

BOMBAY HIGH COURT

Tata Sons, Ltd

Vs.

Commissioner of Income-Tax

Income-tax Reference No. 14 of 1949

(Chagla, C.J. and Tendolkar, J.)

15.03.1950

JUDGMENT

Chagla, C.J.

1. At the direction of the High Court the Tribunal referred the following questions of law for its opinion : For the assessment year 1943-44 and chargeable accounting period 1st January 1942 to 31st December 1942 :

"Whether in the circumstances of the case, the sum of Rs. 39,000 paid by the assessee company towards the grant of special bonus to some of the superior executive officers of the Tata Iron and Steel Company, Limited was an item of expenditure deductible in arriving at the taxable profits for the calendar year 1942 ?"

For the assessment year 1944-45 and chargeable accounting period 1st January 1943 to 31st December 1943 :

"Whether in the circumstances of the case, the sum of Rs. 34,125 paid by the assessee company to some of the superior executive officers of the Tata Iron and Steel Company, Limited, was an item of expenditure deductible in arriving at the taxable profits for the calendar year 1943 ?"

Chagla, C.J.

2. The assessee limited company held the managing agency of the Tata Iron and Steel Co., Ltd., under an agreement dated 2nd May 1948. Under this agreement the assessee company was to be paid commission at different rates which were to be computed upon the net profits of the company. In the account year 1942 the assessee company paid a sum of Rs. 52,000 as the half

share of the bonus which the managed company paid to certain officers of the company. In the account year 1943 the assessee company paid a further sum of Rs. 45,500 as the half share of the bonus paid by the managed company also to certain officers of the managed company. The question that arises in this reference is whether the assessee company is entitled to claim a sum of Rs. 39,000 out of the said sum of Rs. 52,000 (the balance of Rs. 13,000 having been recovered by the assessee company from persons who are co-sharers with them in the commission) as a permissible deduction under Section 10(s)(xv) of the Act and also whether they are similarly entitled to claim Rs. 34,125 out of the said sum of Rs. 45,000 (the balance of Rs. 11,325 having been recovered by the assessee company from their co-sharers) also as a permissible deduction under Section 10(2)(xv).

2. From the facts stated it appears that from 1939 the Tata Iron and Steel Co., Ltd., has been paying bonuses to certain officers and these bonuses have been shared half and half by the said managed company and the assessee company. It is also clear from the facts that the commission payable to the assessee company is entirely dependent upon the profits earned by the managed company and, therefore, the assessee company is directly and vitally interested in the earning of the profits by the managed company. The Tribunal held that the assessee company was not entitled to the deductions they claimed, and perhaps the principal reason that weighed with the Tribunal in coming to that conclusion was that the profits of the relevant accounting year had already been earned and the bonuses were paid subsequent to the earning of these profits and therefore there was no connection between the payment of the bonus and the earning of the profits in the year of account. I entirely and with very great respect agree with what their Lordships of the Privy Council stated in the case of *Tata Hydro Electric Agencies, Bombay v. Income-tax Commissioner, Bombay Presidency and Aden*². In that case their Lordships recognized, and decided cases show, how difficult it is to discriminate between expenditure which is and expenditure which is not solely expended and incurred for the purpose of earning profits or gains, but however difficult the task it has got to be attempted, and we have to decide whether this particular deduction claimed by the assessee company as a deduction is an expenditure laid out or expended wholly and exclusively for the purposes of the business of the assessee company. Now, the decided cases show that one has not got to take an abstract or academic view of what is proper expenditure laid out or expended wholly and exclusively for the purposes of one's business. One has got to take into consideration questions of commercial expediency and the principles of ordinary commercial trading, and the main consideration that has got to weigh with the Court is whether the expenditure was a part of the process of profit making. If the expenditure helps or assists the assessee in making or increasing the profits, then undoubtedly that expenditure would be expended wholly and exclusively for the purposes of business. It has been urged by the Attorney General that the payment made by the assessee was a voluntary payment. That is perfectly true, because there was no obligation whatever upon the assessee to share the bonus with the managed company, and in sharing the bonus the assessee did an act which it was under no obligation to do. But even a voluntary act if performed for commercial expediency would still be an expenditure falling within Section 10(2)(xv) if it can be

shown that it was intended for the purpose of making or increasing the profits of the assessee company. It has also been urged that the payment has been made not to the employees of the assessee company but to the employees of the managed company, a different entity altogether. Here again if it can be shown that there was a very important nexus between the assessee company and the managed company which necessitated the assessee company making the payment to the employees of the managed company, then again it would be possible for the assessee company to satisfy us that the expenditure was one which fell within the ambit of Section 10(2)(xv). Now it cannot be seriously disputed that the bonus was paid by the managed company to their

