BOMBAY HIGH COURT

Commissioner of Income-Tax

Vs

Maharashtra Sugar Mills Ltd

(Kotwal, C.J. V Desai , J.)

22.09.1967

JUDGMENT

Kotval, C.J.

1. The short question that has been referred for our decision in this reference is :
"Whether, on the facts and in the circumstances of this case, the department could disallow a sum of Rs. 1,26,359 a portion of the managing agency commission paid by the assessee-company for the assessment year 1957-58, in computing the incomme from business of the assessee-company ?"

2. The question arises because the assessee, the Maharashtra Sugar Mills Ltd., carries on two inter-connected business activites. It is engaged in the manufacture of sugar and for the purposes of that business the assessee owned in the year of account extensive estates in which it grew its own sugrcane. From the sugarcane thus grown on its own estates the assessee utilised a major part for conversion into sugar in its factory and the rest after meeting the requirements of the factory it also disposed of at times Over and above this quantity of sugarcane it cassionally used to make purchases of sugarcane which were comparatively very small.

3. For the purposes of its business the assessee had appointed managing agents, who have been paid remuneration at the statutory percentage being 10% of the profits of the company. The total remuneration which was debited in the profit and loss account of the assessee for the relevant year as its business expenditure in respect of its managing agency commission was Rs. 4,86,228-6-0. It seems that in the past years the assessee used to be assessed on the basis that part of its managing agency commission as well as several other items of expenditure were partly attributable to their agricultural income and partly to the income from business and the assessee had accepted that position. In the year of account also the assessee had furnished similar statements and it had shown that out of its profits amounting to Rs. 39,70,00 (in round figures), the profits relating to agricultural income would be about Rs. 28 lakhs. On that proportion the Income-tax Officer also apportioned the item of expenditure of the managing agency

commission for the year in question. Therefore, out of the the total managing agency commission of Rs, 4,86,228-6-0 he held that assume Rs. 1,26,359 was attributable to the agricultural activity of the assessee-company and therefore disallowed that part of the expenditure. The assessee had shown different figures upon a different computation but with the difference in the two figures we are not here really concerned, because the question referred is whether, whatever be the figure of disallowance, the expenditure could be disallowed at all.

4. The matter was taken in appeal to the Appellate Assistant Commissioner and the assessee contended that the growing of sugarcane as well as the manufacture of sugar therefrom was one integrated activity or business and that being a single indivisible business of manufacture of sugar, the expenditure on account of the remuneration paid to the managing agents should be allowed against the assessable business profits of the company. It could not be apportioned as the Income-tax Officer has done on the basis that part of the income of the company was agricultural income and therefore liable to the income of the company was agricultural income and therefore liable to exclusion under section 4(3) (vii) of the Income-tax Act. The Appellate Assistant Commissioner did not accept the contention of the assessee. Firstly, according to him, rule 23 permitted the splitting up of the income and the disallowance of the expenditure attributable to the agricultural income of the assessee even in respect of the managing agency commission. On similar grounds upheld also the disallowance of several other items through those items do not form the subject-matter of the reference. Several authorities were cited before the Appellate Assistant Commissioner to show that the expenditure deducted from the total profits of the company after excluding that income which was excluded under section 4. The Appellate Assistant Commissioner, however, distinguished those cases held that they did not affect the application of rule 23.

5. In appeal by the assessee before the Tribunal, the Tribunal held that rule 23 would not apply in the circumstances of the case because the rule merely provides for determining that part of the income which has to be excluded under section 4(3) (vii) and it does not affect the rule that all allowable expenditure must be deducted from the assessable profits of a business. It pointed out that in making allowance for expenditure it was not possible to allocate the expenditure to the excluded portion of the profits of a business. It pointed out that in making allowance for expenditure it was not possible to allocate the expenditure to the excluded portion of the profits not possible to allocate the expenditure which is proportionately attributable to the taxable income of the assessee. The Tribunal held that the sum of Rs. 1,26,359 which was a part of the total amount paid as the managing agency remuneration could not, in the circumstances that the question which we have stated above been referred for our decision.

