THE COMMISSIONER OF INCOME-TAX, BOMBAY

v.

CHANDULAL KESHAVLAL & CO., PETLAD

1960

February, 17

(S. K. DAS, J. L. KAPUR and M. HIDAYATULLAH, JJ.)

Income-tax—Managing Agent relinquishing part of commission due from managed company—Whether amount relinquished is deductible as expenditure expended wholly and exclusively for purpose of his business—Finding, if one of fact—Indian Income-tax Act, 1922 (XI of 1922), s. 10(2)(xv).

The assessee was the Managing Agent of a company and for the accounting year 1950 its total commission was Rs. 3,09,114. At the oral request of the Directors of the Company made during the accounting year the assessee agreed to accept Rs. 1,00,000 only as its commission and relinquished the balance. The Income-tax Officer and the Appellate Assistant Commissioner held that the sum of Rs. 3,09,114 had accrued to the respondent as commission and that the whole amount was taxable. On appeal the Appellate Tribunal held that out of the accrued commission the amount relinquished, i.e. Rs. 2,09,114, was allowable expenditure under s. 10(2)(xv) of the Income-tax Act. The Tribunal found that: (i) the financial condition of the managed company was unsatisfactory, (ii) in the past also the assessee had been remitting part or whole of its commission when the profits of the managed company were unsatisfactory, (iii) in the year of account the profits of the Company would have been Rs. 3,63,078 if the whole commission was deducted, which would be the lowest since 1940, (iv) it was not a bounty by the respondent to the managed company, (v) the business of the respondent was so linked up with the managed company that if the latter was put on a sounder position the assessee would also get a larger commission in future, and (vi) the respondent had accepted Rs. 1,00,000 at the instance of the managed company. The appellant contended that s. 10(2)(xv) applied only when the expenditure was incurred directly for the purpose of the business of the assessee and not when it affected his business only indirectly as a result of the benefit to the managed company.

Held, that the finding of the Tribunal that the amount which was claimed as a deductible allowance under s. 10(2)(xv) was laid out wholly and exclusively for the purpose of the assessee's business was one of fact and as there was evidence to support it, it could not be interfered with. In deciding whether the payment was a deductible expenditure the question of commercial expediency and the principles of ordinary commercial trading had to be taken into consideration. If the payment of expenditure was incurred for the purpose of the trade or business of the assessee it did not matter that the payment enured to the benefit of a third party also. Another test was whether the transaction was properly entered into as a part of the assessee's legitimate

commercial undertaking in order to facilitate the carrying on of its business. But if the expense was incurred for fostering the business of another only or was made by way of distribution of profits or was wholly gratuitous or for some improper or oblique purpose outside the course of business then the expense was not deductible.

Tata Sons Ltd. v. *The Commissioner of Income-tax, Bombay,* (1950) I.T.R. 460, *Union Cold Storage Company Ltd.* v. *Jones,* 8 T.C. 725 and *Odhams Press Ltd.* v. *Cook,* 23 T.C. 233, referred to.

Usher's Wiltshire Brewery Ltd. v. *Bruce,* 6 T.C. 399, *Eastern Investments Ltd.* v. *The Commissioner of Income-tax, West Bengal.* [1951] S.C.R. 594 and *Atherton* v. *British Insulated & Helsby Cables Ltd,* 10 T.C. 156, relied on

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 167 of 1958.

Appeal by special leave from the judgment and order dated the February 15, 1955 of the Bombay High Court in Income-tax Reference No. 29 of 1953.

C. K. Daphtary, Solicitor General of India, R. Ganapathi Iyer and *D. Gupta,* for the appellant.

N. A. Palkhivala and *I. N. Shroff,* for respondent.

1960. February 17 The Judgment of the Court was delivered by

KAPUR J.—This is an appeal by special leave against the judgment and order of the High Court of Bombay. It arises out of a reference by the Income-tax Appellate Tribunal under s. 66(1) of the Indian Income-tax Act (hereinafter termed the Act.) The appellant in this appeal is the Commissioner of Income-tax and the respondent is a partnership firm which, by an agreement dated September 23, 1935, was appointed the Managing Agent of the Keshav Mills Ltd., Petlad. For the sake of convenience the respondent firm will, in this judgment, be termed the Managing Agent and the Keshav Mills Ltd., the Managed Company. By cl. 4 of this agreement the Managing Agent was to get a commission of 4% on the sale proceeds of the cloth, yarn or other goods manufactured and sold by the company and 15% on the amount of bills for charges of ginning and pressing and dyeing or bleaching and on the amount of labour bills and other work done in the running of the factory. The commission was exclusive of other charges such as *adat,* interest, discount, brokerage etc.

