CALCUTTA HIGH COURT

Commissioner of Income-Tax

Vs.

Turner, Morrison & Company Private Limited

Income Tax Reference No. 165 of 1963

(B.N. Banerkee and K.L. Roy, JJ.)

07.08.1967

JUDGMENT

B.N. Banerkee, J.

1. This reference under section 66(1) of the Indian Income-tax Act has been made in circumstances hereinafter related.

2. The assessee, Turner Morrison and Company Private Limited, is an Indian company doing business as the managing agent of certain shipping concerns. During the assessment year 1952-53, the assessee-company used to employ five directors and during the assessment year 1953-54, one more. These persons, although designated as directors (to be more precise either as full directors or as local directors, according to their executive ranks), were, in fact, high executives of the company. They did not hold any shares in the company and had no hand in policy making. Each one of them rose by promotion from lower ranks. Their remuneration and service conditions used to be governed by separate agreement with the assessee-company. They were in no way related to the shareholders of the assessee-company, who mostly belong to the wealthy English family known as "Turner family".

3. During the assessment year 1952-53, the assessee-company paid to one of its directors, of the name of M. G. Robson, a sum of Rs. 1,00,000 by way of compensation for earlier termination of his contract service. Again, during the assessment year 1953-54, the assessee-company paid to two of its directors of the names of J. Morshead and W. L. A. Radcliffe, respectively, Rs. 1,50,000 and Rs. 1,00,000 for the same reason.

4. The circumstances under which payment of compensation to M.G. Robson was decided upon appear from the minutes of two meeting of the directors of the assessee-company. At the meeting held on June 3, 1951, the chairman of the assessee-company reported that, while in the United

Kingdom he and one Mr. Gloag had discussion with the beneficial share-holders of the assessee-company on the subject as to whether, for acceleration of promotion of newer members of the board of directors and for inclusion therein of persons who were qualified to become directors, senior people at the top rank of the assessee-company should retire earlier than the contracted period. He further reported that, at the suggestion of the shareholders, it was thorough advisable to ask M.G. Robson, who was at that time on home leave in the United Kingdom, to agree to his service contract being terminated with the expiry of his leave at the end of September, 1951. He also reported that the agreement with M. G. Robson would terminate with the expiry of the month of March, 1955, by efflux of time and as there was no provision in the agreement for giving notice by either side, M. G. Robson would be entitled to ask for compensation for premature termination of office. The board, thereupon, decided to write to M. G. Robson and find out his reaction to the proposal. In his reply to the letter written by the board, M. G. Robson demanded a sum of Rs. 1,00,000 as compensation. At the next meeting of the board, held on June 25, 1951, the board agreed that the request was not unreasonable and that the company would be saving money by terminating the services of M. G. Robson with effect from September 30, 1951, even on payment of compensation of Rs. 1,00,000. The board, therefore, decided to do so.

5. It was not disputed before us that the circumstances which induced the board earlier to terminate the services of J. Morshead and W.L.A. Radcliffe (who were also contractually due to retire not earlier than March 31, 1955), in the year 1952, were the same circumstances, as in the case of M. G. Robson, and the sums of Rs. 1,50,000 and Rs. 1,00,000 were, respectively, paid to them as compensation for the same reason as in the case of M. G. Robson.

6. In the assessment year 1952-53, the assessee claimed deduction of the amount of compensation paid to M. G. Robson as business expenditure under section 10(2) (xv) of the Indian Income-tax Act. In the assessment year 1953-54, the assessee claimed deduction of the amounts of compensation paid to J. Morshead and W. L. A. Radcliffe as business expenditure under section 10(2) (xv) of the Indian Income-tax Act.

7. The Income-tax Officer disallowed the claim on the ground that the payment of compensation was not for the purpose of business and the more so because the purpose for which the termination had been purportedly, made, namely, to bring in fresh blood, was not carried out by the assessee.

8. In the assessment year 1952-53, the assessee also claimed deduction of a sum of Rs. 2,074, being the amount of fees paid to an architect who valued the business premises of the assessee in connection with the revaluation of the said premises to municipal rates. The Income-tax Officer disallowed this expenditure also on the ground that the same was not a business expenditure.

