Commissioner of Income-Tax, Bombay North

Vs

Chandulal Keshavlal & Co.

Civil Appeal No. 167 of 1958

(S. K. Das, M. Hidayatullah, J. L. Kapur JJ)

17.02.1960

JUDGMENT

KAPUR, J. –

This is an appeal by special leave against the judgment and order of the High Court of Bombay. It arises out of a reference by the Income-tax Appellate Tribunal under section 66(1) of the Indian Income-tax Act (hereinafter termed the Act). The appellant in this appeal is the Commissioner of Income-tax and the respondent is a partnership firm which, by an agreement dated September 23, 1935, was appointed the managing agent of the Keshav Mills Ltd., Petlad. For the sake of convenience the respondent firm will, in this judgment, be termed the managing agent and the Keshav Mills Ltd., the managed company. By clause 4 of this agreement the managing agent was to get a commission of 4 per cent. On the sale proceeds of the cloth, earn or other goods manufactured and sold by the company and 15 per cent. On the amount of bills for charges of giving and pressing and dyeing or bleaching and on the amount of labour bills and other works done in the running of the factory. The commission was exclusive of other

> "The Tribunal has also held that if the managing agency commission or a part thereof is foregone in the interest of the managed company, it would be allowed as an expenditure under section 10(2)(xv) of the Act. We allow the amount foregone under section 10(2)(xv)."

Against this order, at to instance of the appellant, a case was stated to the Bombay High Court for its opinion on the following two questions :

> "(i) Whether on the facts and in the circumstances of the case, the sum of Rs. 2,09,114 was assessable in the hands of the assessee as its income.
>
> (ii) If the answer to question (i) is in the affirmative whether the said sum is an allowable deduction from the assessee's income under section 10(2)(xv) of the Act."

The judgment of the High Court shows that it was inclined to decide the questions in favor of the appellant, but at the instance of the managing agent the Appellate Tribunal was directed to submit supplementary statement.

No fresh evidence was led before the Tribunal but it appears that some emphasis was laid on a letter of the managing agent dated September 18, 1951, sent to the Income-tax Officer. In this letter the managing agent had stated that the only commission which accrued to it was a sum of Rs. 1,00,000

and nothing had been foregone from out of the commission or relinquished. It is also stated that the amount of Rs. 1,00,000 accrued because of the variation of the terms of the managing agency agreement. Reference was also made in the letter to the balance-sheet of the managed company ending December 31, 1950, showing that the paid up capital was rupees 30 lakhs, depreciation fund rupees 14 lakhs, totaling rupees 44 lakhs. As against this sum the block account showed a debit of over rupees 48 lakhs and it was with the object of strengthening the financial position of the managed company and in its interest that the chairman of the board of directors had requested and the managing agent had agreed to accept rupees 1 l

> "It was assumed that what was in the interest of the managed company was in the interest of the managing agent. The interests of the managing agent and the managed company are, so to say, linked up. If the managed company is put on a sounder position, not only the shareholders of the managed company benefit, but also the managing agent, inasmuch as the managing agent would get a larger commission in future."

The basic facts which arise out of the statement of the case and documents which were produced by the managing agent are : (1) the rather unsatisfactory financial position of the managed company as shown by the balance-sheet; (2) in the past also the managing agent had been remitting a part or whole of the commission whenever the profits of the managed company were unsatisfactory; (3) in the per of account the profits of the managed company as per profit and loss account were Rs. 5,72,192. This was after paying to the managing agent commission of Rs. 1,00,000 and if the whole of the accrued commission had been deducted then the profits would have been Rs. 3,63,078 which would be the lowest amount since 1940 and the amount of commission would have been the highest; (4) it was not a bounty by the managing agent to the managed company; (5) the business of the managing agent was so linked up with the managed company that if the latter was put on a sounder position the managing agent would also get a larger commi

> "Now this is a finding of fact and unless it can be suggested that there was no evidence to support the finding of fact we are concluded by this finding of fact."

Therefore the question in regard to section 10(2)(xv) was answered in favour of the managing agent. It is against this judgment and order that the appellant has come in appeal to this court by special leave.

