

# ALLAHABAD HIGH COURT

Raja Ram Kumar Bhargava

Vs.

Commissioner of Income Tax

Income Tax Ref. No. 229 of 1952, connected with I.T. Reference No. 301 of 1958  
(V. Bhargava and Jagdish Sahai, JJ.)

01.02.1962

## JUDGMENT

### **V. Bhargava, J.**

1. These two separately numbered references, in fact, constitute one single reference. Under Section 66(1) of the Indian Income-tax Act (hereinafter referred to as the Act) the Income-tax Appellate Tribunal referred the following question for the opinion of this Court :-

"Whether the Act 71 of 1950 is ultra vires the Constitution of India?"

Thereafter, under Section 66(4) of the Act, this Court called for a supplementary statement of the case with reference to four other questions which, according to the Court, arose out of the appellate order of the Income-tax Appellate Tribunal. The questions, in respect of which the further statement of the case has been received, are :

"Q.1. Whether, on the facts and circumstances of this case, the sum of Rs. 63,283/- paid as commission to K.N. Tangri, B.B. Kapur and G. P. Bhargava in respect of their work done in execution of contracts with the Government was expenditure incurred or laid out wholly and exclusively for the purpose of the business of the assessee?

Q. 2. Whether, if the answer to the first question is in the affirmative, the sum of Rs. 23,239/- out of the aforesaid sum of Rs. 63,283/- was expenditure incurred during the previous year in question?

Q. 3. Whether the sum of Rs. 4,557/- disallowed out of the sum of Rs. 6,557/- paid to Hari Ram in the book depot as commission was expenditure laid out or

incurred wholly and exclusively for the purpose of the business as contemplated by section 10(2) (xv) of the Income-tax Act?

Q. 4. Whether the sum of Rs. 6,000/- disallowed out of Rs. 6,668/12/- paid as commission to the employees of the Bhargava Ice Factory, Kanpur, was expenditure laid out or incurred wholly and exclusively for the purpose of the business of the assessee as contemplated by Section 10(2)(xv) of the Income-tax Act?"

2. The assessee is a Hindu undivided family deriving income from house property and various types of businesses carried on by the family including the business of taking contracts for supply of goods to the Government. During the assessment for the assessment year 1945-46, questions arose relating to several deductions claimed by the assessee. One deduction claimed was a sum of Rs. 10,144/- which was sought to be excluded from the taxable income accruing from the assessee's properties on the ground that this sum had been paid for house and water taxes. The Income-tax Appellate Tribunal rejected this claim, holding that it was inadmissible in view of the explanation to sub-section (1) of Section 9 of the Act introduced by the Indian Income-tax Act (Amendment) Act, 1950 (Act No. LXXI of 1950) (hereinafter referred to as the Amending Act). Section 9 of the Act lays down the principles for computing taxable income from property and clauses (i) to (vii) of sub-section (1) of that section lay down the various allowances that are permitted to the owner as deductions when computing such income. One of the allowances deductible in computing income from property mentioned in clause (iv) of sub-section (1) of Section 9 of the Act, where the property is subject to an annual charge not being a capital charge, is the amount of such charge. The question whether house and water taxes imposed by a municipal board are or are not such a charge came up for decision before the Supreme Court in *Commissioner of Income-tax U. P. v. Gappumal Kanhaiya Lal*,<sup>1</sup> and the Supreme Court, for the reasons given in an earlier judgment in *New Piece Goods Bazar Co., Ltd., Bombay v. Commissioner of Income-tax, Bombay*,<sup>2</sup> held that the house tax and water tax imposed by a municipal board are annual charges which are not capital charges to which the property is subject within the meaning of clause (iv) of sub-section (1) of Section 9 of the Act. The legislature, after this decision by the Supreme Court, intervened and enacted the Amending Act. By Section 2 of the Amending Act, the following explanation was added to sub-section (1) of Section 9 of the Act :

Explanation- For the purposes of clause (iv) of this Sub-section, the expression

'annual charge' does not include any tax in respect of property or income from property levied by a local authority or a State Government or the Central Government."

This explanation was added with a further provision that it shall be deemed always to have been added. Then there was a provision in Section 3 of the Amending Act laying down an exception in respect of cases to which this explanation was not to be applicable. Section 3 of the Amending Act is as follows :

"Section 3 :- Where before the 7th day of October, 1950, the Supreme Court has, on an appeal in respect of the assessment of an assessee for any particular year, held that any tax paid by that assessee in respect of the relevant previous year is an 'annual charge not being a capital charge' within the meaning of clause (iv) of sub-section (1) of Section 9 of the said Act, then nothing contained in Section 2 of this Act shall apply, to the assessment of such assessee for that particular year."

