Commissioner of Income-Tax, Madhya Pradesh, Nagpur and Bhandara

Vs

Swadeshi Cotton and Flour Mills Private Ltd

Civil Appeal No. 587 of 1963

(S. M. Sikri, K. Subha Rao, J. C. Shah JJ)

17.04.1964

JUDGMENT

SIKRI J. -

The respondent, Swadeshi Cotton and Flour Mills, hereinafter referred to as the assessee, is a limited company which owns and runs a textile mill at Indore. For the assessment year 1950- 51 (accounting year calendar year 1949), which was its first year of assessment under the Indian Income-tax Act, 1922 (hereinafter referred to as the Act), it claimed that under section 10(2)(x) of the Act it was entitled to an allowance in respect of the sum of Rs. 1,08,325 which it had paid as bonus for the year 1947 in the calendar year 1949, as a result of the award of the Industrial Tribunal, dated January 13, 1949. The claim of the assessee was not accepted by the income-tax authorities. The Appellate Tribunal held that it was a liability relating to an earlier year and not the year 1949. However, on an application by the assessee it stated a case and referred two questions. We are concerned only with the one which reads thus :

> "Whether on the facts and in the circumstances of the case the assessee is entitled to claim a deduction of bonus of Rs. 1,08,325 relating to the calendar year 1947 in the assessment year 1950-51 ?"

The High Court of Madhya Pradesh answered the question in the affirmative. The appellant, having failed to get a certificate under section 66A(2) of the Act, obtained special leave from this court, and that is how the appeal is before us.

The facts and circumstance referred to in the question have been set out in the statement of the case. Unfortunately, the facts are meagre, but since the appellant is content to base his case on a few facts, which will be referred to shortly, it is not necessary to call for a further statement of the case.

The facts, in brief, are as follows : The assessee paid as bonus to its employees the sum of Rs. 1,08,325-9-3 for the calendar year 1947 in terms of an award made on January 13, 1949, under the Industrial Disputes Act. This amount was debited by the assessee in its profit and loss account for the year 1948 and the corresponding credit was given to the bonus payable account. The books for 1948 had not been closed till the date of order of the Industrial Tribunal, January 1949. This bonus was in fact paid to the employees in the calendar year 1949, the relevant assessment year being 1950-51.

The Appellate Assistant Commissioner had further found that "up to 1946 when the order for payment of bonus used to be received before the company's accounts for the year were finalised, the

amount of bonus used to be in fact debited to the profit and loss account of the respective year." This finding is repeated by the Appellate Tribunal in its appellate order.

On these facts the learned counsel for the appellant, Mr. Sastri, contends that according to the mercantile system of accounting, which is followed by the assessee, and on which its profits have been computed for the accounting calendar year 1949, the year to which the liability is property attributable is the calendar year 1947 and not 1949. He says that it was a legal liability of the assessee which arose in 1947 and should have been estimated and put into the accounts for 1947. In the alternative he has invited us to reopen the accounts for the year 1947, following the practice which, according to him, obtains in England.

In our opinion the answer to the question must depend on the proper interpretation of section 10(2)(x), read with section 10(5), of the Act. These provisions read as follows :

> Section 10(2)(x) : "Any sum paid to an employees 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 :
>
> Provided that the amount of the bonus or commission is of a reasonable amount with reference to -
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> (a) the pay of the employee and the conditions of his service;
>
> (b) the profits of the business, profession or vocation for the year in question; and
>
> (c) the general practice in similar businesses, professions or vocations."
>
> Section 10(5) : "In sub-section (2), 'paid' means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section. . . ."

If we insert the definition of the word "paid" in sub-clause (x) it would read as follows :

> "any sum actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section, to an employees as bonus. . . . ."

As the assessee's profits and gains have been computed according to the mercantile system, the question, using for the time being the terms of the clauses, comes to this :

> "Has this sum of Rs. 1,08,325 been incurred by the assessee according to he mercantile system in the calendar year 1947 or 1949 ?" At first sight the sentence does not read well, but the meaning of the word "incur" includes "to become liable to". Therefore, the question boils down to :
>
> "In what year did the liability of this sum of Rs. 1,08,325 arise according to the mercantile system ?"

The mercantile system of accounting was explained in a judgment of this court in Keshav Mills Ltd. v. Commissioner of Income-tax thus :

> "That system brings into credit what is due, immediately it becomes legally due and before it is actually received, and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed."

These observations were quoted with approval in Calcutta Co. Ltd. v. Commissioner of Income-tax.

