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**WORKMEN OF WILLIAM JACKS & CO. LTD.,
MADRAS**

v.

**MANAGEMENT OF WILLIAM JACKS & CO. LTD.,
MADRAS**

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April 28, 1971

[J. M. SHELAT, I. D. DUA AND V. BHARGAVA, JJ.]

C *The Payment of Bonus Act (21 of 1965), s. 23, Second Schedule, item 2(c) and Third Schedule, item (1)—Advance made by head office to branch office—Interest paid by branch office—If deductible expenditure in calculating profit and loss of branch office—Provision for gratuity etc.—Difference between provision and reserve—Provision when deductible—Deductible income tax calculated without taking into account bonus payable—If correct—Payment of Bonus (Amendment) Act (8 of 1969)—Effect of.*

D The appellants workmen of the respondent claimed that for the two years 1964 and 1965 they were entitled to bonus at the maximum rate of 20% of their annual wages while the respondent contended that there was no available surplus and consequently the liability to pay bonus for these two years could not exceed the minimum of 4% of the wages. The management, *inter alia*, claimed deductions: (1) with respect to interest charged by the London office on advances made by the London office to the respondent-branch during those two years; (2) provision for gratuity and other contingencies; and (3) income tax calculated without taking into account the bonus which would be payable to the workmen.

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The Tribunal allowed the claims.

In appeal to this Court,

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HELD: (1) (a) The amounts claimed as interest are really payments by the branch of the company to its head office. A payment of interest could be justified only on the basis that the head office was a creditor and the branch office a debtor. But a company could not be a creditor and its own debtor simultaneously. The interest paid really represented amounts of money transferred by the respondent-branch to the head office, and similarly, the advances made by London office to the respondent-branch were amounts which continue to be used by the company for its own business at a different place. [544F]

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(b) This is also made manifest by the proviso to item 1 of the Third Schedule to the Act. In the deduction of the current liabilities any amount shown as payable by a company to its head-office whether towards any advance made by the head-office or otherwise, or any interest paid by the company to its head-office is not to be treated as a deductible liability, because, the advance made by the head office is also treated as a part of the investment by the company. [545D]

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(c) Under s. 23 of the Payment of Bonus Act, 1965, there is a presumption as to the correctness of the statements and particulars contained in the balance-sheet and the profit and loss account of a company, if the accounts had been properly audited by qualified auditors. The presumption, however, is confined to the accuracy of the statements and particulars contained in the balance sheet and the profit and loss account. If any item in the accounts is wrongly shown as expenditure, when on the face

of it it is not so, the court is not bound to hold that the method adopted in preparing the accounts is correct simply because the auditors raised no objection. [544H-545C]

Therefore, in the calculation of gross profits for purposes of bonus the sums deducted as interest for the two years must be added back since they were wrongly shown as deductible expenditure in calculating the profit and loss.

(2) The provision for gratuity, and other contingencies such as furlough salary, passage, service and commission, in the present case, was made in respect of *existing and known liabilities*, though, in some cases the exact amount could not be ascertained. It was not a case where it was an anticipated loss or anticipated expenditure which would arise in the future. Such provision is, not a reserve at all and it could not be added back under item 2(c) of the Second Schedule to the Act. It was therefore rightly shown by the respondent as a deductible expenditure in calculating profit and loss. [547D]

Metal Box Co. v. The Workmen, [1969] 1 S.C.R. 750, followed.

(3) The calculation of the amount of income-tax shown as expenditure, without taking into account the bonus which would be payable to the workmen under the Act, was correctly done in accordance with the decision of this Court in the *Metal Box Company case*. In that case, the question was determined on the interpretation of ss. 6(c) and 7 of the Act, and the amendments made by the Payment of Bonus (Amendment) Act, 1969 do not make any change in the law bearing on the question, as laid down by this Court. [547G]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1700 of 1968.

Appeal by special leave from the Award dated March 9, 1968 of the Industrial Tribunal, Madras in Industrial Dispute No. 11 of 1957.

