ALLAHABAD HIGH COURT

Shyamlal Pragnarain

Vs.

Commissioner of Income-tax, U.P

Misc. Case No. 80 of 1949
(Malik, C.J., Agarwala and V. Bhargava, JJ.)

05.01.1955

JUDGMENT

Malik, C. J.

1. This case has been referred to a Full Bench on a difference of opinion.

2. Proviso (2) to Section 66-A, Indian Income-Tax Act is to the effect that when there is a difference of opinion between the Judges hearing a reference the point of law upon which they differ and the case shall then be heard upon that point only by one or more of the other Judges of the High Court and such point shall be decided according to the opinion of the majority of the Judges who have heard the case including those who first heard it. By reason of this proviso we had some doubts whether one of us who was a member of the Division Bench should be on this Full Bench but Mr. Pathak on behalf of the assessee has urged that the proviso only refers to a case where a point of law has been referred for decision and, in such a case, the opinion of the Judge to whom the point has been referred has to go back to the Bench which had heard it and the order has to be passed by it. But that where the whole case has been referred to a new Bench this proviso does not apply and that we can hear the whole reference afresh and give our own decision. This view has been supported by Mr. Jagdish Swarup, counsel for the other side, and both the learned counsel have made a request that even if there be any irregularity they are waving the same and have prayed that the case may be heard and decided by this Bench.

3. Proceeding now to the reference itself, the facts are very simple. Shyam Lal Prag Narain is a firm carrying on business in Agra. On some date prior to the year 1935 the assessee firm had agreed to pay commissions at the rate of 12 per cent to the Manager and 3 per cent to the Assistant Manager. There was no written agreement but commissions at these rates were calculated on the profits without deducting income-tax and payments were made of the amounts thus worked out. On 6-4-1940, the Excess Profits Tax Act received the assent of the Governor General and came into force. The Commissions were calculated upon 31-12-1941, and paid on the profits made without deducting income-tax or excess profits tax. The same procedure was followed the next year and commissions were worked out on the same basis on the profits made

upto 31-12-1942, and paid to the Manager and the Assistant Manager. The total amount paid as commission was treated as an allowable deduction from the income for payment of Income-tax and Excess Profits Tax and no objection was raised by either the Income-tax Officer or the Excess Profits Tax Officer.

4. In the year 1943 the assessee firm made a profit of Rs. 4,58,957/- and paid commissions to the Manager and the Assistant Manager totalling a sum of Rs. 68,842/-. The sum of Rs. 4,58,957/- was the total profit without deducting the income-tax or the excess profit tax payable. The Income-tax Officer accepted the contention of the assessee that the sum of Rs. 68,842/- was an allowable deduction under Section 10 Indian Income-tax Act, but whether he allowed the deduction under Section 10(2) (X) or 10(2) (XV) of the Act is not clear and the counsel for the parties are not agreed on the point. The Excess Profits Tax Officer, however, while accepting the figure that had been worked out by the Income Tax Officer disallowed a sum of Rs. 33,525/- out of the sum of Rs. 68,842/- paid by the assessee firm to the Manager and the Assistant Manager.

5. The assessee appealed to the Tribunal but the appeal failed. The Tribunal thereupon referred the following two questions for decision to this. Court:

> "(1) Whether in spite of the fact that according to the pre-existing practice commission had been allowed on the net profits of the paying firm at the rate of 12 per cent and 3 per cent respectively before dedcution of the tax, under Rule 12 Sch. 1 E.P.T. Rules, the Excess Profits Tax Officer was legally justified in holding that the Excess Profits Tax payable on its profits by the assessee firm should have been deducted before calculating the commission payable at fixed percentage on its net profits?
> (2) Whether on the facts and in the circumstances of the case the payment of commission to Babu Lal and Shrichand at fixed percentage of profits without deduction of the excess profits tax by the assessee therefrom could legally be held by the Excess Profits Tax Officer to be unreasonable and unnecessary within the meaning of Rule 12(1), Sch.1, E.P.T. Act?"

6. As regards the second question, both the learned Judges before whom the reference was put up at the first hearing were of the opinion that the question did not arise. It was as regards the answer to the first question that they had differed. The whole case having been referred to us we now proceed to answer the two questions afresh.

