Commissioner of Income Tax Vs Ramakrishna Mills (Coimbatore) Ltd.

Tax Case No''s. 45 of 1967 and 122 of 1968 (Reference No''s. 17 of 1967 and 51 of 1968)

Court: Madras High Court

Date of Decision: Dec. 19, 1972

Acts Referred:
Companies Act, 1956 â€" Section 2(25), 348, 352#Income Tax Act, 1922 â€" Section 10(2)

Citation: (1974) 44 CompCas 33 : (1973) 92 ITR 477

Hon'ble Judges: V. Ramaswami, J; G. Ramanujam, J

Bench: Division Bench

Advocate: V. Balasubrahmanyan and J. Jayaraman, for the Appellant; S. Swaminathan and K. Ramagopal, for the Respondent

Judgement

Ramanujam, J.
As both the references arise out of the same order of the Income Tax Appellate Tribunal, they can be disposed of

together.

2. The assessee is a limited company, hereinafter called the company, carrying on business of manufacture and sale of yarn. The managing agents

of the company was a partnership-firm called "" S. N. Rangaswamy Naidu & Sons "", hereinafter called "" the firm "". One R. Doraiswamy Naidu was

one of the partners of this firm. He was also employed as manager in the company from the year 1952, as he was technically qualified. The firm

was entitled to a total remuneration of ten per cent. of the net profits of the company or Rs. 35,000, whichever is higher. The managing agents

were actually paid a remuneration of Rs. 35,000 in each of the assessment years 1958-59, 1959-60 and 1960-61. In the said assessment years

the said R. Doraiswamy Naidu in his capacity as manager of the company had received remuneration of Rs. 24,900, Rs. 26,100 and Rs. 27,300

respectively.

3. The company claimed allowance for the remuneration paid to the managing agency firm and also for the salary paid to the manager. The Income

Tax Officer allowed the remuneration paid to the managing agency firm but disallowed the salary paid to the said R. Doraiswamy Naidu on the

ground that the salary paid to him amounted to remuneration paid to the managing agent and that as it was in excess of ten per cent. of the net

profits of the company during the years of account, the payment is prohibited by Section 348 of the Indian Companies Act. His view was that R,

Doraiswamy Naidu, being a partner of the managing agency firm, could not receive any remuneration apart from the ten per cent. of the net profits

fixed under the said section as payable to the managing agent even though he functioned as a manager of the company. In disallowing the salary

paid to the manager on the ground set out above, the Income Tax Officer purported to follow the decision of the Bombay High Court in Ramabe,

A. Thanawala Vs. Jyoti Limited, .

4. The company appealed to the Appellate Assistant Commissioner who, however, reversed the finding of the Income Tax Officer. He held that

the Income Tax Act was a separate code by itself and the payment of salary to the manager was an allowable deduction u/s 10(2)(xv) of the Act.

In that view the Appellate Assistant Commissioner deleted the sums paid as salary to the manager from assessment for the said three assessment

years. The revenue appealed to the Tribunal. The Tribunal held that the salary paid to the manager was an expenditure incurred wholly and

exclusively for the purpose of the company"s business and that, therefore, the company was entitled to deduction u/s 10(2)(xv) of the Income Tax

Act. The Tribunal took the view that though the payment of salary to Doraiswami Naidu was in excess of the remuneration amounting to 10 per

cent. of the net profits of the company paid to the firm and, therefore, contravened the provisions of Section 348 of the Companies Act, that

circumstance alone will not disentitle the company to claim allowance u/s 10(2)(xv), that the assessee"s claim for allowance of the said salary

payment has to be considered only u/s 10(2)(xv) and that if the claim is allowable under that section, it has to be allowed whether or not the salary

payment is in contravention of Section 348 of the Indian Companies Act. The Tribunal then took note of the findings given by the Income Tax

Officer and held that the said Doraiswami Naidu has in fact acted as manager of the company during the relevant assessment years for which he

has been paid the remuneration in question, that he was not only highly qualified in textile technology but also had considerable experience in that

line and that the salary paid to him should be taken to be reasonable and for business considerations.

