

## BENGAL ENAMEL WORKS LTD.

v.

## COMMISSIONER OF INCOME-TAX, WEST BENGAL

December 9, 1969

[J. C. SHAH, ACTING C.J. AND K. S. HEGDE, J.]

*Income-tax Act (11 of 1922), s. 10(2)(xv)—Payment of remuneration by employer to employee—Jurisdiction of tax officers to hold that expenditure was not laid wholly and exclusively for the purpose of business—Whether question of law.*

The appellant, which was doing the business of manufacturing enamelled ware, appointed a technical adviser and the Board of Directors resolved to pay him 15% of the gross annual profits as his remuneration. For the assessment years, 1951-52, 1952-53 and 1953-54, the appellant claimed the amounts paid to the technical adviser as admissible allowances under s. 10(2)(xv) of the Income-tax Act, 1922. The Income-tax Officer found, that the technical adviser was a doctor of medicine without any special qualification for the post, that he was not trained in the technique of enamelled ware, that he and his father-in-law, by the number of shares they held, were able to control the voting before the Board of Directors, that good technical experts in enamelling could have been secured for a smaller remuneration, that the remuneration agreed to be paid to the technical adviser was influenced by extra-commercial considerations and therefore, disallowed a part of the amount, holding that it was expenditure not incurred wholly and exclusively for the purpose of the business. The order was confirmed by the Appellant Assistant Commissioner, the Tribunal and the High Court.

In appeal to this Court,

**HELD :** The question whether an amount claimed as expenditure was laid out or expended wholly and exclusively for the purpose of the business must be decided on the facts and circumstances of each case, and the inference drawn from the facts found is one of law. Ordinarily, an employer, in fixing the remuneration of his employee, is entitled to take into consideration the extent of his business, the nature of duties to be performed, the special aptitude of the employee, the future prospects of the business and other related circumstances, and the taxing authorities cannot substitute their own view as to the reasonable remuneration which should have been agreed to be paid to the employee. But, the taxing authority may disallow an expenditure claimed, on the ground that the payment is not real or is not incurred by the assessee in the course of his business or that it is not laid out wholly and exclusively for the purpose of the business. In doing so, the authority does not substitute its own view of how the assessee's business affairs should be managed, but proceeds to disallow the expenditure, because, the condition of its admissibility is absent. [316 B, D; 317 F-H; 318 A, D]

*Swadeshi Cotton Mills Co. Ltd. v. C.I.T., U.P. 63 I.T.R. 57 (S.C.), followed.*

**CIVIL APPELLATE JURISDICTION :** Civil Appeals Nos. 2143 to 2145 of 1968.

A Appeals from the judgments and orders dated March 18, 1965 of the Calcutta High Court in Income-tax References Nos. 154, 155 and 156 of 1961.

*M. C. Chagla, P. C. Bhartari, and O. C. Mathur*, for the appellant (in C.As. Nos. 2143 and 2144 of 1968).

B *S. Mitra, P. C. Bhartari and O. C. Mathur*, for the appellant (in C.A. No. 2145 of 1968).

*S. T. Desai, S. K. Aiyar and B. D. Sharma*, for the respondent (in all the appeals).

C The Judgment of the Court was delivered by

**Shah, Actng C.J.** These appeals relate to the assessment to tax of M/s. Bengal Enamel Works Ltd.—a public limited company—for the assessment years 1951-52, 1952-53 and 1953-54.

D The Company is doing business of manufacturing “enamelled-ware”. It had originally employed a “technician” at a monthly salary of Rs. 500/-. In June 1941 the technician was relieved, and one Col. Bhattacharya who was a director of the Company was appointed its “Technical Adviser.” He was to receive as remuneration 15% of the gross annual profits of the Company. Col. Bhattacharya resigned his office and Dr. Ganguly (son-in-law of Col. Bhattacharya) was appointed to that office. The Board of Directors resolved on May 18, 1950 to pay to Dr. Ganguly 15% of the gross annual profits (without deducting depreciation) as his remuneration.

F In the assessment years 1951-52, 1952-53 and 1953-54 the Company claimed under s. 10(2)(xv) of the Income-tax Act, 1922, as admissible allowance, in computing its taxable income, Rs. 52,947/-, Rs. 64,356/- and Rs. 79,227/- respectively, paid as remuneration to Dr. Ganguly under the terms of the resolution dated May 18, 1950. The Income-tax Officer, Companies District III, Calcutta, allowed for each of the years remuneration at the rate of Rs. 42,000/- only as a permissible deduction. The order was confirmed in appeal to the Appellate Assistant Commissioner and by the Tribunal.

G The Tribunal referred in respect of each of the three years the following question :

H “Whether on the facts and in the circumstances of the case, the disallowance of a part of the expenses incurred by the assessee for payment of remuneration to its Technical Adviser is permissible under the provisions of s. 10(2)(xv) of the Indian Income-tax Act?”

The High Court answered the question in the affirmative, and disallowed the claim of the Company. With certificate of fitness, these appeals are preferred against the order of the High Court.

