SUREME COURT OF INDIA

Commissioner of Income-Tax, Bombay City I

Vs.

Greaves Cotton And Co. Ltd.

(J Shah, S Sikri and V Ramaswami JJ.)

04.05.1967

JUDGMENT

RAMASWAMI, J.

1. This appeal is brought, by special leave, on behalf of the Commissioner of Income-tax, Bombay, from the judgment of the Bombay High Court dated July 11/12, 1962, in Income-tax Reference No. 52 of 1960.

2. The respondent-company was incorporated as a private limited company in the year 1922. A partnership firm called "M/s. Greaves Cotton & Co. " was appointed as the managing agents of the respondent-company. The said partnership firm continued to be the managing agents from April 1, 1922, to January 7, 1947. From January 8, 1947, a company called M/s. Karamchand Thapar & Brothers Ltd. (hereinafter referred to as the "managing agents") was appointed managing agents of the respondent- company. The managing agents had paid to M/s. Greaves Cotton & Co. a sum of Rs. 27,34,325 for securing the managing agency rights of the respondent company. It appears that the managing agents also paid a sum of Rs. 50 lakhs as purchase price of all the shares held by Messrs. Greaves Cotton & Co. in the respondent-company. The result was that all the shares of the assessee company came to be held by the managing agents. The entire arrangement was completed on January 8, 1947. A fresh managing agency agreement was executed on the same day by the repondent-company in favour of the managing agents. The duration of the agreement was fixed under clause 1 to be period of 20 years. Under clause 2 of the agreement the remuneration of the managing agents was fixed at 2 1/2% on the value of all goods shipped to India by Messrs James Greaves & Co. of Manchester to and for or on behalf of the respondent-company or its constituents. The mode of calculating the commission was also provided in the agreement. The respondent-company made an application on October 19, 1949, to the Controller of Capital Issues, Ministry of Finance, Government of India, for permission to increase it share capital. It was prayed that sanction should be accorded for the issue of 25,000 five per cent. cumulative preference shares of Rs. 100 each and 30,000 ordinary shares of Rs. 100 each. Sanction was accorded by the Controller of Capital Issues on April 25, 1950. The respondent-company then converted itself from a private limited company to a public limited company on May 8, 1950. Two days later, i.e., on May 10, 1950, a fresh managing agency agreement was arrived at between the respondent-company and the managing agents for a period of 20 years. Under this agreement the remuneration of the managing agents was fixed in the following manner :

"(a) A sum at the rate of Rupees five thousand per months as office allowance payable on the last

day of each month for and in connection with the general supervision of the business of the company and the maintenance and upkeep of the managing agents' office in Calcutta including the payment of the rent of the managing agents' office premises in Calcutta.

(b) A commission of ten per cent of the net profits of the assessee company was agreed to be paid to the managing agents."

3. Some time between May 8, 1950, and February 28, 1951, H. E. H. the Nizam of Hyderabad purchased shares worth Rs. 50 lakhs and the said amount had been received by the respondent-company. Out of the said amount of Rs. 50 lakhs about Rs. 33 lakhs had been utilised by the respondent-company and about 17 lakhs in cash remained in the hand of the respondent-company.

4. A meeting of the board of directors of the respondent-company was held on February 28, 1951, and the question of cancellation of the managing agency agreement dated May 10, 1950, was considered at that meeting. It was resolved that a sub-committee consisting of Messrs. T. Komp, J. Blezard and N. M. Wagle be appointed and instructed to submit a report with their recommendations to the board of directors for submission to the members. It appears that in the agenda mentioned in the notice issued for calling that board meeting, there was on item relating to consideration of the question of the cancellation of the managing agency agreement, but the subject appears to have have been taken up for consideration under the residuary item "any other subject with the permission of the chairman". It should be mentioned that the aforesaid three members of the committee were executive directors of the respondent-company. The sub committee submitted its report to the board of directors on March 16, 1951. In this report, the sub committee suggested that a sum of Rs. 18,87,620 should be paid to the managing agents for premature termination of the agreement. The sub-committee also considered that the amount of compensation could not be paid out of Rs. 17 lakhs in the hands of the company unless sanction therefore was obtained from the Controller of Capital Issues. The committee therefore, suggested that compensation must be made from the free profits of the company accruing subsequent to the date on which the application was made to the Controller of Capital Issues. In the report it was also said that in the event the managing agency agreement was terminated, provision will have to made in the articles of association of the company for remuneration in the form of commission payable to the companys non-working directors. The board of directors at their meeting held on March 17, 1951, considered the report of the sub-committee and it was decided that compensation should be made in three equal instalments on April 15, 1951, April 15, 1952, and April 15, 1953. An extraordinary general meeting of the members of the respondent-company was convened on March 31, 1951, for the purpose of considering and passing the following resolutions as extraordinary resolutions :