5. The Tribunal in its order also dealt with another item. The Income Tax Officer has added a sum of Rs. 93,456 as income from undisclosed

source. While dealing with this item the Tribunal held that the Income Tax Officer has proceeded to make this addition on the basis of certain

discrepancy between the stock book maintained by the company and the stock declarations made to the bank with whom the stocks have been

hypothecated, but that the stock as per the books of the company tallied with the declarations made from time to time by the company to the

Textile Commissioner, Bombay, and that the difference between the stock declared to the bank and the stock as per the books of the assessee did

not represent any excess and undisclosed stock. The Tribunal was of the view that it only showed that the stock declarations made to the bank

were not accurate, that the Income Tax Officer was not justified in taking the company"s stock declarations given to the bank as representing the

true position of the stocks especially when the company had a very good reason for giving an inflated statement of the stock to the bank for

obtaining a higher overdraft facility. In that view the Tribunal held that the Income Tax Officer was not justified in adding the sum of Rs. 93,456 as

income from undisclosed source and deleted the same from assessment. At the instance of the revenue the Tribunal has referred to this court the

following first question in T.C. No. 45/1967 and the only question in T.C. No. 122 of 1968 :

Whether, on the facts and in the circumstances of the case and in view of the provisions of the Companies Act, 1956, the salaries paid to the

manager in the three assessment years 1958-59, 1959-60 and 1960-61 were allowable expenditure u/s 10(2)(xv) of the Indian Income Tax Act,

1922?

Whether the finding of the Appellate Tribunal that the stocks disclosed by the assessee to the bank were not inflated to the extent of Rs. 93,456

was such as could reasonably be arrived at by any person acting judicially or properly instructed?

6. At the instance of the assessee the Tribunal has referred to this court the following second question in T.C. 45 of 1967 :

Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the salary paid to the manager contravened

the provision of Section 348 of the Companies Act, 1956 ?

7. It is contended by the revenue at the first instance that the question referred at the instance of the assessee cannot be entertained by this court

for the reasons that the assessee never sought any reference at all. That position is not controverted by Mr. Swaminathan, the learned counsel for

the assessee. But what is contended by him is that even the first question referred at the instance of the revenue involved the consideration of the

question referred at the instance of the assessee. That appears to be so. The first question referred at the instance of the revenue is a

comprehensive one so as to take in the question referred at the instance of the assessee. Therefore, we proceed to consider only the two questions

referred at the instance of the revenue.

8. Mr. Balasubrahrnanyan for the revenue contends that the Tribunal having found that the salary paid to the manager contravened the provisions

of Section 348 of the Companies Act erred in taking the view that it is an allowable expenditure u/s 10(2)(xv) of the Income Tax Act, and that an

expenditure which has been incurred by the company contrary to a statutory provision is not a lawful or an authorised expenditure, and that

Section 10(2)(xv) can be invoked only in relation to a lawful and authorised expenditure incurred in the business. Mr. Swaminathan for the

assessee would, however, contend that the Tribunal''s view that there has been an infringement of Section 348 of the Companies Act is not correct

and that, on the facts of this case, it cannot be said that there has been a violation of the said section. It has, therefore, become necessary for us to

consider the question whether the payment of remuneration to the said R. Doraiswamy Naidu infringed Section 348 as it stood then. Section 348,

after its amendment in the year 1960, clearly treats the remuneration received by a partner of a managing agency firm in any capacity as a

remuneration paid to the managing agent and states that the aggregate sum should not exceed ten per cent. of the net profits of the company in the

financial year. But this amendment is not retrospective. If this amendment were to be retrospective, the learned counsel for the assessee concedes

that the payment made to the manager would violate that section. The revenue submits that though the amendment is not expressly made

retrospective, it is only declaratory or clarificatory in nature and, therefore, the principle of the amended section would have to be applied even in