M. K. Ramamurthi, I. Ramamurthy, Vineet Kumar and Shyamala Pappu, for the appellants.

M. C. Chagla and D. N. Gupta for the respondent.

The Judgment of the Court was delivered by

Bhargava, J.—This appeal by special leave is directed against an Award of the Industrial Tribunal, Madras, in a dispute relating to payment of bonus under the Payment of Bonus Act, 1965 (No. 21 of 1965) (hereinafter referred to as "the Act"). The respondent in the appeal is the employer, William Jacks & Co. Ltd., Madras, while the appellant is the William Jacks & Co. Employees' Union, Madras, representing the workmen employed by the respondent. The appellant claimed that, for the two calendar years 1964 and 1965, the workmen were entitled to bonus at the maximum rate of 20 per cent of their annual wages, while the respondent Co. put forward the case that there was no available

- A** surplus and, consequently, the liability to pay bonus for these two years could not exceed the minimum of 4 per cent of the wages. It may be mentioned that the respondent Co. is a Bench of William Jacks & Co. Ltd. registered in England with its Head Office in London. It appears that in India this Company has three offices. One is in Calcutta which also functions at the Regional
- B** Head Office for all the three Branches in India. The other two Branches are in Bombay and in Madras, the latter being the branch to which the dispute about bonus related. The Company is carrying business as engineers, manufacturers, representatives and general merchants. The business of the Company includes the buying of locally manufactured machinery and other products and selling them to both private and public sector industries. The income of the Company is derived primarily from the sale of imported and indigenous goods at a profit. In addition, the Branch at Madras earns commission credited by London Office on direct shipments from London to customers within the areas served by the Madras Branch, as well as commission on sale of indigenous products, repairs and servicing of equipment sold and by local purchase and sale. These features of the business have been enumerated by us as they may have bearing on some of the questions raised in this appeal.

- E** During the hearing of the reference before the Tribunal, the Company filed its balance-sheets, profits, and loss account, and calculations of available surplus in accordance with the provisions of the Act and its schedules showing that there was no available surplus, so that bonus in excess of 4 per cent was not payable by it. These calculations were challenged on various grounds before the Tribunal, but none of them was accepted and the Award was based on the calculations filed on behalf of the Company. In this appeal before us, learned counsel appearing on behalf of the
- F** appellant has challenged the calculations in respect of seven different items, and we proceed to deal with them in the order in which they were argued by him.

- G** The first claim on behalf of the appellant was that there should be an add back of an estimated sum of Rs. 40,000/-, which was received as direct commission paid by the manufacturers to the London Office for the benefit of the Branch at Madras, in calculating the gross profits on the basis of which available surplus is to be worked out. On this point, the Tribunal in its award did not give any specific finding, though, after mentioning this argument raised before it, the Tribunal still proceeded to accept the Company's account disregarding this objection.
- H** The only evidence on this point is found in the statement of the Company's witness, M. W. 1, Thiru S. S. Mani, who stated that the direct commission received by this Company relating to this

Branch is credited in the accounts of this Branch. The amount of commission received by the Company is included under the head "Commission" in the Profit and Loss Account. In 1964, the sum of Rs. 8,80,504/- and, in 1965, the sum of Rs. 7,46,391/- include the direct commission. According to his evidence, therefore, the direct commission has already been taken into account in calculating the gross profits, and no question can arise of any add back. There is no cross-examination on this point on behalf of the appellant, nor has any evidence been led by the appellant to show that the statement of this witness is incorrect. In the circumstances, this claim has to be rejected.

The second item claimed is add back in respect of handling charges which were included by the London Head Office in the invoices for goods sent to Madras. The argument was that a proportionate amount of administrative (overhead) expenses of the Head Office in London allocable to the Madras Branch have already been deducted as expenditure in accordance with item 6(e) of the second Schedule to the Act, and the further debit of the handling charges amounted to double deduction. This argument proceeds on the basis that handling charges, which are included by the London Head Office in the various invoices, form part of the administrative (overhead) expenses of that office. There is no justification for such an assumption. The only evidence on this point is again that of M. W. I. Mani. He clearly stated that, in the accounts, no sum is shown for handling charges as an expenditure as such. The handling charges are only mentioned in the invoices received from the London Office for goods sent to India. These refer to the amount of handling charges incurred by the London Commercial Departments and all these amounts are recoverable from the customers in India along with the sale price. He added that the administrative (overhead) expenses of the Head Office do not include any portion of the London Commercial Departments expenses. Thus, it is clear that these handling charges have no connection with the administrative (overhead) expenses of the Head office which are taken into account under item 6(e) of the Second Schedule. The actual expenses incurred by various Commercial Departments of the Company in England in handling the particular goods are added in the invoices to the cost of those goods and are realised as part of the sale price. There is no separate entry of handling charges as an expenditure in the accounts of the Company. Consequently, there can arise no question of making any addition in respect of these handling charges while calculating gross profit.

The third item is in respect of the Director's and General Manager's Office expenses in Calcutta amounting to Rs. 44,768/- for the year 1964 and Rs. 50,848/- for the year 1965. The Office

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- A** in Calcutta, as we have indicated above, is a sort of common office supervising the business of the Company at all the three places in Calcutta, Bombay and Madras. The expenditure of this Regional Office is of the same nature as the administrative (overhead) expenses of the Company in London. These sums which have been shown as expenses in the accounts in the Madras Branch are amounts allocable to that Branch. This has been again proved by the same witness, M. W. I, Mani. There is no cross-examination and no evidence to show that the case put forward by him is incorrect. In the circumstances, this objection also fails.