"(1) That in the interest of the company the managing agents, Messrs. Karam Chand Thapar and Brothers Limited, be removed from their officer as such and that notice be given to them determinating the managing agency agreement dated 10th May, 1950, whereby they were appointed managing agents of the company for a period of 20 years from 8th May, 1950, with effect from 31st March, 1951.

(2) That the managing agents, Messrs. Karamchand Thapar & Bros. Ltd., be offered as compensation for loss of officer as such sum of Rs. 18,00,000 payable by instalments of Rs. 6,00,000 on 15th April, 1951, Rs. 6,00,000 on 15th April, 1952, and Rs. 6,00,000 on 15th April, 1953."

5. The extraordinary general meeting adopted the aforesaid two resolutions. By its letter dated April 3, 1951, the respondent-company informed the managing agents about the two resolutions passed at the extraordinary general meeting of the shareholders. By its letter dated April 10, 1951, Mr. Karam Chand Thapar on behalf of the managing agents accepted the termination of the managing agency on payment of compensation of Rs. 18 lakhs. The respondent-company, which adopted the mercantile system of accounting, thereafter appropriated in its books of account the said amount of Rs. 18 lakhs as compensation payable to the manging agents for termination of the managing agency agreement. In the accounting year ended March 31, 1952, the respondent-company claimed deduction of the amount of Rs. 18 lakhs in computation of its profits as expenditure laid out wholly and exclusively for the purpose of its business under section 10(2)(xv) of the Indian Income-tax Act, 1922. The Income-tax Officer rejected the claim of the respondent-company and observed as follows :

"The facts of the case appear to show that the termination of the managing agency and the consequent payment of compensation was not done on strictly business considerations. . . It appears to me that the termination of the managing agency was effected in order to give Messrs. Karam Chand Thapar & Bros. Ltd. a capital receipt of Rs. 18 lakhs and to claim revenue deduction of like amount in the hands of the assessee-company. The amount of Rs. 18 lakhs claimed and the legal expenses connected therewith is disallowed."

6. The respondent-company took the matter in appeal to the Appellate Assistant Commissioner who dismissed the appeal and stated in the course of his order;

"I agree with the Income-tax Officer that the whole transaction of termination of the managing agency and payment of the compensation of Rs. 18 lakhs is only a made up show. Though the ostensible reason given is 'in the interest of the company', in the context and surrounding circumstances of the appellant's case, I am satisfied that the expenditure of the 18 lakhs of Rupees-ostensibly paid for the termination of managing agency-cannot be held to be an expenditure wholly and exclusively laid out for the purpose of the business within the meaning of section 10(2) (xv)."

7. The respondent-company took the matter in further appeal to the Income-tax Appellate Tribunal which dismissed the appeal in a short order. The reasons given by the Appellate Tribunal are set out in paragraph 5 of that order as follows :

"We have carefully considered the various aspects of the case. We cannot understand how by any stretch of imagination the sum of Rs. 18 lakhs paid to the managing agent can be styled as compensation for the loss of officer or money spent wholly and solely for the purpose of the assessee's business. Committee were appointed not in the interest of business, but as desired by the interested parties. The appointment of the managing agents had only been made a few months before they were removed from the office. Managing agency commission is payment for services rendered. How can it be said that the dismissal of the managing agents is wholly and solely for the purpose of the business, unless of course they are inefficient or corrupt ? If services of efficient agents are dispensed with, it would follow that efficiency would go down and profits would be reduced. In our opinion, it is not possible to say that the services of the managing agents were terminated solely to make as saving to the company. The company under article 144 took the power to remunerate director for work done. It appears, as a result of this change, the management of the business was to be conducted by the board itself.

We think that the income-tax authorities have given valid reason for holding that the company's main effort was to put a substantial sum in the hands of the managing agents. The whole affair was nothing short of a farce. It is not a payment made solely to compensate the agents for the loss of employment. The amount cannot be said to have been spent wholly and solely for the purpose of the assessee's business."