7. We consider that at the outset it would be useful to point out the relevant provisions of law as the Tribunal does not appear to have kept them clearly in view when deciding the case and on that account a lot of confusion has been created. Section 10, Income-tax Act provides for the mode of computation of income for the purpose of payment of income-tax; Section 10(2) gives the list of allowable deductions and Section 10(2) (x) allows the deduction of

"any sum paid to an employee 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."

The proviso to this section, however, gives the Income-tax Officer a right to decide whether the amount of the bonus or commission is a reasonable amount, having regard to-

(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 (business, profession or vocation).

Section 21, Excess Profits Tax Act makes the provision of Section 10, Income-tax Act, applicable to the computation of the amount of Excess Profits Tax. The Excess Profits Tax Officer is, therefore, also entitled to consider whether the amount payable to an employee as bonus or commission, where such amount would not have been payable to him as profits or dividend, was a reasonable payment, keeping in view the pay of the employee and the conditions of his service, the profits of the business for the year in question and the general practice in similar business. Rule 12 of Sch. I, Excess Profits Tax Act (XV of 1940) is as follows:

"12. (1) 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. (2) Any person who is dissatisfied with the decision of the Excess Profits Tax Officer under this rule may appeal in the prescribed time and manner to the Appellate Tribunal.
(3) In relation to chargeable accounting periods ending after 31-12-1942, the Central Government may make rules for determining the extent to which deductions shall be allowed in respect of bonuses or commissions paid."

This rule gives the Excess Profits Tax Officer a right to disallow expenses in excess of the amount which he considers reasonable and necessary having regard to the requirements of the business and, where payments are made for services, to the actual services rendered by the person concerned. There is, however, a check on his authority and he can do so after he has obtained prior authority of the Commissioner of Excess Profits Tax. This rule was introduced probably because the employers, when they realised that they would have to pay a large part of their profits as Excess Profits Tax, became generous and gave away a good part of it to their employees, which generosity they would not have shown if they had not to pay Excess Profits Tax.

8. The reasonableness of the amount of bonus or commission has to be determined by the Income-tax Officer and the Excess Profits Tax Officer under Section 10(2) (x) with reference to the proviso, that is, with reference to the pay of the employee, his conditions of service, profits of the business for the year in question and general practice in similar business. The Excess Profits Tax Officer has been given the further power under Rule 12, Sch. I, Excess Profits Tax Act, not to allow deduction in respect of expenses in excess of the amount which he considers reasonable and necessary having regard to the requirements of the business and services rendered. The question of reasonableness of the amount spent must, therefore, be judged with reference to the requirements of the business and if the expenditure relates to a payment for services then the amount must be reasonable having regard to the actual services rendered by the person concerned.

9. Learned counsel for the assessee has admitted that the word 'reasonable' in Section 10(2) (x), Income tax Act or in R.12 of Sch. I, Excess Profits Tax Act, and the words 'necessary having regard to the requirements of the business' in the same rule do not mean that there must be a legal liability to pay. He has admitted-and to our minds rightly-that even an ex gratia payment of bonus or commission may be a reasonable or necessary payment having regard to the requirements of the business under Rule 12 and the amount may be reasonable having regard to the provisions of Section 10(2) (x), proviso, Indian Income-tax Act.

10. As was observed in - *'Basti Sugar Mills Company Ltd. v. State of Uttar Pradesh*[1]*',*

> "It does not appear to be necessary to enter into the history of the relations between the industrialists and their workmen in order to determine the nature of 'bonus'. There can be no doubt, however, that, in modern times, bonus, is clearly regarded as deferred wages payable to employees which may be claimed by them as of right under the terms of employment. In the conditions, under which modern industries function, bonus has now come to be recognized as a right of employees which they can claim from their employers under certain circumstances."

The practice of payment of bonus or commission out of the profits of a business has grown by reason of the recognition that the profits are not entirely due to the capital invested but are at any rate, partly due to the labor put in by the workmen who should, therefore, get a share in them. It is also now recognized that such payments work as an extra incentive and help to promote efficiency and also contentment.