respect of the assessment years in question. We are not inclined to hold that the amendment made in the year 1960 to Section 348 is merely

declaratory or clarificatory. It is true that declaratory or clarificatory statutes must be presumed to be retrospective unless a contrary intention

appears therefrom. In our view, the amendment is remedial or curative in nature. It is only by creating a fiction a partner of the managing agency

firm is treated as a managing agent for the purpose of that section after the amendment. It cannot be said that the said fiction was there even before

the amendment. It is well established that statutory provisions creating or taking away substantive rights are ordinarily prospective and not

retrospective and they are retrospective only if, by express words or by necessary implication, the legislature has made them retrospective. As a

general rule an amendment affecting substantive rights would not have retrospective effect and they will affect only the transaction subsequent to the

amendment and not apply to antecedent transactions. Section 348 as amended cannot be said to be retrospective. We have to, therefore, consider

the scope of the provisions of Section 348 before its amendment. Section 348, before its amendment, ran as follows : "" 348. Remuneration of

managing agent ordinarily not to exceed 10 per cent. of net profits.--Save as otherwise expressly provided in this Act, a company shall not pay to

its managing agent, in respect of any financial year beginning at or after the commencement of this Act, by way of remuneration, whether in respect

of his services as managing agent or in any other capacity, any sum in excess of ten per cent. of the net profits of the company for that financial

year.

9. A reading of the above section shows that though there is a prohibition on the companies paying any sum as remuneration in excess of the limit

prescribed therein, it is subject to the other provisions of the Act. Section 352 authorises a permission being granted to the company to pay

remuneration to the managing agents beyond the prescribed limit. Thus, it is seen that the prohibition is not absolute. It is also seen that the above

section forms part of a scheme to limit the company. Section 198 provides an overall maximum for managerial remuneration. It provides that in the

case of a public company the total remuneration payable by the company to its directors, its managing agents or secretaries or treasurers and

managers shall not exceed 11 per cent. of the net profits of the company as computed in the manner laid down in Sections 349, 350 and 351.

Section 309 provides a limit for remuneration payable to directors. That section provides a maximum percentage of the net profits as payable to

the directors of a company including the managing director. Then comes Section 348 providing for a limit to the remuneration payable to the

managing agents. The word "" ordinarily"" occurring in Section 348 suggests that it is permissible to pay additional remuneration in special

circumstances. That view is also fortified by Section 352 which provides that additional remuneration in excess of the limit specified in Section 348

may be paid to the managing agent if such remuneration is authorised by a special resolution of the company and is approved by the Central

Government as being in public interest. The infringement of Section 348 was not also made penal before 1960. The word "" managing agent"" has

been defined in Section 2(25) as meaning any individual, firm or body corporate entitled to the management of the whole or substantially the whole

of the affairs of the company by virtue of an agreement with the company or by virtue of its memorandum or articles of association. This shows that

an individual, firm or body corporate can be a managing agent. The question is whether a partner of a managing agency firm by himself will come

under the definition of ""managing agent "" so as to attract Section 348. The position has been made clear after the amendment of Section 348 in

1960 by introducing Sub-section (2) stating that for the purpose of the section where the managing agent of the company is a firm any payment

made by way of remuneration to every partner in that firm shall be deemed to be included in the remuneration of the managing agent, that is, by

virtue of this amended provision, every partner of a managing agency firm is deemed to be a managing agent for the purpose of that section. It is

true that Section 348 refers to the remuneration paid to the managing agent whether in respect of his service as managing agent or in any other

capacity. But that will only refer to the services rendered by the managing agent as such, that is, the individual, firm or body corporate coming

under the definition of managing agent. On the face of the definition of managing agent in Section 2(25) every partner of a managing agency firm

cannot be said to be a managing agent, and any remuneration paid to him in his individual capacity for services rendered to the company cannot be

said to be hit by Section 348.

