

## Central Distillery And Chemical Works ... vs Commr. Of Income Tax, U.P., C.P. And ... on 23 November, 1954

**Equivalent citations: AIR1955ALL167, [1955]27ITR100(ALL), AIR 1955 ALLAHABAD 167**

### JUDGMENT

Malik, C.J.

1. These are two connected references, one of them being under Section 66(2), Income-tax Act and the other under Section 21, Excess Profits Tax Act. The facts given in the statement of the case as also in the Appellate Order of the Tribunal related only to the Income-tax reference and no facts have been given as regards the reference made under Section 21, Excess Profits Tax Act.

2. The two questions that have been referred to us for decision are as follows :

"1. Whether on the facts and in the circumstances of this case the sum of Rs. 34,582/- could be claimed by the assessee company as an expenditure laid out and expended wholly and exclusively for the purpose of the business?

2. Whether on the facts and in the circumstances of this case the expense so claimed was an expenditure in the nature of capital and hence not admissible under Section 10(2) (xv), Income-tax Act?"

3. The assessee is a company known as Central Distillery and Chemical Works Limited, Meerut, incorporated under the Indian Companies Act on 14-10-1935, on 1-2-1937, the assessee company entered into a managing agency agreement with Messrs. Krishna, Gupta and Devalal. The managing agency agreement recited that "Whereas Mr. Sam Ernest Devalal, sole proprietor of M/S Devalal & Co., and now one of the partners of the said firm Krishna, Gupta and Devalal, secured the sanction of the Government of the U. P. for a licence for the manufacture of industrial Alcohol, Chemicals etc., and whereas in consideration of the services rendered by him in having promoted and brought about the formation of the said company that the firm of M/S Devalal and Co., as the same is now or may hereafter be constituted shall be the first Managing Agents of the Company....."

The remuneration payable to the Managing Agents was a fixed amount and besides the remuneration mentioned in the agreement they were also probably entitled to some commission. What exactly the remuneration was does not. appear either from the Appellate Order or the Statement of the Case and the copy of the agreement that has been placed before us does not appear to be a correct copy of the deed.

4. Under the Defence of India Rules -- Rule 81, Sub-rule (3)-- the Governor issued a notification on 27-3-1942, authorising the Excise Commissioner, U. P., to exercise control over the work of the company with effect from 1-4-1942. The functions of the Controller were set out in detail in this notification and they amounted to his seeing that the company was worked efficiently so that there might be maximum production of Power Alcohol and it might be available at the cheapest rate. The Controller was also given power of control over the staff and had the power to replace the staff working in the company by making fresh appointments. There was nothing in the notification terminating the managing agency agreement, nor did it expressly provide that the Managing Agents would no longer be entitled to the remuneration fixed in the said agreement.

5. In the relevant assessment year 1945-46, the corresponding accounting period of which was 1-10-1943 to 30-9-1944, a sum of Rs. 34,582/- was payable to the Managing Agents as remuneration and commission. The question arose whether the assessee company could claim deduction of this amount as amount "wholly and exclusively" expended for the purpose of the business. The ground on which the claim was disallowed was that since there was a Controller appointed by the Government the Managing Agents had no work to do and, therefore, it could not be said that the amount was wholly and exclusively spent for the purpose of the business.

6. It is not denied that the agreement being for a fixed period of 20 years and the notification issued under Rule 81(3), Defence of India Rules, not having in any way terminated the agreement between the Managing Agents, the assessee company was liable to pay the remuneration and commission at the rate fixed in the agreement. The mere fact that by reason of the necessity arising out of the prosecution of the war the Government appointed a Controller to supervise the working of the concern and the Controller took charge and did the work which the Managing Agents would normally have done the Managing Agents could not be deprived of the commission and remuneration legally payable to them. That being the position, we see no reason why this amount was not an admissible expenditure under Section 10(2) (xv), Income-tax Act.

