Steel Containers Ltd. Vs Commissioner of Income Tax

Income-tax Reference No. 24 of 1970

Court: Calcutta High Court

Date of Decision: Nov. 27, 1974

Acts Referred:
Income Tax Act, 1922 â€" Section 10(4A)#Income Tax Act, 1961 â€" Section 253, 254, 37, 40

Citation: (1978) 112 ITR 995

Hon'ble Judges: Sabyasachi Mukharji, J; R.N. Pyne, J

Bench: Division Bench

Advocate: K. Roy and A.C.S. Chari, for the Appellant; Ajit Sen Gupta, for the Respondent

Judgement

Sabyasachi Mukharji, J.
This is a reference u/s 256(1) of the Income Tax Act, 1961. This reference relates to the assessment years 1962-

63 and 1963-64, the relevant previous years for which were calendar years 1961 and 1962, respectively. It appears that there was a company

known as Indian Galvanizing Co (1926) Ltd., which has been referred to briefly by the Tribunal as I.G., and we shall follow the same pattern. It

was a subsidiary of Balmer Lawrie & Co. Ltd., which has been referred to shortly as B.L, B.L. held 1,95,722 out of 3,69,459 ordinary shares of

I.G. and was carrying on business in the manufacture of steel containers and drums in the factories at Bombay and at Calcutta. B.L. were its

managing agents appointed as such under an agreement dated 8th December, 1926. This agreement of managing agency expired on the 14th

January, 1957, but by an agreement dated the 11th March, 1957, I.G. reappointed B.L. as managing agents for a period of 10 years as and from

15th January, 1957. In the year 1958, the remuneration that was paid by I.G. to B.L, for acting as managing agent was Rs. 40,000 and the

directors" remuneration was Rs. 8,000. In the calendar year 1959, I.G."s profits were Rs. 90,167. The remuneration that was paid to B.L.

amounted to the same figure of Rs. 40,000, while the directors" remuneration came to Rs. 8,600. It has to be mentioned that the sum actually paid

to B.L. in these years was the minimum remuneration as per Clause 5 of the said managing agency agreement. Some time in 1958, the management

of I.G. appears to have decided to start three new concerns, i.e., the assessee-company took over the factory of I.G. at Bombay, a company

called Industrial Containers Ltd. to take over its Calcutta factory and a third company known as Hopes Metal Windows (India) Ltd- to start a

new business in metal windows. In pursuance of the aforesaid desire the assessee-company was incorporated in Calcutta on the 16th June, 1958,

with a share capital of Rs. 14,00,070 comprised of 1,40,007 shares of Rs. 10 each. A company known as Industrial Containers was also formed.

The assessee-company in pursuance of the scheme took over with effect from 1st January, 1959, the factory of I G. at Bombay in consideration of

which the assessee was allotted 1,40,000 ordinary shares of I.G. and thus became a subsidiary of I.G. and hence of B.L. The Industrial Containers

took over the Calcutta organisation of I.G. and allotted 31,000 out of 31,014 shares to I.G. in consideration thereof. The business of metal

windows, however, did not materialise. On the 30th December, 1960. I.G. went into voluntary liquidation. In 1961, out of its assets some of the

shares held by it in the assessee-company and in the Industrial Containers were distributed to B.L. 76,942 shares of the assessee-company came

into the hands of B.L. and the assessee directly became a subsidiary of B.L. It may incidentally be mentioned that in the relevant years with which

we are concerned, the assessee had not actually become the subsidiary of B.L. but for all practical purposes that does not make any material

difference in this case. As a result of winding up, B.L. ceased to be the managing agents of I.G. The assessee-company commenced business on

the 1st January, 1959. For the two years the assessee-company had no secretaries or managing agents though it was claimed on behalf of the

assessee that B.L. was looking after its affairs as the assessee was one of its subsidiaries. On the 29th December, 1960, the board of directors of

the assessee-company passed a resolution approving the execution of the agreement appointing B.L. as secretaries of the company for a period of

five years from 1st January, 1961. It would be necessary to refer to some of the relevant provisions of the said agreement :

2. It is hereby expressly declared that notwithstanding anything contained in this agreement the secretaries shall not at any time during the

currency of this agreement whether subject to the superintendence, control and direction of the board of directors of the company or otherwise

have or be entitled to the management of the whole or substantially the whole of the affairs of the company.

