

# KERALA HIGH COURT

Haji K. Assainar

Vs

Commissioner of Income-Tax

(Balakrishna Eradi J.)

23.09.1967

## JUDGMENT

### **Balakrishna Eradi J.**

1. This is a reference made by the Income-tax Appellate Tribunal, Madras Bench, under section 66(1) of the Income-tax Act, 1922 (hereinafter referred to as the Act) and the question referred to this court for decision is :

"Whether, on the facts and in the circumstances of the case, the disallowance of Rs. 16,977 from out of the salary paid to T. Mohammed Farooq is justified."

The assessee, Haji K. Assainar, was carrying on business in rice and provisions on wholesale basis with head office at Changanacherry and branches at Kottayam and Cochin. The relevant assessment year is 1959-60 and the accounting period is the Malayalam year 1133 ending on August 16, 1958. In the Cochin branch the assessee's main business consisted of commission agency sales. The net profit of this branch as per the assessee's books was Rs. 1,16,265. In arriving at this amount, the assessee had claimed deduction of a sum of Rs. 19,377 stated to have been paid to one Mohammed Farooq by way of remuneration. The said Mohammed Farooq is the son of a sister-in-law of the assessee. He was employed by the assessee under an agreement dated August 17, 1957, executed between the assessee and Farooq, whereunder his remuneration was fixed at Rs 0-2-0 per rupee in the profit of the Cochin branch or Rs. 2,400 whichever was higher. He was designated as secretary, and as per the agreement his duties were to exercise administrative control over the staff and to initiate and carry out the policies of the business, subject to overall control and directions of the assessee. At the time of the agreement Farooq was aged only 20 years and he had passed the Pre-University Examination held in March, 1957. He had joined the B.Sc. Degree Course at the beginning of the academic year 1957-58, but abandoned his studies in August, 1957, in order to take up employment under the assessee as per the aforesaid agreement. A copy of the agreement has been forwarded to this court as annexure "A" to the statement of the case. The Income-tax Officer was of opinion that, having regard to the fact that Mohammed Farooq was only a student aged 20 years on the date of the agreement, and had no special training in commercial accountancy or business organization, and considering the nature of the duties actually performed by him in the Cochin branch, where even the

experienced accountants were being paid by the assessee only salaries less than Rs. 150 per month, the entire amount of remuneration credited to the account of Farooq could not be regarded as expenditure laid out or expended wholly and exclusively for the purpose of the assessee's business. In the view of the Income-tax Officer the payment was motivated by considerations other than commercial expediency. The accounts disclosed that Mohammed Farooq had actually drawn only Rs. 1,716.89 during the accounting year in question. But, nevertheless, the Income-tax Officer allowed an amount of Rs. 2,400, being the minimum salary mentioned in the agreement as payable to Farooq and he added back the balance as payment made for consideration other than business. The assessee took up the matter in appeal to the Appellate Assistant Commissioner. It was contended before the appellate authority that, even though Mohammed Farooq had not qualified himself in accountancy and business management, he had read some books on these subjects and that he was also familiar with three languages, viz., English, Hindi and Tamil. It was further urged on behalf of the assessee that there was an increase of one lakh in the commission receipts in the Cochin branch during the accounting period due to the efforts of Mohammed Farooq. On these grounds it was contended that the disallowance by the Income-tax Officer of the major portion of the remuneration paid to Farooq was unjustified. The Appellate Assistant Commissioner did not accept the aforesaid contentions of the assessee. He was not satisfied that the increase in the commission receipts was to any extent due to the employment of Farooq in the Cochin branch. On the other hand he was of the view that the probability was that the increase was due to more favorable trading conditions and also to the circumstance that the assessee was himself concentrating his personal attention on the business at Cochin during the relevant accounting period. It was also found by the Appellate Assistant Commissioner that, although the recitals in the agreement would create the impression that Farooq was to exercise administrative control over the staff and to initiate and carry out the policies of the business in the Cochin branch, he was not, as a matter of fact, entrusted with any such responsible functions and the business was being conducted under the direct supervision and control of the assessee himself. He, therefore, concurred with the Income-tax Officer in his finding that the expenditure of which deduction was claimed by the assessee was not laid out or expended wholly and exclusively for the purpose of his business, but was, on the other hand, motivated by considerations which were not relevant to the business. He, therefore, sustained the disallowance of Rs. 16,977.

The assessee appealed to the Income-tax Appellate Tribunal, but the Tribunal also held that the disallowance of Rs. 16,977 from out of the salary paid to Mohammed Farooq was fully justified on the facts and in the circumstances that obtained in the year under consideration. Section 10(2)(xv) of the Act under which the deduction is claimed by the assessee is in the following terms :

"10. (2) Such profits or gains shall be computed after making the following allowances, namely :- .....