After the decisions of the Supreme Court in the two cases cited above, if there had been no amendment of Section 9(1) of the Act, there would be no doubt that the deductions in respect of house tax and water tax claimed by the assessee in the present case would have been allowed and income from the property of the assessee would have had to be computed by the Department after deducting the amount paid as house tax and water tax. The decision by the Income Tax Appellate Tribunal on this point was given against the assessee on the ground that the explanation introduced in the Act by the Amending Act was applicable to his case and it has not been contested that, if the explanation is applicable to the case of the assessee and is a valid provision of law, the assessee would not be entitled to the deduction of the sum of Rs. 10,144/- paid as house and water taxes on his property. It was for this reason that the assessee put forward the plea that this explanation was ultra vires the Constitution.

3. The claim that the introduction of this explanation by the Amending Act was ultra vires the Constitution was put forward before the Tribunal on two grounds. It was urged that the provisions of the Amending Act were ultra vires of Article 14 as well as Article 15 of the Constitution of India. When learned counsel for the assessee argued the reference on this point before us, he, however, did not rely on Article 15 of the Constitution at all and confined his arguments to the submission that the Amending

Act was ultra vires Article 14 of the Constitution only. It was urged that Section 3 of the Amending Act had introduced a discrimination between various assesseees without any proper classification which may have had a nexus with the object for which the explanation was introduced in Section 9 (1) of the Act. The explanation added to Section 9 (1) of the Act was made retrospective by laying down that it was to be deemed always to have been added and was thus applicable to all cases of assesseees but, by Section 3 of the Amending Act, the assesseees whose cases had been decided by the Supreme Court on Appeal before the 7th of October, 1950, were not to be governed by this retrospective addition of the explanation. In urging this point, learned counsel at first proceeded on the assumption that, if there was an assessee in whose case the Supreme Court had, before the 7th of October, 1950, held that any tax paid by the assessee in respect of the previous year was an annual charge not being a capital charge within the meaning of Clause (i) of sub-section (1) of Section 9 of the Act, the provision contained in the explanation was not to apply to that assessee in respect of any year whatsoever and it was urged that a classification between such assesseees, who were exempted from the applicability of the explanation and all other assesseees was totally unreasonable. When, however, it was pointed out that the exemption granted by Section 3 of the Amending Act was confined to those proceedings of assessment of those particular years in respect of which the decision of the Supreme Court had been obtained, learned counsel himself had to concede that it was difficult for him to challenge the classification made by this provision of law. The effect of the classification was that the assessment cases, in which the Supreme Court had given its decision, were not to be re-opened for the purpose of applying the explanation introduced by this Amending Act in the principal Act but all other cases were to be decided on the basis that the explanation was applicable to them as it had to be deemed to have been added retrospectively. Under the Constitution, the Supreme Court is the highest Court of law in this country and the law declared by the Supreme Court is binding on all courts.

In view of these provisions contained in the Constitution, it seems to us that the legislature cannot be said to be making any unreasonable classification in giving sanctity to the decisions given by the Supreme Court, leaving them untouched by the subsequent legislation, while all other cases, in which the Supreme Court will not have given its decision, are to be governed by the amended law. A decision given by the Supreme Court results in finality and thereafter no party to any proceeding can have the case re-opened. While the Supreme Court has not given a decision, the decisions given by other courts may still be challenged and, in that view, may be treated on par

with pending cases. The effect at Section 3 of the Amending Act, therefore, was that the amendment adding the explanation retrospectively was made applicable to all cases of assessment which were pending on the 7th day of October, 1950, when this amendment first came into force by virtue of the Income Tax (Amendment) Ordinance No. XXVIII of 1950 which was later replaced by the Amending Act as well as to cases which started subsequent to that date. The cases were treated as pending cases if the Supreme Court had not yet given its decision in respect of that particular case. On the other hand, the explanation, though retrospective, was made inapplicable to all those cases in which the decision given had attained finality because the Supreme Court had already given its pronouncement prior to the explanation having been first introduced either by the Amending Act or by the amending Ordinance. It seems to us that a classification based on giving sanctity to decisions of the Supreme Court cannot be said to be an unreasonable classification, nor can it be said that such a classification has no nexus with the object of the enactment. The law, as it stood earlier, was interpreted by the Supreme Court in the cases which were finally decided by the Supreme Court and the legislature, in making exception contained in Section 3 of the Amending Act, only desired that those judgments already pronounced by the Supreme Court should not be affected by the fresh legislation. All other cases, in which the Supreme Court had not given its final decision, were to be governed by the amended law so as to give effect to the intention expressed by the legislature itself by adding the explanation to sub-section (1) of Section 9 of the Act. That a classification based on cases pending or decided is a reasonable classification was held by the Supreme Court in *Ramjilal v. Income-tax Officer, Mohindar Garh*,<sup>3</sup> Their Lordships held :

"In any case, the provision that pending proceedings should be concluded according to the law applicable at the time when the rights or liabilities accrued and the proceedings commenced is a reasonable law founded upon a reasonable classification of the assesseees which is permissible under the equal protection clause and to which no exception can be taken."