3. The secretaries shall be responsible for the keeping and custody of the books and papers of the company and shall duly make, keep, file or

cause to be made, kept and filed all such registered returns, statements and accounts as under the provisions of the Companies Act, 1956, or any

statutory modification thereof for the time being in force are required to be made, kept and filed by the company or its officers and the secretaries

shall perform all such duties for the company as are ordinarily performed by secretaries.

4. The secretaries may subject to the provisions of Clause 2 hereof in addition to their duties as secretaries of the company perform any other

duties and work for the company as the board of directors of the company may determine.

5. The secretaries shall have power to perform all the duties which may be performed by a secretary under the Companies Act, 1956, or subject

to the provisions of Clause 2(m) hereof in the performance of their duties under this agreement.

6. The secretaries shall be entitled to receive from the company by way of remuneration for its services as secretaries the sum of, or in respect of

any period of less than one calendar month, calculated at the rate of rupees ten thousand per calendar month, such sum being payable in arrear on

the last day of each calendar month.

7. The remuneration payable under Clause 6 hereof shall not be regarded as in any manner or to any extent intended to reimburse the secretaries in

respect of any expenses incurred or to be incurred by the secretaries on behalf of the company and the secretaries, in addition to receiving such

remuneration, shall be entitled to be reimbursed by the company in respect of any expenses incurred by the secretaries on behalf of the company

and sanctioned by the board of directors of the company.

2. It appears that under Clause 6 of the said agreement B.L. became entitled to remuneration of Rs. 10,000 per month and under Clause 7 of the

reimbursement of the expenses incurred by them on behalf of the assessee. In accordance with the agreement the assessee paid Rs. 1,20,000 each

in the calendar years 1961 and 1962, and these items were included as part of debit of Rs. 3,68,946 and Rs. 4,76,025 shown in the assessee''s

balance-sheet for the two years against the head "" Miscellaneous expenses "". In addition to the above remuneration the assessee paid to B.L. sums

of Rs. 41,319 and Rs. 38,991, respectively, for the aforesaid two previous years by way of reimbursement of expenses in respect of various

services rendered by them to the asses see-company.

3. The Income Tax Officer in making the assessment for the relevant assessment years 1962-63 and 1963-64 was of the opinion that the entire

remuneration paid to B.L. should be disallowed in view of the provisions of Section 37 as well as Section 40(c)(i) of the Income Tax Act, 1961.

He held, inter alia :

(i) B.L, rendered various managerial services to the assessee-company and other concerns for which it charged fees. The assessee had paid Rs.

41,319 and Rs. 38,991 to B.L. by way of such fees ;

(ii) The assessee did not, despite several opportunities given, show any satisfactory evidence of the necessity for the appointment of B.L. as

secretaries when there was no such necessity in the earlier years and when it was otherwise being remunerated for services rendered by it ;

(iii) B.L. had not rendered any additional service than in the earlier year and had no responsibility in the management. It was being appointed as

secretaries and remunerated only because it held the majority of the shares in the assessee-company.

4. There was some correspondence with regard to this matter between the Income Tax Officer and the assessee, namely, the assessee''s letter to

the Income Tax Officer dated the 30th October, 1963, the Income Tax Officer''s reply dated 3rd December, 1963, and the assessee''s reply

thereto dated 19th December, 1963. These three letters have been made part of the statement of case in this reference before us. We may shortly

refer to these three letters. By the letter dated the 30th October, 1963, the assessee had written to the Income Tax Officer that no single person in

the office of the secretary devoted his whole time to the secretarial work but the categories of persons mentioned in the said letter rendered their

several export knowledge in the service o! the company as was required, namely, the directors, senior executives, chief accountant, chief personal

officer, junior executive, taxation officer, sales tax officer. On receipt of this letter the Income Tax Officer wrote back on the 3rd December, 1963,

enquiring of the assessee whether apart from specific duties mentioned in the said agreement any other duties were allotted to the secretaries as

part of Clause 4 of the said agreement and if so, to produce the necessary resolution of the board of directors. The Income Tax Officer further

stated that the main duties as under the said agreement were that the secretaries should be responsible for keeping and the custody of the books

and the statutory returns as required under the various provisions of the Indian Companies Act. It was mentioned that separate charges were made

by these secretaries for centralised services rendered by them. The Income Tax Officer enquired whether there were any separate services

rendered by the secretaries for which no separate bill had been submitted. He enquired of the assessee what were the specialised service that was

required of the secretaries. On the 19th December, 1963, the assessee wrote back to the Income Tax Officer setting out the list of specific duties

alleged to have been performed by the secretaries.

