Supreme Court of India
Commissioner Of Income-Tax, ... vs E. Francescanto on 30 November, 1965
Equivalent citations: 1966 60 ITR 442 SC
Author: S Rao
Bench: J Shah, K S Rao, S Sikri
JUDGMENT Subba Rao, J.

1. This appeal by special leave is preferred against the judgment and order of the High Court of Bombay in a reference made to it by the Income-tax Appellate Tribunal under section 66(1) of the Indian Income-tax Act, 1922, hereinafter called the Act.

2. The following question was referred to the High Court :

"Whether, on the facts and in the circumstances of the case, the commission of Rs. 2,45,557 was exempt in the hands of the assessee by virtue of the Notification No. 878F dated March 21,1922, as amended by Notification No. 8 dated March 24, 1928 ?"

3. The facts that led up to the reference may be briefly stated :

One S. P. Gallini was dosing business in art-silk in the name and style of "Rayon Yarns Import Company". Under an agreement dated May 30, 1948, he appointed E. Francescanto, the respondent, as his manager. For the assessment year 1949-50 Gallini claimed a deduction of Rs. 2,45,557 the commission paid by him to the respondent in terms of the agreement, from his taxable in come. But the Income-tax Officer a rejected the claim on the ground that "the payment of commission is but a way to reduce his income and his tax liability." That is to say, in effect and substance he held that the profits of the said company were divided between Gallini, the employer, and the respondent, his employee, to evade income-tax and, therefore, the said amount was to be included in the taxable income of the employer. After having assessed the said amount in the hands of the employer for the assessment year 1949-50, the department sought to assess the said income over again in the hands of the assessee as commission received by him from his employer. The assessee claimed exemption on the basis of the Notification No. 878F dated March 21, 1922, as amended by Notification No. 8 dated March 24, 1928. The claim was rejected. On appeal, the Appellate Assistant Commissioner came to the same conclusion as the Income-tax Officer. On further appeal, the Appellate Tribunal, Bombay held that the conditions laid down by the said notification had been fulfilled and that the assessee was entitiled to the exemption claimed by him. At the instance of the revenue, the aforesaid question was referred to the High Court for its opinion. The High Court agreed with the Appellate Tribunal and answered the question in the affirmative. Hence, the present appeal.

4. Mr. Desai, learned counsel for the revenue, contended that, in order to qualify for the exemption under the aforesaid notification the assessee had to fulfill the conditions laid down therein, that he had not fulfilled any one of them and that, therefore, he was not entitled to any exemption.

5. Mr. A. V. Viswanatha Sastri, learned counsel for the assessee, argued that, as the employer had been assessed on the same income as was now assessed in the hands of the employee presumably on

the ground that the division of profits was sham and that the said income continued to be the income of the employer, the revenue could not assess the said income to tax once again as the income of the assessee, as in fact it never became his income. He further contended that in any event the assessee was entitled to the exemption under the notification as the conditions laid down therein were fully complied with.

6. At the outset we may point out that the first argument advanced by Mr. A. V. Viswanatha Sastri is not available to him. The entire proceedings up to now went on the basis that the commission was the income of the assessee, but he was entitled to an exemption under the said notification. The question referred by the Tribunal to the High Court was also related to the exemption under the said notification. If his argument be accepted, no question of exemption under the notification would arise, as the income was not the income of the assessee but of his employer. That question not having been referred to the High Court, it is not open to the assessee to raise it for the first time before us.

7. The answer to the question referred to the High Court depends upon the terms of the said notification and the fact whether the conditions of the said notification were complied with. The relevant part of the notification reads :

"The following classes of income shall be exempt from the tax payable under the said Act, but shall be taken into account in determining the total income of an assessee for the purposes of the said Act :

(i) Sums received by an assessee on account of salary, bonus, commission or other remuneration for services rendered, or in lieu of interest on money advanced to a person for the purpose of his business.

Where such sums have been paid out of, or determined with reference to the profits of such business, and by reason of such mode of payment or determination, have not been allowed as a deduction but have been assessed and charged under the head 'business'".

8. Under this notification commission received by an assessee is exempt from tax if the following three conditions are satisfied : (i) the said sum has been paid out of or determined with reference to the profits of such business; (ii) the said amount has not been allowed as a deduction but has been included in the profits of the business; and (iii) income-tax has been assessed and charged on the said profits including the said income under the head "business". The three conditions are cumulative and unless all the three conditions are satisfied no exemption can be given. The object of the notification is self-evident : it is to prevent imposition of tax on the same income twice over.

