Maheshwari Devi Jute Mills Ltd. vs Commissioner Of Income Tax on 3 May, 1950

JUDGMENT

Malik, C.J.

1. This is a reference under Section 66 (1) of the Indian Income-tax Act, 1922, read with Section 21 of the Excess Profits Tax Act, 1940. The question referred to us is as follows:

> Whether, in the circumstances of the case, Section 10A of the Excess Profits Tax Act was rightly applied and, if so, whether there is material to justify the finding that the main purpose of the transaction, i.e., appointment of two general managers in addition to the already existing whole-time manager and managing agents, was the avoidance or reduction of liability to excess profits tax.

2. The assessee is the Maheshwari Devi Jute Mills, Ltd., Kanpur. It was a private limited company up to the 7th August, 1941, By a resolution of the company it was changed from a private limited to a public limited company. The members of two closely related families of Khaitan and Bagla formed the private limited company. The managing agents of this company were the Khaitan and Bagla families and they were working on a remuneration of Rs. 1,500 per month, in addition to a commission of 10 per cent. on the profits of the company. On the 27th September, 1941, a resolution was passed appointing 1 member each of the two families as joint managers of the assessee company on a remuneration of Rs. 2,000 per mensem each, free of all taxes, to look after the management of the company. The two persons so selected were Harishankar Bagla and Mr. Munna Lal Khaitan. They were to work with effect from the 1st October, 1941 The reason for the appointment of two joint general managers was because it was stated that "the company's work had considerably increased."

3. The Income-tax Officer has under Section 10 (2) (xii) of the Act [now Section 10 (2) (xv)] held that this was an expenditure incurred for the purpose of business and allowed a deduction of Rs. 54,779 as business expenditure. The Excess Profits Tax Officer, however, came to the conclusion under Section 10A of the Excess Profits Tax Act that " the main purpose " behind the appointment of two joint general managers was to reduce the liability to pay excess profits tax.

4. The question framed by the Appellate Tribunal can be divided in two parts. One part of it is whether there was material to justify the finding that the main purpose of the transaction was the avoidance or reduction of liability to excess profits tax.

5. It is obvious that what was the main purpose of the assessee in entering into a transaction of this nature cannot be proved by direct evidence and the conclusion must always depend upon the facts and circumstances of each case. If the facts and circumstances were such that the Income-tax

Appellate Tribunal could come to the conclusion that the transaction was entered into with the purpose of avoiding or reducing the liability to pay excess profits tax, then this Court not being a court of appeal, has no right to interfere. All that we are called upon to do is to answer the question whether there was material before the Appellate Tribunal which could lead them to the conclusion arrived at by them. I want to make it clear that even if two views were possible and the Appellate Tribunal had taken a view which is not the view* that we would have taken it is not open to us to say that there was no material on which the conclusion could be arrived at.

6. The facts and circumstances mentioned by the Appellate Tribunal on which they came to the conclusion that the main purpose was the avoidance or the reduction of liability under the Excess Profits Tax Act were as follows:

> (1) That the private limited company was formed by the members of two closely related families of Khaitan and Bagla ;
>
> (2) That the members of the same family were working as managing agents under the name of Khaitan Bagla & Company ;
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> (3) That Harishankar Bagla was a director of the company and both ho and Munna Lal Khaitan were partners in the managing agency firm ;
>
> (4) That there was a whole time manager who was paid a remuneration of Rs. 19,482;
>
> (5) That the ostensible reason given by the directors was false as the loom age of the company had practically remained unchanged and there had been no substantial increase in the outturn ;
>
> (6) That as a matter of fact, the outturn was somewhat less in the chargeable accounting period than in the preceding year;
>
> (7) That the joint general managers were required to do what was the duty of the firm of managing agents who under the Articles of Association of the company were required to carry on the business of the company ; and (8) That the transaction equally benefited the two families who had equal interest and the two joint general managers came one from each family.

7. On these facts it is impossible to suggest that there was no material on which the finding that the main purpose of the transaction was the avoidance or the reduction of liability to pay excess profits tax could be arrived at; and this is our answer to the second part of the question.

8. The first part of the question is whether in the circumstances of the case Section 10 A of the Excess Profits Tax Act was rightly applied.

9. The argument advanced by learned Counsel before us was not exactly the same as was advanced before the Appellate Tribunal. What was urged before the Appellate Tribunal was that Section 10A of the Excess Profits Tax Act was not applicable but that the deduction of Rs. 54,779 should, if at all, have been made under Rule 12 of Schedule I of the Excess Profits Tax Act. The ground on which this argument was advanced was that the sum was claimed as having been spent for purposes of carrying on the business, and if the Excess Profits Tax Officer considered that the expenditure of this amount was not reasonable and necessary, having regard to the requirements of the business, then he could disallow it after having obtained the prior authority of the Commissioner of Excess Profits Tax.

10. Section 2, Sub-section (19), of the Excess Profits Tax Act defines "profits" as meaning profits as determined in accordance with the First Schedule, and the relevant portion of Rule 1 of the First Schedule is as follows:

> The profits of a business during the standard period, or during any chargeable accounting period, shall be separately computed, and shall, subject to the provisions of this Schedule, be computed on the principles on which the profits of a business are computed for the purposes of income-tax under Section 10 of the Indian Income-tax Act, 1922.