5. In view of the aforesaid order of the Income Tax Officer the assessee preferred an appeal before the Appellate Assistant Commissioner. The

Appellate Assistant Commissioner found that the sums of Rs. 31,319 and Rs. 38,991 paid by the assessee to B. L. did not include any element of

remuneration to the directors and senior executives of B.L. and the assessee did not pay any remuneration to its own directors. The Appellate

Assistant Commissioner was of the view that the remuneration paid to B.L. was excessive in terms of Section 40(c) and that it could be fixed at

Rs. 3,000 per month in view, inter alia, of the following facts :

(a) that no remuneration had been paid to B. L. in 1959 and 1960, though there were huge profits and though the extent of reimbursement was

smaller;

(b) that in reimbursing the expenses, the element of services rendered by the staff of B.L. was taken into account and it was only the remuneration

attributable to some supervisory duties or managerial functions that could be allotted to the secretaries ;

(c) that the appellant had no competitors in the market and its high profits were due not to the secretaries but to the monopolistic nature of the

business; and

(d) that B.L. was now getting substantial remuneration as secretaries of there subsidiaries of I,G. whereas they did not get even a fraction of the

remuneration in the past as the managing agents of I.G. The assessee preferred further appeal to the Tribunal. In view of the controversy that has

been canvassed before us, it would be necessary to set out some of the ground3 of appeal before the Tribunal. The grounds of appeal before the

Tribunal, inter alia, were as follows :

(1) that the Appellate Assistant Commissioner erred in upholding the disallowance of Rs. 84,000 out of Rs. 1,20,000 paid as secretaries''

remuneration to Balmer Lawrie & Co. Ltd. ;

(2) on the facts and in the circumstances of the case, the Appellate Assistant Commissioner should have allowed the entire amount of Rs. 1,20,000

and not merely Rs. 36,000 was an admissible deduction ;

(3) that the Appellate Assistant Commissioner''s decision that the sum of Rs. 1,20,000 paid as remuneration to the secretaries is excessive and that

the reasonable remuneration for their services would be Rs. 36,000 is wholly arbitrary and not at all justified having regard to the nature and extent

of the services rendered by the secretaries;.....

(6) that the sum of Rs. 1,20,000 paid to the secretaries in terms of the agreement entered into by the appellant and the secretaries as normal

business appointment was laid out wholly and exclusively for the purpose of the appellant''s business and no part of it was disallowable under the

provisions of Section 40(c) of the Income Tax Act, 1961.

6. It was contended on behalf of the assessee that the provisions of Section 40(c)(i) were applicable only in the case of an individual whether he

was a director or shareholder substantially interested in the assessee-company and had no application where the remuneration was paid or allotted

to corporate entity. It was contended that the reasons given by the Appellate Assistant Commissioner for disallowing a portion of the remuneration

were unsustainable because, inter alia :

(i) in the earlier years B.L. had looked after the assessee''s work as the managing agents of I.G. The assessee was wholly the subsidiary of I.G.

and hence no separate remuneration was paid to B.L.

(ii) That the Appellate Assistant Commissioner erred in saying that only managerial services were rendered by the company whereas in fact their

functions were extensive.

(iii) The assessee had no monopoly in the trade and the large profits were due to the expert services of B.L.

(iv) The fact that B.L. got remuneration from other companies for services rendered to them was irrelevant in judging the remuneration paid by the

assessee-company. Also on the basis of the managing agency agree ment with I.G. it would have been entitled to have in the years under appeal

Rs. 1,34,445 and Rs. 2,19,218 and the remuneration actually paid to them was much less.

7. The Tribunal considered the assessee''s contention that Section 40(c)(i) of the 1961 Act had no application and accepted the said contention.