- C** The fourth objection, on which greatest emphasis was laid by learned counsel for the parties, relates to the question of interest charged by the London Office in the sum of Rs. 1,00,657/- for 1964 and Rs. 1,65,255/- for 1965 on advances made by the London Office to this Branch at Madras during these years. It was urged that, having regard to the proviso to item 1(iii) of the Third Schedule to the Act, this interest should be disallowed.
- D** It, however, appears to us that the question of this interest should be examined from a different aspect and that is whether this interest can be held to be a legitimate item of expenditure in calculating the profit and loss of the Company at Madras. It is clear that these amounts have been paid by the Branch at Madras to Head Office in London and represent interest which the London Office demanded from the Madras Branch on the advances made by the former to the latter. These payments are, thus, by a Branch of the Company to its Head Office. The Head Office and the Branch Office both belong to the same Company. Such a payment of interest could be justified only on the basis that the London Office was the creditor and the Madras Branch the debtor in respect of the advances on which the interest has been claimed by the London Office. On the face of it, a Company cannot be a creditor and its own debtor simultaneously. No relationship of creditor and debtor can exist between two different Offices of the same Company. The interest paid merely amounts to money transferred by the Madras Branch to the Head Office and, similarly, advances made by the London Office to the Madras Branch are amounts which continue to be used by the Company for its business at a different place.

- H** Learned counsel appearing for the Company drew our attention to section 23 of the Act, under which there is a presumption as to the correctness of statements and particulars contained in the balance-sheet and profit and loss account of a Company if they had been properly audited by qualified auditors, and urged that, since the interest charged by the Head Office to the Branch

Office at Madras was accepted as a proper expenditure for calculation of profit and loss account by the auditors, the Court under section 23 must accept that it was correctly shown as an expenditure. The presumption under section 23 is confined to the accuracy of the statements and particulars contained in the balance-sheet and the profit and loss account. If any item in the accounts is wrongly shown as expenditure when, on the face of it, it is not so, the Court is not bound to hold that the method adopted in preparing the accounts is correct simply because the auditors raised no objection. While the interest was paid on advances not made by a creditor to a debtor, but by the Company's one office to another, the money purported to be transferred as interest cannot be held to be an expenditure incurred by the Branch paying it to the other. In fact, there are indications in the Act itself to support the view that such advances made to one office by another of the same Company cannot be treated as liabilities. This is made manifest by the proviso to item 1 of the Third Schedule. Under this item, every Company, other than a banking company, is allowed a return on paid up equity share capital and on reserves shown in its balance-sheet. The proviso then deals with the case of a foreign Company and permits a deduction of 8.5 per cent on the aggregate of the value of the not fixed assets and the current assets of the company in India after deducting the amount of the current liabilities. In deduction of the current liabilities, however, any amount shown as payable by the Company to its Head Office, whether it bears any advance made by the Head Office or otherwise, or any interest paid by the Company to its Head Office, is not be treated as a liability. The reason very clearly is that the object of the deduction under item 1 of the Third Schedule is to permit a Company a return on money invested by it for its business as a prior charge when calculating the surplus for purposes of bonus. In the case of an Indian Company, this object is achieved by giving a return of 8.5 per cent on the equity share capital and 6 per cent on reserves. In the case of a foreign Company, the same object is served by working out the difference between the total of fixed assets and current assets, and the current liabilities, which will represent the actual value of the net holdings of the Company as its investment. The advances made by the Head Office to a Branch Office are not deductible as liabilities, because that amount is also treated as a part of the investment by the Company on which the Company should be given the return of 8.5 per cent. It does not, therefore, partake of the nature of a loan on which interest can be charged by the Head Office from the Branch Office. The principle of calculation laid down in item 1 of the Third Schedule, thus, recognises the position that the Head Office and the Branch Office do not function as creditor and debtor when only interest could be legitimately charged by the Head Office from

