Commissioner Of Income-Tax, Uttar ... vs A. Tellery And Sons Pvt. Ltd. on 4 October, 1966

Equivalent citations: [1967]63ITR288(SC), AIRONLINE 1966 SC 13, (1967) 63 ITR 288

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Bench: J.C. Shah

JUDGMENT

Ramaswami, J.

1. This appeal is brought, by special leave, from the judgment of the Allahabad High Court dated April 4, 1963, in Misc. I. T. Application No. 453 of 1960, holding that no question of law arises out of the order of the Income-tax Tribunal and dismissing the application of the appellant under section 66(2) of the Income-tax Act, 1922 (hereinafter called the "Act").

2. The respondent is a private limited company carrying on the business of manufacture and export of carpets having their head office at Bhadohi which was formerly in the State of Banaras. The respondent used to obtain yarn from a firm known as Allahabad Woollen Mills At Allahabad for the purpose of its business, viz., the manufacture and export of carpets. The Allahabad Woollen Mills supplied yarn to the respondent for three years ending March 31, 1947, March 31, 1948, and March 31, 1949. While making the assessment of the Allahabad Woollen Mills for the assessment years 1947-48, 1948-49 and 1949-50, the Income-tax Officer held that the goods were supplied by the Allahabad Woollen Mills to the respondent at a lower rate and profit, to that extent, had been diverted. In making the assessments of the Allahabad Woollen Mills the Income-tax Officer, therefore made an addition of Rs. 30,577 for the assessment year 1948-49 and a sum of Rs. 32,213 for the assessment year 1949-50. These additions were made under section 42(2) of the Act as the Income-tax Officer found that the shareholders of the respondent-company were partners in the Allahabad Woollen Mills which functioned as a firm till March 31, 1948, and thereafter converted itself into a limited company of the same name in which also the said partners were the main shareholders. The respondent was then a non-resident company as it was carrying on business at Bhadohi in the State of Banaras. The Allahabad Woollen Mills Ltd. thereafter sent to the respondent-company a debit note for a sum of Rs. 46,582, on August 22, 1953, and another debit note for a sum of Rs. 32,213, on March 23, 1954. These amounts were claimed by the Allahabad Woollen Mills as extra price of mill yarn supplied by them to the respondent for the accounting period from April 1, 1946, to March 31, 1949. The respondent admitted the liability and after amending its profit and loss account for 1949-50, the respondent claimed a sum of Rs. 78,795, as a

deduction under section 10(2)(xv) of the Act in its assessment for the assessment year 1950-51. The claim was finally rejected by the Appellate Tribunal on the ground that the liability was accepted by the respondent long after the previous year relevant to the assessment year 1950-51. The Tribunal, however, adde : "We do not express any opinion whether the claim is maintainable in the subsequent years." The respondent thereafter amended its profit and loss account for the accounting years 1952-53 and 1953-54 corresponding to the assessment years 1954-55 and 1955-56 and claimed the sum of Rs. 46,582, as a deduction in the assessment year 1954-55. The claim was disallowed by the Income-tax Officer by his order dated December 30, 1957, and it was held that the alleged payment was an ex gratia payment and could not be considered to be a payment arising out of the business transaction with the Allahabad Woollen Mills. The Income-tax Officer, therefore, disallowed the amount of Rs. 46,582 in computing the profits of the respondent. On appeal, the Appellate Assistant Commissioner affirmed the order of the Income-tax Officer on this point and held that it was not a bona fide business transaction prompted by commercial expediency. The respondent preferred a further appeal to the Income-tax Appellate Tribunal which allowed the appeal and held that the debit note was accepted for reasons of commercial expediency. In the course of its order the Tribunal stated as follows :

3. "The claim was disallowed by the Income-tax Officer as an ex gratia payment made by the appellant to the Allahabad Woollen Mills Ltd., and the Appellate Assistant Commissioner was of the opinion that passing of the debit note was not a bona fide business transaction prompted by commercial expediency. We are unable to concur. We see nothing to warrant the conclusion that the acceptance of the debit note issued by the Allahabad Woollen Mills Ltd. was not prompted by considerations of commercial expediency. It may be true that the Allahabad Woollen Mills Ltd. had supplied woollen yarn to the appellant-company at less than market price with the object of reducing the tax burden but when, eventually, it was found that the tax had to be paid, the latter presented the debit note to the appellant-company. It does not appear to us to be a transaction done mala fide. There is also nothing unnatural on the part of the appellant-company in the acceptance of the debit notes in view of the fact that the two companies had business dealings with each other for a long time and were closely connected. In our opinion the debit notes were accepted for reasons of commercial expediency. The claim should be allowed."

