

ALLAHABAD HIGH COURT

British India Corporation Ltd., Kanpur

Vs.

Commissioner of Excess Profits Tax Cum Income Tax

Misc. Case No. 131 of 1948
(V. Bhargava and Mehrotra, JJ.)

22.03.1957

JUDGMENT

V. Bhargava, J.

1. In these two cases a consolidated statement of the case has been submitted by the Income Tax Appellate Tribunal after framing one question which covers the points raised in both the cases. The question is :

"Whether, on the facts and circumstances of this case, the amounts of Rs. 6,15,000/- for the chargeable accounting period from 1-1-1943 to 31-12-1943, and of Rs. 3,87,400/- for the chargeable accounting period from 1-1-1944 to 31-12-1944, were rightly disallowed under Rule 12(1) of Schedule I of the Excess Profits Tax Act ?"

The statement of the case shows that, during the two chargeable accounting periods in question, the assessee paid to its directors in addition to the prescribed fee of Rs. 1,800/- per annum, various sums of money as commission calculated at a fixed rate of the profits earned by the assessee. The total sum thus paid in addition to the prescribed fee in the first chargeable accounting period in question was Rs. 18,61,800/- whereas, in the second chargeable accounting period, it was Rs. 11,48,192/-. Part of this payment was accepted by the Department as being necessary payment to the directors and was allowed as deductible expenditure. In the first chargeable accounting period, the sum of Rs. 21,900/- paid to each director and, in the second chargeable accounting period, the sum of Rs. 14,550/- paid to each director were admitted by the assessee to have been paid without any reference to extra services rendered by the directors. These payments to the directors were consequently, disallowed by the Department and the assessee did not seek any reference to this Court in respect of this decision. The remaining sums paid to the directors in the two chargeable accounting periods amounted to Rs. 6,15,000/- in the first chargeable accounting period and Rs. 3,87,400/- in the second chargeable accounting period and these are the amounts in dispute in these references.

2. It has been accepted by the Department that, for a long time the assessee company had been

paying commissions to its directors and managers. The commissions so paid were calculated on the basis of the profits earned by the assessee company at a percentage which varied with each director. On 24-2-1940, the Board of Directors passed a resolution that the commissions on profits would be payable to the managing directors and the branch managers entitled thereto, on the net audited profits only, after the depreciation had been allowed for, but prior to any allocation or appropriation of such profits including provision for taxation. This resolution was further clarified by a subsequent resolution on 27-7-1940, holding that the words "including provisions for taxation" were intended to and did specifically cover all forms of taxation including the excess profits tax and other like impositions and, therefore, no deduction of excess profits tax and other like impositions was to be made from the audited profits prior to the calculation of managerial commissions. The resolution was given retrospective effect, so that it came into force even for the chargeable accounting period from 1-1-1939 to 31-12-1939. It was in pursuance of these resolutions that the directors were paid the various amounts of commissions including the amounts now in dispute. The Excess Profits Tax Officer, when making the assessment, held that the rates of commission had been fixed long before the commencement of the War and no deduction had admittedly been made for the excess profits tax liability in computing the net profits of the corporation for the purpose of calculating commission payable to directors and managers. As a result of War conditions, the profits of the corporation had gone up tremendously from about ten lacs of rupees during the pre-war period to about two crores in the relevant chargeable accounting period and the commission of the managers on the basis of net profits had risen in the same proportion. Since the excess profits tax, which was intended to prevent the owner of a business from making a large fortune out of what was a national danger, was not deducted from the net profits in calculating commission, the employees stood to benefit from the national emergency to a greater extent than the employer. The Excess Profits Tax Officer then referred to the case of *Walchand and Co. Ltd. v The Hindustan Construction Co., Ltd*¹, and, following it, held that it appeared to be both unnecessary and unreasonable to pay more than the agreed proportion of the profits after deduction of the excess profits tax. He went on to give the finding that though the increased expenditure under commission was of a nature which, under the provisions of Section 18 of the Income Tax Act, was an allowable deduction, it was unreasonable and unnecessary having regard to the requirements of the business and the actual services rendered by the persons concerned. It was on this view that the Excess Profits Tax Officer disallowed these amounts and excluded them from the expenditure claimed by the assessee under rule 12 of Schedule I of the Excess Profits Tax Act. On appeal, the Income Tax Appellate Tribunal affirmed this decision of the Excess Profits Tax Officer. In the appellate order, the Tribunal mentioned the various contentions which were raised on behalf of the assessee and the Department including the fact that it had been pointed out on behalf of the Department that there was no evidence as to any extra services rendered by the directors and managers and if there were any extra services, the amount of commission already allowed by the Excess Profits Tax Officer in both the chargeable accounting periods from 1-1-1943 to 31-12-1943 and from 1-1-1944 to 31-12-1944 was quite adequate with due regard to the provisions of R. 12 of Schedule I of the