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The amount of commission was to be credited in the account of the Managing Agent every six months and it was entitled to interest at the rate of six per cent. per annum on the amount so credited. There were other conditions in the Agency Agreement which are not necessary for the purposes of this case. The total commission for the accounting year 1950 was a sum of Rs. 3,09,114. Sometime during the accounting year, at the oral request of the Board of Directors of the Managed Company, the Managing Agent agreed to accept a sum of Rs. 1,00,000 only as its commission which was credited to the account of the Managing Agent in the books of the company at the end of the year 1950. The Income-tax Officer and the Appellate Assistant Commissioner held that the amount which accrued as commission to the Managing Agent was Rs. 3,09,114 and that amount was taxable. An appeal was taken to the Income-tax Appellate Tribunal by the Managing Agent. By an order dated February 26, 1953, the Appellate Tribunal held that the amount which accrued to the Managing Agent as commission was Rs. 3,09,114 but it accepted Rs. 1,00,000 as taxable income and Rs. 2,09,114 was held to be an allowable expenditure within s. 10(2)(xv) of the Act and it was therefore allowed. The Tribunal in its order said that in the past also the Managing Agent had, in the interest of the Managed Company, waived a portion of the Commission and then made the following observation:

> "The Tribunal has also held that if the Managing Agency Commission or a part thereof is foregone in the interest of the Managed Company, it would be allowed as an expenditure under Section 10(2)(xv) of the Act. We allow the amount foregone under Section 10(2)(xv)."

Against this order, at the instance of the appellant, a case was stated to the Bombay High Court for its opinion on the following two questions:

> (i) Whether on the facts and in the circumstances of the case, the sum of Rs. 2,09,114 was assessable in the hands of the assessee as its income.
>
> (ii) If the answer to question (i) is in the affirmative whether the said sum is an allowable

deduction from the assessee's income under Section 10(2)(xv) of the Act.

The judgment of the High Court shows that it was inclined to decide the questions in favour of the appellant, but at the instance of the Managing Agent the Appellate Tribunal was directed to submit a supplementary Statement.

No fresh evidence was led before the Tribunal but it appears that some emphasis was laid on a letter of the Managing Agent dated September 18, 1951, sent to the Income-tax Officer. In this letter the Managing Agent had stated that the only commission which accrued to it was a sum of Rs. 1,00,000 and nothing had been foregone from out of the commission or relinquished. It is also stated that the amount of Rs. 1,00,000 accrued because of the variation of the terms of the Managing Agency Agreement. Reference was also made in the letter to the Balance Sheet of the Managed Company ending December 31, 1950, showing that the paid up capital was rupees 30 lacs, depreciation fund rupees 14 lacs, totalling rupees 44 lacs. As against this sum the Block Account showed a debit of over rupees 48 lacs and it was with the object of strengthening the financial position of the Managed Company and in its interest that the Chairman of the Board of Directors had requested and the Managing Agent had agreed to accept rupees 1 lac as commission. The Income-tax Appellate Tribunal submitted a supplementary Statement of Case dated May 3, 1954, in which it said (1) that there was no oblique motive in accepting Rs. 1,00,000 instead of rupees 3 lacs odd as commission and that the remission was bona fide. It was also remarked that it was not even faintly suggested by the Department that what was given up by the Managing Agent from the commission was done with some dishonest motive; (2) the amount foregone by the Managing Agent was an expenditure incurred wholly and exclusively for the purpose of the business of the Managing Agent; (3) that when the appeal was decided by the Appellate Tribunal it did not have the slightest doubt in its mind that the commission was foregone for business considerations; and (4) that the

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amount was given up or expended for reasons of commercial expediency. A very significant paragraph in the supplementary Statement of the Case was paragraph 4 which stated:

> "It was assumed that what was in the interest of the managed company was in the interest of the managing agent. The interests of the managing agent and the managed company are, so to say, linked up. If the managed company is put on a sounder position, not only the shareholders of the managed company benefit, but also the managing agent, inasmuch as the managing agent would get a larger commission in future."