On the facts of this case, then when did the legal liability arise in respect of the bonus ? This depends on the facts of the case and the nature of the bonus awarded in this case. This court has examined the nature of profit bonus - It is common ground that the bonus with which we are concerned with was a profit bonus - in various cases. It is explained in Muir Mills Co. v. Suti Mills Mazdoor Union that "there are two conditions which have to be satisfied before a demand for bus can be justified and they are : (1) when wages fall short of the living standard, and (2) the industry makes huge profits part of which are due to the contribution which the workmen make in increasing production. The demand for bonus becomes an industrial claim when either or both these conditions are satisfied."

This mater was again considered in the case of Associated Cement Cos. v. Their Workmen. This court observed :

> "It is relevant to add that in dealing with the concept of bonus this court ruled that bonus is neither a gratuitous payment made by the employer to his workmen nor can it be regarded as a deferred wage. According to this decision, where wages fall short of the living standard and the industry makes profit part of which is due to the contribution of labour, a claim for bonus can be legitimately made."

In 1961, this court was able to say that "the right to claim bonus which has been universally recognised by industrial adjudication in cases of employment falling under the said Act has now attained the status of a legal right. Bonus can be claimed as a matter of right provided of course by the application of the Full Bench Formula it is shown that for the relevant year the employer has sufficient available surplus in hand" (vide Gajendragadkar J., as he then was, in Workmen v. Hercules Insurance Co.).

In Indian Tea Association v. Workmen this court held that "the profit bonus can be awarded only by reference to a relevant year and a claim for such bonus has therefore to be made from year to year and has to be settled either amicably between the parties or if a reference is made, it has to be determined by industrial adjudication. A general claim for the introduction of profit bonus cannot be made or entertained in the form in which it has been done in the present proceedings".

It follows from the above decisions of this court that :

> (a) workmen are entitled to make a claim to profit bonus if certain conditions are satisfied;
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> (b) the workmen have to make a claim from year to year;
>
> (c) this claim has either to be settled amicably or by industrial adjudication; and
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> (d) if there is a loss or if no claim is made, no bonus will be permissible.

In our opinion, it is only when the claim to profit bonus, if made, is settled amicably or by industrial

adjudication that a liability is incurred by the employer, who follows the mercantile system of accounting, within section 10(2)(x), read with section 10(5) of the Act.

On the facts of this case, it is clear that it was only in 1949 that the claim to profit bonus was settled by an award of the industrial tribunal. Therefore, the only year the liability can be properly attributed to is 1949, and hence we are of the opinion that the High Court was right in answering the question in favour of the assessee.

The second contention of the learned counsel does not appeal to us. We are of the opinion that this system of reopening accounts does not fit in with scheme of the Indian Income-tax Act. We have already held in Commissioner of Income-tax v. Gajapathy Naidu that, as far as receipts are concerned, there can be no reopening of accounts. The same would be the position in respect of expenses. But even in England accounts are not opened in every case. Halsbury gives various instances in foot-note (m) at page 148, Vol. 20. Mr. Sastri has relied on various English cases but it is unnecessary to refer to them as Lord Radcliffe explains the position in England, in Southern Railway of Peru Ltd. v. Owen, thus :

> "The courts have not found it impossible hitherto to make considerable adjustments in the actual fall of receipts or payments in order to arrive at a truer statement of the profits of a successive years. After all, that is why income and expenditure accounting is preferred to cash accounting for this purpose. As I understand the matter, the principle that justified the attribution of something that was, in fact, received in one year to the profits of an earlier year, as in such cases as Isaac Holden and Sons v. Inland Revenue Commissioners and Newcastle Breweries Ltd. v. Inland Revenue Commissioners was just this, that the payment had been earned by services given in the earlier years and, therefore, a true statement of profit required that the year which had borne the burden of the cost should have appropriated to it the benefit of the receipt."

The principle mentioned by Lord Radcliffe would not apply to a profit bonus. As stated above, a profit bonus is strictly not wages, at least not for the purpose of computing liability to income-tax; it is not an expense, in the ordinary sense of the term, incurred for the purpose of earning profits. A fortiori profits have already been made. It is more like sharing of profits on the basis of a certain formula.

One other point raised by Mr. Sastri remains. He urged that the words "for the year in question" in the proviso to sub-section 10(2)(x) mean "for the year in which allowance is claimed". We are unable to agree with him.

The words "for the year in question" mean the year in respect of which bonus is paid.

In the result, the appeal fails and is dismissed with costs.

Appeal dismissed.

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