Excess Profits Tax Act. After mentioning the argument advanced, the Tribunal proceeded to give their own decision in the following words :

"We have considered the several aspects of the matter arising out of these appeals and must hold that the Excess Profits Tax Officer was justified in exercising his discretion under rule 12(1), Schedule I of the Act and we see nothing wrong in the method of commutation of the amount of commission for each of the relevant chargeable accounting periods."

This decision by the Tribunal does not at all make clear the various aspects of the matter which the Tribunal took into consideration. The Tribunal did not record any finding that any extra services had been rendered by the directors who had been paid the commission calculated on the net profits before deduction of the excess profits tax chargeable from the assessee. In view of the fact that the Tribunal have not mentioned at all the various aspects that were considered by them, the only inference that follows is that the Tribunal agreed with the reasons which had been given by the Excess Profits Tax Officer for disallowing these amounts. In their order, they have said that they must hold that the Excess Profits Tax Officer was justified in exercising his discretion under Rule 12(1), Schedule I of the Excess Profits Tax Act. This decision by them amounts to laying down that the exercise of the discretion by the Excess Profits Tax Officer on the grounds given by him was approved by them. If there were any additional reasons which led the Tribunal to uphold the order of the Excess Profits Tax Officer, the Tribunal would have given those reasons in their appellate order and given the findings of fact arrived at by them which had not been arrived at by the Excess Profits Tax Officer and which would have justified the view that the amount had been rightly disallowed. In the circumstances, in dealing with these cases, we have to proceed on the basis that both the Excess Profits Tax Officer and the Income Tax Appellate Tribunal have disallowed these expenses on the same ground which appears from the order of the Excess Profits Tax Officer to be that payments had not been made in accordance with the terms of the agreement between the assessee and the directors but they were payments beyond the terms of the agreement.

The finding of the Excess Profits Tax Officer amounted to laying down that the previous practice and agreements gave no indication that the commission had to be paid without deducting the excess profits tax from the net profits, so that what was payable to the directors was the commission calculated on net profits after deducting the excess profits tax assessment. We infer this, particularly, from the fact that the Excess Profits Tax Officer relied upon the decision reported in 1944-12 ITR 104 : AIR 1944 Bombay 5. The question that we have to examine is how far the Excess Profits Tax Officer was justified in the decision which was affirmed by the Income Tax Appellate Tribunal.

3. It appears to us that the consideration, which led the Excess Profits Tax Officer to disallow these amounts, was not decisive of the question that arose for decision. It was held by the Full

Bench of this Court in *Shyamlal Pragnarain v. Commissioner of Income Tax U. P., Lucknow*²,

"The amount could be disallowed in whole or in part if it was found that it was
²(1955) 27 ITR 404 : AIR 1955 All 299

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.

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."

In that case also, the payments made to the employees had been disallowed on the ground that those payments were not necessitated by the terms and conditions of service of the employees. Dealing with this aspect, the Full Bench held :

"We have already said that the question whether it was an ex gratia payment or a payment which the assessee was liable to make 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) of the Income Tax Act and rule 12, Schedule I of the 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 circumstance of any great importance, as the question of reasonableness under Rule 12 of Schedule I to the 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 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."