10. In this connection, the learned counsel for the revenue relies on the decision of the Bombay High Court in Ramabe, A. Thanawala Vs. Jyoti

Limited, . In that case the scope of Sections 198, 309 and 348 came up for consideration. Chagla C.J., speaking for the Bench, held that Section

309 of the Companies Act deals with and controls remuneration paid-to a director in his capacity as a director and in no other capacity, that a

director, in addition to the receipt of remuneration as a director, may also receive remuneration in a different capacity such as a technical adviser,

and that the remuneration received by him in such a technical capacity should not be taken into account in deciding whether the amount paid to him

exceeded the limit prescribed in that section. As regards Section 198 the learned Chief Justice said that what is sought to be controlled by that

section is the cost of management and that, therefore, the remuneration paid for any other purpose to a director in his capacity as a technical expert

is not to be taken into consideration for the purpose of limiting the overall maximum managerial remuneration to 11 per cent. of the net profits

mentioned in Section 198. But as regards the scope of Section 348 it was held in that case that as the section is clear and emphatic that a managing

agent cannot receive more than 10 per cent. of the net profits of the company either in his capacity as managing agent or in any other capacity and

that the remuneration which a partner of a managing agency firm receives from the company managed by it, as a technical expert, has to be taken

into account for the purpose of limiting the remuneration of the managing agency firm to 10 per cent. as per the section. The basis of the said

decision is that a partner of a managing agency firm is himself a managing agent and, therefore, the remuneration received by him for services

rendered to the company in his individual capacity should also be treated as a remuneration to the managing agency firm. The relevant observations

therein are these:

Now, a firm has no legal existence ; it is not a legal entity ; it is merely a compendious manner of describing partners carrying on a business.

Therefore, the argument of Mr. Desai comes to this that although the company in law could not pay A and B jointly, it could pay A and B

separately and individually. In our opinion, full effect must be given to the clear and emphatic language used by the legislature in Section 348 that a

managing agent cannot receive more than 10 per cent. of net profits either in his capacity as managing agent or in any other capacity. The whole

object of the legislature would be defeated and the mischief aimed at would not be overcome if we were to take the view that although the

company had paid up to 10 per cent. of the net profits to the managing agents, it could further pay extra amounts to each one of the partners of the

managing agents if the managing agency happened to be a firm. That would put a firm in an infinitely more advantageous position than an individual.

If the managing agent was an individual, he would have to content himself with the remuneration fixed u/s 348, but if he showed the wisdom and the

foresight of having a partner and starting a partnership firm, then he and his partner individually could get out of the limitation placed in Section 348

and each separately and individually could receive from the company any amount without any limit whatsoever.

11. With great respect, we are not inclined to accept the above reasoning as correct. As pointed out by a subsequent decision of the same court

the significance of the definition of "" managing agent"" in Section 2(25) has been lost sight of by the learned judges, and they have merely proceeded

with the object sought to be achieved by that provision. In Nandial More Vs. Ramchandiram Mirchandani and Others, the question whether a

partner of a managing agency firm could himself be a managing agent came up for consideration, and dealing with the earlier case Mody J.,

speaking for the Bench, expressed:

The report, however, shows that unfortunately the attention of that court was not invited to the provisions of Section 2(25) which defines

''managing agent''. We have already pointed out that on a true construction of Section 2(25) the legislature did not intend a partner of a firm of

managing agent to be himself a managing agent. We feel that the judgment would have been otherwise if the court''s attention in that case had been

drawn to Section 2(25). ..... The intention of the legislature is to be gathered from the words used and the court is not entitled to travel outside the

words unless sufficient reasons exist. As we have already stated, such reasons do not exist here. .... .If the legislature intends that for the purposes

of this disqualification every partner of a firm of managing agents should himself be treated as a managing agent, the legislature should make suitable

amendments to effectuate that intention. But it is the legislature and the legislature alone which can do so. A court cannot, in the guise of

interpretation, an interpretation based on a supposed intention of the legislature, in reality embark to legislate and usurp the functions of the

legislature.

