GUJARAT HIGH COURT

Laxmandas Sejram

Vs.

Commissioner of Income-Tax

ITR No. 17 of 1963

(J.M. Shelat, C.J. and P.N. Bhagwati, J.)

04.09.1964

JUDGMENT

P.N. Bhagwati, J.

1. The question which arises in this reference is whether a certain commission paid by the assessee to an employee is an allowable expenditure in computing the profits of the assessee from business. The assessee is a registered firm carrying on business in cloth at Mahavir Market, Ahmadabad. There were at the material time seven partners in the assessee-firm, two of them being Badarmal and Mithalal. These two were also partners in another firm called Messrs. Badarmal Ishverlal which carried on business in Maskati Market, Ahmadabad. The firm, Messrs. Badarmal Ishverlal, closed down some time towards the end of Samvat year 2014, but at or about this time a new firm called Messrs. Badarmal Mithalal was started in which both Badarmal and Mithalal joined as partners. This firm of Messrs. Badarmal Mithalal, it appears, was in existence during Samvat year 2015, being the accounting year corresponding to the assessment year 1960-61 with which we are concerned in the present reference. Mithalal was also during this period a partner in another firm called Messrs. Multanmal Mukundchand. These facts about Badarmal and Mithalal being partners in other firms are not very much relevant but they do throw some little light on the determination of the question before us and we have, therefore, stated them. The controversy in the present reference, however, arises in respect of one Kevalchand, who was an employee of the assessee-firm for several years prior to Samvat year 2014. Kevalchand was drawing what the Tribunal has called a "modest salary" of ₹ 200 per month. Besides being an employee of the assessee-firm, Kevalchand was also a partner in a firm called Messrs. Rasiklal Ranmal. This firm was dissolved in the end of Samvat year 2013 and the share of Kevalchand in the profits of this firm for Samvat year 2013 came to ₹ 13,842 as determined by the revenue authorities in the case of the assessment of Kevalchand. It appears that since the firm of Messrs. Rasiklal Ranmal was dissolved and consequently that source of income of Kevalchand came to

an end, Kevalchand approached the partners of the assessee-firm and stated to them that either he should be taken as a partner in the assessee-firm or he should be relieved so that he could join some other person as a partner with whom he had already made some arrangement. The assessee-firm was not in a position to spare the services of Kevalchand and his continuance with the assessee-firm was absolutely essential in connection with out-station sales which were extensive and spread district-wise as also in connection with recovery of outstandings from out-station sales. It was, therefore, not possible for the assessee-firm to relieve Kevalchand and to let him go. The partners of the assessee-firm were at the same time not prepared to take up Kevalchand as a partner.

2. An agreement was, therefore, arrived at between the assessee-firm and Kevalchand which struck a middle path. The agreement was dated Magsar Vadi 11th, Samvat year 2014, that is, 17th December, 1957, and under the agreement Kevalchand agreed to continue to work for the assessee-firm up to the end of Samvat year 2015 and if no other arrangement was made and he desired to be relieved from the commencement of Samvat year 2016, he was to be allowed to b relieved after settling all his responsibilities in connection with the affairs of the assessee-firm and in consideration for this, the assessee-firm agreed to pay to Kevalchand for Samvat year 2014 the salary which he was for Samvat year 2015 not only salary and bonus as is Samvat year 2014 but also, in addition, commission at the rate of three annas per ₹ 100 on out-station sales. Kevalchand accordingly continued with the assessee-firm and for Samvat year 2014 the assessee-firm paid him ₹ 2,400 as salary and an identical amount as bonus. For Samvat year 2015 the assessee-firm paid to Kevalchand ₹ 2,400 as salary and an identical amount as bonus and in addition, the assessee-firm also paid ₹ 16,334 as commission as provided in the agreement. The profit of the assessee-firm for Samvat year 2015 came to ₹ 1,24,712 after deducting interest payable to the partners. The agreement expired on Asovad 30, Samvat year 2015, and on the expiration of the agreement, Kevalchand was taken up as a partner in the assessee-firm with 0-1-6 share with effect from Kartak Sudi 1, Samvat year 2016. Now the assessee-firm in its assessment for the assessment year 1960-61, for which the corresponding accounting year was Samvat year 2015, claimed the entire amount paid to Kevalchand as a permissible deduction in computing its profits from business. The assessee-firm claimed the deduction under section 10(2)(xv) but the Income-tax Officer took the view that the claim for deduction could be considered only under section 10(2)(x) and he proceeded to apply this latter section for the purpose of determining whether the claim for deduction was justified. The Income-tax Officer held that for the purpose of determining whether the commission paid was reasonable or not, the fact that the payment was made under a contractual obligation was immaterial and the question had to be considered with reference to the tests laid down in the proviso to section 10(2)(x). The Income-tax Officer observed that it was certainly not a general practice in the line of business of the assessee-firm to pay such heavy commission to an

