Swadeshi Cotton Mills Co. Ltd. vs Commissioner Of Income-Tax, Uttar ... on 20 September, 1966

Equivalent citations: [1967]63ITR57(SC)

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Bench: J.C. Shah

JUDGMENT

Ramaswami, J.

1. The appellant-company is a public limited company which is managed by a firm of managing agents known as Jaipuria Brothers Ltd., another public limited company. Under article 135 of the articles of association of the appellant-company the managing agents were entrusted with general management of the affairs of the company. The remuneration for such management was an office allowances at Rs. 5,000 per month plus a commission of 10 per cent. of the net profits of the company. The total remuneration for the managing agents for the relevant accounting year was computed at Rs. 11,70,899. For the relevant accounting year there were five directors of the appellant- company. Two of these directors were Sri Gajadhar Jaipuria and Sri Mungturam Jaipuria. These two directors were the nominees of the managing agents and were also the directors of Jaipuria Brothers Ltd., the managing agents. Under article 118 of the articles of association of the appellant-company, the five directors were entitled during the accounting year to directors fees at the rate of Rs. 100 per month to each director besides traveling expenses for attending the meetings. For the accounting period a sum of Rs. 6,900 was paid on account of such directors fees to the five directors. On July 26, 1948, the directors of the appellant-company passed a resolution recommending to the shareholders of the company to amend article 118 by providing that the directors should be paid a commission at the rate of 1 per cent. of the net profits of the company after providing for necessary expenses and charges, but before deducting the amount of commission itself in addition to their fees at the rate of Rs. 100 per month for each one of the directors. This recommendation was adopted at an extraordinary general meeting of the shareholders of the company held on August 26, 1948, by a special resolution by which article 118 was amended to make provision for payment of commission also in addition to fees to the directors. By reason of the amendment of article the directors became entitled to and were paid an additional remuneration amounting to Rs. 1,11,000 for the accounting year ending December 31, 1948. Out of this amount each of the directors became entitled to a sum of Rs. 22,218. Before the Income-tax Officer the appellant-company claimed the said remuneration of Rs. 1,11,000 paid to the directors as a deduction under section 10(2)(xv) of the Income-tax Act on the ground that the said sum had been laid out or expended wholly and exclusively for the purposes of the companys business. The Income-tax Officer disallowed the claim of the appellant-company on the ground that the directors

had not rendered any extra service so as to entitled them to the additional remuneration. The appellant-company preferred an appeal to the Appellate Assistant Commissioner but the appeal was dismissed. The appellant-company took the matter in further appeal to the Appellate Tribunal which affirmed the view of the income-tax authorities that the amount was not admissible as a deduction under section 10(2)(xv) of the Income-tax Act.

Under section 66(2) of the Income-tax Act the Appellate Tribunal referred the following question of law for the opinion of the High Court :

> "Whether the sum of Rs. 1,11,090 paid as remuneration to the five directors of the assessee-company during the relevant previous year was an expenditure incurred wholly and exclusively for the purpose of the business under section 10(2)(xv) of the Income-tax Act ?"

2. By its order dated April 23, 1962, the High Court answered this question of law in favour of the income-tax department and against the assessee. This appeal is brought, by special leave, against the order of the High Court dated April 23, 1962, in the income-tax reference.

3. On behalf of the appellant learned counsel put forward the argument that the amount of Rs. 1,11,090 paid to the directors was spent wholly and exclusively for the purpose of the company and was therefore properly claimed as a deduction under section 10(2)(xv) of the Income- tax Act. It was pointed out that the amendment to article 118 was adopted by a special resolution of the shareholders and the amendment was made in accordance with law and the payment cannot be called in question in income-tax proceedings. In our opinion, there is no substance in this argument. It is true that as between the directors and the company the resolution had a binding effect and the payment had to be legally made. But it is for the Income-tax Officer to decide whether the amount so paid to the directors was wholly and exclusively spent for the purpose of the business with in the meaning of section 10(2)(xv) of the Income-tax Act. It is an erroneous proposition contend that as soon as an assessee has established two facts, viz.,the existence of an agreement between the employer and the employee and the fact of actual payment, no discretion is left to the Income-tax Officer except to hold that the payment was made wholly and exclusively for the purposes of the business. Although the payment might have been made and although there might be an agreement in existence, it would still be open to the Income-tax Officer to take into consideration all the relevant factors which will go to show whether the amount was paid as required by section 10(2)(xv). The question as to whether an amount claimed as expenditure was laid out or expended wholly and exclusively for the purpose of such business, profession or vocation has to be decided on the facts and in the light of the circumstances of each case. But, as observed by this court in Eastern Investments Ltd. v. Commissioner of Income-tax, the final conclusion on the admissibility of an allowance claimed is one of law. It is for example open to the assessee to contend that the decision arrive at by the income-tax authorities was based on no evidence at all. If the assessee satisfies the court that the decision of the income-tax Officer is defective 4 in law. But, as we have already stated, it is not open to the assessee to contend that merely because of the existence of an agreement, between the employer and must hold that the payment was made exclusively and wholly for the purpose of the business. It is manifest that the Income-tax Officer is entitled to examine the