8. At the instance of the respondent-company the Appellate Tribunal stated a case to the High Court under section 66(1) of the Income-tax Act on the following question of law :

"Whether, on the facts and circumstances of this case, the amount of Rs. 18 lakhs paid by the assessee-company to the managing agents on the termination of their managing agency agreement dated May 10, 1950, was an admissible deduction under section 10(2) (xv) of the Income-tax Act ?"

9. By its judgment dated July 11/12, 1962, the High Court answered the reference in favour of the respondent-company and against the appellant. The High Court held that the managing agency was terminated with the objects of taking over the management by the board of directors and the termination of the managing agency agreement was in the interests of the commercial expediency and there was no evidence which could lead to the inference that the termination of the managing agency agreement was done with any oblique motive.

10. On behalf of the appellant Mr. Narasaraju put forward the argument that the High Court exceeded its jurisdiction in interfering with the finding of fact recorded by the Appellate Tribunal that the termination of the managing agency agreement was not a bona fide transaction but the termination was effected for extra-commercial consideration an d was done for an improper or oblique purpose. It was pointed out for the appellant that the findings of the Appellate Tribunal that the transaction was not bona fide was supported by sufficient material on the record. It was said : (1) that the managing agents had to controlling interest in the respondent-company and since they were also its managing agents there was a conflict between their interest and duty, (2) the members of the sub-committee were not independent persons but they were the employees of the respondent-company, (3) that the subject of the cancellation of the managing agency agreement was not on the agenda of the meeting of the board of directors, but nevertheless the board considered it at its meeting, (4) the report of the sub-committee was submitted on March 16, 1951, and the very next day the directors met and decided to terminate the managing agency agreement and no objection, whatsoever, was raised by the managing agents to such termination, and (5) on May 10, 1950, the respondent-company had been able to secure an agreement favourable to itself and nothing happened within 7 months thereafter which could make it commercially expedient for the respondent-company to terminate the managing agency agreement. In our opinion, there is much justification for the contention put forward by Mr. Narasaraju on behalf of the appellant. It is well-established that the High Court is not a court of appeal in a reference under section 66 of the Income-tax Act and it is not open to the High Court in such reference to embark upon a reappraisal of the evidence and to arrive at findings of the fact contrary to those of the Appellate Tribunal. It is duty of the High Court to confine itself of the facts as found by the Appellate Tribunal and to answer the question of law in the context of those facts. It is true that the finding of fact will be defective in law if there is no evidence to support it or if the finding is unreasonable or perverse. But in the hearing of a reference under section 66 of the Income-tax Act it is not open to the assessee to challenge such a findings of fact unless he has applied for a reference of the specific question under section 66(1). In India Cements Ltd. v. Commissioner of Income-tax it was pointed out by this court that in a reference the High Court must accept the findings of fact reached by the

Appellate Tribunal and it is for the party who applied for a reference to challenge those findings of fact, first, by an application under section 66(1). If the party concerned has failed to file an application under section 66(1) expressly raising the question about the validity of the findings of fact, he is not entitled to urge before the High Court that the findings are vitiated for any reason. The same view has been expressed by this court in Commissioner of Income-tax v. Sri Meenakshi Mills Ltd. We are therefore of the opinion that the High Court was in error in embarking upon a reappraisal of the evidence before the Appellate Tribunal and in setting aside the finding of fact of the Appellate Tribunal that the termination of the managing agency agreement was not a bona fide transaction and the same done for an improper or oblique purpose.

