J.K. Cotton Manufacturers vs Commissioner Of Income Tax on 13 December, 1951

Equivalent citations: AIR1952ALL488, [1952]21ITR129(ALL), AIR 1952 ALLAHABAD 488

JUDGMENT

Malik, C.J.

1. This is a reference under Section 66 (1), Income-tax Act. The question referred to us is as follows :

> "Whether, in the circumstances of the case, the payment of Rs. 10,000 to Mr. J.N. Cocolas is a legitimate expense?"

2. The assessee Messrs J.K. Cotton Manufacturers, Kanpur was a private registered company and one Shri J.N. Cocolas was the Director in charge of the company till September, 1938. He was previously drawing a salary of Rs. 6,000 per year and later his salary was increased to Rs. 10,000 per year. He ceased to be the Director in charge in September 1938 and since then he was working merely as one of the Directors of the company. The private limited company decided to go into voluntary liquidation with effect from 30-9-1941, and the actual order of dissolution was passed by the District Judge of Kanpur on 8-12-1941. From the 1-10-1941, a new public company, which was floated, took over the business of the private limited company. The Board of Directors of this dissolved company, by their resolution dated 2-2-1942 approved and confirmed the payment of a Sum of Rs. 10,000 to Shri Cocolas in recognition of his past services to the company and this sum of RS. 10,000 was debited to the profit and loss account of the company for the year commencing l-10-1940. The Income tax Officer did not allow this sum of Rs. 10,000 as an admissible deduction and, before the Income-tax Appellate Tribunal, Allahabad, the point was raised whether, in the circumstances of the case, this payment of Rs. 0,000 to Shri Cocolas was "an expenditure laid out wholly and exclusively for purposes of the business of the private company". The Tribunal held against the assessee and relied on three circumstances firstly, that there was no obligation on the part of the company to pay any such allowance to Shri Cocolas; secondly, that there was no practice of making any such payment to the employees of the company; and, lastly, that the company had decided to enter into voluntary liquidation. On a consideration of these three facts, the Tribunal was of the opinion that the payment of Rs. 10,000 to Shri Cocolas could not be said to amount to an expenditure laid out wholly and exclusively for purposes of the company.

3. On behalf of the assesses, Shri Pathak has relied on Clause (x) of Sub-section (2) of Section 10, Income-tax Act. Section 10 (2) (x), Income-tax Act, allows deduction of an amount payable to an employee as bonus or commission for services rendered, provided that the amount of bonus or commission is reasonable, keeping in view the pay of the employee and the conditions of his service,

the profits of the business, profession or vocation for the year in question and the general practice in similar businesses, professions or vocations. As no reliance was placed on this section of the Act and as the amount was not claimed as bonus or commission to an employee for the services rendered, the tribunal has not considered whether the amount paid to Shri Cocolas was a reasonable amount. In the application under Section 66 (1), In come-tax Act, for reference of the question to this Court, the assessee appears to have relied on Clause (xv) of Sub-section (2) of Section 10, Income-tax Act as was done by him before the Income-tax Appellate Tribunal. This is clear from para. 4 of the application which runs as follows :

"4. That, in arriving at the findings of fact mentioned at No. in para 3 of this application, the Bench committed an error of law, namely, a provision in favour of an employee made at a time when the company had decided to close down and when, in fact, the employee as such has retired about three years earlier cannot be taken to be an expenditure which was required for keeping the trade going."

4. It may be that no reliance was placed on Clause (x) of Sub-section (2) of Section 10, Income-tax Act, as the assessee realised that it could not be claimed that the amount paid to Shri Cocolas was a reasonable amount. It is not for us to go into this question. No facts have been given which would enable us to judge whether the amount could or could not be claimed as an allowable deduction under Section 10 (2) (x), Income-tax Act. We shall, therefore, confine ourselves only to Clause (xv) of Sub-section (2) of Section 10 of the Act, the relevant portion of which is to the following effect :

> "10 (2) (xv)--Any expenditure laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

Primarily, this must be a question of fact to be decided on the materials placed before the Tribunal. It is not claimed on behalf of the assessee that there was no evidence before the Tribunal on which it could come to the conclusion that the amount paid to Shri Cocolas had not been "expended wholly and exclusively for the purpose of such business." The circumstances relied on by the Tribunal appear to us to justify the conclusion arrived at by it.

5. Shri Pathak has, however, urged that the point of law that he wanted to urge is that the Tribunal committed an error of law in its view that the amount spent could not be held to be wholly and exclusively laid out for purposes of the business unless it related to expenditure for purposes of future business. In other words, if an employee has worked well, it is open to the asses-see to recognise such exceptionally good service which has resulted in profits to the assessee, by making payment of a gratuity to him and any gratuity paid in such circumstances will be an allowable business expenditure. It is not necessary for us to answer this general question. It may be that, in certain circumstances, such a payment may be justified and may be deductable as an expenditure wholly and exclusively incurred for purposes of the business of the assessee. It, however, appears from the statement of the case and the facts put before the Tribunal that, on the eve of the closing of the business when the employee was leaving the undertaking, the assesses decided to pay a sum of money to him for services which had been rendered by him more than three years before. In such circumstances, without any further facts justifying the payment, it is not possible to hold that the expenditure was wholly and exclusively for purposes of the business of the company.

6. Our answer to the question referred to us is that the payment of Rs. 10,000 to Shri J.N. Cocolas has not been proved to be a legitimate expense in the sense that it was expense incurred wholly and exclusively for purposes of the business of the assessee. The opposite party is entitled to its costs which we assess at Rs. 200.