The basic facts which arise out of the Statement of the Case and the documents which were produced by the Managing Agent are: (1) the rather unsatisfactory financial position of the Managed Company as shown by the Balance Sheet; (2) in the past also the Managing Agent had been remitting a part or whole of the commission whenever the profits of the Managed Company were unsatisfactory; (3) in the year of account the profits of the managed company as per profit and loss account were Rs. 5,72,192. This was after paying to the Managing Agent a commission of Rs. 1,00,000 and if the whole of the accrued commission had been deducted then the profits would have been Rs. 3,63,078 which would be the lowest amount since 1940 and the amount of commission would have been the highest; (4) it was not a bounty by the Managing Agent to the Managed Company; (5) the business of the Managing Agent was so linked up with the Managed Company that if the latter was put on a sounder position the Managing Agent would also get a larger commission in future; and (6) the Managing Agent had accepted Rs. 1,00,000 at the instance of the Chairman of the Board of Directors of the Managed Company. This was the material on which the Tribunal gave a finding in its supplementary Statement 'that what was given up by the assessee was an expenditure for the purpose of the assessee's business'. On this statement the High Court by its judgment dated February 15, 1955, held

the finding of the Appellate Tribunal to be one of fact. It said:

> "Now this is a finding of fact and unless it can be suggested that there was no evidence to support the finding of fact we are concluded by this finding of fact."

Therefore the question in regard to s. 10(2)(xv) was answered in favour of the Managing Agent. It is against this judgment and order that the appellant has come in appeal to this Court by special leave.

For the appellant it was argued that there was no evidence in support of the finding that the amount of about rupees 2 lacs which was foregone by the Managing Agent was wholly and exclusively laid out for the purpose of the Managing Agent's business and emphasis was laid on the finding of the Appellate Tribunal in its order dated February 26, 1953, that in the past the Commission had been given up by the Managing Agent in the interest of the Managed Company and that if the Managing Agent's commission or part thereof was foregone in the interest of the Managed Company it was not an allowable expenditure under s. 10(2)(xv). It was also argued that there was no evidence in support of the finding that the amount was expended for the benefit of the Managing Agent and that even if as a result of the amount being foregone the Managing Agent was helped because it benefited the Managed Company, then s. 10(2)(xv) would not be attracted; in other words the question had to be looked at from the point of view of the direct concern of the Managing Agent and not of remoter or indirect result which may flow as a result of the benefit to the Managed Company and in each case the question on each set of facts is whether the benefit is to the assessee i. e., the Managing Agent or to some one else.

In his argument the learned Solicitor General referred to the following cases:

Tata Sons Ltd. v. *The Commissioner of Income-tax, Bombay* (1). There the assessee was the Managing Agent of another company and was entitled to receive commission on the net profits of the Managed Com-

(1) [1950] 18 I.T.R. 460.

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pany. During the relevant year the assessee voluntarily paid a sum of money towards the bonus which the Managed Company paid to some of its officers and claimed it as a deductible expenditure under s. 10(2)(xv) of the Act. This deduction was allowed on the ground that the object of the payment from the point of view of commercial principles was to increase the profits of the Managed Company and thereby the Commission of the Managing Agent. It was argued there also that the payment was entirely gratuitous but that contention was repelled, because the object of the payment from the point of view of commercial principles was to increase the efficiency of the Managed Company and thereby to increase the profits of the Managed Company and the commission of the Managing Agent. And thus there was an important nexus between the Managed Company and the Managing Agent. It was also held that the question whether money was wholly expended or laid out for the purpose of the business of the assessee company must be determined upon principles of ordinary commercial trading.

The second case was *Union Cold Storage Company Ltd.* v. *Jones* (1). There a British company transferred its foreign cold storage business carried on by it directly or through subsidiary companies to an American Company for a term of years in consideration of certain annual payments to the subsidiary companies and of a guarantee of any sum necessary to meet its fixed charges and maintain its dividends. The property remained the property of the British Company but it was placed under the sole control of and was used by the American Company for its own business. There was no demise or lease to the American Company and no rent was payable but the American Company was to keep it in proper repair and working order. The British Company paid fire insurance premiums in respect of the premises—machinery etc., and claimed deductions for the sums so paid out of its profits and for wear and tear of the machinery and plant of the transferred business. It was held that the insurance premiums did not

(1) 8 T.C. 725.

represent money wholly and exclusively laid out for the purpose of trade of the assessee company as the machinery and plant were not used for those purposes and the deductions claimed were therefore not admissible. It was argued in that case that by the agreement the assessee company had secured not only the right to receive upto the sum specified but also that the American company would have an incentive to send business to the assessee company in order that its profits should reach that specified figure and therefore the expenditure was deductible. But it was held that in order to be so deductible it had to be for the benefit of the trade which immediately concerned the assessee company. It was also held that if it was of such a nature then the deduction was *prima facie* a proper one even though it might inure to the benefit of a third party and the matter had to be tested from the point of view of the assessee company.