employee getting a meagre salary of ₹ 200 per month. The Income-tax Officer also pointed out that Kevalchand was attending to the affairs of the assessee-firm in the past without payment of any commission meaning thereby that the work which he was to do after the agreement was the same which he was doing before. The Income-tax Officer also added that no special circumstances appeared in the year of account warranting the payment of such a heavy commission by the assessee-firm. On these facts the Income-tax Officer came to the conclusion that the commission paid to Kevalchand was excessive as compared to his salary and he accordingly disallowed half the commission, namely, ₹ 8,167. The assessee appealed to the Appellate Assistant Commissioner against this disallowance and in the appeal the Appellate Assistant Commissioner set aside the order of the Income-tax Officer and allowed the whole of the commission as a permissible deduction under section 10(2)(x). The Income-tax Officer thereupon carried the matter in appeal before the Tribunal. The Tribunal did not disbelieve the genuineness of the agreement nor did it disbelieve the genuineness of the payment made to Kevalchand but took the view that the payment of such a large commission was unreasonable and the Income-tax Officer was, therefore, justified in disallowing one half of it. The Tribunal held that no special circumstances which justified the payment of such a large commission were established and in taking this view the only circumstance to which the Tribunal adverted was the fact that Kevalchand continued to do the same work after the agreement which he was doing prior to the agreement as if that was the only circumstance on record bearing upon this point. The Tribunal negatived the argument urged before it that because Badarmal and Mithalal, two of the partners of the assessee-firm, joined the firm of Messrs. Badarmal Mithalal and were consequently unable to attend the management of the affairs of the assessee-firm, it was found necessary to continue the services of Kevalchand on the new terms as to payment of bonus and commission. The Tribunal stated that even prior to their joining the firm of Messrs. Badarmal Mithalal they were partners in the firm of Messrs. Badarmal Ishverlal and they could not, therefore, have been giving their whole time attention to the assessee-firm prior to their joining the firm of Messrs. Badarmal Mithalal. The Tribunal in the end observed that the Income-tax Officer had come to the correct conclusion that in respect of payment of commission to Kevalchand all the conditions laid down in section 10(2)(x) were not satisfied and in this view of the matter the Tribunal set aside the order of the Appellate Assistant Commissioner and restored that of the Income-tax Officer. The correctness of this decision of the Tribunal is challenged before us on the present reference.

3. The first question which Mr. M. M. Thakore, learned advocate appearing on behalf of the assessee, agitated before us was whether the claim for deduction of the amount paid as commission to Kevalchand fell to be governed by section 10(2)(x) or section 10(2)(xv). It was contended on behalf of the assessee that the validity of the claim for deduction was required to be judged by reference to section 10(2)(xv) and not section 10(2)(x) and the reason for this contention was obvious. If the validity of the claim for deduction was required to be tested by reference to section 10(2)(xv), no question of reasonableness of the amount paid as commission

would arise and the only question which would be require to be considered would be whether the expenditure was laid out wholly and exclusively for the purpose of business vide *Subodhchandra Popatlal v. Commissioner of Income-tax*[1], Now section 10(2)(x) permits the deduction of :

> "any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission :
> 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 businesses, professions or vocations..."

4. Section 10(2)(xv) deals with the case of "any expenditure (not being an allowance of

[1](1953) 24 ITR 566 (Bom)

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." It would thus be seen that if the deduction claimed is of an expenditure of the nature specified in section 10(2)(x), the claim for deduction of that expenditure must be considered with reference to that provision and the benefit of deduction under section 10(2)(xv) cannot be claimed because by its express language the provision contained in section 10(2)(xv) applies only to an expenditure which is not of the nature described in any of the clauses (i) to (xiv) which include clause (x). The question which, therefore, requires to be considered is whether commission paid to Kevalchand in the present case is an expenditure of the nature specified in section 10(2)(x). If it is, then the claim for deduction of that expenditure can be allowed only if the conditions of section 10(2)(x) are satisfied and section 10(2)(xv) cannot be invoked by the assessee.