It is true that in terms the dictum laid down by their Lordships of the Supreme Court in this case does not apply to the case before us but it is clear that their Lordships of the Supreme Court approved of the principle that a classification, for purposes of applying a law based on rights or liabilities having accrued and proceedings having commenced prior to the enactment of that law and rights or liabilities accruing and proceedings commencing subsequent to the amendment of the law, is a reasonable

classification which is permissible under the equal protection clause. That principle justifies our view that the classification brought about by the provisions of the Amending Act is also reasonable, being founded upon sanctity being attached to the finality of the judgments of the Supreme Court. This view of ours also finds support from a decision of the Bombay High Court where this question was directly canvassed and answered in favor of the validity of the Amending Act. The decision of the Bombay High Court is reported in *Jamnadas Prabhudas v. Commissioner of Income-tax, Bombay City*,<sup>4</sup> The question referred to us by the Income Tax Appellate Tribunal under Section 66 (1) of the Act is, therefore, answered in the negative against the assessee.

4. The first question referred under the orders of this Court relates to the sum of Rs. 63,283/- shown as paid to three persons, K. N. Tangri, B. B. Kanpur and G. P. Bhargava. It appears that the assessee, besides earning income from house property and other businesses, was also carrying on a business of taking contracts for supply of cartons to the Government. The business was carried on under the name and style of R. K. Bhargava Carton Factory. In the accounts for this business, this sum of Rs. 63,283/- was shown as paid to these three persons. K. N. Tangri, who was the General Manager of the assessee, was paid Rs. 31,662/- being the commission at the rate of - per cent on the turnover of contracts Nos. 3 and 4 and 1½ per cent on the turnover of contracts Nos. 1 and 5 to 8. B. B. Kapur was paid the sum of Rs. 18,923/- which was the commission calculated at - per cent on the turnover of contracts Nos. 3 and 4 and 1 per cent on the turnover of other contracts. G. P. Bhargava was paid the sum of Rs. 12,698/- at the rate of - per cent on the turnover of contracts Nos. 3 and 4 and - per cent on the turnover of other contracts. It seems that these three persons, in addition to the commission paid to them, were drawing monthly remuneration. K. N. Tangri was getting remuneration at the rate of Rs. 450/- per mensem, B. B. Kapoor at the rate of Rs. 350/- per mensem and G. P. Bhargava at the rate of Rs. 300/- per mensem. The Income Tax Officer held that the commission paid to these three persons was an allowance of the nature covered by Section 10 (2) (x) of the Act and disallowed it on the ground that it was not a reasonable expenditure. Before the Income Tax Appellate Tribunal, it was urged on behalf of the assessee that the claim for deduction of this amount paid to these three persons should have been considered under Section 10 (2) (xv) of the Act and not under Section 10 (2)(x) of the Act on the ground that the case of the assessee really was that this was expenditure laid out wholly and exclusively for the purpose of carrying on the business in connection with which this payment was

made and was not a commission of the nature mentioned in Section 10 (2)(x) of the Act. The Tribunal accepted this contention put forward on behalf of the assessee and, consequently, proceeded to deal with the point as to whether it was an allowable expenditure by applying the provisions of Section 10 (2)(xv) of the Act. The Income Tax Department did not seek any reference to this Court against the view of the Tribunal that this expenditure had to be considered under Section 10 (2)(xv) and not under Section 10 (2)(x) of the Act.

Learned counsel for the Department, however, raised this question before us and urged that, in determining whether this sum paid to these three persons is an allowable deduction or not, provisions of Section 10 (2) (x) of the Act should be applied and, while those provisions are applicable, it should be held that the provisions of Section 10 (2)(xv) of the Act cannot apply. There was some dispute on the question whether, the Department not having sought any reference to this Court on this question of law decided by the Tribunal against the Department, such a plea could now be put forward in this reference on behalf of the Department. We have, however, not gone into this aspect because we have come to the view that the Tribunal was right in holding that the relevant provision to be considered was that contained in Section 10 (2)(xv) of the Act and not in Section 10 (2)(x) of the Act. Section 10(2)(x) of the Act permits a 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 :

Provided that the amount of the bonus or commission is of a reasonable amount with reference 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, professions or vocations."

Under Section 10 (2)(xv) of the Act, an assessee can claim a deduction in respect of

"any expenditure not being an allowance of the nature described in any of the Clauses (i) to (xiv) inclusive, and not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