6. The Tribunal in its order has referred to several cases particularly to S. A. S. S. Chellappa Chetiar v. Commissioner of Income-tax and the decision of this court in Salt & Industries Agencies Ltd. v. Commissioner of Income-tax and to a decision of the Supreme Court in Commissioner of Income-tax v. C. Parekh & Co. (India) Ltd. These cases lay down the principle

that, where income of an assessee is either excluded or income is exempt under any provision of the Income-tax Act, it is not permissible to disallow the proportionate part of the expenditure attributable to such excluded income or exempt income. No doubt, these authorities were not directly concerned with a case of exclusion of agriculture income as such which is provided for in section 4(3) (vii), but the principle would be the same and Mr. Joshi has urged a two-fold contention. He has again relied on rule 23 of the Indian Income-tax Rules, 1922, and urged that upon the terms of that rule there is a clear provision that excepting one deduction no other deduction on account of business of the assessee and therefore the department was entitled to deduct pro rata the portion of the amount expended on account of the managing agency commission. In view of this specific provision of law, Mr. Joshi says that the rule to which the Tribunal adverted would not apply. Secondly, Mr. Joshi has urged that, since the income from agriculture is exempt, this amount of Rs. 1,26,359, which is the expenditure attributable to the agricultural income, should not be allowed to be deducted by the assessee as an expense, as the assessee is likely to get a double advantage.

7. Turning to the first contention, it is clear that the business of the assessee is only one, namely, the manufacture of sugar. Their business is not that of cultivation of sugarcane. Whatever sugarcane is grown is for the purpose of the manufacture of sugar. The business being one and indivisible it is clear that the expenditure which the assessee incurs for that business has to be allowed to the assessee. In this case, the expenditure is allowable under section 10(2) (xv), being "any expenditure..... 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 managing agency commission was an expenditure allowable to the assessee for their business of manufacture of sugar under section 10(2) (xv) unless of course there is statutory provision to the contrary, as submitted.

8. We, therefore, turn to consider whether rule 23 makes any difference to this position in law. Rule 23 runs as follows :

> "23. (1) In the case of income which is partially agricultural income as defined in section 2 and partially income chargeable to income-tax under the head 'business', in determining that part which is chargeable to income-tax the market value of any agicultural produce which has been raised by the assessee or received by him as rent-in-kind and which has been utilised as raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted, and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent-in-kind.
> (2) For the purposes of sub-rule (1) 'market value' shall be deemed to be :-
> (a) where agricultural produce is originally sold in the market in its raw state or after application to it of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render it fit to be taken to market, the value calculated according to the average

price at which it has been so sold during the year previous to that in which the assessment is made;

(b) where agricultural produce is not ordinarily sold in the market in its raw state, the aggregate of -

(1) the expenses of cultivation;

(2) the land revenue or rent paid for the area in which it was grown; and (3) such amount as the Income-tax Officer finds, having regard to all the circumstances in each case, to represent a reasonable rate of profit on the sale of the produce in question as agricultural produce."

9. The rule is not couched in very clear language and that is what has given rise to the argument before us. It provides for the determination of the income chargeable to income-tax where there is a business which has more than one activity, as here, partially from agriculture and partially from business and it says that in determining that part which is chargeable to income-tax, the market-value of any agricultural produce which has been raised by the assessee and utilised as the raw material for the purposes of its business (we leave out the inapplicable part) shall be deducted. In other words, the provision is that where the agricultural produce is used for the purposes of business the value of that agricultural produce shall be deductible from the accounts of the business in determining what part is chargeable to income-tax. If the rule had stopped at this, there would have been no difficulty, but there is the last clause in the rule upon which the entire submission on behalf of the department has been founded and that clause is "and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator..... ". (We again leave out the inapplicable part). The contention is that when the rule says "no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator" the whole of the managing agency commission cannot be deducted because of that express provision. Part of it is expenditure incurred by the assessee as a cultivator. It is urged that undoubtedly a part of the activities of this company which the managing agents were appointed to oversee consisted of agriculture and therefore upon the terms of this clause no further deduction could be allowed. The whole of the managing agency commission could not be deducted as an expenditure. That part of it which is attributable to its proportionate agricultural income must not be allowed to be deducted in order to comply with the direction that no further part of the agricultural expenditure can be deducted.

10. Now it is clear that when the clause just referred to uses the words "further deduction" it refers back to deduction of an expenditure in the agricultural activity of the assessee. The qualification on the words "no further deduction", as laid down by the clause is, "in respect of any expenditure incurred by the assessee as a cultivator". The question is whether the amount of the managing agency commission can possibly be covered by these words. Is the managing agency commission or any part of it "expenditure incurred by the assessee as a cultivator". The rule contemplates a case of an assessee business consists of more than one activity, namely, business and agriculture and deals with and the income chargeable to income-tax has to be

determined. It is difficult to hold that the expenditure incurred by expenditure incurred by them "as a cultivator". The expression is not "in respect of" cultivation or "in connection with" cultivation but the expression is expenditure incurred as a cultivator. That would imply that the expenditure should be of a nature which is normally made by a cultivator-and not expenditure which is somehow connected with the activities and expenditure in appointing managing agents can hardly be said to be expenditure incurred as a cultivator.

