A **COMMISSIONER OF INCOME-TAX, GUJARAT AHMEDABAD**

v.

TEJAJI FARASRAM KHARAWALLA LTD.

July 19, 1967

B [J. C. SHAH, S. M. SIKRI AND V. RAMASWAMI, JJ.]

Indian Income-tax Act, 1922, s. 4(3) (*vi*)— *Allowance to agent for expenses wholly and necessarily in the performance of duties— Exemption under section whether applicable to whole amount so sanctioned whether actually expended or not—'Incurred' whether includes 'to be incurred'.*

The respondents were selling agents for the goods manufactured
C by another company. They were paid 7½% on the sales as selling commission and 5% as contingency expenses. The question in income-tax proceedings was whether the amount not spent out of the grant for contingency expenses was exempt from taxation by virtue of s. 4(3) (vi) of the Indian Income-tax Act, 1922. The High Court in reference held that the "5% commission" received by the respondents represented a special allowance to meet expenditure and was on that account exempt from tax. The Revenue appealed.

D HELD: (i) In the context in which the expression 'incurred' occurs in s. 4(3) (vi) it undoubtedly means 'incurred or to be incurred'. To qualify for exemption the allowance must be granted to meet expenses incurred or to be incurred wholly and necessarily in the performance of the duties of an office or employment of profit. [41A]

(ii) In framing s. 4(3) (vi) the intention of the framers of the
E Act was to grant exemption in respect of amounts received by the assessee, not for his own benefit, but for the specific purpose of meeting the expenses wholly and necessarily incurred or to be incurred in the performance of his duties as agent. It would therefore be reasonable to hold that the allowance granted to meet the expenses wholly and necessarily incurred or to be incurred in the performance of the duties of the office or employment of the grantee alone qualifies for exemption under the Act, and any surplus re-
F maining in the hands of the grantee after meeting the expenses does not bear the character of the allowance for meeting expenses. This would be so even if the employer has disabled himself from demanding refund of the amount not expended for meeting the expenses incurred or to be incurred in the performance of the duties of an office of employment or profit, and the surplus remaining in the hands of the grantee acquires for the purpose of the Income-tax Act, the character of additional remuneration. [40C-E]

G *Tejaji Farasram Kharawalla* v. *Commissioner of Income-tax, Bombay (Mofussil)*, [1948] 16 I.T.R. 260, disapproved.

(iii) The allowance may be in respect of a period longer than the accounting year or years. But on that account the whole receipt reduced by the expenses actually incurred in the year of account is not liable to be brought to tax in that year. In such a case it will be the duty of the Income-tax Officer to determine the amount allowed in respect of the year of account in which the expenditure
H has been incurred and the difference between the amount so determind and the amount actually expended would alone be brought to tax. [41G]

The position in this respect remains the same even after the amendment of s. 4(3) (vi) by the Finance Act, 1955. [41B]

Commissioner of Income-tax, U.P. v. *Sharma & Company*, 57 I.T.R. 470, disapproved. A

CIVIL APPELLATE JURISDICTION: Civil Apeal No. 2162 of 1966.

Appeal from the judgment and order dated September 6, 9, 1963 of the Gujarat High Court in Income-tax Reference No. 9 of 1963. B

B. Sen, A. N. Kirpal, R. N. Sachthey and *S. P. Nayar*, for the appellant.

I. N. Shroff, for the respondent.

The Judgment of the Court was delivered by

Shah, J.—By an agreement dated October 29, 1928 Ciba (India) Ltd.—hereinafter called 'the principals'—appointed one C Tejaji Farasram Kharawalla selling agent for the District of Ahmedabad in respect of certain kinds of dyes and dye-stuffs, and agreed to pay him commission at the rate of 12½% on sales by him of dyes and dye-stuffs of the principals. The commission was to include "all charges in connection with the upkeep of offices and godown, turnover rebates and contingency expenses etc." D

The terms relating to commission were modified by agreement dated August 20, 1935 and out of the commission agreed to be paid, 7½% was to be treated as the selling commission and 5% was to be treated as compensation in lieu of the contingency expenses which the selling agent had to meet, "such as commission to Dyeing Masters, agents etc.". The rights of the selling agent were assigned with the consent of the principals to the respondent E Company with effect from October 27, 1947. In assessing the income of the Company for the assessment year 1949-50, the Income-tax Officer included in the taxable income Rs. 58,025/- being the difference between Rs. 1,90,538/- received by the Company as "5% commission" and Rs. 1,32,512/- spent by the Company for meeting the charges which the selling agent was to meet. The F Income-tax Appellate Tribunal, however, upheld the contention of the Company that in the computation of the income of the Company, the "5% commission" was wholly exempt by virtue of s. 4 (3)(vi) of the Income-tax Act, 1922.