It will thus be seen that, if the deduction claimed happens to be an expenditure of the nature mentioned in Section 10 (2) (x) of the Act, the claim for deduction of that expenditure has to be confined to that provision and benefit of deduction under Section 10 (2) (xv) of the Act cannot be claimed because of the exception made therein by which that provision has been made applicable only to all such expenditure as may not be an allowance of the nature described in any of the Clauses (i) to (xiv) which include Clause (x). The question, that has, therefore, to be seen in this case, is whether this allowance, being claimed by the assessee, is an allowance of the nature mentioned in Section 10 (2) (x) of the Act or not. It is no doubt true that this amount in question was paid to K. N. Tangri, B. B. Kapur and G.P. Bhargava who were in the service of the assessee and the amount paid has been described as commission, but we do not think that this mere description of this amount as commission necessarily makes the provisions of Section 10 (2)(x) of the Act applicable. Under Section 10 (2)(x) of the Act, the sum in question must be that paid to an employee as bonus or commission for services rendered. The word 'commission' in this clause should, in our opinion, be interpreted *ejusdem generis* with the word 'bonus'. The word 'commission', in business practice, covers various kinds of payments made under different circumstances. There are cases where a servant is employed by a businessman and, as a condition of his employment, it is agreed prior to the services having been rendered that he would be paid for his services at a fixed rate of percentage of the turnover or profits. In such a case, it is clear that the commission payable to the employee will, in fact, represent the salary to be drawn by him for his services. The payment on the percentage basis will only determine the measure of the salary. It would be a payment under the conditions of service and not a payment in the nature of a reward or appreciation or *ex gratia* payment because of the employer being particularly pleased with the services rendered. Bonus paid to employees does not form part of conditions of service and cannot be claimed by the assessee on the basis of any contract entitling the assessee to receive that payment. No doubt, under the present industrial practice, it is now recognized that bonus can be claimed by employees as of right and is not merely an *ex gratia* payment. Even then, the bonus that is paid to the employees is not paid as a claim justified by the conditions of service and it seems to us that the word 'commission' used in Section 10 (2)(x) of the Act should be interpreted to cover payments of a similar nature so as to exclude cases where the payment, though described as commission, really represents salary under the conditions of service and not a payment analogous to bonus. It appears to us that this interpretation of the word

'commission' is fully justified by the language of Clause (a) of the proviso. In this clause of the proviso, the amount of bonus or commission has to be determined to be a reasonable amount with reference to "the pay of the employee and the conditions of his service". If, in any case, an employee receives no fixed amount as pay and his conditions of service lay down that he shall be paid at a percentage rate on the turnover or profits, such a payment would clearly be one of the conditions of service and would represent the salary payable to him. It seems to be very anomalous that the reasonableness of payment under such a condition of service should be determined with reference to the same condition of service. The use of the expression 'the pay of the employee and the conditions of his service' in Clause (a) of the proviso makes it clear that the bonus or commission, the reasonableness of which has to be determined, must be bonus or commission apart from the pay and the conditions of service, so that its reasonableness can be tested on the basis of the pay and the conditions of service. The submission of learned counsel for the Department that all kinds of commission paid to an employee, even if they form part of the pay of the employee or part of the conditions of his service, would still be governed by the provisions of Section 10 (2) (x) of the Act cannot, therefore, be accepted by us.

5. In this connection, learned counsel for the Department drew our attention to a sentence in the judgment of their Lordships of the Supreme Court in *Commissioner of Excess Profits Tax, Madras v. N. M. Rayaloo Iyer and Sons*,<sup>5</sup> where it was said :

"It is true that in considering whether the deduction claimed by the assesseees for payments made as bonus or commission paid to an employee is to be allowed, the taxing officer must have regard to the provisions of Section 10(2) (x) of the Income-tax Act and clause (12) of Schedule 1 of the Excess Profits Tax Act; and in assessing the reasonableness, consideration of commercial expediency must undoubtedly be taken into account."

Learned counsel for the Department urged that this view was expressed by the Supreme Court in a case where, according to the facts before the Supreme Court, the assessee had written to the employee concerned, agreeing to pay him remuneration at the rate of Rs. 1,800/- per annum and 5 per cent of the net profits of the concern (Colours Trading Company) calculated by deducting from the gross profits of the business salaries, wages and other outgoings but without making any deduction for capital. Later, by a letter dated March 30, 1943, the salary of that employee was fixed at Rs. 3,000/- per annum and the commission was enhanced to 12½ per cent of the net profits. It was urged that these facts show that the commission was paid to the

employs under a promise made in the letter issued prior to the services having been rendered by the employee and it was with reference to this payment that the Supreme Court expressed the view that, in order to consider whether the payment was a deductible allowance, the taxing officer had to pay regard to the provisions of Section 10 (2) (x) of the Act. It appears to us that such a wide interpretation of the decision of the Supreme Court is not justified. The facts, as mentioned in the judgment, themselves indicate that, from the very beginning, the Supreme Court proceeded on the basis that the employee concerned was receiving his salary at the rate of Rs. 1,800/- per annum for some time and at the rate of Rs. 3,000/- per annum later and that the commission, which was being paid, was not a part of the salary of that employee. Further, the contents of the letter quoted in the judgment of the Supreme Court themselves show that the commission paid to the employee could not, in that case, have been treated as being a part of the salary. The first letter showed that the commission had to be calculated at the rate of 5 per cent of the net profits after deducting from the gross profits of the business salaries, wages and other outgoings. If this commission had itself formed part of the salary of the employee, it could obviously not be calculated after deducting this amount as part of the salaries paid out from the gross profits. It was only because this commission was treated as a payment apart from the payment of salary of the employee that it was permissible to calculate the amount of commission after deducting from gross profits, amongst other allowable expenses, salaries paid to the employees including that employee.