11. It was admitted in the case before us that commission was paid to the Manager and the Assistant Manager at the rate of 12 per cent. and 3 per cent. without deducting either Income-tax or Excess Profits Tax and no dispute had arisen for decision between the assessee and the Manager and Assistant Manager as regards the terms of the contract. For the purposes of taxation, the question whether the payment was made to the Manager and the Assistant Manager

under a legal contract or it was merely an ex gratia payment does not appear to be of much importance. The payment was made and the amount was claimed as an allowable deduction. Whether the amount of expenditure incurred could be reduced or disallowed had to be considered in accordance with the provisions of Section 10(2) (x), Income-tax Act and R.12, Sch. I, Excess Profits Tax Act. The amount could be disallowed in whole or in part if it was found that it was not reasonable and it was not necessary having regard to the requirements of the business and the actual services rendered by the Manager and the Assistant Manager. This was the point that the Excess Profits Tax Officer was required to decide and to which the Appellate Tribunal should have directed its attention. The question as to the terms of the contract may have been a matter of importance as between the employer and the employee but not for the purposes of the determination of the question of reasonableness or necessity either under the Income-tax Act or the Excess Profits Tax Act.

[1] AIR 1954 All 538 at p.547

12. It has also not been disputed before us that the questions of reasonableness and the payment being necessary having regard to the requirements of the business have to be judged in accordance with the exigencies of the business keeping in view ordinary commercial practice and commercial expediency, and the Excess Profits Tax Officer must, for this purpose, place himself as far as possible in the shoes of the persons carrying on the business and judge the question from their point of view.

13. In the case before us the Appellate Tribunal did not clearly bear in mind what it was called upon to decide and the line followed by it in its appellate order for coming to the conclusion that the Excess Profits Tax Officer was justified in reducing the amount is something like this:

> "(a) The Excess Profits Tax payable on the profits made by the assessee firm should have been deducted before calculating the commission payable to the Manager and the Assistant Manager.
> (b) Payment made to them on the basis adopted by the assessee firm was of a large sum than what was due to them; and
> (c) the payment could not, therefore, be held to be necessary for the requirements of the business as it was both unnecessary and unreasonable to pay more than the agreed amount."

14. The whole basis of the decision of the Appellate Tribunal, therefore, is that the payment in excess of the agreed amount, being ex gratia payment, could not be held to be reasonable or necessary for the requirements of the business. The Excess Profits Tax Officer followed more or less the same line. He said that in accordance with the decision in - '*Walchand and Co. Ltd. v. Hindustan Construction Co. Ltd*[2].', the amount of excess profits tax had to be deducted before commission could be worked out for payment to the Manager and the Assistant Manager, and it was, therefore, unnecessary and unreasonable to pay more than the agreed proportion of the

profits. The Excess Profits Tax Officer, however, went on to hold that the whole amount paid was an allowable deduction under Section 10, Income-tax Act.

15. We have already said that the question whether it was an ex gratia payment or a payment which the assessee was liable to made under an agreement does not decide the point. Even an ex gratia payment may be considered to be an allowable deduction under Section 10(2) (x), Income-tax Act, and R.12, Sch. I, Excess Profits Tax Act. On the mere finding, therefore, that it was an ex gratia payment, without considering other facts and circumstances, neither the Excess Profits Tax Officer nor the Appellate Tribunal could come to the conclusion that the payment was necessarily neither reasonable nor necessary having regard to the requirements of the business. Learned counsel for the Department has not disputed this proposition but he has urged that the question whether it was a legal liability that was being discharged or it was merely an ex gratia payment that was being made might be one of the points to be taken into consideration. Even if it is a point to be taken into consideration, it cannot be said to be a circumstances of any great importance, as the question of reasonableness under Rule 12 of Sch. I, Excess Profits Tax Act, has to be decided in accordance with the provisions of that rule and the Excess Profits Tax Officer has to decide the question of reasonableness and the question whether the

[2] AIR 1944 Bom 5

payment was necessary having regard to the requirements of the business and in accordance with the services rendered by the employees with reference to business principles and exigencies of the business.

16. A large number of cases were cited on the point whether Excess Profits Tax should or should not be deducted before calculating the commission payable to an employee. This must depend in each case on the terms of the contract. Where the contract is in writing the terms of the written agreement have to be interpreted, but where there is no written agreement, as in this case, the terms of the agreement have to be gathered from such material as may be available.