The Commissioner then moved the Tribunal to draw up a statement of the case and to refer the following question to the G High Court of Judicature at Bombay:

> "Whether on the facts of the case, a portion *viz.* 5%, of the selling agency commission of 12½% received by the assessee company from M/s Ciba Ltd. in the course of carrying on the selling agency business is exempt from tax under s. 4(3)(vi) of the Act?"

But the Tribunal only referred the following question: H

> "Whether the assessee company held an office or employment of profit within the meaning of s. 4(3)(vi) of the Indian Income-tax Act?"

A The application preferred by the Commissioner to the High Court for calling upon the Tribunal to submit a statement on the question originally submitted was rejected, and the High Court answered the question referred by the Tribunal in the affirmative, observing that it had been conclusively determined by their earlier decision in *Tejaji Farasram Kharawalla* v. *Commissioner of Income-tax, Bombay (Mofussil)*(1)—which arose out of a proceeding for assess-
B ment to tax of the income of the original selling agent under the same agency agreement. It appears that in so observing the Court was under some misapprehension, for the question referred by the Tribunal had not been decided in the earlier judgment.

Against the order passed by the High Court recording an
C answer in the affirmative on the question referred by the Tribunal and against the order dismissing the notice of motion, the Commissioner appealed to this Court. This Court set aside the order passed by the High Court dismissing the application of the Commissioner and without expressing any opinion on the correctness or otherwise of the answer recorded by the High Court on the question referred by the Tribunal, remanded the case to the High
D Court with a direction that the Tribunal be called upon to state a case on the question raised in the application of the Commissioner.

The case was then heard by the High Court of Gujarat to which it stood transferred because of the reorganisation of the State of Bombay. The High Court of Gujarat held that the "5% E commission" received by the Company represented a special allowance to meet expenditure "such as commission to Dyeing Masters, agents etc.", and was on that account exempt from tax. The High Court also held that the Company held an office or employment of profit. The Commissioner has again appealed to this Court against the answers recorded by the High Court on the F original and supplementary question.

Section 4(3)(vi) of the Indian Income-tax Act, 1922, as it stood in the year of assessment read as follows:—

> "Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving them:

G

. . . . .

> (vi) Any special allowance, benefit or perquisite specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit."

H The clause grants exemption in respect of expenses "incurred": but on that account an allowance granted to meet expenses to be incurred in future in the performance of the duties of an

(1) [1948] 16 I.T.R. 260.

office or employment of profit is not outside the exemption claimed. In the context in which the expression "incurred" occurs, it undoubtedly means "incurred or to be incurred". To qualify for exemption the allowance must it is clear be granted to meet expenses incurred or to be incurred wholly and necessarily in the performance of the duties of an office or employment of profit. But the purpose for which the allowance is granted, in our judgment, is alone not determinative of the claim to exemption. An allowance though made to a person holding an office or employment of profit intended for appropriation towards expenditure incurred or to be incurred in the discharge of the duties, does not constitute any real income of the grantee. It is in truth expenditure incurred by the employer through the agency of the grantee. The intention of the framers of the Act was to grant exemption in respect of amounts received by the assessee, not for his own benefit, but for the specific purpose of meeting the expenses wholly and necessarily incurred or to be incurred in the performance of his duties as an agent. It would, therefore, be reasonable to hold that the allowance granted to meet the expenses wholly and necessarily incurred or to be incurred in the performance of the duties of the office or employment of the grantee alone qualifies for exemption under the Act, and any surplus remaining in the hands of the grantee after meeting the expenses does not bear the character of the allowance for meeting expenses but for performing the duties of the office or employment. This would be so even if the employer has disabled himself from demanding refund of the amount not expended for meeting the expenses incurred or to be incurred in the performance of the duties of an office or employment of profit, and the surplus remaining in the hands of the grantee acquires for the purpose of the Income-tax Act the character of additional remuneration.