That was, therefore, a case where the commission was not of the particular nature explained by us above where it forms part of the salary and is paid under the conditions of service. It is also to be noticed that, in that case, the ultimate decision given by their Lordships of the Supreme Court was based on the applicability of clause (12) of Schedule 1 of the Excess Profits Tax Act and not of Section 10 (2) (x) of the Act. In the circumstances, we are unable to agree with learned counsel that the Supreme Court, in that decision, intended to lay down that the provisions of Section 10 (2) (x) of the Act would apply for judging whether an amount is an allowable deduction or not in all cases where the amount is described as commission irrespective of the nature of that commission or the circumstances under which that commission is paid. Their Lordships, at no stage, considered the case of an amount paid as commission representing salary payable to the employee under his conditions of service.

6. Reliance has also been placed by learned counsel for the Department on certain remarks in the judgment of a Full Bench of this Court in *Shyamlal Pragnarain v.*

*Commissioner of Income-tax, United Provinces, Lucknow,* <sup>6</sup> One of us was a member of that Full Bench. The Full Bench held :

"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 has arisen for decision between the assessee and the manager and assistant manager as regards the terms of the contracts. 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) of the Income-tax Act and R. 12, Schedule 1 of the Excess Profits Tax Act."

It was urged that these comments of the Full Bench show that the commission paid even under a legal contract would be covered by the provisions of Section 10 (2) (x) of the Act and the question whether it is allowable or not would have to be determined with reference to that provision of law. It is again to be noticed that, in that case, the Full Bench was not concerned with the question whether the commission, which was being claimed as an allowable deduction, was or was not a part of the salary of the manager or the assistant manager. On the other hand, in the remarks made in a few paragraphs preceding these comments, the Full Bench referred to the nature and the right under which bonus was claimed and the Full Bench proceeded on the basis that the commission, which was being claimed as a deduction in that case, was similar in nature to bonus. That case also does not militate against the view now being taken by us that the commission, which forms part of the salary under the conditions of service, can be claimed as an allowable expenditure under Section 10(2)(xv) of the Act on the ground that it is not an allowance of the nature described in Section 10(2) (x) of the Act.

7. The Income-tax Appellate Tribunal, after having held that the provisions of Section 10(2) (xv) of the Act were applicable still appears to have fallen into an error in basing its decision, disallowing this claim, on the ground that the amount already estimated by the Appellate Assistant Commissioner of Income-tax was reasonable in the

circumstances of the case. Expenditure claimed under Section 10 (2) (xv) of the Act is not to be tested on the basis of reasonableness at all. All expenditure incurred wholly and exclusively for the purpose of the business must be allowed and the only question that is to be seen is whether the particular expenditure claimed was expended wholly and exclusively for the purpose of the business. The principles that have to be kept in view in arriving at a decision on such a point can be taken from the view expressed by their Lordships of the Supreme Court in *Eastern Investments Ltd. v. Commissioner of Income-tax, West Bengal*,<sup>7</sup> In that case, the Supreme Court had occasion to consider the scope of Section 12(2) of the Act where income, profits and gains have to be computed after making allowance for "any expenditure incurred solely for the purpose of making or earning such income, profits or gains". It has appeared to us that the scope of the word 'solely' used in Section 12(2) of the Act cannot be very different from the scope of the words 'wholly and exclusively' used in Section 10 (2) (xv) of the Act. Their Lordships, in the case cited above, held that the principles, which are relevant, are –

- (1) though the question must be decided on the facts of each case, the final conclusion is one of law;
- (2) it is not necessary to show that the expenditure was a profitable one or that, in fact, any profit was earned;
- (3) it is enough to show that the money was expended not of necessity and with a view to a direct and immediate benefit to the trade but voluntarily on the ground of commercial expediency, and in order indirectly to facilitate the carrying on of the business;
- (4) beyond that no hard and fast rule can be laid down to explain what is meant by the word 'solely'.

In *F. E. Dinshaw Ltd. v. Commissioner of Income Tax, Bombay City*<sup>8</sup> the Bombay High Court held that the principle, on which the decision of the Supreme Court in 1951-20 ITR 1 (supra) rested, was the same and raised the same considerations as arise under Section 10(2) (xv) of the Act. Reference may also be made to a decision of the Madras High Court in the case of *Newton Studios Ltd. Madras v. Commissioner of Income Tax, Madras*,<sup>9</sup> In that case also, the Madras High Court applied the principles laid down by the Supreme Court in the case of 1951-20 ITR 1 (supra) with reference to Section 12(2) of the Act holding that the same principles apply when the claim for deduction is under Section 10(2) (xv) of the Act. The learned Judges, explaining the

applicability of those principles, proceeded to hold :