5. The contention urged by Mr. M. M. Thakore on the construction of section 10(2)(x) was that that provision applied only to those cases where a sum was paid by an employer to an employee as bonus or commission after the services were rendered and where the payment was in the nature of an ex gratia payment. He urged that bonus was an ex gratia payment and commission following as it did after bonus must, therefore, be construed ejusdem generis so as to be confined only to an ex gratia payment. This contention is, in our opinion, wholly devoid of force and is, as a matter of fact, opposed to the plain and grammatical construction of the words used in the section. In the first place there is no scope at all for the application of the doctrine of ejusdem generis. The principle of ejusdem generis can be invoked only when general words follow particular and specific words. The rule of interpretation embodied in this principle is that if the particular and specific words which precede the general words and which constitute the members of the enumeration constitute a class or genus and that class or genus is not exhausted by the enumeration, the general words are construed as confined to that class or genus. It is difficult to

see how this rule can be invoked in the present case where the words used are "bonus" and "commission". There is nothing general about the word "commission" as contrasted to anything particular or specific about the word "bonus". Each word denotes a particular and specific concept without the one including the other. Moreover, to invoke the applicability of the doctrine of ejusdem generis it must be possible to find a class or genus to which the matters specifically enumerated belong so that the general words can be confined to that class or genus. Now on class or genus can be constituted by the mention of only one object or specie. It would not, therefore, be right to attempt to cut down the plain and natural connotation of the word "commission" by reference to the immediately preceding word "bonus". Besides it is no longer true to say that bonus is an ex gratia payment. As observed by Chagla C.J., as he then was, in *Subodh chandra Popatlal's case*[2] "the expression 'bonus' is not used in the sense in which it was once understood, viz., an ex gratia payment. It is used in the sense in which it is now understood, viz., a certain remuneration or emolument to which an employee becomes entitled on the satisfaction of a certain condition precedent, and if an employer were to agree with his employee that he will be entitled to a certain amount provided the business made profit it would be a bonus, and the employee would be legally entitled to recover that amount." Bonus can thus be as much a matter of contractual obligation as salary. The word "commission" cannot, therefore, be read in a narrow and constricted manner as Mr.

[2](1953) 24 ITR 566 (Bom)

M. M. Thakore would have us do. The payment of commission may be voluntary or it may be under a contractual obligation. But whatever it is, if it is commission over and above the salary, then the claim for deduction of such commission must be considered with reference to the provisions of section 10(2)(x). Mr. M. M. Thakore relied on a decision of the Allahabad High Court in *Raja Ram Kumar Bhargava v. Commissioner of Income-tax*[3], It is no doubt true that in this decision there are observations which seem to suggest that the learned judges of the Allahabad High Court who decided this case regarded bonus and commission mentioned in section 10(2)(x) as in the nature of ex gratia payments. But with the greatest respect to those learned judges we do not think that that view is a correct one. As a matter of fact that view is directly contrary to what has been held by the Bombay High Court in *Subodh chandra Popatlal's case*[4] The learned judges of the Allahabad High Court also held that having regard to clause (a) of the proviso to section 10(2)(x) it was clear that "bonus" or "commission", the reasonableness of which has to be determined under that section, 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. This of course is unexceptionable, but from that it does not follow that bonus or commission within the meaning of section 10(2)(x) must be an ex gratia payment. All that would seem to follow from this observation is that bonus or commission to fall within section 10(2)(x) must be over and above the salary of the employee. As a matter of fact Chagla C.J. in *Subodh chandra Popatlal's case*[5] also says that "section 10(2)(x) deals with a special case where a sum is paid to an employee over and above is salary as bonus or commission for services rendered". If, therefore, any bonus or commission is paid to an employee over and above his salary, the claim for deduction in respect of such bonus or commission would have to be tested

under section 10(2)(x), but if such bonus or commission represents his salary or is part of his salary, section 10(2)(xv) would apply.

6. This being the position we must consider whether commission paid to Kevalchand in the present case represented his salary or was a part of it. The answer to that question is clearly provided by the agreement itself. The agreement in terms distinguishes between the salary of Kevalchand which was ₹ 200 per month and the commission of annas 3 per ₹ 100 on out-station sales which he was to receive during Samvat year 2015. The commission paid to Kevalchand was, therefore, an emolument over and above his salary and the question whether the payment of such commission is or is not a permissible deduction would, therefore, have to be determined by reference to section 10(2)(x) and not section 10(2)(xv).