For the appellant it was argued that there was no evidence in support of the finding that the amount of about rupees 2 lakhs which was foregone by the managing agent was wholly and exclusively laid out for the purpose of the managing agent's business and emphasis was laid on the finding of the Appellate Tribunal in its order dated February 26, 1953, that in the past the commission had been given up by the managing agent in the interest of the managed company and that if the managing agent's commission or part thereof was foregone in the interest of the managed company it was not an allowable expenditure under section 10(2)(xv). It was also argued that there was no evidence in support of the finding that the amount was expended for the benefit of the managing agent and that even if as a result of the amount being foregone the managing agent was helped because it benefited the managed company, then section 10(2)(xv) would not be attracted; in other words the question had to be looked at from the point of view

In his argument the learned Solicitor-General referred to the following cases :

> Tata Sons Ltd. v. Commissioner of Income-tax. There the assessee was the managing agent of another company and was entitled to receive commission on the net profits of the managed company. During the relevant per the assessee voluntarily paid a sum of money towards the bonus which the managed company paid to some of its officers and claimed it is as a deductible expenditure under section 10(2)(xv) of the Act. This deduction was allowed on the ground that the object of the payment from the point of view of commercial principles was to increase the profits of the managed company and thereby the commission of the managing agent. It was argued there also that the payment was entirely gratuitous but that connection was repelled, because the object of the payment from the point of view of commercial principles was to increase the efficiency of the managed company and thereby to increase the profits of the managed company and the commission of the managing agent. And thus there was an important nexus between the ma

The second case was Union Cold Storage Company Limited v. Jones. There a British company transferred its foreign cold storage business carried on by it directly or thorough subsidiary companies to an American company for a term of years in consideration of certain annual payments to the subsidiary companies and of a guarantee of any sum necessary to meet its fixed charges and maintain its dividends. The property remained the property of the British company but it was placed under the sole control of and was used by the American company and no rent was payable but the American company was to keep it in proper repair and working order. The British company paid fire insurance premiums in respect of the premises machinery etc., and claimed deductions for the sums so paid out of its profits and for wear and tear of the machinery and plaint of the transferred business. It was held that the insurance premiums did not represent money wholly and exclusively laid out for the purpose of trade of the assessee company as

The learned Solicitor-General relied upon a passage in the judgment at page 741 :

> "they the commissioner find that there was a relax result of this agreement which incurred to the benefit to the appellant company but I think in term they indicate that result was not a direct result a but a reflex result. In their reasons in which they come to their conclusion that they say the arrangements with regard to the stores and machinery and plaint were not of an ordinary nature and they did not extend the appellant company market. They also say that the machinery and plant in question is used primarily for the purpose of the trade of the National Company. With those finding before us I think it is quite clear as a matter of fact that the facts so found differentiate this case wholly from the Usher case."

From this it was sought to be argued that what one is the took at the is the direct results to the assessee and not remoter or indirect results. What the court found in that case was that insurance presumes were paid by the British company as owner and not in the course of business and that the assets were used not for its business but for the business of another. The real test laid down after reference to Usher's Wiltshire Brewery Limited v. Bruce was the deduction may be allowed in cases where the payment or expenditure is incurred for the purposes of the trade of the subject making the return and it does not matter this that this payment may insure to the benefit of a third party.

Another case relied on was Easter Investments Ltd. v. Commissioner of Income-tax, where a private limited company had a share capital of rupees 250 lakhs of which shares of the value of Rs. 50 lakhs were held by A and the remaining by his nominees. The company was in need of money and with

the consent of A it resolves to reduce the share capital by rupees 50 lakhs by the company taking over rupees 5 lakhs worth of shares and issuing to a debentures of the face value of rupees 50 lakhs carrying interest at 5 per cent. The Income-tax Appellate Tribunal and the High court held that the interest on the debentures was not an allowable under the sections 12(2) of the Act. This court on appeal was of the opinions that the transactions was of a commercial nature from the point of view of the assessee company and on a review of all the facts it came to the conclusion that the transactions was a of a commercial natures from the point of view of the assessee company and on a review of all the facts it came to the concl edient then it does not become a deductible allowance. If as a result of the transactions the assessee benefit it is immaterial that a third party also benefits thereby. At page 5 Bose, J., observed :

> "In the absence of a suggestion of fraud this is not relevant at all for giving effect to the provisions of section 12(2) of the Income-tax Act. Most commercial transactions are entered into for the mutual benefit of both sides, or at any rate each side hopes to gain something for itself. The test for present purposes is not whether the other party benefited, nor indeed whether this was a prudent transactions which resulted in ultimate gain to the appellant, but whether it as properly entered into as a part of the appellant legitimate commercial undertaking in order indirectly to facilitate the carrying on the business."