The learned Solicitor General relied upon a passage in the judgment at p. 741 :

> ".....they (the Commissioners) find that there was a reflex result of this Agreement which inured to the benefit of the Appellant Company but I think in terms they indicate that that result was not a direct result but a reflex result. In their reasons in which they came to their conclusion they say the arrangements with regard to the stores and machinery and plant were not of an ordinary nature and they did not extend the Appellant Company's market. They also say that the machinery and plant in question is used primarily for the purposes of the trade of the National Company. With those findings before us I think it is quite clear as a matter of fact that the facts so found differentiate this case wholly from *Usher's case.*"

From this it was sought to be argued that what one is to look at is the direct result to the assessee and not remoter or indirect results. What the court found in that case was that insurance premiums were paid by the British Company as owners and not in the course of business and that the assets were used not for its business but for the business of another.

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The real test laid down after reference to *Usher's Wiltshire Brewery Ltd.* v. *Bruce*(1) was that deduction may be allowed in cases where the payment or expenditure is incurred for the purpose of the trade of the subject making the return and it does not matter that this payment may inure to the benefit of a third party.

Another case relied on was *Eastern Investments Ltd.* v. *The Commissioner of Income-tax, West Bengal*(2) where a private limited company had a share capital of rupees 250 lacs of which shares of the value of rupees 50 lacs were held by A and the remaining by his nominees. The company was in need of money and with the consent of A it resolved to reduce the share capital by rupees 50 lacks by the company taking over rupees 50 lacs worth of shares and issuing to A debentures of the face value of rupees 50 lacs carrying interest at 5%. The Income-tax Appellate Tribunal and the High Court held that the interest on debentures was not an allowable expenditure under s. 12(2) of the Act. This Court, on appeal, was of the opinion that the transaction was of a commercial nature from the point of view of the assessee company and on a review of all the facts it came to the conclusion that the transaction was voluntarily entered into in order indirectly to facilitate the carrying on of the business of the company and so made on the ground of commercial expediency. The argument that the debentures were held by the shareholder was rejected on the ground that it made no difference whether the debentures were held by the shareholder or by an outsider. The test laid down by this case therefore was that in the absence of fraud or an oblique motive and if a transaction is of a nature which is entered into in the course of business of the assessee and is commercially expedient then it does become a deductible allowance. If as a result of the transaction the assessee benefits it is immaterial that a third party also benefits thereby. At page 599, Bose J., observed;

"In the absence of a suggestion of a fraud this is not relevant at all for giving effect to the provi-

(1) 6 T.C. 399. (2) [1951] S.C.R. 594.

sions of section 12(2) of the Income-tax Act. Most commercial transactions are entered into for the mutual benefit of both sides, or at any rate each side hopes to gain something for itself. The test for present purposes is not whether the other party benefited, nor indeed whether this was a prudent transaction which resulted in ultimate gain to the appellant, but whether it was properly entered into as a part of the appellant's legitimate commercial undertaking in order indirectly to facilitate the carrying on of its business."

In *Odhams Press Ltd.* v. *Cook*(1) the assessee company had acquired all the shares in a subsidiary company and printed and published a periodical for the subsidiary company. The subsidiary company made a loss during the accounting year and the assessee company wrote off that amount of loss from the amounts due to it from the subsidiary company and claimed a deduction of that loss from its profits on trading account or as money laid out or expended for the purpose of its trade. The Special Commissioners found that the sum was not written off wholly or exclusively for the purpose of their trade or business and therefore it was an inadmissible deduction. This question was held to be one of fact and that there was evidence to justify that conclusion. Viscount Caldecote L.C., said that the trade or the business of one Company even though it may affect very closely the trade or business of another was not the same thing as that other's trade or business. In computing the profits and gains of the assessee, it is his trade that is to be regarded. At page 110, Viscount Maugham observed:

"My Lords, the question thus put answers itself. There were beyond dispute, the two relationships, between the Company and the Coming Fashions Ltd., already referred to. The allowance of the £2927 5s. 8d. to Coming Fashions Ltd., might have been 'laid out or expended for the purpose of the trade' of Coming Fashions Ltd., or to some extent for both purposes and it is plain that these facts alone were sufficient to show that there was evidence

(1) 23 T. C. 233.