11. Secondly, it seems to us that these words were used because of the definition of "agricultural income" in section 2(1) of the Act. In clause (b) of section 2(1) "agricultural income" is defined as meaning :

"(b) any income derived from such land by -
(i) agriculture, or
(ii) the performance by a cultivator.... of any process ordinarily employed by a cultivator.... to render the produce raised or received by him fit to be taken to market, or
(iii) the sale by a cultivator.... of the produce raised.... in respect of which no process has been performed other than a process of the nature described in sub-clause (ii)."

12. The definition thus emphasis the process ordinarily employed by a cultivator in raising crops and contemplates all the processes up to the stage of sale of those crops. It is with reference to that definition that the expression is used in rule 23(1) "expenditure incurred.... as a cultivator". Managing agents are never appointed except by a company and the expression is defined in the Companies Act in section 356. In the present case also the managing agents have been appointed by a regular agreement under section 356 of the Companies Act. Since the business of the company is the manufacture of sugar and the managing agents were appointed to manage that business and since moreover the agricultural activity of the company subserves only that business, we do not think that even having regard to the provisions of rule 23 the commission payable by the assessee to the managing agents could be said to be paid to them by the assessee "as a cultivator". It seems to us that this clause which prohibits the granting of any further deductions is limited to the normal expenditure which a cultivator incurs in the process of earning agricultural income as defined in the Act. There is nothing to show that the managing agents were by an express term appointed specifically to supervise the cultivating or agricultural activity of the assessee. They were appointed as the managing agents of a business and the remuneration payable to them must be held to be expenditure incurred by the assessee for the purposes of their business. It can by no stretch of language be held to be expenditure incurred by the assessee as a cultivator. We do not think therefore that rule 23 prohibits the allowance of the full amount of the remuneration paid to the managing agents in this case.

13. Thirdly, we may point out that where these rules intended that any part of the income earned from agriculture should be treated as a business income the rule expressly says so. For instance, in rule 24 it is provided that : "Income derived from the sale of tea grown and manufactured by

the seller in the taxable territories shall be computed as if it were income derived from business, and 40 per cent. of such income shall be deemed to be income, profits and gains liable to tax." Now here by a fiction the legislature has treated the agricultural income as if it were business income to a certain extent. If the intention of rule 23 was the same we have no doubt that those who framed the Rules would have similarly said so in clear terms. As it is, the expression which they have used is "expenditure incurred by the assessee as a cultivator" and we do not think that even having regard to the nature of the business of the assessee in this case the remuneration which the assessee paid to their managing agents could be said to be "expenditure incurred by the assessee as a cultivator".

14. No doubt rule 23 is made under the powers given to the Central Board of Revenue to make rules under section 59(1) read with section 59(2) (a) and section 59(1) permits the making of rules for carrying out the purposes of the Act and for the ascertainment and determination of any class of income. This rule is made under clause (a) of sub-section (2) of section 59 which says that without prejudice to the generality of the power, such rules may –

> "(a) prescribe the manner in which, and in the procedure by which, the income, profits and gains shall be arrived at in the case of -
> (i) incomes derived in part from agriculture and in part from business".
> (ii)

15. These rules no doubt become a part of the Act "as if enacted in this Act" by virtue of sub-section (5) of section 59. To that extent if the rule were applicable, it would no doubt modify the normal principle that all expenditure not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly or exclusively for the purpose of the business should be allowed, but, as we have shown, upon a plain reading of the terms of the rule, it cannot apply to an expenditure of the nature that we have before us, namely, commission paid to the managing agents of the company.

16. Then we turn to the alternative argument of counsel that, since the income was wholly exempted under the provisions of section 4(3) (viii), the assessee should not be allowed to claim this amount paid to the managing agents as a commission as an allowable expenditure, because the assessee in that case would get a double advantage. The income, it is said, is free from tax and yet the assessee claims deduction for the expenditure in respect of the same income which is excluded. That would give him a double advantage, it is said. This contention cannot be upheld for the reason that it is covered by a decision of the Supreme Court in Commissioner of Income-tax v. Indian Bank Limited and by our decision recently given in I. T. Reference No. 69 of 1962, decided on 11th September, 1967.

17. In the result, we answer the question referred in the negative. The Commissioner shall pay the costs of the assessee. The notice of motion is not pressed. Therefore, there shall be no order on it.