17. As was pointed out by Lord Simon in - *'L.C. Ltd. v. G.B. Ollivant, Ltd.'*[3],

> ".....the problem.....is the not unfamiliar one of deciding how an agreement should be construed when its written terms provide elaborately for many things, but do not include any express provision to meet a contingency which the parties presumably never anticipated but which has since occurred. The rule to be followed in such cases is clear. The only difficulty is in applying it. The rule is that we are not to make a new agreement for the parties, or to speculate how they would have dealt with the new contingency had they anticipated it; but that (except in cases when the intervening event produces frustration) we have to take the words of the agreement as they stand and apply them, as best we can, to the new situation which has caused the difficulty."

18. In that case there was a written agreement. The question arose between two contracting

parties whether the price which was to be paid by certain instalments was to be calculated on the basis of profits after deduction of the Excess Profits Tax or before deduction of the Excess Profits Tax. Two of the Law Lords, Viscount Simon and Lord Macmillan, were of the opinion that excess profits tax should not be deducted from the profits while the other three Law Lords, Lord Thankerton, Lord Russell and Lord Wright, took the contrary view.

19. In Halsbury's Laws of England, Edition 3, Vol.6, Para.591, p.291, the law on the point is stated as follows:

> "Directors who are remunerated by a percentage of the net profits or by commission on the sum available for distribution are entitled to compute their remuneration on the profits before income-tax is deducted therefrom. As regards profits tax it seems that if on the true construction of the agreement the profits on which the remuneration is based are the divisible profits or profits available for distribution profits tax will be deductible before the amount of the profits is ascertained, but if the profits on which remuneration is to be computed are the profits earned, meaning the profits before their disposal, profits tax will not be deductible in computing them."

The law is now well settled that whenever there is an agreement to share profits, the profits are inclusive of and not exclusive of the income-tax unless the contract explicitly

[3]1945-13 ITR (Supp) 23

mentions otherwise. (See - *'Ashton Gas Co. v. Attorney-General[4]',.)* The reason is obvious. Income-tax is a share of the profits which the State claims as its own for the amenities supplied by it in making it possible for a company to work and earn its profits. The State, therefore, is one of the many co-sharers in the profits earned and the profits must therefore necessarily be inclusive of the amount which is payable to the State as its share.

20. Learned counsel for the assessee has urged that Excess Profits Tax is of the same nature as income-tax and he has referred us to a decision of the House of *Lords in - 'Inland Revenue Commissioners v. Dowdall, O'Mahoney and Co. Ltd.[5]',* The facts of that case were entirely different. A company was assessed to and paid taxes in Eire. It had, however, branches in the United Kingdom and in the computation of the profits for purposes of assessment it was claimed that the Taxes, Income-tax and Excess Profits Tax, paid in Eire should be excluded as deductible expenditure. Lord Oaksey pointed out that the taxes paid in Eire were not paid wholly and exclusively for the purposes of the company's trade in the United Kingdom and the amount paid as such could not be claimed as deductible expenditure. Reliance was, however, placed on a sentence in the judgment of Lord Reid at page 419, where his Lordship, dealing with the question as to what is expenditure, quoted with approval the observations of Lord Normand in - '*Smith's Potato Estates Ltd. v. Bolland[6]',* which are as follows:

"There is the more substantial reason, that income-tax is an impost made upon profits after they have been earned, and that unless the observations of Lord Davey in - '*Strong and Co. of Romsey Ltd. v. Woodifield*[7]*',* which have often been referred to and applied in later cases, are to be disregarded, a payment out of profits after they have been earned is not within the purposes of the trade carried on by the tax-payer. But excess profits tax also is levied on profits after they are earned and, apart from the statutory provision, is in pari pasu with income-tax."

It is urged that Excess Profits Tax and Income-tax are both imposts on profits and both must be treated alike and the principle governing the - 'Ashton Gas Company's case' should be applied to Excess Profits Tax also.

21. Two other cases were also cited by Mr. Pathak - 'Re Ollivant and Co. Ltd.'s Agreement', (1942) 2 All England Reporter 528 (H) and 1948 AC 508.