These views expressed by the Full Bench are fully applicable to the ground on which the Excess Profits Tax Officer and the Income Tax Appellate Tribunal have disallowed these two disputed amounts in the present cases. The Excess Profits Tax Officer and the Tribunal held that, under the terms of agreement between the assessee and the directors the proper way of paying the commission was to calculate it after deducting the excess profits tax liability. That was the reason why three amounts, which were paid to the directors, were disallowed. As held by the Full Bench of this Court, this is not a point on the basis of which question of reasonableness and the necessity of the payment 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 could be decided. What was needed was that the Excess Profits Tax Officer and the Income Tax Appellate Tribunal should have, apart from this aspect, gone into the question whether these payments made to the directors were necessary and justified or not, keeping in view ordinary commercial practice and commercial expediency and taking into account services rendered by the persons to whom the payments were made. There is not even a word in the order of the Excess Profits Tax Officer or in the appellate order of the Income Tax Appellate Tribunal indicating that these points were ever in their minds, or they applied their minds to these relevant questions. Both the Excess Profits Tax Officer and the Income Tax Appellate Tribunal proceeded on the basis that, as the payments were not justified under the agreement, they were expenses which had to be disallowed under Rule 12 of Schedule I of the Excess Profits Tax Act. Such a decision cannot be upheld in view of the decision of the Full Bench cited above.

4. Learned Counsel for the Department urged two other points before us: One point was that there is material on the record which has been made part of the statement of the case and on the basis of which it may be possible to arrive at a finding whether the payments made to the directors were necessary for the business and were commensurate with the services rendered by those persons. Learned Counsel suggested that we should examine that material in order to find out whether the disallowance of those amounts was correct. It is true that with the statement of the case the Tribunal have attached certain annexures, some of which contain material from which it may be possible to find out to a certain extent what were the services rendered by the directors to whom the payments were made but it appears to us that, if we start examining this question and recording our own findings of fact, we would be exercising jurisdiction which is not vested in us under the Excess Profits Tax Act and the Indian Income Tax Act. The question referred to us has to be answered on the basis of facts found by the Income-tax Appellate Tribunal. The Tribunal did not give any findings of fact with regard to the necessity for payments, considering the exigencies of the business, nor did the Tribunal record any finding of fact with regard to the services rendered by the persons to whom the payments were made. The Tribunal chose to disallow these amounts only on one single basis which has been mentioned above. Our answer to the question referred to us has, therefore, to be confined to the point as to whether the reason, which led the Tribunal to disallow the amounts, was a sufficient reason. If

the Tribunal had thought that other reasons existed, those reasons should have been made the basis of their order when disposing of the appeal. It is not now for us to record fresh findings of fact and then, on their basis, to answer the question referred to us. The basis, which was accepted by the Tribunal, not being proper and sufficient, the order disallowing these amounts cannot be upheld.

5. The second point, which was urged by learned counsel for the Department, was that the case of (1955) 27 ITR 404 : AIR 1955 Allahabad 299 is distinguishable from the case before us on the ground that in that case, the assessee, whose case came up before the Full Bench of this Court, was a firm and the payments, which were in dispute, were payments made to the employees of that firm, whereas the present case relates to a company and the payments in question are those made to the directors of the company. We are unable to see any distinction. The question whether the payments should or should not be disallowed on the ground that they were unnecessary in view of the exigencies of the business and were not commensurate with the services rendered does not depend at all on the assessee being an individual, a firm or a company. Whoever the assessee may be, the question will depend on the nature and extent of the business, the practice prevailing in the business, requirements of the business and the actual services rendered by the persons to whom the payments in dispute have been made. Whether the payments be made by a company or a firm can have no bearing on these aspects which have to be examined in order to give a proper decision. Further, it would make no difference whether the payment is made to an employee or to a director. Under Rule 12 of Schedule I of the Excess Profits Tax Act identical considerations are applicable for disallowing payments made to directors and payments made to employees. No different grounds have been mentioned which would distinguish the case of payments made to directors from the case of payments made to employees when the question, that has to be gone into depends upon the extent of the services rendered by the directors or the employees. The distinction sought to be drawn by learned counsel between this case and the Full Bench case relied upon by us does not, therefore, exist. The views expressed in that case are fully applicable to the facts in the present case and lead to the conclusion that there was no sufficient ground on which the Excess Profits Tax Officer and the Income Tax Appellate Tribunal could disallow these amounts. In view of the fact that there is a Full Bench decision of this Court which is fully applicable in the present case, we have not considered it necessary to examine the cases of other High Courts. The case of 1944-12 ITR 104 : AIR 1944 Bombay 5, relied upon by the Excess Profits Tax Officer was taken notice of by the Full Bench of this Court.

6. In the circumstances, the question referred to us is answered in the negative. The assessee will be entitled to its costs from the Department which we fix at Rs. 300/- in each case.

Answer in the negative. .