4. Thereafter, the Commissioner of Income-tax applied to the Tribunal under section 66(1) of the Act for a reference to the High Court. The application was dismissed by the Tribunal and in the course of its order the Tribunal stated as follows :

> "The question before the Tribunal was whether the sum of Rs. 46,582 was a permissible deduction under section 10(2)(xv). The department held that this was a sort of ex gratia payment and that the payment was not out of bona fide business consideration. The Tribunal, after considering the facts and circumstances of the case under which the assessee-company came to accept the debit note for the above sum, held that there was nothing to indicate any mala fides and that it was so accepted out of commercial expediency. We do not think that this finding gives rise to a question of law."

5. The Commissioner of Income-tax thereafter made an application under section 66(2) of the Act to the Allahabad High Court which dismissed the application by its judgment dated April 4, 1962.

6. On behalf of the appellant Mr. Sen put forward the argument that the question whether, on the facts and circumstances of this case, the amount of Rs. 46,582 was a permissible deduction under section 10(2)(xv) of the Act was a mixed question of fact and law and the High Court was in error in not directing the Tribunal to state a case under section 66(2) of the Act. It was submitted by learned counsel that the High Court was not right in holding that no question of law arose out of the order of the Tribunal and that the finding of the Tribunal that the payment was made for commercial considerations and not ex gratia was a pure finding of fact which could not be interfered with. In our opinion, the argument put forward on behalf of the appellant is well- founded and must be accepted as correct. It is true that the question whether the assessee is entitled to a deduction of certain expenditure under section 10(2)(xv) of the Act should be decided on the facts of each particular case but the final conclusion on the question is always one of law. To put it differently, the question whether the expenditure was laid out or expended wholly and exclusively for the purpose of the business is a question which involves, in the first place, the ascertainment of facts by the Appellate Tribunal, and, in the second place, the application of the correct principle of law to the facts so found. The question, therefore, is a mixed question of fact and law. It is a question of law because the Tribunal has to determine what is the meaning to be given to the statutory phrase "expenditure laid out or expended wholly and exclusively for the purpose of such business". The proper construction of statutory language is always a matter of law and, therefore, the claim of the assessee in any particular case that he is entitled to a deduction of certain items of expenditure under section 10(2)(xv) of the Act involves the application of the law to the facts found in the setting of the particular case. In Eastern Investments Ltd. v. Commissioner of Income-tax it was held by this court that the question whether an expenditure was incurred solely for the purpose of carrying on the business of the assessee and was made on the ground of commercial expediency was not a pure question of fact but was a mixed question of act and law which was subject to review and the decision of the High Court was reversed and the claim of the assessee was allowed by this court on the ground that section 12(2) of the Act applied to the case. Similarly, in a later case, Commissioner of Income-tax v. Royal Calcutta Turf Club this court reiterated the principle that though the question whether an item of expenditure was wholly and exclusively laid out for the purpose of the assessees business must be decided on the facts of each case, the final conclusion was one of law because it involved the interpretation of the scope and meaning of the statute.

7. For these reasons we hold that the judgment of the High Court dated April 4, 1962, should be set aside. The High Court is directed to ask the Income-tax Appellate Tribunal to state a case on the following question of law and refer it under section 66(2) of the Act :

> "Whether, on the facts and circumstances of the case, the sum of Rs. 46,582 was a permissible deduction under section 10(2)(xv) of the Income-tax Act in the assessment year 1954-55 ?"

8. After receipt of the reference the High Court should deal with it in accordance with law. We accordingly allow this appeal but there will be no order as to costs.

9. Appeal allowed.