- A the Branch Office. In calculation of the gross profit for purposes of bonus, therefore, the two sums of Rs. 1,00,657/- for 1964 and Rs. 1,65,255/- for 1965 must be added back on the basis that they are wrongly shown as expenditure deductible in calculating profit and loss.
- B The fifth objection relates to a sum of Rs. 11,747/- in 1964 and Rs. 7,251/- in 1965 shown as expenses incurred in the Jax Board Factory on the ground that the Jax Board Factory had ceased to function for these two years. It is, no doubt, true that M. W. I, Mani, admits that the Jax Board Factory had no production in those two years; but there is nothing to show that the Factory had completely ceased to function. The expenses are actual expenses in the factory during those two years as certified by the Auditors and there is no material on the basis of which it can be held that these expenses were not incurred. This objection, therefore, fails.
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- D The sixth claim on behalf of the appellant is that the provision for gratuity and other contingencies should also be added back as representing "other reserves" under item 2(c) of the Second Schedule to the Act. The other contingencies referred to relate to provision made for furlough salary, passage, service and commission. All these items are clearly in respect of liabilities which had already accrued in the years in which the provision was made. They are not in respect of anticipated liabilities which may arise in future. The principles on which these have been calculated were explained by the same witness M. W. I, Mani. In the case of gratuity, for example, provision has been made in respect of the employees on the basis of the amount of service put in by them up to the years to which the accounts relate. In some cases, of course, where the exact liability was not ascertainable, provision has been made on the basis of the estimated existing liability. Such provision is quite different and distinct from a reserve. This Court in *Metal Box Co. of India Ltd. v. Their Workmen*⁽¹⁾ held:
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- G "The distinction between a provision and a reserve is in commercial accountancy fairly well-known. Provisions made against anticipated losses and contingencies are charges against profits and, therefore, to be taken into account against gross receipts in the Profit and Loss account and the balance-sheet. On the other hand, reserves are appropriations of profits, the assets by which they are represented being retained to form part of the capital employed in the business. Provisions are usually
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shown in the balance-sheet by way of deductions from the assets in respect of which they are made whereas general reserves and reserve funds are shown as part of the proprietor's interest : (See *Spicer and Peglar's Book-keeping and Accounts*, 15th ed. p. 42). An amount set aside out of profit and other surpluses, not designed to meet a liability contingency commitment or diminution in value of assets known to exist at the date of the balance-sheet is a reserve but an amount set aside out of profits and other surpluses to provide for any known liability of which the amount cannot be determined with substantial accuracy is a provision. (See *William Pickles Accountancy*, Second Edn., 192, Part III, cl. 7, Sch. VI to the Companies Act, 1956 which defines provision and reserve.)"

The provision for gratuity, furlough salary, passage, service and commission in the present case was all made in respect of existing and known liabilities, though, in some cases, the amount could not be ascertained with accuracy. It was not a case where it was an anticipated loss or anticipated expenditure which would arise in future. Such provision is, therefore, not a reserve at all and cannot be added back under item 2(c) of the Second Schedule.

The last ground for challenge of the award relates to the deduction for income-tax. In the present case, the amount of income-tax shown as expenditure has been calculated without taking into account the bonus which would be payable to the workmen under the award. The point raised that it should be calculated after taking into account the bonus is fully met by the decision of this Court in the case of *Metal Box Co. of India*⁽¹⁾. That case clearly lays down that, in calculating the income-tax deductible in working out the gross profit, the bonus which would be payable under the Act is not to be taken into account and the tax must be worked out ignoring that bonus at the rates applicable in the relevant years. Learned counsel for the appellant, however, drew out attention to the amendment made subsequently by Parliament in the Act by the Payment of Bonus (Amendment) Act 8 of 1969, and urged that this amendment should be treated as the parliamentary exposition of the law which was interpreted by this Court in the case of *Metal Box Co. of India*⁽²⁾. In that case, the question was determined by interpretation of only sections 6(c) and 7 of the Act. The Amendment Act 8 of 1969 makes no substantial changes in either of these two sections. In fact, section 6 remains unamended and in section 7, the only amendment is that the principles laid down in that section are to be applied not only in respect of section 6(c), but also other sections of the Act. This change became

(1) [1969]1 S.C.R. 750.

A necessary, because amendment was made in section 5 of the Act by making certain additions which referred to direct tax, including income-tax. That amendment in section 5 has no bearing at all on the question whether income-tax to be taken into account in calculation should be worked out after taking into account the bonus payable under the Act or without having regard to it. Consequently, there is no reason for us to differ from the view expressed by this Court in *Metal Box case*(1). This ground of challenge also, therefore, fails.

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C As a result, we hold that the Tribunal was right in accepting the calculations made by the Company, except in respect of the interest paid on advances made by the Head Office to the Branch at Madras. The interest shown as expenditure in the accounts has to be added back, as indicated by us above, and the available surplus for purposes of calculation of the bonus payable as well as for purposes of set on or set off must be amended accordingly. We leave this calculation to the Tribunal. With this partial amendment in the award, the appeal is dismissed. In the circumstances of this case, we make no order as to costs.

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V.P.S.

Appeal dismissed.

(1) [1969] 1 S.C.R. 71.