11. It was, however, argued by Mr. Kolah for the respondent-company that the question whether the assessee was entitled to a deduction of certain expenditure under section 10(2) (xv) of the Income-tax Act was a mixed question of fact and law and the High Court did not act beyond its jurisdiction in appraising the evidence given by the parties before the Appellate Tribunal on this question. It is true that the question referred to the High Court was a mixed question of fact and law. In Eastern Investments Ltd. v. Commissioner of Income-tax it was held by this court that the question whether an expenditure was incurred solely for the purpose of carrying on the business of the assessee and was made on the ground of commercial expediency was not a pure question of fact but was mixed question of fact and law which was subject to review by the High Court. Similarly, in a later case, Commissioner of Income-tax v. Royal Calcutta Turf Club this court reiterated the principle that though the question whether an item of expenditure was wholly and exclusively laid out for the purpose of the assessees business must be decided on the facts of each case, the final conclusion was one of law because it involved the interpretation of the scope and meaning of the statute. To put it differently, the question whether the expenditure was laid out or expended wholly or exclusively for the purpose of business is a question which involves, in the first place, the ascertainment of facts by the Appellate Tribunal and, in the second place, the application of the correct principal of law on the facts so found. The question therefore is a mixed question of fact and law. It is a question of law because the Appellate Tribunal has to determine what is the meaning of the statutory phrase "expenditure laid out or expended wholly or exclusively for the purpose of business". The proper construction of the statutory language is always a matter of law and therefore the claim of the assessee in any particular case that he is entitled to deduction of certain items of expenditure under section 10(2) (xv) of the Income-tax Act involves the application of the law to the facts found in the setting of the particular case. But this does not mean that in the hearing of a reference on this question the High Court is entitled to go beyond the findings of fact recorded by the Appellate Tribunal. It is manifest that it is the duty of the High Court to confine itself solely to the facts found and proceed to apply the principle of law in the background and setting of the fact found by the Appellate Tribunal. In the present case, the question whether the termination of the managing agency by the respondent-company was not a bona fide one and was done for an oblique or improper purpose is essentially a question of fact and the High Court had no jurisdiction to interfere with the finding of the Tribunal on that question in proceeding to answer the reference.

12. Mr. Kolah then stressed the argument that the order of the Appellate Tribunal itself is defective in law because there is no clear finding recorded by the Appellate Tribunal that the termination the managing agency agreement was not bona fides or made the with an ulterior or oblique motive. It was pointed out that the Appellate Tribunal has not considered the relevant evidence in deciding the question whether the termination of the managing agency agreement was band find and was in the interest of commercial expediency. It was stated, in the first place, that the managing agency was a valuable asset acquired by payment of Rs. 27 lakhs by managing agents to Messrs. Greaves Cotton

& Co. It was also pointed out that the remuneration payable under the 1950 agreement was much less than that provided in the 1947 agreement and if such an agreement was to be terminated, reasonable compensation had to be paid to the managing agents. It was urged that the respondent-company wanted to manage its affairs by its board of directors and for the purpose they bona fide desired to terminate the managing agency agreement. No collusion was alleged between the respondent-company and the managing agents. The respondent-company has not acted in a secret was but an independent sub-committee was appointed to go into the question. It was not shown that after the management was taken over by the board o directors the affairs of the respondent-company had suffered. On the other hand, it was positively shown that the respondent-company had within seven years recouped to the extent of Rs. 16 lakhs out of Rs. 18 lakhs by saving the managing agency commission which would otherwise have been payable to the managing agents. Reference was also made to the affidavit of Mr. Parelwalla dated January 8, 1959, which was filed before the Appellate Tribunal. It was alleged that a statement was filed before the Appellate Assistant Commissioner disclosing that for the period of seven years up to March 31, 1958, there was a saving of Rs. 15,78,753. Neither the Appellate Assistant Commissioner nor the Appellate Tribunal has taken any cognisance of the affidavit of Mr. Parelwalla or the statement of the annual saving furnished by Mr. Parelwalla. In our view, there is considerable justification for the argument of Mr. Kolah and the order of the Appellate Tribunal is highly unsatisfactory as it has not taken into account all the relevant material adduced by the parties in the case on the question in controversy and the finding of the Appellate Tribunal is not clear and therefore defective in law.

13. We have therefore reached the conclusion that the question of law referred to the High Court cannot be answered in view of the defective finding by the Appellate Tribunal which is recorded without consideration of all the evidence. It will be open to the Appellate Tribunal to rehear the appeal under section 66(5) of the Act record a clear finding in after hearing the parties and after considering all the relevant material in the case as to whether the amount of Rs. 18 lakhs paid by the respondent-company to the managing agents on the termination of the managing agency agreement was an admissible deduction under section 10(2) (xv) of the Income-tax Act. After recording a clear finding on the question, the Appellate Tribunal will finally dispose of the appeal.

14. For the reasons already given we set aside the judgment of the Bombay High Court dated July 11, 12, 1962, and vacate the answer recorded by the High Court. We allow this appeal to the extent and manner indicated above. The parties will bear their own costs up to this stage.

15. Appeal allowed in part. Case remanded.