(xv) 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."

The remuneration paid to Mohammed Farooq was not an allowance of the nature described in any of the clauses (i) to (xiv); nor was it of the nature of capital expenditure, or personal expenses of the assessee. The only question therefore is whether the amount paid to Mohammed

Farooq of which deduction is claimed by the assessee can be regarded as expenditure laid out or expended wholly and exclusively for the purpose of the assessee's business. *In Commissioner of Income-tax v. Chandulal Keshavlal & Co.* the Supreme Court has observed thus at page 610 :

"The cases we have discussed above show that it is a question of fact in each case whether the amount which is claimed as a deductible allowance under section 10(2)(xv) of the Income-tax Act was laid out wholly and exclusively for the purpose of such business and if the fact-finding Tribunal comes to the conclusion on evidence which would justify that conclusion it being for them to find the evidence and to give the finding then it will become an admissible deduction. The decision of such questions is for the Income-tax Appellate Tribunal and the decision must be sustained if there is evidence upon which the Tribunal could have arrived at such a conclusion."

In the present case, the Income-tax Officer as well as the appellate authorities have concurrently come to the conclusion on a consideration of all the facts disclosed by the materials available on record that the payment of such a large amount to Farooq, who was only a young undergraduate studying for the B. Sc. Degree course on the date of the agreement evidenced by annexure "A" and who possessed no knowledge of commercial accountancy nor any experience in business administration, was motivated by considerations which were not relevant to the business. The learned counsel appearing for the assessee laid great stress on the circumstance that the truth of the payment is not disputed by the department and that Farooq has been assessed to tax in respect of the amounts credited to his account by the assessee as remuneration. In order to get the benefit of section 10(2)(xv) it is not sufficient merely to establish the truth of the payment; it has to be further shown that the amount so paid was laid out or expended wholly and exclusively for the purpose of the assessee's business. In *Jethabhai Hirji and Co. v. Commissioner of Income-tax Chagla C.J.* has stated the legal position as follows :

"..... it is erroneous to contend that as soon as an assessee has established these facts, viz., the existence of an agreement between the employer and the employee and the fact of actual payment, no discretion is left to the Income-tax Officer except to hold that the payment was made wholly and exclusively for the purposes of the business. Although the payment might have been made and although there might be an agreement in existence, it would be open to the Income-tax Officer to take into consideration various factors which would go to show whether the amount was paid as required by the section. For instance, the Income-tax Officer may take into consideration whether the moneys were paid to a near relation of the employer. He may take into consideration the extent of the business and the particular service rendered by the employee which called for a special remuneration at the hands of his employer. He may take into consideration the quantum of the payment made with a view to decide whether the payment was or was not grossly out of proportion to the work done by the employer. If after taking these factors into consideration he comes to the conclusion that the payment was not made wholly and exclusively for the purpose of the business of the assessee, it would be open to him either to disallow the whole sum or a part of the sum paid. The question whether a particular sum was expended wholly and exclusively for the purposes of such business must essentially be a question of fact to be determined by the Income-tax Officer. But it would be open to the assessee to contend, as it has been contended in this case, that the decision arrived at by the Income-tax Officer was based on no evidence at all. If the assessee

satisfies the court that apart from the actual payment and existence of the agreement there were no other factors which were taken into consideration by the Income-tax Officer, then perhaps the court would say that the Income-tax Officer, was not justified in coming to the conclusion that he did."

We are not prepared to hold that the conclusion concurrently arrived at in this case by the three authorities below is not supported by any evidence or that it is unreasonable or perverse. Mohammed Farooq was examined before the Income-tax Officer, the case having been remitted to the officer by the Appellate Assistant Commissioner for that specific purpose, and his deposition is annexure "C" to the statement of the case. It is seen from annexure "C", that Farooq has candidly admitted that even though in the agreement it was recited that he had experience in commercial accountancy and business organization, he had not taken any course in accountancy nor studied in any school or institute of business organization. He only claimed to have read some books on the subject. He also admitted that, except for having learned typewriting and being conversant with Hindi and Tamil, he had not had any other training for business, and that there was no record to show that he was in fact exercising any supervision over the staff. Admittedly, he had not been invested with power to sign cheques at the relevant time. Having regard to all these facts brought out in the evidence and to the circumstance that the persons concerned is a relative of the assessee, the conclusion arrived at by the authorities below that the payment of the large amount in question by way of remuneration to Farooq was motivated not by considerations of commercial expediency but by considerations extraneous to the business, was fully warranted. It follows that the amount of which deductions is claimed was not laid out or expended wholly and exclusively for the purpose of the assessee's business, and the disallowance of the sum was quite justified and proper. The question referred is, therefore, answered in the affirmative, that is against the assessee and in favour of the department. We make no order as to costs.

Question answered in the affirmative.