²64 IA 215 : (AIR 1937 PC 139)

employees in order to increase the efficiency of the working of the company. An increased efficiency of that company would incidentally result in higher and better profits, and the assessee company would be as much interested in the working of the managed company being more efficient as the managed company itself. Whatever tended to increase the profits of the managed company would also tend to increase the income and profits of the assessee company. Therefore it cannot be suggested that the assessee company had an indirect or ulterior motive in making this payment. The only motive by which it was actuated was a purely commercial and pecuniary one and that was to see that more profits were made by the managed company so that its own commission should thereby be increased. The Attorney-General has drawn our attention to Section 10(2)(x) and has pointed out that the Legislature has controlled by certain limitations which it has laid down the payment of bonus by an employer to an employee and it is not open to an employer to pay any bonus to an employee and claim the payment of that bonus as a permissible deduction. It is only a reasonable bonus falling within the limitations laid down in Section 10(2)(x) that can be claimed by an employer as permissible deduction, and the Attorney-General's argument is that if we allow the claim of the assessee company, then what we would be doing would be to permit the employer of the managed company to pay a bonus and claim a deduction under Section 10(2)(x) and then permit the assessee company to pay as and by way of an extra-bonus to the same employees and again claim a deduction under Section 10(2)(xv). In our opinion there is no conflict between clause (x) and clause (xv) and the two are easily reconcilable. It is only a reasonable bonus as falling within the ambit of Section 10(2)(x) which is shared by the assessee company who is interested in the payment of the bonus that can be claimed by the assessee as a deduction under Section 10(2)(xv). It is not suggested and I do not think it can be suggested that the bonus paid by the managed company in the years 1942 and 1913 was an unreasonable bonus or a bonus with regard to which a deduction cannot be claimed under Section 10(2)(x). It is this reasonable bonus which has been shared voluntarily by the assessee company out of considerations of commercial expediency, and having shared if, the assessee company claims a deduction under Section 10(2)(xv), whereas the half share which the managed company paid as bonus to its employees would fall under Section 10(2)(xv) the payment made by the assessee which is not a bonus but which is an expenditure laid out or expended wholly or exclusively for its business would fall under Section 10(2)(xv). Therefore we are not permitting the assessee to circumvent the provisions of Section 10(2)(x) nor permit the

payment to the employees of the managed company a bonus higher than what the law would permit under Section 10(2)(x).

3. It is also suggested by the Attorney-General that the payment by the assessee is entirely gratuitous and no consideration has been proved by the assessee for this payment. In my opinion the consideration is apparent on the face of the record before us. Once it is assumed, and I think we are justified in making that assumption, that the bonus was paid out of commercial considerations by the managed company, then in the payment of that bonus the assessee would be interested, and when it shared that bonus, it received part of the benefit which went to the managed company, and that part of the benefit would be the increased commission that the assessee would get by reason of the employees of the managed company being contented and having an impetus to work whole heartedly and producing more profits for the employers.

4. Turning now to the cases that were cited at the bar, in the first place we have the judgment of Rankin, C.J. in *Anglo Persian Oil Co. Ltd. v. Commissioner of Income-tax*³, In that case a lump sum was paid by an assessee as compensation for the loss of agency which was caused to its managing agents by the managing agency being terminated and instead of having to pay a recurring sum every year the assessee compounded its liability in a lump sum. The question that arose for the consideration of the Calcutta High Court was whether this payment was a permissible deduction. The two points which Sir George Rankin had to consider in his judgment were : (1) whether the payment was made solely for the purpose of earning profits, and (2) if so, the payment was made in the year of account. With regard to the first point the learned Chief Justice stated that if it appeared from the assessee's own case or the facts found that the payment was made by way of distribution of profits or was wholly gratuitous or for some improper or oblique purpose outside the course of business management, the deduction would not be permissible, but as no such suggestion had been made, there was no reason why the deduction should be disallowed. In my opinion in the case before us also the payment is not wholly gratuitous nor is it for any improper or oblique purpose nor is it outside the course of the business management of the assessee company.

5. With regard to the second point the learned Chief Justice held that clause (is) of Sub-Section (2) of Section 10 which corresponds to our present Section 10(a)(xv) did not say and did not mean that the expenditure must be made with a view to produce profits in the year of account.