"Under our taxing system, it is for the assessee to conduct his business, and in his wisdom or otherwise to fix the remuneration to this staff. The Income-tax Act does not clothe the taxing authority with any power or jurisdiction to determine the reasonableness of the amount so fixed and paid by the assessee. The only test for the deductibility of such remuneration is whether the expenditure has been incurred solely and exclusively for the purpose of the business. If the reality of the payment is challenged or is in dispute, different considerations arise; so also in cases where the tax authorities are able to point to some consideration other than the purpose of the business as accounting for any portion of the payment made. In such cases, or course, such portion of the amount claimed, which is either not held to have been paid or is held to have been paid for reasons other than business expediency, could and should be disallowed; but the reason for the disallowance is because either the portion disallowed is not paid, or because the expenditure is not solely and exclusively for the business, and not on the ground that in the opinion of the Income-tax Officer or other taxing authority the remuneration is 'unreasonably' high - either because the employee does not, in the authority's opinion, deserve so much, or because the assessee could have secured other employees on more favorable terms."

We consider that these are the principles which apply to the present case also and we have, therefore, to examine and see whether the payments made by the assessee to the three employees, viz., K.N. Tangri, B.B. Kapur and G. P. Bhargava, fall within these principles.

8. The assessee, in order to put forward the facts and circumstances under which those payments were made, filed an affidavit sworn by the assessee, Raja Ram Kumar Bhargava, himself, as well as affidavits sworn by two of the employees concerned, K. N. Tangri and B. B. Kapur. The assessee, in his affidavit, stated that the manufacture of cartons was a new business of a pioneer nature, that trained and experienced hands were not available and that, with a view to secure more personal interest and infuse a greater spirit of efficiency and carefulness in doing their duties, he considered it necessary in the interest of the business to engage the services of these three persons, K.N. Tangri, B.B. Kapur and G. P. Bhargava, on the basis of commission paid on the

turnover in addition to the monthly salary which they were drawing for other work that they were doing earlier. He added that this cast heavy and arduous duties upon these employees and he felt that they should be reasonably and adequately compensated for that work. He also asserted that, in fixing the remuneration of these persons, he took into account the circumstance that the work was unwieldy and complicated, that the delivery time was short, that the contracted goods were not available in the market, that the rejection of goods entitled a dead-loss of material and labor and that a breach of contract with the Government might involve the assessee in heavy damages. Later, when he found that, due to the excellent work put in by those employees, there was a regular flow of fresh contracts, he raised the rate of commission payable to them. The rate of commission was raised on the further ground considered by him to be reasonable and fair because of the increase in the volume of work, the number of contracts and their value and the enormous intricacies and complications involved in the manufacture of various and varying types of cartons. The affidavits filed by K.N. Tangri and B. B. Kapur, more or less, supported these assertions made by the assessee in his affidavit. All the income-tax authorities as well as the Income-tax Appellate Tribunal accepted the first part of the assessee's case that, initially, when the commission was fixed by the assessee for payment to these employees, there was justification for that payment as that payment was necessitated by the exigencies of the business. For this reason, the initial commission fixed by the assessee and paid at that initial rate to these three employees was allowed and that allowance was upheld by the Income-tax Appellate Tribunal also. The Income-tax Appellate Tribunal, however, agreed with the Appellate Assistant Commissioner of Income-tax in disallowing the commission at the increased rate which was allowed by the assessee to the employees during the sub-sequent conduct of the business. This rate was raised with effect from 1st October, 1943. The Tribunal held that they had no doubt in their mind that no extra work was done by these employees, so that there was no justification in the increase of the rate of commission. The affidavit filed on behalf of the assessee clearly showed how and why extra work fell upon those employees when it became necessary to raise the rate of commission with effect from 1st October, 1943. On those affidavits, the persons swearing the affidavits were not cross-examined by the income-tax authorities or by the Tribunal and, in fact, no indication was given to the assessee that the facts given in the affidavits were not going to be accepted in those assessment proceedings. In thus disregarding the affidavits filed, the Tribunal clearly committed an error of law. The error is exactly similar to that pointed out by their Lordships of the Supreme Court in the case of *Mehta Parikh and Co. v.*