The Tribunal was of the view that Section 40(c)(i) could not apply to the allowance or remuneration paid to a corporate entity. The Tribunal has

set out its reasons in its order for coming to that conclusion; inasmuch as we are not concerned, for the reasons mentioned hereinafter, with the said

question, it is not necessary for us to refer in detail to the reasonings of the Tribunal on this aspect of the matter. The Tribunal, however, examined

the facts in detail and came to the conclusion that under the terms of the agreement dated the 9th January, 1961, B.L. became only the secretary of

the company as contemplated by the Companies Act. The allocation of duties other than those of the secretaries according to that agreement

would have required the resolution of the company and the Tribunal noted that though opportunity had been given and the assessee was called

upon to produce such a resolution, none was produced. Nor was there any evidence of any additional payments made to B.L. which would have

been consistent with the allotment of additional duties in fact entrusted to them. The Tribunal found that the specialised services as per list given by

the assessee did not amount to any variation of the normal duties of a secretary of a company. It was true, the Tribunal noted, that B. L. was

reimbursed only for the services rendered by its staff but not towards the remuneration paid to its directors and senior executives but the Tribunal

observed that B.L. was having several activities of its own and its directorial and top executive establishment was concerned with its own affairs

and management. The expenses incurred in respect of the services rendered by the several departments of B.L. including those of taxation and

personal officers and the Delhi representative were got reimbursed from the several companies. In fact, the Tribunal found the services of B.L. to

the assessee for which they had to be remunerated under the agreement were in fact only those of a secretary of a company. Having regard to the

facts that B.L. had got much less remuneration in the earlier two years, that their responsibilities as secretary were much less than before and there

was no secretary of the company in the earlier two years, the Tribunal was of the opinion that the remuneration paid from 1961 onwards needed

scrutiny. The Tribunal recorded that there was no evidence to support the assessee''s contention that in the earlier years also B.L. was rendering

services to the assessee as the managing agents of I.G. as claimed by the assessee. The Tribunal also noted that the assessee''s establishment

expenses had increased progressively and the Tribunal had given a break-up of the said increase in its order. The Tribunal referred to the annual

reports of the assessee from which, according to the Tribunal, it appeared that the assessee''s business, whether it was monopoly or not, needed

no special impetus. The remuneration paid to a secretary, according to the Tribunal, should be much less than that paid to the managing agents or

secretaries and treasurers and could be reasonably fixed at Rs. 2,000 to Rs. 3,000 per month. The Tribunal, however, took into account that there

was a company which was acting as the secretary and there were pooled services available. In the premises, the Tribunal fixed the remuneration at

Rs. 5,000 per month. The Tribunal relied mainly on the following factors :

(i) The payment was made to the company which was the assessee''s holding company;

(ii) The services rendered were purely secretarial;

(iii) The services rendered had no direct and immediate impact on the company''s trade or extent of business;

(iv) As the managing agents were doing much heavier work, the payee company did not derive such a large remuneration;

(v) That there were no secretaries in the first two years of the company''s working; and

(vi) B. L. had been engaged as secretaries in the third year of the company''s work while they were on the point of losing their managing agency.

8. For the reasons mentioned in the Tribunal''s order and for the said factors indicated as before, the Tribunal came to the conclusion that the entire

remuneration paid to B.L. was not wholly and exclusively for the purpose of the assessee''s business, tn the premises, the Tribunal disallowed a

sum of Rs. 60,000, namely, Rs. 5,000 per month, for each of the two years under appeal.

9. In the background of the aforesaid facts and circumstances of the case on an application being made, the Tribunal has referred the following

questions at the instance of the assessee :

(1) In the appeal by the assessee against the disallowance sustained by the Appellate Assistant Commissioner of Income Tax u/s 40(c) of the

Income Tax Act, 1961, and without a cross-appeal or cross-objections by the department, and after finding that Section 40(c) was not applicable

was it open to the Tribunal yet to sustain the disallowance partially u/s 37 ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the entire remuneration allowed to the

secretaries was not laid out wholly and exclusively for the purpose of the assessee''s business and in determining the allowable amount of such

remuneration at Rs. 60,000 ?

10. At the instance of the revenue, the Tribunal has also referred a third question, namely :

Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the provisions of Section 40(c) of the Income

Tax Act, 1961, could not be invoked to disallow any portion of the remuneration paid to Messrs. Balmer Lawrie & Co. Ltd. ?