22. 'Ollivant and Co.'s case' was not a case arising out of either Income-tax Act or Excess Profits Tax Act. The question there arose of interpretation of a contract. It is not necessary to give the terms of the contract, nor to deal with this case at any length as the case is really not relevant for our purposes. Learned counsel has relied on a passage at p.532 in the judgment of Lord Greene M.R. that:

".....the excess profits tax was not expenditure attributable to the working of the business, but expenditure which falls to be charged after the results of the working

[4]1906 AC 10 [6]1948 AC 508 at p.530
[5]1952 AC 401 [7]1906 AC 448 at p.453

of the business have been ascertained;....."

The difference that has been pointed out in the passage quoted from Halsbury's Laws of England has also been brought out in the judgment of Lord Greene that divisible profits of a trading company cannot properly be ascertained without making deduction for Excess Profits Tax.

23. In - 'Smith's Potato Estates' case' the question was whether legal and accountancy expenses incurred by a trader in contesting the amount of an assessment to excess profits tax were not allowable as deductions in computing profits for the purposes of a subsequent assessment to income-tax or excess profits tax. It was held that they were not money wholly and exclusively laid out or expended for the purposes of the trade. The passage relied on at page 527 is as follows:

"The reason is not far to seek. It is that neither the cost of ascertaining taxable profit nor

> the cost of disputing it with the Revenue Authorities is money spent to enable the trader to earn profit in his trade. What profit he has earned, he has earned before ever the voice of the tax gatherer is heard. He would have earned no more and no less if there was no such thing as income-tax. His profit is no more affected by the eligibility of tax than is a man's temparature altered by the purchase of the thermometer, even though he starts by haggling about the price of it."

It is urged that from this sentence we must deduce and hold that profits always mean profits inclusive of Income-tax and Excess Profits Tax. A judgment is an authority for the proposition it decides and we cannot take the observations quoted above as meaning that whatever may be the terms of the agreement, it must always be held that Excess Profits Tax for all purposes must be treated in the same way as Income-tax.

24. It is true that assessment under the Income-tax Act and the Excess Profits Tax Act is made more or less on the same principles and the tax is recoverable in the same manner and both are in one sense tax on profits made. But the reasons for the imposition of the tax in the two cases are entirely different. While Income-tax is a tax on the total income from all sources and is claimed on the ground that the State is entitled to a share in the profits, Excess Profits Tax is levied only on income from business and purports to be the whole or part of the extra profits made due to the extraordinary situation created by the war over and above the normal profits made by the business. The preamble to the Excess Profits Tax Act makes that clear and is to the following effect:

> "Whereas it is expedient to impose a tax on excess profits arising out of certain businesses in the conditions prevailing during the present hostilities;"

As has been pointed out in several cases, the idea was that the person making this extra profit should not be allowed to keep it to himself when this profit was being made as a result of a calamity which the rest of his countrymen had to face. In England ultimately the whole of this extra profit was taken away by the State. In India, however, two-third was taken away by the State and the person making the profits was allowed to keep one-third for himself. This was, therefore, treated more or less as profit which was not earned by the business but it was a windfall resulting from a world calamity, and Section 4, Excess Profits Tax Act-the charging section- provides that:

> "Subject to the provisions of this Act, there shall, in respect of any business to which this Act applies, be charged, levied and paid on the amount by which the profits during any chargeable accounting period exceed the standard profits....."

The Tax is, therefore, in respect of a business in contrast to the provisions of the Income-tax Act which provides for a tax being levied on a person. Under Section 12, Excess Profits Tax Act,

excess profits tax has to be deducted as an expenditure for the purposes of computation of Income-tax. Income-tax is levied on a sliding scale. While Excess Profits Tax is charged either at a fixed percentage of the difference between the profits earned and the standard profits. There is no provision in the Excess Profits Tax Act for any refund being made, as there is in Section 48, Income-tax Act. The whole concept behind the two taxes, even if there are many things common between the two, is different and it cannot, therefore, be said that Excess Profits Tax must for all purposes be treated in the same way as Income-tax.

25. In - *'Birt, Potter and Huges, Ltd. v. Commissioner of Inland Revenue*[8]*',* Lord Hanworth M.R. pointing out the nature of the Excess Profits Tax at page 990 said:

> "It does not appear there that the tax is charged upon a person in respect of his activities. It is a tax designed to catch a portion of the amount which is deemed by the Legislature to be in excess of the normal profits of trade or business."