9. The assessee appealed against the two assessment order before the Appellate Assistant

Commissioner. The Appellate Assistant Commissioner dismissed both the appeals, being of the same view as expressed by the Income-tax Officer.

10. Thereupon, the assessee preferred second appeals before the Appellate Tribunal against both the orders. The Tribunal allowed the appeals. The reasons which weighed with the Tribunal in allowing compensation paid to the three directors, as business expenditure, were :

> "We are unable to appreciate the soundness of the reason for making the disallowance. May be, that initially when the terminations were being effected, the company genuinely wanted to bring in fresh persons on the board of directors but actually having terminated their services they did not do so. This factor, in our opinion, cannot lead to the conclusion that the expenditure incurred for paying the compensation to the outgoing directors on the premature terminations of their services was not a business expenditure. To understand what a legitimate business expenses is, one has got to view it from the angle of a businessman. Now, in all these cases we find that the years concerned were holding an agreement in their hands which they could have validly enforced in a court of law and taken out of the company's income a much higher amount than what the actually received as compensation. These outgoing directors, however, did not do so and instead accepted the lower amount as compensation for the loss of their employment. It is clearly a case, where, in doing so, the company benefited monetarily. The subject-matter and the principle involved here had once been before the Tribunal in the assessees case relating to the assessment year 1951-52. The disallowance in that case relating to the compensation paid to one Mr. Squarey under similar circumstances and the Tribunal held it to be an allowable expenditure and accordingly deleted the add back. On the facts as stated above and on our consideration of the entire aspect of the matter, we are of the opinion that the compensation paid for loss of office to the aforesaid directors benefits the company in its business, inasmuch as it saved a good lot of monetary outgoing and at the same time was in pursuance of the general policy of the company to introduce new directors."

11. The Tribunal allowed the claim by the assessee for deduction of Rs. 2,074, paid as fees to the architect, with the following observation :

> "It is submitted on behalf of the assessee that the payment having been made in order to reduce the recurrent expenses payable by way of municipal taxes, the amount should be allowed as a business expenditure and more so because major portion of the property in question, almost 2/3rd, was being used for the purpose of the business. The income-tax authorities below have disallowed it as a capital expenditure. We do not think that the payment is of a capital nature. Looking at the payment and the purpose for which the payment is made, it appears to be a settlement of the assessees exact liability of taxation by an authority. There is no reason why this amount should be called a capital expenditure."

12. Dissatisfied with the order of the Tribunal, the revenue induced the Tribunal to refer the following two question of law to this court for opinion :

> "(1) Whether, on the facts and in the circumstances of the case, the compensations of Rs. 1,00,000 paid to Mr. M. G. Robson in the previous year relating to the assessment year 1952-53, Rs. 1,50,000 to Mr. J. Morshead and Rs. 1,00,000 to Mr. W.L.A. Radcliffe in the previous year relating to the assessment year 1953-54, were admissible deduction in law for the purpose of assessment under the Income-tax Act ?
> (2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 2,074 being the fees paid to the architects was not a capital expenditure ?"

13. Mr. B.L. Pal, learned counsel for the revenue, submitted that the compensation was paid to the directors either, (a) for setting up consequences of wrongful breach of service contracts, by payment of damages, or (b) in pursuit of a policy, which was not an economic policy in the interest of trade, of removing senior officials, and replacing them by qualified junior officials, which again was not implemented by appointment of junior men to senior positions. Mr. Pal submitted that in either event the compensation paid to the directors would not be money wholly and exclusively expended for the purpose of business of the assessee, within the meaning of section 10(2) (xv) of the Indian Income-tax Act. In support of his argument that damages paid for breach of contract of employment was not an allowable revenue expenditure, Mr. Pal strongly relief on a judgment of the Court of Appeal in England in *Godden v. A. Wilsons Stores (Holdings) Ltd*[1]*.,* In that case, the assessee employed a person as the manager, for a fixed period, on contract basis. Before the expiry of the period, the assessee arranged to dispose of its business. In order earlier to terminate the services of the manager, the assessee offered him a certain amount as compensation, in lieu of contractual notice. In disallowing this sum as a business expenditure, Upjohn L.J. observed :

