Nandlal Bhandari Mills Ltd.

Vs

State of Madhya Bharat (now Madhya Pradesh)

Civil Appeals Nos. 344-346 of 1960

(S. K. Das, M. Hidayatullah, J. C. Shah JJ)

17.07.1961

JUDGMENT

HIDAYATULLAH J. –

These three consolidated appeals by special leave are against a common judgment and order of the High Court of Madhya Pradesh, dated September 8, 1958, in three second appeals filed under rule 13 of the Indore Industrial Tax Rules, 1927, of the former Holkar State, which were in force before the State became Part of Madhya Bharat State. They concern three assessments relating to the assessment years 1941, 1942 and 1943, respectively. These second appeals were originally filed in the Madhya Bharat High Court as early as 1952; but the records of the appeals were destroyed by fire and had to be reconstructed. By the time the appeals were ready, Madhya Bharat had merged in the new State of Madhya Pradesh, and the appeals were accordingly heard by a Divisional bench of that High Court.

The appellant is a textile mill and a public joint stock company called the Nandlal Bhandari and Sons, as agents, secretaries and treasures of the mills, and under clause (6) of the agreement of agency, it agreed to pay to the agents an office allowance, commission on the company's net profits and commission on the sale proceeds of sales of yarn, cloth, etc. The remuneration of the agents for the three accounting years was as follows :

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Remuneration As per agree-

Accounting Years ment. --------------------------------

1941 1942 1943 Rs. Rs. Rs.--

Clause 6 Rs. 1500 18,000 18,000 18,000 p.m. for the for the year. year.(a) Fixed monthlyallowance as officeallowance(b) Commission on @ 16% net 2,68,335 6,15,946 10,52,939the company's net on profitsprofits(c) Commission onthe sale proceeds @ 1-9-0 1,10,156 1,64,751 2,71,672of sales of yarn per cent.cloth etc. on sales--##

In computing the tax, the mills claimed to deduct under rule 3(2)(ix) of the Rules the above amounts paid as remuneration. The rule reads :

"(ix) any expenditure (not being in the nature of capital) incurred solely for the

> purposes of earning such profits or gains."

The assessing officer accepted the appellant's claim for deduction but only as to a part. We are not required in these appeals to consider the correctness of the quantum of the deduction in view of what transpired later. The assessing officer also disallowed certain other claims made by the appellant, which again need not be mentioned. The appellant then appealed to the appellate authority, and on December 31, 1951, the appellate authority, while accepting some of the appellant's other contentions, upheld the order refusing to deduct the agents' commission on profits under rule 3(2)(ix). Three second appeals were preferred in the Madhya Bharat High Court under rule 13 of the amended Rules. They were dismissed by the High Court of Madhya Pradesh, and hence the present appeals.

The Indore Industrial Tax Rules were first promulgated in 1926 by Cabinet Resolution (No. 373 dated March 22, 1926). In 1927, by Cabinet Resolution No. 1991 dated November 23, 1927, the Rules were modified, and the new Rules were made applicable retrospectively form May 1, 1926. These Rules were framed for the levy of the tax and for ascertainment and determination of the income of cotton mills. The tax called the "industrial tax" was leviable under rule 3, which imposed the charge. It says that the industrial tax shall be payable by an assessee in respect of the profits or gains of any cotton mills industry carried on by him in the Holkar State. Sub-rule (2) of rule 3 provides that such profits or gains are to be computed after making allowances, inter alia, for any expenditure incurred solely for the purpose of earning such profits or gains. Rule 6, which is a part of the rule imposing a charge, lays down the rates which are : (a) on all incomes up to Rs. 50,000, at 1 1/2 annas per rupee, and (b) above, at

It is necessary at this stage to see the legislative machinery existing in the Holkar State in 1927 and onwards. On February 27, 1926, His Highness Maharaja Tukoji Rao III abdicated, and his son, H. H. Maharaja Yeshwant Rao Holkar, became the Ruler, whose installation ceremony was performed on March 11, 1926. A Regency Council was appointed under the orders of the Government of the India for the administration of the State during the minority of the Maharaja. This Regency Council, which was called the Cabinet, was entrusted with the administration of the State according to existing rules and practice, under the supervision and with the advice of the Agent to the Governor-General in Central India. The Prime Minister of the State was the Chairman. H. H. Maharaja Yeshwant Rao Holkar attained majority on September 6, 1929, and resumed sovereign powers on May 9, 1930. It was during the minority of the Ruler that the Cabinet had promulgated the amended Rules of 1927. In 1931, the decision of the Privy Council in t

> "A payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits. It assumes that profits have first come into existence. But profits on their coming into existence attract tax at that point and the revenue is not concerned with the subsequent application of the profits."

