rule 12 of Schedule I after obtaining the prior authority of the commissioner of Excess profits Tax, the excess of bonuses payable arrived at on the basis of excess profits tax payable on balance sheet profits without deduction of excess profits tax has been disallowed under rule 12 of Schedule I as under :

Bonuses paid to 6 employees :

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            #

S. No. Name of the Bonus pay- Bonus that would Excess of Date of

Employee Ment clai- be payable on bonus agree-

med for the basis of disallowed ment

the year profits after under r. 12

1943 deducting of Sch. I.

E.P.T. paya-

able on basis

of balance
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sheet profits

Rs. Rs. Rs.

1. S. H. Gidwani 2,46,260 1,06,583 1,39,427 3-1-33

2. Bhogilal B.

Shah 74,251 32,410 41,841 8-3-34

3. J. A. Gandhi 64,621 25,449 39,172 24-3-44

4. A. C. Shah 29,700 12,964 16,742 as sanc-

tioned by

directors.

5. A. N. Tankaria 14,850 6,482 8,386

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53 employees admitted 2,45,550

to the benefits of

Provident Funds'

Scheme as per

figures worked

out in a attached

list. 2,40,733 1,04,043 1,36,690

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Total amount disallowed under rule 12 of Sch, I 3,82,240"

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When the matter reached the Appellate Tribunal, it called for a further report from the Excess profits Tax Officer, and he submitted it giving his finding and his reasons why the payments and the contribution by the assessee company were unreasonable and unnecessary. He observed as follows :

> "Unlike section 10 and 10A of the Excess Profits Tax Act it is not necessary for the Excess Profits Tax Officer to prove the motive of payment. If the payments are excessive having regard to the requirements of the business and the services rendered, then rule 12 requires that such amounts in excess are to be disallowed. In case of other textile mills at Ahmedabad, no payments of the nature similar to this are made. Even in cases where the bonus is paid, such payments are not exceeding 3 to 6 months' salaries paid to the employees. Looking at this practice there is no doubt that the bonus payments claimed in this case are clearly excessive."

He appended a detailed scheduled of payments to the five officer employees as well as to the 53 employees to the whose provident fund contributions were made by the assessee company, and showed that in the case of four of the employees to whom salary was paid, the percentage of bonus to salary ranged between 412 to 884 per cent., if payment was calculated before deducting the excess profits tax. In the case of the fifth employee to whom no salary was paid in the year, a sum of no less than Rs. 2.46,260 was paid as bonus in the relevant year. He also showed that the percentage of the provident fund contribution to salary ranged from 56 per cent. to 553 per cent. and this, according to him, was also excessive. He therefore concluded as follows :

> "From the figures supplied in the attached lists, it may kindly be seen that the contribution by the company as bonus not only exceeds the contributions of the employees but is several times more than the annual salaries paid to the employees. If such excessive payments as claimed were foreseen at the time when the recognition was given, the commissioner of Income-tax while recognising the fund would not have recognised the fund without this rule (rule 10 of the Provident Fund Rules) and basis being changed.

from the above facts, it is clear that the payments made to the five employees and the 53 employees admitted to the benefits of the provident fund are clearly excessive having regard to the requirements of the business and the actual services rendered by the persons concerned within the meaning of rule 12(1) of Schedule 1."

Learned counsel for the assessee company contended that there was not evidence whatever, on which the conclusion that the payments were unreasonable could be justified, and that the matter was wrongly apprehended by the authorities. According to him, the Excess Profits Tax Officer could have acted on one of the two and only two grounds, viz. :

> (a) that this payment of percentage without deduction of excess profits tax was per se unreasonable and unnecessary; or
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> (b) that a payment to an individual employee or to his provident fund by the company was unreasonable or unnecessarily large, having regard to the requirements of the business.

he contended that the Excess Profits Tax Officer had acted solely on the first ground and had thus acted not under rule 12 of Schedule I but on a rule of thumb which led to rather inconsistent and startling results in that a few hundreds of rupees paid to one employee came to be considered unreasonable but not tens of thousands of rupees paid to another employee. He stated that there was no enquiry made as to whether the emoluments paid to any of these employees were unreasonable.

In our opinion, none of these arguments can avail the assessee company. to begin with, it was never the case of the assessee company that there was no evidence to support the findings of the Tribunal. In the thirteen questions proposed by the assessee company, none relates to the existence or even the quantum of the evidence. The assessee company was more interested in relying on the arguments and the regulations as embodying a provision that income-tax, super-tax and excess profits tax should to be deducted before applying the percentages, or, in the alternative, in showing that "profits" indicate the ordinary trading profits and not what is left over after payment of these taxes. Question No. 8 of these proposed questions does not involve any consideration whether the decision proceeded on evidence or material.

Further, the assessee company seems to have acquiesced in the modified questions because it did not seek special leave of this court at that stage. Even in the statement of the case filed here, there is no mentioned of the Tribunal having acted on no evidence. We are also of the opinion that there was evidence on which the tribunal could reach the conclusion that the payments were unreasonably high, having regard to the requirements of the business. The Excess Profits Tax Officer had prepared schedules showing the proportion of bonus or additional payments to the salary of these employees and also the proportion of the provident fund contributions to salary and had stated that in no other concern such extraordinarily high payments were beings made. The Tribunal also examined one of the employees of the assessee company who was present, and collected date in relation to some typical cases. All this material was before the Tribunal when it gave its finding.

The Schedules which are appended to the order of the Excess Profits Tax Officer's remand report speak volumes. The payments even in the lowest cases seem extraordinarily high, and cannot be justified as dictated by the requirements of the business. There was again the practice of other concerns similarly situated to make a comparative study. The Excess Profits Tax Officer on a view of the matter held that it was not reasonable to apply the percentage before deducting the taxes. The process of his reasoning was that looking to the fact above stated, the payments to the five employees and the contributions to the provident fund were unnecessarily large and also unreasonable, having regard to the requirements of the business, and he proceeded to prove them, not by taking up each individual case but by insisting that the percentage be applied only after all the taxes were paid by the assessee company. It was open to the Excess Profits Tax Officer to say that payment to an employee or contributions to the provide

In our view, the decision of the High court impugned here was correct. We were not invited to interpret the agreements and the regulations, if our conclusion on this part was against the assessee company, and we do not therefore proceed to do so. Even otherwise, we think it uncessary, in view of the fact that we consider that the action of the Excess Profits Tax officer was referable to the rule under which he acted.

The result is that the appeal fails and is dismissed with costs.

Appeal dismissed.

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