11. The first question with which we are concerned in this case is whether the Tribunal was competent to disallow a portion of the remuneration

paid to B. L. u/s 37 of the Income Tax Act, 1961, in the facts and circumstances of the case. As mentioned hereinbefore, the Income Tax Officer

had disallowed the entire amount both u/s 40(c)(i) as well as u/s 37 of the Act. In appeal from the said order the Appellate Assistant

Commissioner had only relied upon Section 40(c)(i) in making the partial disallowance of the remuneration paid to B. L. In the further appeal the

Tribunal found that Section 40(c) was not applicable in the facts and circumstances of the case because the remuneration was paid to a corporate

entity. The Tribunal, however, on examination of the facts came to the conclusion that the entirety of the remuneration paid was not wholly and

exclusively for the purpose of the assessee"s business and in the premises had disallowed a part It is the propriety and validity of this action that is

in controversy by the first question placed before us. Counsel for the assessee contended that inasmuch as the Appellate Assistant Commissioner

had only relied upon Section 40(c)(i) of the Income Tax Act, 1961, the only question open before the Appellate Tribunal was whether any part of

the allowance was to be allowed or disallowed under the said section ; whether the allowance was to be made or disallowance was to be made

under any other provisions of the Act was not the subject-matter of the appeal before the Appellate Tribunal. In that context, it was contended that

the respondent had got a point in their favour and it was not open to the appellate authority to dislodge the assessee of the point. It was further

contended that it was possible with the leave of the court for an applicant to expand the appeal but the appeal could not be expanded to the

prejudice of the assessee in the manner it had been done. Counsel drew our attention to the provisions of Sections 253 and 254 of -the Act and

contended that the power and jurisdiction of the Appellate Tribunal was to pass such order which it thought fit thereupon and it was contended that

the affect-matter of the appeal was the propriety or validity of allowance u/s 40(c)(i) of the Act and not whether allowance or disallowance could

be upheld on any other provisions of law. In this connection, counsel drew our attention to the decisions in the case of. Indira Balkrishna Vs.

Commissioner of Income Tax, Bombay North, Kutch, Saurashtra, Ahmedabad, , in the case of Puranmal Radhakishan and Company Vs.

Commissioner of Income Tax, Bombay, , in the case of V. RAMASWAMY IYENGAR AND ANOTHER Vs. COMMISSIONER OF Income

Tax, MADRAS., , in the case of F.Y. Khambhaty Vs. Commissioner of Income Tax, Gujarat, and in the case of SETH CHAMPALALji

RAMSWARUP, BEAWAR Vs. COMMISSIONER OF Income Tax, U.P. and V.P., . Reliance was placed on the decision in the case of

Pathikonda Balasubba Setty (Deceased) Vs. Commissioner of Income Tax, Mysore, . These decisions reiterate the principle there that the power

of the Tribunal is limited to the subject-matter of the appeal and the scope of the respondent''s right to support the order appealed from is also

limited. The question, therefore, is what is the subject-matter of the appeal. We have noted the grounds of the appeal before the Tribunal. The

assessee''s grievance before the Tribunal was in fact that as the assessee stated in the grounds of appeal that the Appellate Assistant Commissioner

erred in upholding the disallowance of Rs. 84,000 out of Rs. 1,20,000, so the grievance that was before the Tribunal was the disallowance of the

sum of Rs. 84,000. It is not so much the grounds of disallowance that was appealed from but the factum of disallowance for which the assessee

was aggrieved and that was the subject-matter of the appeal before the Tribunal. If we look at the ground No. 6 it would be clear that the assessee

was contending that the entire expenditure had been wholly and exclusively laid out for the assessee''s business. Therefore, whether that was so or

not was a question canvassed before the appellate authority. This position in our opinion can be examined from the principle of the decision of the

Supreme Court in the case of Commissioner of Income Tax, Madras Vs. Mahalakshmi Textile Mills Ltd., . There what had happened was that the

assessee which had carried on the business of manufacture and sale of cotton yarn, had spent Rs. 93,215 for introduction of "" Casablanca

conversion system "" in its spinning plant. Substantially this involved replacement of certain roller stands and fluted roller fitted with rubber aprons to

the spinning machinery, removal of ring frames from certain existing parts, introduction, inter alia, of ball-bearing, jockey-pulleys for converting the

original band drivers to tape drivers and other additions and alterations in the drafting mechanism. The assessee claimed development rebate on the

ground that introduction of the ""Casablanca conversion system"" involved installation of new machinery and for the first time before the Appellate

Tribunal claimed in the alternative that the amount laid out was in any event expenditure for current repairs allowable u/s 10(2)(v) of the Indian