In computing the taxable income of an assessee whether an amount claimed as expenditure was laid out or expended wholly and exclusively for the purpose of the business, profession or vocation of the assessee must be decided on the facts and in the light of the circumstances of each case : *Swadeshi Cotton Mills Co. Ltd. vs. Commissioner of Income-tax, U.P.*<sup>(1)</sup>. Resolution of the assessee fixing the remuneration to be paid to an employee and production of vouchers for payment together with proof of rendering service do not exclude an enquiry whether the expenditure was laid out wholly and exclusively for the purpose of the assessee's business. It is open to the Tax Officers to hold—agreement to pay and payment notwithstanding—that the expenditure was not laid out wholly and exclusively for the purpose of the business: *Swadeshi Cotton Mills Co. Ltd.'s case*<sup>(1)</sup>. But an inference from the facts found that the expenditure was wholly and exclusively laid out for the purpose of the business is one of law and not of fact, and the High Court in a reference under s. 66 of the Income-tax Act is competent to decide that the inference raised by the Tribunal is erroneous in law.

In the present case, the facts found are these : Col. Bhattacharya and his son-in-law Dr. Ganguly were two of the directors of the Company who between them held on January 1, 1950 49% of the total number of shares of the Company and the other directors of the Company held only 1% of the shares. Dr. Ganguly had received no training in the technique of enamelling : he was a medical practitioner earning Rs. 20,000/- per annum by the exercise of his profession. Apparently no applications were invited for the appointment of a Technical Adviser when Col. Bhattacharya resigned his office. In the resolution passed by the Directors it was recorded that many "personal enquiries" regarding the post were made, but no candidate was found suitable. The Board, it was recorded, considered the applications of S. Urbeneck and J. Schulser but the qualifications of these two candidates did not impress the directors: moreover the terms of service offered by J. Schulser were not acceptable to the Board and therefore the only applicant Dr. Ganguly who was working on probation in the post for some time past and had worked without remuneration up to December 31, 1949 was considered. The applications of S. Urbeneck and J. Schulser though called for by the Income-tax Officer were not produced by the Company. At the relevant time "a good technical expert in enamelling"

(1) 63 I.T.R. 57.

- A could be secured for a monthly remuneration of Rs. 1,000/- or Rs. 1,200/- provided that appointment was not for a short period.

B In the view of the Income-tax Officer, Dr. Ganguly came to be appointed to the post of Technical Adviser of the Company as soon as his father-in-law vacated the post and "the generous remuneration offered to him was influenced by factors other than commercial considerations, and considering that Dr. Ganguly was giving up his professional practice in allopathic medicine which yielded him an annual income of Rs. 20,000/- to engage himself as a whole-time Adviser attending to the development of the industry a gross remuneration of Rs. 3,500/- per month, beside the remuneration of Rs. 1,000/- per month that he obtained as Secretary of the Managing Agents of the Company, would be adequate." With that view the Appellate Assistant Commissioner and the Income-tax Appellate Tribunal have substantially agreed. The Tribunal observed that they were inclined to conclude that "extra-commercial considerations" had influenced the fixation of remuneration of Dr. Ganguly and that partial disallowance of the remuneration "so influenced seems quite fair".

E Counsel for the Company urged, relying upon the judgments of this Court in *J. K. Woollen Manufacturers v. Commissioner of Income-tax, U.P.*<sup>(1)</sup> and *Commissioners of Income-tax, Bombay v. Walchand & Co. Private Ltd.*<sup>(2)</sup> that in determining the admissibility of an allowance as expenditure laid out and expended wholly and exclusively for the purpose of the business has to be adjudged from the point of view of the employer and not of the revenue, the Taxing authorities had no power to disallow the remuneration paid to its Technical Adviser, merely because they think that the Company may probably have secured the services of another Adviser for a smaller remuneration. But these cases, in our judgment, have no bearing here. The departmental authorities have not attempted to reduce the allowance on the ground that the remuneration paid to Dr. Ganguli was in their view excessive. Indisputably an employer in fixing the remuneration of his employee is entitled to take into consideration the extent of his business, the nature of duties to be performed, the special aptitude of the employee, the future prospects of the business and other related circumstances and the taxing authorities cannot substitute their own view as to the reasonable remuneration which should have been agreed to be paid to the employee. But the taxing authority may disallow an expenditure claimed on the ground that the payment is not real or is not incurred by the assessee in the course of his business or that it is not laid out wholly and exclusively for the purpose of the business

(1) A.I.R. 1969 S.C. 609.

(2) 65 I.T.R. 381.

of the assessee. Thereby the authority does not substitute its own view of how the assessee's business affairs should be managed, but proceeds to disallow the expenditure because the condition of its admissibility is absent.

It has been uniformly found by all the authorities that the remuneration agreed to be paid to Dr. Ganguly was influenced by "extra-commercial considerations". Dr. Ganguly and Col. Bhattacharya were able to control the voting before the Board of Directors. Dr. Ganguly was not trained in the technique of "enamelled-ware," and had no special qualifications for the post. The remuneration agreed to be paid was much in excess of what was normally payable, and also of what Dr. Ganguly was earning by practising his profession as a doctor of medicine. The criticism that the Tribunal's finding was based on no evidence or was based on irrelevant considerations cannot therefore be accepted. Where an amount paid to an employee pursuant to an agreement is excessive because of "extra-commercial considerations," the taxing authority has jurisdiction to disallow a part of the amount as expenditure not incurred wholly and exclusively for the purpose of the business : *Swadeshi Cotton Mills Co. Ltd. v. Commissioner of Income-tax, U.P.*(<sup>1</sup>).

The appeals fail and are dismissed with costs. One hearing fee.

V.P.S.

*Appeals dismissed.*

(1) 63 I.T.R. 57.