In Odhams Press Ltd. v. Cook the assessee company had acquired all the shares in a subsidiary company and printed and published a periodical for the subsidiary company. The subsidiary company made a loss during the accounting year and the assessee company wrote off that amount of loss from the amounts due to it from the subsidiary company and claimed a deductions of that loss from its profits on trading accounts or as money laid out or expended for the purpose of its trade. The Special Commissioner front that the sum was not written off wholly or exclusively for the purpose of their trade or business and therefore it was an inadmissible deduction. This question was held to be of fact and that there was evidence to justify that conclusion. Viscount Caldecote, L.C., said that the trade or business of another was not the same thing a s that other trade or business. In computing the profit and gains of the assessee, it is his trade that is to be regarded. At page 110 Viscount Maugham observed :

> "My Lords the question thus put answered itself. There were, beyond dispute, the two relationship between the company and the Coming Fashions Ltd., already referred to. The allowance of the pounds 2,927 5s.8d. to Coming Fashions Ltd., might have been 'laid out or expended for the purpose of the trade' of the company or for the purpose of the trade of Coming Fashions Ltd., or to some extend for both purposes and it is plaint that these facts alone were sufficient to show that there was evidence to justify the conclusion of the Commissioner that the sum written of was not written off wholly and exclusively for the purpose of the trade or business of the appellants."

The connections between the assessee company and the subsidiary company, apart from the holding of shares, was that the assessee company did printing for the subsidiary company. The effect of the transactions was debiting of another entity loss to the assessee company but there was no direct connection between the profit of the assessee company with the amounts was not wholly and exclusively written off for the purpose of the assessee company. Viscount Maugham said :

> "Is there any real ground for contending on the incidence that one reason for writing off the sum was not enable to Coming Fashions Ltd., to continue to carry on its

business as compiler and vendor of 'Every woman's' ?"

The cases we have discussed a over show that it is question of fact in each case whether the amount which is claimed as a deductible allowance under section 10(2)(xv) of the Income-tax Act was laid out wholly and exclusively for the purpose of the such business and if the act finding tribunal comes to the conclusion of evidence which would justify that conclusion it being for them to find the evidence and to give the such question is for the Income-tax Appellate Tribunal and the decision must be sustained if there is evidence upon which the Tribunal could have arrived at such a conclusion.

Another fact that emerges from these cases is that if the expense is incurred for fostering the business of another only or was made by way of distribution of profit or was wholly gratuitous or for some improper or oblique purpose outside the course of business then the expenses is not. In deciding whether a payment of money is deductible expenditure one has to make take into consideration question of commercial expediency and the principles of ordinary commercial trading. If the payment r expenditure is incurred for the purpose of trade of the assessee it does not matter that the payment may insure to the benefit of a third party (Usher Wiltshire Brewery Limited v. Bruce). Another test is whether the transactions is properly entered into as a part of the assessee legitimate commercial undertaking in order to facilitate the carrying on of its business; and it is not immaterial that a third party also benefits thereby (Eastern Investments Ltd. v. Commissioner of Income-tax). But in every case it is a question

> "It was made clear in the above cited cases of Ushers Wiltshire Brewery v. Bruce and Smith v. Incorporated Council of Law Reporting that a sum of money expended not of necessary and with view to a direct and immediate benefit to the trade, but voluntarily and on the ground of commercial expendiency and on order indirectly to facilitate the carrying on of the business may yet be expended wholly and exclusively for the purpose of the trade; and it appears to me that the findings of the Commissioners in the present case in bring the payment in the question within that description. They found (in words which I have already quoted) that the payments was made for the purpose of enabling the company to retain the series of existing and future members of their staff and of increasing the efficiency of the staff; and after referring to the contention of the Crown that the sum of pounds 31,784 was not money wholly and exclusively laid out for the purposes of the trade under the rule above referred to, they found that

Thus in case like the present one in order to justify deduction the sum must be given up for the reason of commercial expediency; it may be voluntary, but so long as it is incurred for the assessee benefit the deductions would be climbable.

The Income-tax Appellate Tribunal has found in favour of the managing agent that the amount was expended for reason of commercial expediency, it was not given as bounty but to strengthen the managed company and if the financial position of the managed company became strong the managing agent would benefit thereby. That finding is one of fact. On that findings the Income-tax Appellate Tribunal rightly came to the conclusions that it was a deductible expense under section 10(2)(xv).

In our opinion the judgment of the High Court was right and we would dismiss this appeal with costs.

Appeal dismissed.

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