12. With respect, we are inclined to agree with the observations of the Bench in the latter case. The definition of "" managing agent"" in Section 2(25)

cannot include a partner in a managing agency firm, even though the firm is composed of partners. It is true that a firm has no legal existence and

that it is only a compendious name of describing all partners carrying on a business. But when the definition refers to the firm, the collective body of

partners entitled to manage the affairs of the company as managing agent, it cannot be said that every one of the partners of the firm is himself a

managing agent entitled to manage the company. As already stated, that is the position after the amendment of Section 348. Even there it is only for

the purpose of that section a partner of a managing agency firm has himself been treated as a managing agent and not for all purposes. We are,

therefore, of the opinion that the Tribunal''s view that the payment of remuneration made to R. Doraiswamy Naidu for the services rendered by him

in his individual capacity as manager would infringe Section 348 of the Companies Act is not correct. Such a payment will clearly fall u/s 10(2)(xv)

as an expenditure exclusively incurred for the purpose of the business in view of the finding of the Tribunal that the expenditure was governed only

by business considerations and was reasonable.

13. Even assuming that the said payment infringed Section 348 of the Companies Act, still the company is entitled, in our view, to the deduction u/s

10(2)(xv). As pointed out by the Tribunal, in considering the allowability of an expenditure u/s 10(2)(xv) one cannot travel outside the provisions of

the Income Tax Act and deny the benefit of deduction under that section on the ground that the payment is unauthorised or has been prohibited by

some other statute. As already stated, Section 348 does not impose an absolute prohibition and if there is an excess payment it could be

authorised u/s 352. Therefore, the only thing that can be said against the company is that they did not get the required permission from the Central

Government as per Section 352 for paying the remuneration in excess of the limit prescribed in Section 348. We are not inclined to hold that any

payment in excess of the limit prescribed in Section 348 is illegal so as to have it excluded from Section 10(2)(xv) and that Section 10(2)(xv) only

contemplates expenditure which is not prohibited by any statute.

14. In Commissioner of Income Tax, Madras Vs. Coimbatore Salem Transport (Private) Limited., the question arose as to whether the payment

of tips as mamool by a transport company was an allowable deduction u/s 10(2)(xv) and this court held:

Here the transport business of the assessee is entirely a lawful one. It does not become illegal by reason only that the assessee paid out moneys

by way of tips to certain people on the route. There is no evidence as to what exactly was the nature of the tips and as to whether they were legal

or improper. All tips in one sense may be improper but not necessarily so always or are illegal. In the absence of evidence on this matter, we have

to go by the factual observations of the Tribunal. As we said, the Tribunal has remarked that such expenditures as are sought to be deducted in this

case are inevitable if the assessee has to carry on its business. Learned counsel for the revenue addressed arguments to us on the assumption that

the expenditures sought to be deducted constituted improper or illegal acts and that expenditures incurred even in a lawful business are not eligible

for deduction. One view may be that if profits derived from an illegal business are chargeable to tax, by the same logic the expenditure, be it illegal

or improper, incurred in order to make such profits may legitimately be allowed as deduction. If the acts involved in the expenditure are in

contravention of law, even so it may be a matter for consideration whether, for purposes of revenue, it should really matter in considering and

allowing deductions as business expenditure.

15. The view taken in that case seems to be that wherever expenses which are claimed as deductions have a direct and proximate connection with

the business which has earned the income, whether they are in contravention of any law or otherwise, they will be allowable deductions as business

expenditure. In Commissioner of Wealth-tax, Gujarat Vs. S.C. Kothari, the Supreme Court had to consider the question whether the loss incurred

in respect of an illegal contract which contravened Section 15(4) of the Forward Contracts (Regulation) Act, 1952, could be set off against the

profits earned in respect of other transactions. The court expressed the view that for the purpose of Section 10(1) of the Indian Income Tax Act,