> "It is perfectly true that this payment might have been so devised that the company might have been entitled to claim this as deductible expense, as being the remuneration of Mr. Paton during this period, but, in fact, it was not so devised. I return to paragraph (c) of the letter of the 27th February, 1958, which sets out perfectly clearly what the parties were intending to do. What the parties were intending to do was to give Mr. Paton Pounds 1,900 in lieu of notice, which is as common a transaction as one can possibly have. In other words, they were paying him compensation for the fact that they were not going to employ him for that full time for which they were bound to employ him : and for that and other reasons, Mr. Paton was happy and willing to accept that arrangement. To my way of thinking, that payment cannot possible be described as a payment for the purpose of trade. It was made because the company was not going on to trade and they were left with the possibility of an action for damages against them for breach of the agreement of employment. I accept Mr. Bornemans submission that though it was made on the

occasion of discontinuance, it was not because of that, and it was not to enable them to discontinue business : they were going to do that any way. But this payment was not made for the purpose of the trade they were going to carry on, it was to get rid of a possible law suit after discontinuance."

14. In our opinion, the above case is distinguishable on facts. The payment of compensation to the manager was being made nor for the purposes of the expedient conduct of the business of the assessee but for the winding up of that business. The assessee was going to close down the business and wanted to get rid of the manager. Such riddance was not possible, earlier than the contracted period, except by payment of damages to the said manager. This payment was made not for the carriage of the business but to avoid payment of large damages, which might have befallen to the assessee if it had not succeeded in setting up the service agreement. In the instant case, the payment of compensation was made for more efficient carriage of business of the assessee as considered later in this judgment. This is the difference between the instant case and Goddens case relied on by Mr. Pal.

[1]40 Tax Cas 161

15. Now, in *Atherton v. British Insulated and Helsby Cables Ltd*[2]*.,* Lord Cave observed :

"That a sum of money expended, not of necessity and with a view of to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purpose of the trade."

16. Following the view in Athertons case the English Court of Appeal in *Mitchell v. B.W. Noble Ltd*[3]*.,* allowed the sum paid by the assessee as compensation to a director, so as to get rid of him, and thus avoid a scandal injurious to the assessees trade, as business expenditure with the observation (per Lord Hanworth) :

"It seems to me that the directors had to handle a situation of both delicacy and gravity, and, their bona fides not being questioned, it is clear that they took a course which they were justified in taking and made a payment in the interest of the carrying on of their trade. That being so, the second question arises : Is it to be treated as a capital expense. It is said, and not unfairly, that you have a sum definitely agreed, a payment no doubt by installments but for all practical purposes the sum is immediately ascertained and is in that sense in the nature of a capital payment, liquidated thought may be over a subsequent period of time : and it is said that for this payment obtained an immediate result, namely, the resignation of the director. It was not a recurring incident; it was not something which would have to be dealt with in subsequent years, but it was an immediate result final in its conclusion inasmuch as it severed the connection between the director and the company. Now, all that is very true and I agree that perhaps it is more difficult to see whether it should be treated as a capital payment or not, but I think Mr. Justice Rowlatt puts it well at

the end of his judgment where he says : This gentleman being there as an unsatisfactory servant was not a permanency. He was no doubt there for his life, but I do not think you can say : "By an expenditure of capital I will get rid of this nuisance affecting my business, and have his room rather than his company by making this capital expenditure. " I cannot took at it in that way. It seems to me it is simply this, although the largeness of the figures and the peculiar nature of the circumstances perplex one, that this is no more than a payment to get rid of a servant in the course of the business and in the year in which the trouble comes.

We have had a number of cases reviewed again which were discussed and considered in this court and in the House of Lords in the *British Insulated and Helsby Cables Ltd. v. Atherton* and the Lord Chancellor given instances of payments which although apparently final in their quality have been held to be properly chargeable against the receipts for the year. `Instances, he says on page 213 (10 Tax Cases at page 192) of such payments may be found in the gratuity of Pounds 1,500 paid to a reporter on his retirement (*Smith v. Incorporated Council of Law Reporting*[4]*),*. . . and in the expenditure of Pounds 4,494 in the purchase of an annuity for the benefit of an actuary who had retired, which in Hancocks case was allowed, and I think rightly allowed, to be deducted from profits. Now I respectfully share the view of Lord Buckmaster that it is not easy to find much

[2]10 Tax Cas 155 [4]6 T.C. 477

[3]11 Tax Cases 372

help from the particular facts of decided cases; not is it easy to define

the limits of the principle upon which one is acting. At the same time I think in a concrete case it is possible to be attributed to revenue. I do not in the least wish to go back upon anything that I said myself in the British Insulated and Helsby Cable case, but it appears to me upon the facts of this case that this payment should be treated as a revenue item and not as a capital item."