*Commissioner of Income Tax, Bombay*,<sup>10</sup> In that case, the assessee had filed the cash book and three affidavits. The Income-tax Officer and the Appellate Assistant Commissioner of Income-tax accepted the cash book and did not challenge the entries therein, did not call for further documents or vouchers in relation to those entries, nor did they require the presence of the deponents of the three affidavits. The assessee also did not consider the presence of the deponents of the three affidavits necessary. It was held by the Supreme Court in these circumstances that the assessee took it that the affidavits of those parties were enough and neither the Appellate Assistant Commissioner nor the Income-tax Officer who was present at the hearing of the appeal before the Appellate Assistant Commissioner, considered it necessary to call for them in order to cross-examine them with reference to the statements made by them in their affidavits and, in those circumstances, it was not open to the Revenue to challenge the correctness of the entries in the cash book, or the statements of those deponents in their affidavits. The circumstances of the case before us are exactly similar. Here also affidavits were filed by the assessee and his employees and neither party considered it necessary to enforce the attendance of the deponents. The deponents were not cross-examined, so that the assessee was entitled to believe that the facts given in the affidavits would be accepted and the assessment order would be made on the basis that those facts were correct. The Tribunal was not entitled, in these circumstances, to disregard the facts given in the affidavits and record a finding contrary to them. The facts, as we have indicated earlier, showed that, at a later stage of the business the work that had to be done by the three employees, increased enormously and it also became more varied and complicated. These were the reasons which led the assessee to increase the rate of commission. It is impossible to hold on these facts that the payment made to the employees at the higher rate was not justified by the expediency of the business. The Tribunal appeared to make a point out of the fact that the commission had been agreed to be paid on the turnover and not on the profits. This fact, if at all, supports the case of the assessee rather than militating against it. The turnover will determine the amount of work which would have to be done or which would have to be supervised by the employees put incharge of the business. If the turnover increased enormously, the work done would also increase in the same proportion and such increase in work would certainly justify increase in payment. The Tribunal also considered that an initial commission at a total rate of 1½ per cent between the three employees fixed at the time when this business was begun would have been sufficient because with the increase in the turnover the actual amount calculated at that rate would automatically increase and the employees would have

been properly remunerated by that increase. The Tribunal seems to have lost sight of the fact, asserted in the affidavit, that there was an increase not only in the volume of the work but there were other complications so as to make the nature of the work more complicated. Initially, the cartons to be supplied were to be only of one type but, later on, cartons of various types were to be manufactured. In fact, the organization for manufacture of cartons had to be altered and the employees had to supervise the new organization and not merely continue to supervise the previous organization. These are the facts which appear in the affidavits and which have been ignored by the Tribunal in the appellate order. Another circumstance held against the assessee by the Tribunal was that, for a period of four months, G. P. Bhargava was absent due to illness and yet he was paid this commission though he was not paid the salary for that period. This ground again ignores the nature of the payment which is being claimed as an expenditure in this case. The payment to G. P. Bhargava as commission was being made on the basis of a percentage of the turnover after completion of each contract. It does not appear anywhere on the record that the absence of G. P. Bhargava for a period of four months, in any way, hampered the completion of any of the contracts or reduced the value of the work which he may have done before or after his illness for the completion of that contract. The affidavits filed on behalf of the assessee show that G. P. Bhargava had participated in the work of all those contracts in respect of which he had been paid his commission and, consequently, the payment to him on completion of the contracts was a justified one even though he was absent for a short period in between and was not paid his salary for other work for that period. It will thus be seen that the Tribunal in this case went wrong in giving the decision against the assessee in as much as the Tribunal wrongly rejected the facts given in the affidavits or ignored facts given therein and based its conclusions on findings recorded contrary to the facts given in the affidavits. On the facts as the Tribunal was bound to accept, it is impossible to hold that the assessee's case that this money was paid to these employees for the purpose of running the business and as a matter of business expediency was not correct. The money having been paid for such a purpose, it must be held that it was expended wholly and exclusively for the purpose of the business and must be allowed as a deduction under Section 10 (2) (xv) of the Act. This question is answered accordingly in the affirmative in favour of the assessee.

9. On question No. 2, learned counsel for the assessee has urged that the decision given by the Income-tax Appellate Tribunal should be held to be incorrect on two grounds : The first ground is that the Income-tax Appellate Tribunal proceeded to

record the finding that commission to the extent of Rs. 23,239/- should have been claimed in the preceding year without any appeal having been filed by the Department before the Tribunal and even without any such ground having been raised on behalf of the Department. The Income-tax Officer and the Appellate Assistant Commissioner of Income-tax had recorded the finding that the entire sum claimed as deductible expenditure in respect of payments made to K. N. Tangri, B. B. Kapur and G. P. Bhargava was to be treated as expenditure in the previous year relating to the assessment year in question and that view was not challenged before the Income-tax Appellate Tribunal. The Tribunal, however, on its own initiative, recorded the finding that this commission was earned by the employees in the preceding year, meaning the previous year relating to the assessment year preceding the assessment year in question, so that this expenditure could not be claimed in this assessment.

The Income-tax Officer and the Appellate Assistant Commissioner of Income-tax had disallowed the payment made to these three employees on the ground that it was not justified under Section 10 (2) (x) of the Act without recording any finding that any part of the amount claimed as deductible expenditure was expenditure not incurred in the previous year relating to the assessment year in question. In these circumstances, it does appear that it was not open to the Tribunal, on its own initiative, to record a reverse finding.