1922, the losses which have actually been incurred in carrying on a particular illegal business must be deducted before the true figure relating to

profits which have to be brought to tax can be computed or determined. If the business is illegal neither the profits earned nor the losses incurred

would be enforceable in law; but that does not take the profits out of the taxing statute and similarly the taint of illegality of the business cannot

detract from the losses being taken into account for computation of the amount which can be subjected to tax u/s 10(1). The Supreme Court

referred to the divergence of opinion as regards the applicability of Section 10(2)(xv) to an expenditure incurred in respect of an illegal activity

between the Punjab High Court in RAJ WOOLLEN INDUSTRIES Vs. COMMISSIONER OF Income Tax, SIMLA., and the Full Bench of

the Allahabad High Court in Chandrika Prasad Ram Swarup v. Commissioner of Income Tax,) [1939] 1 ITR 269 and expressed :

Section 10(2) enumerates various items which are admissible as deductions. They are, however, not exhaustive of all allowances which can be

made in ascertaining the profits of a business taxable u/s 10(1). It is undoubtedly true that profits and gains which are liable to be taxed u/s 10(1)

are what are understood to be such under ordinary commercial principles. The loss for which the deduction is claimed must be one that springs

directly from the carrying on of the business and is incidental to it. If this is established the deduction must be allowed provided that there is no

provision against it, express or implied, in the Act. (See Badridas Daga Vs. The Commissioner of Income Tax, "".

The Supreme Court further observed :

It certainly seems to have been held and that view has not been shown to be incorrect that so far as the admissible deductions u/s 10(2) are

concerned they cannot be claimed by the assessee if such expenses have been incurred in either payment of a penalty for infraction of law or the

execution of some illegal activity. This, however, is based on the principle that an expenditure is not deductible unless it is a commercial loss in

trade and a penalty imposed for breach of the law during the course of the trade cannot be described as such. Penalties which are incurred for

infraction of the law are not a normal incident of business and they fall on the assessee in some character other than that of a trader.

16. In COMMISSIONER OF Income Tax, PATIALA Vs. PIARA SINGH. [1971] 82 I. T. R. (SH. N.) 27., it was again held that even an

illegal business is a business within the meaning of the Indian Income Tax Act, 1922, and if profits from illegal business are assessable to tax there

is no reason either on principle or on authority for refusing to take into account losses from illegal business. In that case the assessee was carrying

on a regular smuggling activity which consisted of taking out of Indian currency notes and exchanging them with gold in Pakistan and smuggling that

gold into India. At one stage he was caught by the customs authorities and cash amounting to Rs. 65,500 was confiscated from him. That amount

was claimed as a trade loss. The court held that as the hazard of losing the money with which the gold had to be acquired was inherent in the

activity and, therefore, the confiscation of the amount was allowable as a loss u/s 10(1).

17. In Central Distillery and Chemical Works Ltd., Meerut Vs. Commr. of Income Tax, U.P., C.P. and Lucknow, , the assessee-company

appointed a firm of partners as its managing agents. Under the Defence of India Rules the Government issued a notification appointing a Controller

to control and supervise the working of the company but the notification neither terminated the managing agency agreement nor did it expressly

provide that the managing agents would not be entitled to the remuneration. In the assessment year 1945-46 the shareholders passed a resolution

sanctioning payment of remuneration to the managing agents as per the managing agency agreement. The Controller, however, did not sanction the

payment. But the assessee paid the amount later to the managing agents. The question was whether the assessee could claim u/s 10(2)(xv)

deduction of the remuneration paid to the managing agents as being expenditure laid out or expended wholly or exclusively for the purpose of the

business. As in this case, there also it was contended that the payment made to the managing agents was contrary to the Defence of India Rules.

But the court held that the mere fact that the Controller did not give the sanction for the payment will not take the payment outside Section 10(2)

(xv). In Jaswant Sugar Mills Ltd. Vs. Commissioner of Income Tax, , a company manufacturing sugar had paid commission to their selling agents

at the rate of 21/2% as per the agreement entered earlier, even though the Government had introduced control on the sale of sugar. The company

claimed the said commission as a business expenditure. But, the Income Tax Officer was of the view that after the control was introduced by the

Government on the sale of sugar, there was no necessity for the assessee to pay any commission on the sale of controlled sugar and disallowed the

commission in part. That was challenged by the assessee. The court held that so long as the agency agreement between the company and the sole

selling agent was in force, the commission of 21/2% is payable and, therefore, it is an allowable deduction u/s 10(2)(xv).