It seems that, as a result of this decision, a notification was issued in August, 1931, and another on February 2/3, 1932, by the Commerce and Industry Department of the Holkar State. The latter notification reads as follows :

> "Commerce and Industry Department Notification. Notification No. 1 dated the 2nd/3rd February, 1932. In continuation of this office Notification No. 4733 dated the December 6, 1927 (vide issue No. II dated the December 12, 1927, of the Holkar

> Sirkar Gazette) embodying modified rules for the levy of the industrial tax the Cabinet in their Resolution No. 1072 dated the August 25, 1931, have ordered that the agents' commission on 'profits' should not be allowed to be deducted from the assessable profits."

It is to be noticed that this notification refers to the earlier Notification No. 4733 of December 6, 1927, under which were published the amended Industrial Tax Rules, 1927, and to the notification of August, 1931. The latter has not been produced before us.

This notification led to representations by the persons affected by it. The Maharaja of Holkar thereupon referred the matter for the opinion of the Full Bench of the High Court of the State. It appears that the opinion of the High Court was in favour of disallowing such deductions. On July 14, 1933, another notification (No. 13) was issued, which read as follows :

> "In continuation of this office Notification No. I dated February 3, 1932, it is hereby published for the information of the mills and factories concerned that on submission of the Prime Minister's (Legal Department) report No. 25 dated May 11, 1933, His Highness the Maharaja is pleased to order (vide Huzur Shri Shankar Order No. 173 dated June 29, 1933) that the opinion of the Full Bench of the High Court being that the managing agent's commission on profits is not an item of expenditure incurred solely for the purpose of earning the said profit within the meaning of rule 3(2)(ix) of the said Industrial Tax Rules and this being also the view of the Cabinet as expressed in their resolution No. 1072 dated August 28, 1931, the aforesaid Cabinet Resolution be given effect to and the industrial tax due on the amount of the managing agent's commission on profits be recovered with effect from the date of the said Cabinet Resolution."

The notification, it is contended before this court, had not the force of law and was not enforceable against the appellants, who claim that they are entitled to show that the remuneration paid to the agents was deductible from, the profits of the mills before computing the industrial tax. In this connection, the appellants wish to use the later decision of the House of Lords in Union Cold Storage Co. Ltd. v. Adamson and of the Privy Council in Indian Radio and Cable Communications Co. Ltd. v. Commissioner of Income-tax, in which the decision in the Pondicherry Railway Company case was explained. In the case before the Privy Council, Lord Maugham observed :

> "It is not universally true to say that a payment the making of which is conditional on profits being earned cannot properly be described as an expenditure incurred for the purpose of earning such profits. The typical exception is that of a payment to a director or a manager of a commission on the profits of a company... If a company having made an managers as the contractual recompense for their service during the year, it is plain that the real net profit is only Pounds 9,000."

Lord Macmillan in the former case observed that the Pondicherry Railway Company case 3 must be read in the context of the facts of that case, and there, the obligation was first to find out the net profits of the company and then to divide them. These two sets of cases proceed upon different principles. If the agreement is to share the profits, the expenditure cannot properly be treated as one incurred solely for the purpose as remuneration to help in the earning of the profits, the deduction can be claimed.

All this would of curse be pertinent to consider, if there was no legislative enactment on the subject. If the matter was not one concluded by law, then there would be room for judicial interpretation of the rule. The rival claims in these appeals are thus confined to the legislative force of the notifications issued in 1931, 1932 and 1933 respectively. The appellant's contention is that the notifications were not an act of legislation but an interpretation by the sovereign. Mr. Desai concedes that if they be regarded as legislation, then the later decisions of the Privy Council and some of this court cannot be called in aid, because where the law itself speaks with clarity, judicial interpretation is out of place. He contends, however, that the two notifications were not framed as rules and were not expressly stated to be amendments of the rules then existing. He points out that after the first notification which was nothing more than an administrative direction to the assessing officers to include in the p