We are unable to agree with the decision of the Bombay High Court in *Tejaji Farasram Kharawalla's case*(1) that the object with which the grant is made by the employer determines the claim to exemption under s. 4(3)(vi) of the Income-tax Act. The observations made by Chagla, C.J., at p. 267 that "what is emphasized in this sub-clause s. 4(3)(vi) is the purpose of the grant, the object with which the grant was made. . . . Once it is established that the grant was for that particular purpose, it is no longer necessary for the assessee to prove that in fact he expended that grant for the purpose for which it was given. He may spend more, or he may spend less, but *qua* that grant which is given for a particular purpose, he is entitled to the exemption", do not, in our judgment, give due effect to the key words "to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit." What is exempted is not the consideration paid for meeting the expenditure incurred or to be incurred in the performance of the duties of an office or

(1) 16 I.T.R. 260.

employment: the exemption operates only in respect of a special allowance or benefit specifically granted to meet expenses wholly and necessarily incurred in the discharge of the duties of the office or employment.

The judgment of the Allahabad High Court in *Commissioner of Income-tax, U. P.* v. *Sharma & Company*(1) and especially the observations of Pathak, J., on which reliance was placed by counsel for the Company may also be referred to. In *Sharma & Company's* case(1) the assessee firm which was the sole selling agent of a "cotton mill", received a sum exceeding Rs. 67,000/- from the owners of the mills for the purpose of meeting the expenses in connection with the management of a retail cloth shop on behalf of the mill and actually spent only Rs. 12,641/-. The claim of the firm that it was entitled to exemption from liability to pay tax under s. 44(3)(vi) of the Act (before it was amended in 1955) even in respect of the balance retained by it was upheld by the High Court of Allahabad. Pathak, J., observed that s. 4(3)(vi), as it then stood, required the Income-tax Officer to enquire whether the purpose of the grant was covered by the language of the clause, and he was not concerned to determine whether the amount granted was actually expended by the recipient. The learned Judge in so holding was impressed by two considerations: that the expression "incurred" means incurred already, or to be incurred in future; and that income-tax being an annual tax in a case where the allowance is an *ad hoc* allowance which is to cover a period longer than or ending after the year of account, or is a periodical allowance, the Income-tax Officer may under the Act exempt expenditure incurred in the year of account and no more, and thereby the intention of the employer would be wholly frustrated and the employee may be called upon to pay tax on a receipt which is not his income.

The expression "incurred" means for reasons already set out incurred or to be incurred. But that has no bearing on the question whether the unexpended surplus in the hands of the employee is taxable. And we do not feel impressed by the second consideration. The allowance may be in respect of a period longer than the accounting year or which runs into the succeeding accounting year or years. But on that account the whole receipt reduced by the expenses actually incurred in the year of account is not liable to be brought to tax. If it appears from a review of the circumstances that a special allowance is made for a period longer than the year of account, or that the period covered by the grant of a special allowance extends beyond the close of the account year, it would, in our judgment, be the duty of the Income-tax Officer to determine the amount allowed in respect of the year of account in which the expenditure has been incurred, and the difference between the amount so determined and the amount actually expended would alone be brought to tax.

(1) 57 I.T.R. 470.

It may be noted that the Parliament has by the Finance Act, 1955, with effect from April 1, 1955, recast cl. (vi) of s. 4(3) of the Income-tax Act, 1922 and has expressly provided that the special allowance granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit to the extent to which such expenses are actually incurred for that purpose, was exempt from tax. The Legislature, by the amendment made it clear that only the expenses actually incurred by the assessee will be exempted under s. 4(3)(vi). But the principle that an amount granted to cover expenses to be incurred for a period which extends beyond the year of account in which the grant is received will be allocated between the year of account and the period outside the year of account will apply to the Act as amended. A B C

There is no doubt that the selling agent under the agreement with the principals holds an employment for profit. No argument to the contrary was advanced before us. It is unnecessary therefore to consider the elaborate judgment of the High Court on the question whether the selling agent holds an office within the meaning of s. 4(3) (vi) of the Act. D

The appeal is therefore allowed and the answer recorded by the High Court to the supplementary question is discharged, and the following answer to the supplementary question is recorded:

"That portion of 5 per cent of the selling agency commission received by the assessee company is exempt under s. 4 (3) (vi) of the Income-tax Act, 1922, which is wholly and necessarily incurred in the year of account in the performance of the duties of the company as selling agent." E

There will be no order as to costs in this appeal in this Court and in the High Court. F

G.C. *Appeal allowed.*