26. This, however, is a division which is hardly necessary for the purposes of this case. As we have held, the question on what basis commission was payable might be an important question when it arises between two contracting parties and how the point has to be decided has been dealt with in several cases the summary of which if we may say so, has been correctly made in the passage quoted from Halsbury's Laws of England.

27. Some of the cases cited in this connection by learned counsel for the Department may now be noticed though even they, to our minds, are not of much importance.

28. In - *'Yeovil Rural District Council v. South Sommerset and District Electricity Co. Ltd*[9]*.',* the question arose between the Rural District Council and the Electricity Co., whether the liability to pay excess profits tax was a factor which a rating authority was entitled to take into consideration with others in deciding what percentage of the net receipts should be allocated to tenants' profits when the net receipts were apportioned between hypothetical landlord, hypothetical tenant, and rating authority. Lord Tucker quoted with approval Lord Dunedin's remarks in - *'Port of London Authority v. Assessment Committee of Orsett Union*[10]*',* as follows:

> "This seems to me to be the key of the whole matter. Sterility in earning profits is

[8](1928) 12 Tax Cas 978
[9](1947) 1 All England Reporter 669
[10]1920 AC 273 at p.299

> one thing sterility in the disposing of profits in another.

The former effects value, the latter does not."
and then went on to say:

"Applying this statement to the present case, excess profits tax sterilises the disposition of a percentage of the profits, but, so far from sterilising the earnings of profits, it only takes effect if and when such profits have resulted from a condition of fertility. I find it impossible to distinguish between income-tax and excess profits tax for the present purposes."

29. In - *'Condran v. Stark*[11]*',* Peterson J. pointed out the difference between Income-tax and Excess Profits Tax. He said:

"Income-tax is ultimately payable by the person who is entitled to receive the profits. A company pays income-tax on behalf of the share-holder and the income-tax payable on his dividend is treated as part of his dividend, so that if he is in fact entitled to exemption he can recover the amount of the tax from the Revenue Authorities.....Excess profits duty on the other hand is assessed on the person; owning or carrying on the business and is recoverable as a debt from him.....and is payable in respect of the profits of the business, and not in respect of the benefit which a share-holder or partner derives from the business; .....Nor are excess profits duty and income-tax payable in respect of the same fund; for excess profits duty is for the purpose of income tax treated as an outgoing of the business, which reduces the profits in respect of which income-tax is assessable.....In my view excess profits duty is.....a debt due to the Crown, the amount being ascertained with reference to the amount by which the profits exceed the prewar standard."

30. This view was followed by the Court of Appeal in - *'Patent Castings Syndicate, Ltd. v. Etherington*[12]*',* The question, however, in that case arose between two contracting parties and it related to the meaning of the expression 'payable commission out of the net profits'. Warrington, L.J., remarked that a reasonable interpretation of the agreement would be that the company intended to give to its employees a share of the money which belonged to it and not a share out of a sum of money which did not belong to the company but was payable to His Majesty's Treasury. At p.267 the learned Judge posed a question, "What light, if any, do these statutory provisions throw upon the construction of this agreement" and in answer said:

"In my judgment they only throw this light, that, unlike income-tax, excess profits duty is not a part of the profits which is payable to the company carrying on the business, or to its shareholders. Excess profits duty is, for the purpose of ascertaining what is payable to the shareholders of the company, an outgoing, a sum of money which has to be paid to a third person as a debt of the company, and is therefore an outgoing which has to be paid before it can be ascertained what are

[11](1917) 1 Ch 639

[12](1919) 2 Ch 254

the profits distributable amongst the shareholders of the company by way of dividend."

At p.269 the learned Judge agreed with the decision of Peterson, J. in the case already quoted.

31. In - *'Vulcan Motor and Engineering Co. v. Hampson[13]',* which again was a case arising out of a dispute between two contracting parties as to the fund out of which commission was payable, the agreement provided for payment of commission out of the net profits for the year. Bankes, L.J. pointed out that on a true construction of the contract the parties were not contracting for payment of anything except the amount of profit divisible amongst the share-holders.