6. The next case is a decision of the House of Lords, viz. *Atherton v. British Insulated and Helsby Cables, Ltd.*⁴, The observations relevant to the facts in this case are found in the speech of Viscount Cave at p. 191. It is true that what the House of Lords was considering was whether a sum of 31,784 which was paid by the assessee company as a nucleus for a pension fund was a revenue or a capital expenditure, but at p. 191 Viscount Cave makes certain observations with regard to the nature of the expenditure which is wholly an expenditure laid out or expended for the purpose of trade which are very material. After citing certain cases the learned Law Lord observed (p. 191) :

"..It was made clear in the above cited cases that a sum of money expended, not of necessity and with a view 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 let be expended wholly and exclusively for the purposes of the trade."

Therefore, it is quite clear that you may have a payment made voluntarily, you may have a payment made not for immediately benefiting the trade and which does not directly facilitate the carrying on of the business and yet the same can be said to have been expended wholly and exclusively for the purposes of the trade.

7. Then we have a decision of our own Court viz., *Commissioner of Income-tax, Bombay v. Tata Sons Limited*⁵, That was also a case of the present assessee company. In that case Beaumont, C.J. and Rangnekar, J. took

³1933-1 ITR 129 : AIR 1933 Cal 777

⁵41 Bom LR 362 : AIR 1939 Bom 283

⁴(1925) 10 Tax Cas 155 : (1925-1 KB 421)

the view that a part of the commission earned by the managing agents had been assigned and, therefore, it did not form part of the income of the assessee, and having taken that view the Court wanted the Commissioner to state a case on those lines. The Commissioner objected to the raising of a further point as suggested by the Court and, therefore, the Court had to decide the point raised by the Commissioner whether the payment by the managing agents of a part of their commission in order to induce the person to whom this commission was assigned to give a loan to the managed company in that case was a permissible deduction, and they held that it was. According to the learned Chief Justice the arrangement made by the managing agents was the wisest which could be made under the circumstances, and the Chief Justice emphasized that in a commercial sense the payment of this share of the commission was an expenditure solely for the purpose of earning profits and gains, viz., the retention of the commission agency. In my opinion in this case also, testing it by a purely commercial test, the assessee company has acted very wisely in sharing the bonus with the managed company in order that their own profits should be safeguarded and if possible increased.

8. We were also referred to a case reported in *Robert Addie and Sons' Collieries Ltd. v. Commissioners of Inland Revenue*⁶, There also the question was whether a certain sum was a capital or revenue expenditure. But what was relied upon by Sir Jamshedji was the observation of Lord President Clyde on the question which we have to consider in the present reference. The Lord President expressed his opinion that the question whether money was wholly expended or laid out for the purpose of trade must be determined upon principles of ordinary commercial trading. That opinion was cited with approval by the Privy Council in the case of *Tata Hydro-Electric Agencies v. The Commissioner of Income-tax*⁷, referred to above.

9. The Attorney-General has relied on another case in *Union Cold Storage Co. Ltd. v. Jones*⁸, and

ha drew our attention to the remarks of Pollock M.B. at p. 733, where the Master of the Rolls emphasized the fact that it was quite plain that the intention of the Legislature was not to make a broad general rule that whatever the subject likes to spend in his business can be deducted but only such sums were to be allowed to which the character can be assigned that they had been wholly and exclusively laid out for the purpose of the subject's business. We respectfully and entirely agree with these remarks. It is not every deduction that is a permissible deduction under the Income-tax law. It must be a deduction which falls under one or the other heads of Section 10, and unless the assessee satisfies the income-tax authorities that the claim that he is making with regard to the deduction under Section 10(2)(xv) falls strictly within its compass and ambit, the assessee would not be permitted that deduction. But having considered the whole case and the question submitted to us I am satisfied that looking purely at it from the point of view of commercial principles what the assessee company has done is something which had as its object increasing the profits of the Tata Iron and Steel Co., and thereby increasing its own share of the commission. In that view of the case the only conclusion I can come to is that the sums claimed by the assessee company were wholly and exclusively expended for the purposes of the business.

10. I would, therefore, answer the questions submitted to us in the affirmative with regard

⁶1924-8 TC 671 : (1924 SC 231).

⁸1924-8 TC 725 : (129 LT 512)

⁷(64 IA 215 : AIR 1937 PC 139),

to both the accounting years. The Commissioner to pay the costs of the reference.

Answers in the affirmative

.