9. In the instant case, admittedly, the third condition was satisfied, for in assessing Gallini the said amount was disallowed in the computation of the profits of the business and had been assessed and charged under the head "business" in his hands.

10. As regards the first condition, Mr. Desai contended that under the terms of the agreement the said commission was the first charge before the profits were arrived at and, therefore, the said condition was not complied with.

11. The agreement entered into between Gallini and the respondent is dated May 30, 1948. The relevant part of paragraph 9(b) of the agreement reads :

"If your services are not discontinued on or before 31st January, 1949, you will be entitled to commission @ 1/2% (half of one per cent.) upon the value of all sales resulted on or after 1st June, 1948, and up to 31st January, 1949, except direct sales effected by the makers to other than to ourselves."

12. Prima facie this recital supports the contention that commission had to be paid not out of the profits but on the turnover of each sale. But the High Court held that, having regard to the nature of the business carried on by Gallini, the incomings of the business were nothing but the profits earned by him in the sale transactions, and, therefore, the commission agreed to be paid to the assessee was only out of the profits of the employer's business. The reasoning of the High Court is found in the following observations :

"... the trading assets of the assessee (employer) are the forward contracts made by him on the strength of his business contacts with foreign contractors. The benefits of these contracts he transferred to local merchants at a profit of 2 to 5%. This kind of business hardly required any investment of capital. The incomings of the employer's business were nothing but the profits earned by him in the sale transactions. It is out of this amount that was coming into his hands that he agreed to pay half per cent. on sales effected by him to the assessee. If there was no sale, the assessee earned no commission. If there was a sale it only brought resulting profits to the hands of the employer. That being the factual position, there to cannot be any doubt that, on the agreement between the parties, the commission paid to the assessee was paid out of the profits of the business of the employer."

13. In our view, this reasoning is not sound. It is not possible to say that the entire incomings of the employer's business were profits. There must have been a capital, however little, invested in the business and overhead charges must have been incurred in carrying out the business. The profits could only be the balance arrived at after deducting the outgoings from the incomings. We cannot, therefore, sustain the validity of the said reasoning. But, though under the agreement the commission payable to the assessee had to be calculated at a certain percentage on the gross turnover of the business, we find that the commission was in fact paid out of the profits of the business. The Income-tax Officer added the commission of Rs. 2,45,557 to the profits disclosed by the employer and assessed the total sum of Rs. 7,74,454 to tax. He did so, because in his view the commission was paid out of the profits to evade tax to that extent. It was said that the said finding of Income-tax Officer was not conclusive and that the Truibunal should have given an independent finding in the present proceedings. Though the said finding was not conclusive, it would certainly prove that the income-tax department, after enquiry, found that the said commission was part of the profits of the employer. In the absence of any other evidence, the Tribunal accepted that finding and

we do not see any justification to disturb the same. If so, it follows that the said commission was in fact paid out of the profits of the employers business.

14. The second condition was also fulfilled in this case, for, though the employer claimed the commission paid to the assessee as a deduction, the Income-tax Officer included that amount in the profits of the business and assessed that income to tax. Therefore, the said sum had not been allowed as deduction to the employer.

15. In this view, as all the three conditions laid down by the notification had been complied with, the assessee was entitled to exemption from tax in respect of the said commission.

16. We shall now notice briefly the decisions cited at the bar.

17. In M. K. Kirtikar v. Commission of Income-tax it was held that as the mode of computation of the commission of the assessee was 1% of the turnover, it did not satisfy the requirement of the notification that the source out of which the commission was paid was the profit of the employer.

18. The decision in Commission of Income-tax v. Mulraj Karsondas and Ramanlal C. Parekh v. Krishnamachari, Commissioner of Income-tax dealt with the case where the salary of an employee was deducted before the profits were ascertained and the courts held that the salary was not paid out of the profits.

19. The decision in V. Narayanaswami Iyer v. Commissioner of Income-tax turned upon the third condition of the notification and it was found that the commission was disallowed under section 10(2)(xv) of the Income-tax Act. The decision in Balakrishnan v. Commissioner of Income-tax is directly in point, for in that case under circumstances similar to those in the present one, it was held that the commission was paid out of the profits.

20. None of these decisions had laid down any principal of universal application. Whether the commission was paid out of the profits or determined with reference to the profits has to be decided on the facts of each case. In the present case, the Tribunal rightly found that the commission was paid out the profits of the business. We, therefore, agree with the conclusion of the High Court, though on different grounds.

21. In the result, the appeal fails and is dismissed with costs.

22. Appeal dismissed.