7. Turning now to section 10(2)(x) it is apparent that three tests are laid down in the section for the purpose of determining the reasonableness of the commission paid to an employee. The question whether the amount of the commission is a reasonable amount or not has to be determined with reference to three factors. But it is now well-settled that these factors have to be considered from the point of view of a normal prudent businessman. The reasonableness of the payment with reference to these factors has to be judged not on any subjective standard of the assessing authority but from the point of view of commercial expediency vide *Mysore Fertiliser Co. v. Commissioner of Income-*

[3](1963) 47 ITR 680 (All)
[5](1953) 24 ITR 566 (Bom)
[4](1953) 24 ITR 566 (Bom)

tax[6], Now let us see whether this approach has been adopted by the Tribunal in the present case. It is clear from the order of the Tribunal that the Tribunal relied mainly and substantially on the fact that the nature of the work done by Kevalchand remained unchanged even after the agreement and concluded that since the work which Kevalchand was required to do after the agreement was the same which he was doing prior to the agreement, it could not be said that there were any special circumstances which warranted the payment of such a large commission to Kevalchand. Now it is undoubtedly true that the work which Kevalchand was required to do under the agreement was in no way greater or more onerous than that which he was doing before, but there are, as observed by the Madras High Court in *Mysore Fertiliser Co. v. Commissioner of Income-tax*[7], "obvious limits to the exaltation of this plea to a rigid and inflexible principle in deciding on the basis of commercial expediency of what constitutes reasonable expenditure... under section 10(2)(x)". If this argument were pushed to its logical extreme, even payment of bonus or any commission at all would have been unreasonable which the revenue authorities obviously did not so regard. Of course this circumstance would undoubtedly have some relevance but it must be considered along with other circumstances and the question whether commercial expediency justified the payment of this commission to Kevalchand must be judged in the light of all the circumstances which existed at the time when the agreement was made. Now what were those circumstances ? They clearly appear from the record of the case.

8. The record clearly shows that Kevalchand was a partner in Messrs. Rasiklal Ranmal and that he ceased to be a partner in that firm in or about the end of Samvat year 2013. His share in the profits of that firm was ₹ 13,842. This source having come to an end in the end of Samvat year 2013, Kevalchand approached the partners of the assessee-firm and asked them either to take him up as a partner in the assessee-firm or to relieve him so that he could join someone else as a partner - a matter in regard to which he had already made some arrangement. This was a perfectly natural piece of conduct on the part of Kevalchand. The partners of the assessee-firm were not prepared to take up Kevalchand as a partner in the assessee-firm but at the same time they were not in a position to let him go because there were considerable out-station sales which were spread in different districts and out standings in respect of such outstation sales had to be recovered and Kevalchand was an old employee conversant with the business of the the assessee-firm and its constituents. The assessee-firm was, therefore, under a business necessity to continue Kevalchand in employment and it was under these circumstances that the agreement was entered into between the assessee-firm and Kevalchand. Samvat year 2014 was current at that time and it was, therefore, provided that during that year Kevalchand would get only the salary of ₹ 200 per month which he was receiving at the time together with bonus of an equivalent amount but, during Samvat year 2015, Kevalchand would be paid, in addition, commission at the rate of annas 3 per ₹ 100 on outstation sales. It is significant to note that these terms were agreed to only up to the end of Samvat year 2015 and not for a longer duration. It was necessary to keep Kevalchand for some time at least in order to attend to outstation sales and for this purpose these terms as regards payment of bonus and commission were agreed to by the assessee-firm. It is also important to note that the assessee-firm could have granted an increase in salary to Kevalchand to retain

[6](1956) 30 ITR 734 Mad

[7](1956) 30 ITR 734 (Mad)

him in employment, but what the assessee-firm did was not to increase the salary beyond ₹ 200 per month but to grant by way of additional remuneration a percentage on outstation sales. This was certainly a prudent act of management on the part of the assessee-firm, for correlating additional remuneration with outstation sales would certainly act as an incentive to Kevalchand to increase outstation sales and thereby increase the profits of the assessee-firm. These circumstances clearly emerge from the agreement and it is significant that the genuineness of the agreement was not disbelieved by the Tribunal nor did the Tribunal find any of the statements made in the agreement incorrect. As a matter of fact we find that on the expiration of the agreement Kevalchand was taken up as a partner in the assessee-firm and this lends considerable support to the statement in the agreement that Kevalchand demanded from the partners of the assessee-firm that he should be taken up as a partner or else he should be allowed to go so that he could join someone else as a partner. Kevalchand was obviously so indispensable that the partners of the assessee-firm had ultimately to yield to the insistence of Kevalchand and admit him as a partner in the assessee-firm rather than let him go. These were the circumstances under

which the agreement was made and they clearly show that the plain dictates of commercial expediency were the cause of the agreement.