11. Section 10 (1) of the Indian Income-tax Act lays down that:

> The tax shall be payable by an assesses under the head profits and gains of business, profession or vocation in respect of the profits or gains of any business, profession or vocation carried on by him.

12. The allowable deductions are mentioned in Sub-section (2), Clause (xii), which is now Clause (xv), as:

> any expenditure not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of such business, profession or vocation.

13. The argument advanced by Mr. Pathak was that the Income-tax Officer having held that the sum of Rs. 54,779 was expended wholly and exclusively for the purpose of such business, it could not be said that the expenditure was for the main purpose of avoiding payment of excess profits tax. Rule 1 of Schedule I of the Excess Profits Tax Act casts a duty on the Excess Profits Tax Officer to compute the profits of a business during the standard period and during any chargeable accounting period in accordance with the provisions of Section 10 of the Indian Income-tax Act, 1922, and the fact, that the Income-tax Officer might have already computed that profit does not take away the duty that has been cast on the Excess Profits Tax Officer to do the work for himself except to the extent mentioned in the provisos. The second proviso to rule 1 is that:

> Where the profits during any standard period have already been determined for the purpose of an assessment under the Indian Income-tax Act, 1922, such profits as so

> determined shall, subject to the adjustments required by this Schedule, be taken as the profits during that period for the purpose of excess profits tax.

14. It would be seen, therefore, that it is only for the purpose of finding out the profits during any standard period that the Excess Profits Tax Officer has to rely on the determination of the profits for the purpose of an assessment under the Indian Income-tax Act, 1922. There is no similar provision about the chargeable accounting period for the payment of excess profits tax. The reason is obvious. The standard period was generally fixed with respect to the profits made before the war, the income-tax assessment of which period had in most cases been completed and it was not considered necessary to direct the Excess Profits Tax Officer to reopen the old assessments in trying to fix what Were the profits made during the standard period. But for the chargeable accounting period it being the duty of the Excess Profits Tax Officer to compute the profits in accordance with the provisions of Section 10 of the Indian Income-tax Act and the First Schedule to the Excess Profits Tax Act, he could not be guided by the opinion of the Income-tax Officer in the matter.

15. The point strenuously urged by Mr. Pathak, and which does not appear to have been raised before the Appellate Tribunal is that the stage for applying Section 10A of the Excess Profits Tax Act can only arise after the profits have been computed in accordance with the provisions of the First Schedule. His contention is that if this principle had been followed, the Excess Profits Tax Officer would have been required first to ascertain the profits or gains of the business under Section 10 of the Income-tax Act after allowing deductions permissible under Clause (xii) [now Clause (xv)] of Sub-section (2) of that section and in that case he would have arrived at the same finding as the Income-tax Officer that the payment made to these two joint general managers was an expenditure wholly and exclusively for the purpose of the business. After he had arrived at this finding, it would not have been possible for him to apply the provisions of Section 10A of the Excess Profits Tax Act because he would then, be required to give a finding that the main purpose of the transaction under which this payment was made to the general managers was the avoidance or reduction of the liability to excess profits tax which would be inconsistent with the finding arrived at by him that the expenditure was wholly and exclusively for the purpose of the business. He has placed before us the excess profits tax assessment order where the Excess Profits Tax Officer has set out the total profits as found by the Income-tax Officer and added to that, besides the two other sums with which we are not concerned, this sum of Rs. 54,779. We cannot see any reason at all why the computation of the profits should be made before action is taken under Section 10A of the Excess Profits Tax Act. The Excess Profits Tax Officer may, in some cases, prefer to decide the question under Section 10A first before he starts computation of the profits; he may in some cases, find it convenient to do both together ; he may as well in some cases compute the profits first and then decide the question under Section 10A and then make the necessary adjustments. There can be cases where if the provisions of Section 10 A of the Excess Profits Tax Act are not first taken into consideration, the Excess Profits Tax Officer may find on computation that there are no profits or gains at all liable to excess profits tax, or that the liability has been transferred to some other person and does not rest on the person whose profits are under assessment. In such cases, it will naturally be expedient or necessary to decide the question under Section 10A first and compute the actual profits afterwards. In this case the finding that the transaction of appointment of the two general managers was with the main purpose of avoidance or reduction of liability to excess profits tax necessarily led to the inference

that the expenditure incurred in payment of salaries to them was not wholly and exclusively for the business so that the decision of the question under Section 10A automatically amounted to a simultaneous decision of the question involved under Clause (xii)-now Clause (xv)-of Sub-section (2) of Section 10 of the Income-tax Act.

16. Our answer to the question formulated by the Department is that, in the circumstances of the case, Section 10A of the Excess Profits Tax Act was rightly applied and there was material to justify the finding that the main purpose of the transaction, that is, the appointment of two general managers, was the avoidance or reduction of liability to excess profits tax.

17. The assessee must pay the costs of the Department which we fix at a sum of Rs. 400.