17. The observation of Viscount Cave was approved of by the Supreme Court in *Commissioner of Income-tax v. Chandulal Keshavlal & Co*[5]*.,* In the other decision of the Supreme Court, say for example, in *Commissioner of Income-tax v. Royal Calcutta Turf Club*[6]*,* in *Commissioner of Income-tax v. Chari and Chari Ltd*[7]*.,* and in *Swadeshi Cotton Mills Ltd. v. Commissioner of Income-tax*[8]*,* the view that the Supreme Court expressed was in consonance with the view expressed by Viscount Cave in *Atherton v. British Insulated and Helsby Cables Ltd*. This court in *Calcutta Landing & Shipping Co. Ltd. v. Commissioner of Income-tax*[9]*,* summarized the views expressed in different judgments and observed :

"It is now well settled that the expression expenditure laid out or expended wholly and exclusively for the purpose of such business includes expenditure voluntarily incurred for commercial expediency and in order indirectly to facilitate business. It is immaterial if a third party also benefits thereby. It is further well settled that an expenditure incurred in maintaining the efficiency of the manpower from time to time utilised in a business is also expenditure wholly or exclusively laid out for the purpose of such business. It is also well

settled that the employment of, say a director, at a reasonable extra remuneration to supervise a particular business of the company, regard being had to his expert knowledge in that particular line of business, is expenditure within the meaning of section 10(2) (xv) and the revenue authorities are not justified in reducing such remuneration. The expression commercial expediency is an expression of wide import and expenditure in commercial expediency includes such expenditure as a prudent man may incur for the purpose of business. An expenditure which is entirely gratuitous and has no connection with the business does not come within the meaning of section 10(2) (xv) of the Act."

18. This being the position in law, we have to see for what purpose were the payments made to the three directors. Mr. Pal, in our opinion, is not right in his contentions that the payment of compensation was made to the three directors so as to settle up the consequence of wrongful beach of service contract by payment of damages. On the other hand, Mr. Palkhivala is right in his submission that, in the circumstances of the instant case, what really happened was that the promises, namely, the three directors, dispensed with or remitted the performance of the remaining part of the services contract by the promisor, namely, the assessee, by acceptance of monetary satisfaction in lieu of performance. In making this submission, Mr. Palkhivala has no doubt the provisions of section 63 of the Contract Act in his mind, which section reads :

[5](1960) 38 I.T.R. 601 [7](1965) 57 ITR 400 [9](1967) 65 I.T.R. 1
[6](1961) 41 ITR 414 [8](1967) 63 ITR 57

"Every promise may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit."

Now, if by getting rid of the three directors, the assessee-company was benefiting economically, that it to say, was reducing top-heavy administration costs, then, there is no reason why the payment of compensation, which enabled the assessee to effect such economy, should not be treated as expenditure wholly and exclusively for the purpose of its business.

19. Mr. Pall argued that there was no economic objects behind the payment of compensation-the only professed objects being to open up the way for promotion of qualified junior men to senior positions, which object again was not followed up. In our opinion, Mr. Pal is not right in this submission. If we read the minutes of the board meetings, held on the 3rd and the 25th June, 1951, together, we are left in no doubt that the real object of the assessee was to save money because the three directors were consuming a good deal and the compensation that was paid to them was much less than what they would have consumed if the service agreement had not been terminated in the manner done. Mr. Palkhivala handed over to us the following analysis showing the measure of economy achieved by payment of compensation to the three directors :