32. Coming to the decisions of the Indian Courts, the decision in - *'James Finlay and Co. Ltd. v. Finlay Mills Ltd[14].',* is not very helpful as the decision turned merely on the words of the agreement which provided that commission was payable at a particular rate without setting aside any sum for payment of income-tax or super-tax or any other tax on income.

33. In AIR 1944 Bombay 5, Beaumont C.J. had again to deal with the question of interpretation of a written agreement and while dealing with that question he pointed out the difference between the Income-tax and Excess Profits Tax.

34. In - *'Commissioner of Income-tax, Delhi v. Delhi Flour Mills Co. Ltd[15].',* the question arose whether, in calculating the annual net profits of the company for purposes of ascertaining the amount payable as commission to the Managing Agents, Excess Profits Tax was or was not to be deducted. The learned Judges were of the opinion that the amount was not deductible and quoted the observations made in some of the English cases.

35. In - *'N.M. Rayaloo Iyer and Sons v. Commissioner of Income-tax/Excess Profits Tax, Madras[16]',* the mails question turned on the interpretation of certains letters and the other questions in the case are not relevant for our purposes.

36. The position, therefore, is that the cases cited at the Bar mainly relate to the question of interpretation of written agreements. In the case before us, the assessee had been paying commission at 12 per cent and 3 per cent from the year 1935 to the year 1940 on the profits earned without deducting Income-tax. The fact that Income-tax was not deducted will not, however, be very helpful in determining the terms of the agreement relating to the deduction of Excess Profits Tax. For two years at least, in 1941 and 1942, commission was paid without deducting Excess Profits Tax and neither the Income-tax Officer nor the Excess Profits Tax Officer objected to such payment. The Appellate Tribunal has observed in its appellate order that:

> ".... the past records showed that according to the existing practice, the commission had been allowed on the net profits at 12 per cent and 3 per cent respectively before deduction of tax."

[13](1921) 3 KB 597
[14]47 Bom LR 774
[15] AIR 1953 Pun180 (FB)
[16] AIR 1955 Mad 56

Mr. Pathak on behalf of the assessee has urged that this is a finding in his favour on a question of fact. Learned counsel for the Department has, however, urged that it is not a finding as regards the terms of the contract but a mere statement of fact as to what was actually done. We find it difficult to hold that this was a finding of fact as to the terms of the oral agreement between the parties. The Appellate Tribunal appear to have taken the view that for working out the commission payable to the Manager and the Assistant Manager, Excess Profits Tax had to be deducted out of the profits more as a matter of law than a matter depending on the terms of the agreement between the parties.

37. The Questions framed appear to us to be defective. The first question is whether the Excess Profits Tax Officer could under Rule 12, Sch. I, Excess Profits Tax Act go against the pre-existing practice and hold that commission payable should have been calculated after deduction of Excess Profits Tax. The powers of the Excess Profits Tax Officer are limited by the provisions of Section 10(2) (x), Income-tax Act and R.12, Sch. I, Excess Profits Tax Act. What the assessee should pay to the Manager and the Assistant Manager depends on the terms of the contract between the parties. The Excess Profits Tax Officer can, however, decide under Rule 12 of Sch. I, Excess Profits Tax Act whether the payment is reasonable after taking into consideration the provisions of that clause and he has to decide whether the deduction claimed was a reasonable deduction and was necessary having regard to the exigencies of the business and the services rendered by the Manager and the Assistant Manager. That is our answer to the first question.

38. The second question too is not very happily worded. Any contract between the assessee firm and its employees does not take away the right of the Excess Profits Tax Officer to consider the question of the reasonableness of the payment under Section 10(2) (x), Income-tax Act or R.12, Sch. I, Excess Profits Tax Act, but the mere fact that it was a voluntary payment does not by itself make it either unreasonable or unnecessary. The decision has to be made by the Excess Profits Tax Officer with reference to all the facts and circumstances and in accordance with the exigencies of the business. He must take note of all such other matters as businessmen would generally take into consideration in coming to the conclusion whether a particular bonus or commission should or should not be paid having regard to the requirements of the business and the services rendered by the employees. That is our answer to the second question.

39. The assessee should get its costs of this reference which we assess at a sum of Rs. 500/-.

Answer accordingly.