10. The second ground urged by learned counsel, which must also be accepted, is that, even on merits, the finding recorded by the Tribunal is clearly incorrect. The view taken by the Tribunal is that this payment was made to the employees in respect of contracts which were carried out not only in the year of account but also in the preceding year of account and the income from the work done in the year preceding to the year of account had been taken into consideration in that year's account, so that the expenses regarding this commission should also have been charged in the preceding year and not claimed in this year. This finding was recorded on the basis that the assessee was maintaining accounts on mercantile system and, since the income of the contract was taken into account in the preceding previous year, this expenditure on commission should also have been claimed for the preceding previous year. The Tribunal, it is clear, fell into an error because no care was taken to examine when the right to receive this commission accrued to the employees, so that it became a liability to the assessee. According to the facts put forward on behalf of the assessee, the commission to the employees was payable on each contract only after the completion of that contract. No payment was to be made during the pendency of one single

contract as commission on the turnover of that contract. Consequently, it was immaterial whether some of the contracts were such that parts of those contracts were carried out in the preceding year and parts in the previous year in question. The right of the employees to receive commission could only accrue to them when the whole of each contract was completed and there was no assertion that the deductions claimed in respect of commission related to any contract which had been completed in the preceding year. In fact, the Tribunal itself recognized the circumstance that the contracts were carried out in the preceding year as well as in the previous year in question which necessarily implies that the contracts were completed in the previous year in question and not in the preceding year. The income accruing from the contract had to be credited in the accounts as income already accrued if payment from the Government in respect of the portion of the contract carried out in the preceding year became due on that portion of the contract having been carried out. This would not, however, change the position between the assessee and his employees. The employees could not claim that any commission became due to them until each contract was completed in its entirety and, since all the contracts were completed in the previous year in question, the entire amount paid as commission to the employees became payable only for the previous year in question and could legitimately be claimed as a deductible expenditure in this very assessment. The Tribunal fell into an error because the Tribunal ignored the circumstance that the right to receive the commission accrued to the employees only on completion of the contracts which took place in the previous year in question. In these circumstances, this second question is also answered in the affirmative in favor of the assessee.

#### Questions Nos. 3 and 4

11. These two questions may be taken up together. Question No. 3 relates to the disallowance of a payment claimed to have been made to one Hari Ram, Manager, Newal Kishore Book Depot, as commission. Question No. 4 relates to the payment made as commission on the sales in the assessee's Bhargava Ice Factory to the employees of that factory. It appears from the appellate order of the Tribunal that these payments were justified by the assessee on the ground that they were made in order, in the first case, to act as an incentive to Hari Ram to sell more publications and, in the second case to increase the sale of the produce of the Bhargava Ice Factory. The Tribunal, in examining these two amounts, held that these payments were made without any written agreements and the commission had been adjusted at the end of

the year. They noticed the fact that, if there had been an agreement between the parties, the natural course would have been to periodically credit the employees with the earnings of their commission as and when the sales had been effected and the absence of such adjustments gave color to the fact that the arrangements were not genuine. The Tribunal thought that those agreements were an afterthought to bring down the profits. This inference was drawn on the further ground that there was no particular reason to allow such high commission for the ordinary duties of the employees. These findings recorded by the Tribunal are all findings of fact and it is not possible to hold that these findings are without any material. This decision given by the Tribunal amounts to holding that these payments claimed as deductible expenditure were not at all genuine. Such a finding of fact stands in the way of the assessee claiming these amounts as expenditure deductible under Section 10 (2) (xv) of the Act. The amounts covered by these two questions differ in nature from the amounts claimed in the first two questions inasmuch as, in the case of the amounts claimed in the first two questions, the fact of payments having been made to K. N. Tangri, B. B. Kapur and G. P. Bhargava to the extent of the amounts claimed was accepted as correct whereas, in the case of these two amounts, the finding is that these payments were not at all genuine. Consequently, both these questions are answered in the negative against the assessee.

12. In view of the fact that the question originally referred by the Income-tax Appellate Tribunal to this Court under Section 66 (1) of the Act is being answered in favor of the assessee and in view of the fact that the amounts covered by questions Nos. 3 and 4 are very small as compared with the amounts covered by questions Nos. 1 and 2, we consider that it would be fair in this case to allow the assessee costs of these references. We, consequently, direct that the assessee shall be entitled to the costs of these references from the Department which we fixed at Rs. 300/- representing fee of learned counsel for the assessee. The same amount shall be treated as fee of learned counsel for the Department for purposes of taxation.

Question answered.

Cases Referred.

1. 1950-18 ITR 584
2. 1950-18 ITR 516

3. AIR 1951 SC 97
4. 1951-20 ITR 160: AIR 1951 Bom 438
5. 1961-41 ITR 671: (AIR 1961 SC 692)
6. 1955-27 ITR 404: AIR 1955 All 299 (FB)
7. 1951-20 ITR 1
8. 1959-36 ITR 114: AIR 1959 Bom 427
9. 1955-28 ITR 378: AIR 1955 Mad 646
10. 1956-30 ITR 181: AIR 1956 SC 554