	M.G. Robson	W.L.A. Radcliffe	J. Morshead

1. Assessment year to which the sum relates...	1952-53	1953-54	1953-54
2. Salary per year...	Rs. 80,000/-	Rs. 80,000/-	Rs. 2,50,000/-
3. Date of termination of service...	30-9-51	30-6-52	30-9-52.
4. Balance of service period as per agreement...	3 yrs 6 months	2 yrs 9 months	2 yrs 6 months
5. Salary payable for the balance of service period...	Rs. 2,80,000/-	Rs. 2,20,000/-	Rs, 6,25,000/-
6. Compensation paid	Rs. 1,00,000/-	Rs. 1,00,000/-	Rs. 1,50,000/-
7. Benefit to the company...	Rs. 1,80,000/-	Rs. 1,20,000/-	Rs. 4,75,000/-

20. The correctness of this analysis was not disputed by the learned counsel for the revenue. That being so, we feel that the assessee decided to promote qualified junior men to senior position as director, with a definite purpose, namely, to cut down the administration expenditure and thus save money. The fact that the assessee did not immediately promote junior men to fill up such positions is inconsequential because an initial economy measure, if subsequently further economised, does not detract from the value of the first economy measure. We are, therefore, of the view that the payment of compensation was by way of money saving device, in the interest of the business of the assessee, and, as such, was expenditure wholely and exclusively laid out for business purpose.

21. Mr. Pal, by way of last desperate attempt, argued that even if business economy was the consideration in so far as payment of compensation to M.G. Robson was concerned, the payments of compensation to J. Morshead and W. L. A. Radcliffe were made on different considerations. He drew inspiration for this argument from the following passage in the judgment

of the Appellate Assistant Commissioner for the year 1953-54 :

> "It may be stated that from the correspondence with the two directors and the minutes on records it is not true that the services were terminated in order to effect economy in the administration, but the two directors were asked to retire or their services were terminated in order to accelerate promotion of new members of the board of directors and this cannot be considered to be an expenditure for commercial expediency."

22. Questioned by ourselves, Mr. Pal admitted that no new circumstances or consideration came into existence when the assessee decided to pay compensation to J. Morshead and W. L. A. Radcliffe for premature retirement and the action was motivated by the identical purpose. The same resolution of the board, namely, those of June 3, 1951, and June 21, 1951, authorized the action. If that be so, then the inference by the Appellate Assistant Commissioner that the compensation was not paid to effect economy was not a correct inference on the materials before him. We are of the opinion that the Tribunal made the correct inference on the facts when it observed that :

> "The compensation paid for loss of office to the aforesaid directors (meaning all the three) benefited the company in its business inasmuch as it saved a lot on monetary outgoing."
> The last argument of Mr. Pal must, therefore, also fails.

Question No. 1 must be answered in the affirmative and in favour of the assessee.
23. We now turn to the second question. it is not disputed that the premises, in respect whereof the municipal revaluation took place, was the business premises of the assessee and that the taxes were payable out of the earnings of the business. If the municipal assessment of consolidated rates had been unduly enhanced, the assessee would have been compelled to pay more by way of rates. In the interest of business, it was necessary for the assessee, to have the premises properly valued. The expenditure incurred was to secure evidence of an expert on the exact or proper valuation of the premises. This, in our opinion, is proper business expenditure within the meaning of section 10(2) (xv).

24. In *Birla Cotton Spinning and Weaving Mills Ltd. v. Commissioner of Income-tax, Calcutta*[10], this court observed that expenditure incurred by an assessee in opposing an illegal and coercive governmental action with the object of saving taxation and safeguarding the business was justified by commercial expediency and was therefore an allowable expenditure. In the instant case, revaluation was being made by a statutory body, namely, the Corporation of Calcutta. If the revolulation had not been properly made, the assessee would have been compelled to pay more. For seeing that it was properly taxed, the expenditure was incurred for procuring evidence of proper valuation. That, in our opinion, was justified by commercial expediency and the expenditure should be allowed under section 10(2) (xv) of the Act.

25. In the view that we take, we hold that question No. 2 must also be answered in the affirmative and in favour of the assessee. Both the questions are thus answered in the affirmative and in favour of the assessee. The Commissioner of Income-tax must pay costs of this reference to the assessee.

K.L. Roy, J.

26. I agree

[10](1967) 64 ITR 568