circumstances of each case to determine for himself whether the remuneration paid to the employee or any portion thereof was properly deducted under section 10(2)(xv) of the income-tax Act. The view that we have expressed is born out by the decision of the Judicial Committee in Aspro Limited v. Commissioner of Taxes. In that case, there were two shareholders of a company and they were also the sole directors of the company At the end of each trading year the company fixed at general meeting about two-third of the profits as directors fees, and in the year 1931, as about large a sum as Pounds 10,000 was debited in the accounts as directors fees. The Commissioner of Income-tax disallowed this item to the extent of Pounds 8,000 and the question that the question that fell for determination of the Judicial Committee was whether this disallowance was justified. At page 269 of Report, the judicial Committee pointed out that the true issue that arises in cases like this is whether there was evidence before the magistrate on which he was entitled to refuse to hold it proved that the Pounds 10,000 had been exclusively incurred in the production of the assessable income and that assessment was excessive. A similar view was expressed by the Bombay High Court in Jethabhai Hirji and Co. v. Commissioner of Income-tax and it was held in that case that the Income-tax Tribunal was right in disallowing under section 10(2)(xv) the sum of Rs. 11,000 out of the sum of Rs. 11,000 out of the sum of Rs. 12,000 paid by the assessee to his employees as commission.

4. In the present case the finding of the Appellate Tribunal in that the payment of the commission was made to the directors for extra- commercial business. In support of this finding the Tribunal has pointed out, in the first place, that the directors did not render any special service in the accounting year which justified the payment of additional remuneration to them. In the second place, the tribunal has pointed out that the work the appellant-company was done substantially by the firm of managing agents known as Jaipuria Brothers Ltd. and very little work was done by the directors. It was also observed by the Tribunal that in the past the directors were paid only the directors' fee at the rate of Rs. 100 per month and this was not considered by the directors to be inadequate for discharging their responsibility. It is true that in the accounting year the gross profits of the company had increased by about 30 lakhs rupees, but the Appellate Tribunal found that the increase was due to the control of cloth having been lifted on January 23, 1948, in the first month of the commencement of the accounting period, and due to cloth remaining uncontrolled till August 2, 1948, the company made abnormal profits. Thus the increase in profits was not due to any special exertion of the directors which alone could justify the payment of any extra remuneration. In view of these facts and circumstances, the Appellate Tribunal held that the expenditure was not incurred wholly and exclusively for the purpose of the business of the appellant company. The same view has been taken by the High Court which also found that the appellant was not entitled to claim deduction of this expenditure under section 10(2)(xv) of the Income-tax Act. In our opinion, learned counsel on behalf of the appellant has been unable to show that the view taken by the High Court is, in any way, vitiated in law.

5. It was contended on behalf of the appellant that the payment of remuneration to the directors was in accordance with the practice of about three companies mentioned in paragraph 19 of the special leave application, but no evidence of such practice was produced before the Appellate Tribunal. It appears that the appellant produced only figures relating to the Courepore Co. Ltd. and contended that the company made a profit of about Rs. 19 lakhs on which a remuneration of over Rs. 5 lakhs

was paid to the managing agents and a sum of Rs. 34,000 as remuneration to the directors. The Appellate Tribunal rejected the argument and observed that on the basis of a solitary example the alleged practice of remunerating directors by payment of additional remuneration could not be said to be established. We accordingly reject the argument of the appellant on this aspect of the case.

6. For the reason expressed, we hold that there is no merit in this appeal which is accordingly dismissed with costs.

7. Appeal dismissed.