9. It must also be noted that the genuineness of the payment made to Kevalchand was at no time challenged by the revenue authorities and the Tribunal also accepted the payment as genuine and the only ground on which the Tribunal disallowed one half of it was that it appeared to be unreasonable. Now there is nothing on record to show that Kevalchand was in any way related to or personally connected with the partners of the assessee-firm. It is, therefore, rather difficult to believe that the assessee-firm would agree to pay this commission to Kevalchand unless they found that it was absolutely necessary to do so in the interest of their business. Of course when we say this we do not wish to suggest that in such a case the amount of commission must always be considered reasonable but the fact that the payment has been genuinely made to an employee who is not in any way related to or personally connected with the assessee and in whom the assessee is not interested otherwise than as an employee would be prima facie evidence to show that the payment was made because the assessee considered it necessary from the point of view of commercial expediency to do so.

10. These were the circumstances on record which the Tribunal should have taken into account in deciding whether from the point of view of commercial expediency, the payment of the full amount of commission to Kevalchand was justified. The Tribunal unfortunately failed to take these circumstances into account and proceeded only on one circumstance, namely, that the work to be done by Kevalchand continued to be the same as before. This was clearly a wrong approach and it vitiated the finding of the Tribunal that the amount of commission paid to Kevalchand was to the extent of one half unreasonable. The learned Advocate-General contended that this finding of the Tribunal was a finding of fact and since the Tribunal had taken into account all the three tests laid down in the proviso to section 10(2)(x) in reaching the finding, it was not open to us to reappreciate the evidence and to substitute our own determination as regards the reasonableness of the amount. This contention however suffers from a two-fold infirmity. In the first instance it is not correct to say that the Tribunal took into account all the three tests set out in the proviso to section to 10(2)(x). One of the factors required to be taken into account was the profit of the assessee-firm and this the Tribunal clearly failed to take into account. The profit of the assessee-firm in Samvat year 2015 was ₹ 1,24,712 and having regard to this profit we do not see how the commission of ₹ 16,334 can be said to be unreasonable. It is no doubt true that the Tribunal in confirming the order of the Income-tax Officer took into account the factor of pay and conditions of service but that factor was wrongly interpreted by the Tribunal. The Tribunal appeared to take the view that such a large commission would not be paid to an employee with such a meagre salary as ₹ 200 per month. Now this would certainly be true if the commission was paid ex gratia in reward of the services rendered but where as in the present case the remuneration under the contract of service consists of two parts, namely, salary and commission, and commission is paid as part of remuneration, this would be a totally wrong approach. In such a case, if the salary is

low, the commission would have to be large in order to make up adequate total remuneration and to say in that case that the commission is unduly large compared to the meagre salary would be to misapply the test. Moreover it is now well-settled that, though a finding of fact reached by the Tribunal cannot be discarded by the court if there is some evidence to support it, the finding cannot be regarded as immune from the scrutiny of the court if it appears that the Tribunal has not considered evidence covering all essential matters : vide *Commissioner of Income-tax v. Indian Woollen Textiles Mills*[8], In such a case the Tribunal having misdirected itself in law in arriving at the finding the court can certainly set aside the finding on a reference under section 66. When we find that in considering the three tests laid down in the proviso to section 10(2)(x), the Tribunal has ignored various circumstances on record which were extremely relevant in considering whether from the point of view of commercial expediency, which is the only point of view from which the matter must be looked at, these three tests were satisfied, we are certainly entitled to interfere with the decision of the Tribunal. We are of the view that on the facts and circumstances which were on record before the Tribunal, there was nothing to show that any part of the commission paid by the assessee-firm to Kevalchand was unreasonable so as to be disallowed as a permissible expenditure under section 10(2)(x).

11. Our answer to the question referred to us is, therefore, in the negative. The Commissioner will pay the costs of the reference to the assessee.

12. Question answered in the negative.

[8](1964) 51 ITR 291 (SC)