This view was taken by the Full Bench of the Madhya Bharat High Court in Rajkumar Mills Ltd. v. Madhya Bharat State. The question which is involved in these appeals also arose in that case. It was observed by the Full Bench :

> "This Notification makes it abundantly clear that His Highness the Maharaja ordered that the industrial tax due on the amount of the managing agent's commission on profits be recovered. This being an order of the Ruler, who enjoyed sovereign powers, that order is not open to challenge. This is a mandate emanating from a sovereign and as such has the force of law. This court has, therefore, no power to go behind the order and enquire as to whether the managing agent's commission on profits is an item of expenditure solely incurred for the purpose of earning profits or not. In this view of the matter the point at issue is concluded by Huzur Shri Shanker Order No. 173 dated June 29, 1933."

This view was affirmed by the High Court of Madhya Pradesh in the judgment under appeal.

In our judgment, the two notifications cannot be described as "judicial interpretation". If anything, they must be interpreted as legislative exposition of rule 3(2)(ix) and in the nature of an explanation. This court in Ameer-un-nissa Begum v. Mahboob Begum, in dealing with the Firmans of His Exalted Highness the Nizam of Hyderabad, observed as follows :

> "It cannot be disputed that prior to the integration of Hyderabad State with the Indian Union and the coming into force of the Indian Constitution, the Nizam of Hyderabad enjoyed uncontrolled sovereign powers. He was the supreme legislature, the supreme judiciary and the supreme head of the executive, and there were no constitutional limitations upon his authority to act in any of these capacities. The Firmans were expressions of the sovereign will of the Nizam and they were blinding in the same way as any other law; - nay, they would override all other laws which were in conflict with them. So long as a particular Firman held the field, that alone would govern or regulate the rights of the parties concerned, though it could be annulled or modified by a later Firman at any time that the Nizam willed."

The same can be said of the Ruler of the Holkar State. When to the order of the Ruler was added the usual mode of making and promulgating rules, the position which emerges is really unassailable.

Mr. Desai, in attempting to show that the ruling does not apply to the case raised two contentions. The first was based upon a more recent decision of this court in Madhaorao v. State of Madhya

Bharat, where certain Kalambandis of the Maharaja of Gwalior were existing law under article 372 of the Constitution, observed :

> "In dealing with the question as to whether the orders issued by such an absolute monarch amount to a law or regulation having the force of law, or whether they constitute merely administrative orders, it is important to bear in mind that the distinction between executive orders and legislative commands is likely to be merely academic where the Ruler is the source of all power. There was no constitutional limitation upon the authority of the Ruler to act in any capacity he liked; he would be the supreme legislature, the supreme judiciary and the supreme head of the executive, and all his orders, however issued, would have the force of law and would govern and regulate the affairs of the State including the rights of its citizens."

It was, however, pointed out in the case that even where an order is issued by the sovereign Ruler, one must look to the character of the order and its content to find out whether it enacted a binding rule. Mr. Desai has constructed his entire argument on the basis of these observations, and has contended that the orders only expressed an opinion and did not bind. He pointed out as the second limb of his argument that these notifications were not expressed as a rule but as an order, and that they did not seek to amend the rules, not to add to them. He referred to other notifications in which a legislative act was clearly discernible, as for example, Notification No. 22/Com., dated May 17, 1946, by which for the existing rule 4, a new rule was substituted. An examination of the Rules, however, shows that there was no set pattern of language. Some of the rules do not read like rules at all. Notes have been appended to the rules, which are not proper, and rule 29 says :

> "All matters not dealt with in these rules may be submitted to the Member-in-Charge, Commerce and Industry Department, for decision."

The existence of such a rule seems to obliterate the frontiers between legislative, judicial and executive exercise of the power of a State, such as we understand it. There being no invariable use of a clear-cut legislative language, each general order emanating from the sovereign Ruler and promulgated in the same manner as any other rule and having its roots in a resolution of the Cabinet must be regarded as one binding upon the subject. This is the purport of the decisions of this court, and the present case falls in line with those which have been previously decided. There is nothing in the content, the character or the nature of these notifications, which would put them on a level lower than the Rules, which had been earlier promulgated.

In our opinion, the judgment of the High Court under appeal is correct, and the appeals are accordingly dismissed with costs, one set.

Appeals dismissed.

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