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to justify the conclusion of the Commissioner that the sum written off was not written off wholly and exclusively for the purpose of the trade or business of the Appellants."

The connection between the assessee company and the subsidiary company, apart from the holding of shares, was that the assessee company did printing for the subsidiary company. The effect of the transaction was debiting of another entity's loss to the assessee company but there was no direct connection between the profits of the assessee company with that of the amount claimed. The real point in that case was that the amount was not wholly and exclusively written off for the purpose of the assessee company. Viscount Maugham said :

"Is there any real ground for contending on the evidence that one reason for writing off the sum was not to enable Coming Fashions Ltd., to continue to carry on its business as compiler and vendor of 'Everywoman's' ?"

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 s. 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.

Another fact that emerges from these cases is that if the expense is incurred for fostering the business of another only or was made by way of distribution of profits or was wholly gratuitous or for some improper or oblique purpose outside the course of business then the expense is not deductible. In deciding whether a payment of money is a deductible expenditure one has to take into consideration questions of commercial expediency and the principles of ordinary commercial trading. If the payment or expenditure

is incurred for the purpose of the trade of the assessee it does not matter that the payment may inure to the benefit of a third party (*Usher's Wiltshire Brewery Ltd.* v. *Bruce*(1)). Another test is whether the transaction is properly entered into as a part of the assessee's legitimate commercial undertaking in order to facilitate the carrying on of its business; and it is immaterial that a third party also benefits thereby (*Eastern Investments Ltd.* v. *The Commissioner of Income-tax, West Bengal* (2)). But in every case it is a question of fact whether the expenditure was expended wholly and exclusively for the purpose of trade or business of the assessee. In the present case the finding is that it was laid out for the purpose of the assessee's business and there is evidence to support this finding. Mr. Palkhivala referred in this connection to *Atherton* v. *British Insulated & Helsby Cables Ltd.* (3) where, at page 191, Viscount Cave L. C., observed:

"It was made clear in the above cited cases of *Ushers Wiltshire Brewery* v. *Bruce* (1) and *Smith* v. *Incorporated Council of Law Reporting* (4) 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 yet be expended wholly and exclusively for the purpose of the trade; and it appear's to me that the findings of the Commissioners in the present case bring the payment in question within that description. They found (in words which I have already quoted) that the payment was made for the sound commercial purpose of enabling the Company to retain the services of existing and future members of their staff and of increasing the efficiency of the staff; and after referring to the contention of the Crown that the sum of £31,784 was not money wholly and exclusively laid out for the purposes of the trade under the Rule above referred to, they found that the deduction was admissible—thus in effect, although

(1) 6 T.C. 399
(2) [1951] S.C.R. 594
(3) 10 T.C. 155
(4) 6 T.C. 477

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not in terms, negativing the Crown's contention. I think that there was ample material to support the findings of the Commissioners, and accordingly that this prohibition does not apply."

Thus in cases like the present one in order to justify deduction the sum must be given up for reasons of commercial expediency; it may be voluntary, but so long as it is incurred for the assessee's benefit the deduction would be claimable.

The Income-tax Appellate Tribunal has found in favour of the Managing Agent that the amount was expended for reasons of commercial expediency, it was not given as a bounty but to strengthen the Managed Company and if the financial position of the Managed Company became strong the Managing Agent would benefit thereby. That finding is one of fact. On that finding the Income-tax Appellate Tribunal rightly came to the conclusion that it was a deductible expense under s. 10(2)(xv).

In our opinion the judgment of the High Court was right and we would dismiss this appeal with costs.

Appeal dismissed.

THE COMMISSIONER OF INCOME-TAX, BOMBAY NORTH & OTHERS.

v.

M/S. HARIVALLABHDAS KALIDAS AND CO.,

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February, 19

(S. K. Das, J. L. Kapur and M. Hidayatullah. JJ.)

Income-tax—Managing Agent's Commission payable at the end of the year—Rate of Commission reduced before then by agreement—If voluntary relinquishment of a portion of accrued commission.

The respondent-firm Harivallabhdas Kalidas was appointed the Managing Agent of Shri Ambika Mills Ltd., the appellant in the connected appeal by means of a Managing Agency Agreement the relevant portion of which ran thus:—

"(2)(a) The Company shall pay each year to the said Firm either the commission of 5 (five) per cent on the total sale proceeds of yarn, and of all cloth, manufactured from cotton,