18. The learned counsel for the revenue places reliance on an observation of the Supreme Court in Haji Aziz and Abdul Shakoor Bros. Vs. The

Commissioner of Income Tax, Bombay City II, and states that wherever an expenditure is incurred contrary to a statutory provision such

expenditure cannot be brought in u/s 10(2)(xv). In that case a consignment of dates which was imported by steamer was confiscated by the

customs authorities u/s 167 of the Sea Customs Act. The assessee was given an option u/s 183 of that Act to pay a fine in lieu of confiscation. The

assessee paid the fine and had the dates released. The assessee sought a deduction of the amount of fine paid as an allowable expenditure u/s

10(2)(xv) of the Income Tax Act. The Supreme Court held that a sum which was paid by way of penalty for a breach of the law cannot be said to

be an amount wholly and exclusively laid out for the purpose of the business within the meaning of Section 10(2)(xv) and, therefore, it was not an

allowable deduction. In the course of the judgment, their Lordships of the Supreme Court said :

Infraction of the law is not a normal incident of business, and, therefore, only such disbursements can be deducted as are really incidental to the

business itself. They cannot be deducted if they fall on the assessee in some character other than that of a trader. Therefore, where a penalty is

incurred for the contravention of any specific statutory provision, it cannot be said to be a commercial loss falling on the assessee as a trader, the

test being that the expenses which are for the purpose of enabling a person to carry on trade for making profits in the business are permitted but

not if they are merely connected with the business.

19. But we are of the view that the above decision cannot support the stand taken by the revenue. It is true infraction of law is not a normal

incident of business and the penalty incurred for any contravention of the law cannot be treated as a business expenditure. But here, payment made

to the manager is found to be exclusively for the purpose of the business and it cannot be said to be unrelated to the business. The expenses have

been incurred for making profits in the business. We are not concerned here with any payment made as penalty for infraction of the law and,

therefore, the payment cannot be said to be not for the purpose of the business. The above decision of the Supreme Court is concerned with the

allowability of an amount paid as penalty for infraction of the law. This will not apply to the facts of this case where the amount in question is

payment made for services rendered to the company, and the only objection is that the amount paid is in excess of the limit prescribed u/s 348 of

the Companies Act. As already said Section 348 as it then stood was only regulatory and not mandatory. We are, therefore, of the view that the

payment which has been made only for the purpose of the business cannot be disallowed. The assessee''s claim in this regard has, therefore, to be

upheld on both the grounds that there is no infringement of Section 348 of the Companies Act when payment had been made to a partner of the

managing agency firm and that even if there is an infringement, it will not disentitle the assessee to claim deduction u/s 10(2)(xv).

20. As regards the addition of Rs. 93,456, representing the undisclosed income, it is seen that the addition was made only because there was

discrepancy in the stock shown in the account books and the declarations made to the banks with whom the goods had been hypothecated. But,

as pointed out by the Tribunal, the entries in the books tally with the returns submitted to the Textile Commissioner at Bombay. It is true that there

is some variation between the stock declarations given to the bank and in the entries in the stock books maintained by the assessee. But that is

explained by the assessee saying that the stock declarations given to the banks were only rough estimates and not accurate and that those entered

in the account books and those shown in the returns submitted by the assessee to the Textile Commissioner alone are to be taken as the basis. In

the circumstances of this case we do not see any error in the order of the Tribunal. The Tribunal is justified in accepting the books as correct

because the entries therein tallied with the returns submitted by the assessee to the Textile Commissioner and ignoring the stock declarations made

by the assessee to the banks.

21. The result is that the questions are answered in the affirmative and in favour of the assessee. The assessee will have his costs. Counsel''s fee,

Rs. 250 (one set).