7. Learned counsel for the Commissioner of Income-tax has, however, suggested that this amount would not be an admissible expenditure as the amount was not shown in the Profit & Loss Account prepared for the relevant accounting period. This is not one of the grounds given in the Appellate Order or in the Statement of the Case for disallowing the deduction of the amount as an allowable expenditure. Moreover, it appears from the Statement of the Case that the shareholders of the company passed a resolution on 31-3-1943, that they were still bound to make the payment to the Managing Agents and the payment be made to them. It also appears from the same statement that the Controller was approached to sanction the payment but he did not sanction it.

Learned counsel has referred us to a portion of the order of the Appellate Tribunal that the Directors did not enter this amount in the Profit & Loss Account. The portion of the Appellate Order read out to us did not relate to the remuneration and commission payable to the Managing Agents. Moreover, there is nothing in the Statement of the Case or the Appellate Order to indicate how the Profit & Loss Account was prepared and by whom; nor is there anything to show in what circumstances that amount was not included in the Account. The amount was no doubt paid later, as the Controller had refused to sanction the payment. It is, however, admitted that the accounts were

maintained on the mercantile basis and if the liability had accrued to the company, the question, whether the payment was actually made in that year, was not material.

8. The first question, therefore, must be answered in the affirmative.

9. We may point out that the appeal before the Tribunal arising out of the Excess Profits Tax assessment was not separately dealt with, though the provisions under the Income-tax Act and the Excess Profits Tax Act are not exactly identical. In the absence of any further facts, therefore, we must hold that our answer to this question would govern both the references.

10. As regards the second question, the Tribunal held that the amount payable as remuneration and commission to the Managing Agents was capital expenditure and could not, therefore, be claimed as an allowable expenditure under Section 10 (2)(xv), Income-tax Act. For this finding the Tribunal has relied on the recital contained in the managing agency agreement from which it has deduced that the assessee company has acquired a running business and as part of its terms of acquisition it retained the services of the Managing Agents on the remuneration stipulated in the deed, and has tried to bring this case in line with the decision of the House of Lords in -- 'Royal Insurance Co. v. Watson (Surveyor of Taxes)', 1897 AC 1 (A).

The decision in that case is, however, distinguishable and was not applicable to the facts of the case before the Tribunal. Upon the transfer of an insurance business the transferees had agreed to take into their service the transferors' manager at a fixed salary, with liberty to commute the same by payment to him of a gross sum to be calculated upon life tables if the services of the manager were terminated. The manager worked for only a short time. His services were then terminated and he was paid a gross sum in commutation of his salary. It was this amount, that was paid to him in commutation of his salary, that was claimed as an allowable expenditure. It was held that "the agreement to pay the commutation money was in fact part of the consideration for the transfer of the business, that the payment was therefore a 'sum employed as capital' and could not be deducted."

The question did not arise in that case as to the salary payable to the manager for the work done by him. The manager was paid the amount not because of the services rendered by him to the transferee-company, but by reason of the agreement between the transferors and the transferees that if the manager's services were not retained, he would be paid a lump sum. This sum, therefore, could not be connected with the services rendered by the manager to the assessee and was paid as agreed upon in the deed of transfer and was, in the circumstances, held to be a part of the purchase price,

11. In the case before us, there is no provision for any commutation. The amount claimed is remuneration payable to the Managing Agents for the services to be rendered by them. The terms of the agreement are also quite different. From the portion already quoted it would appear that managing agency agreement was entered into with Messrs. Krishna, Gupta and Devalal because one of their partners, Devalal, had (1) secured the sanction of the Government of U. P. for a licence for the manufacture of industrial Alcohol, Chemicals, etc., and (2) rendered services in having

promoted and brought about the formation of the assessee company.

12. The promoters are not infrequently appointed as Managing Agents after the formation of the company. That may be a reason for giving the managing agency to a particular concern, but it does not necessarily follow that the remuneration paid to them can be said to be a part of the purchase price paid for acquisition of the business.

13. The answer to the first part of the second question must, therefore, be in the negative. We hold that the amount was admissible as an allowable expenditure under Section 10(2) (xv), Income-tax Act.

14. The assessee company is entitled to its costs which we assess at Rs. 400/- in each case. This order shall cover the other reference also.