Income Tax Act, 1922. The Tribunal inspected the factory, studied the working of the machinery and considered the literature of the manufacturers

and held that though the development rebate was not admissible the amount spent was admissible u/s 10(2)(v) since as a result of the stress and

strain of production over a long period there was need for change in the plant and that the assessee had replaced old parts. It was held by the

court that the Tribunal had evidence before it from which it could be concluded that by introducing the "" casablanca conversion system "" the

assessee made current repairs to the machinery and plant and the sum of Rs. 93,215 was allowable as an expenditure incurred for current repairs

u/s 10(2)(v) of the Act. The Supreme Court further held that because the Tribunal rejected the assessee''s claim for development rebate, it was not

bound to disallow the claim of the assessee for allowance of the amount spent, if it was a permissible allowance on another ground. Whether the

allowance was admissible under one head or another of Sub-section (2) of Section 10, the subject-matter of the appeal remained the same and the

Tribunal having held that the expenditure incurred fell within the terms of Section 10(2)(v), though not u/s 10(2)(vib), it had jurisdiction to admit

that expenditure as permissible allowance in the computation of the taxable income of the assessee. The Supreme Court observed that tinder

Section 33(4) of the Indian Income Tax Act, 1922, which is in similar terms to Section 254 of the Income Tax Act, 1961, the Tribunal was

competent to pass such orders on appeal "" as it thinks fit "". There was nothing in the Income Tax Act which restricted the Tribunal to the

determination of the questions raised before the departmental authority. All questions, whether of law or of fact, which related to the assessment of

the assessee might be raised before the Tribunal. If for reasons recorded by the departmental authority in respect of a contention raised by the

assessee, grant of relief to him on another ground was justified, it would be open to the departmental authority and the Tribunal, and indeed they

would be under a duty, to grant that relief. Similarly, if the disallowance of certain expenditure to an assessee was warranted by certain provision of

law where the allowance and disallowance were the subject-matter of the appeal, in our opinion, the Tribunal was competent u/s 254 to deal with

that question and decide the same in accordance with law. Therefore, the first question referred to this court must be answered in the affirmative

and in favour of the revenue.

12. The next question, as mentioned hereinbefore, is directed against the propriety of the Tribunal''s action in disallowing Rs. 60,000 u/s 37 of the

Income Tax Act, 1961. The first contention on behalf of the assessee before us was that Section 37 had no application to the facts of the case. It

was contended that the question of applicability of Section 40(c)(i) would arise only where an expenditure was held to be exclusively and wholly

for the purpose of the assessee''s business. It was, secondly, urged that the question of reasonableness of expenditure or whether the expenditure

was excessive or not was not for consideration u/s 37 of the Income Tax Act, 1961. It was contended further that it was possible if the Tribunal

came to the conclusion that the money was not paid or that the money had not been spent wholly or exclusively for the assessee''s business to

disallow the entire amount spent but it was not within the jurisdiction of the revenue or of the Tribunal to estimate a part of it and disallow a part. In

other words, it was contended that if an expenditure was for the purpose of the assessee''s business, it was not for the revenue to dictate how the

expenditure was to be incurred so long as the expenditure was for the purpose of the assessee''s business. It was the assessee who had to see

what sum was required to be spent for the purpose of the business. Therefore, it was contended that the revenue and the Tribunal had no

jurisdiction at all to determine the reasonableness of the expenditure and to determine whether the sum that was paid was excessive or

disproportionate to the requirement.

13. In this connection we might refer to the relevant provisions of Section 37 of the Act as well as Section 40(c)(i) of the Act.

37. General.--(1) Any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital

expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall

be allowed in computing the income chargeable under the head " Profits and gains of business or profession ".

(2) Notwithstanding anything contained in Sub-section (1), no expenditure in the nature of entertainment expenditure shall be allowed in the case of

a company, which exceeds the aggregate amount computed as hereunder :

(i) On the first Rs. 10,00,000 of the profits and at the rate of 1% or Rs.

gains of the business (computed before making 5,000, which-ever is higher.

any allowance u/s 33 or in respect of

entertainment expenditure)

(ii) On the next Rs. 40,00,000 of the profits and at the rate of Ã¯Â¿Â½%

gains of the business (computed in the manner

aforesaid)

(iii) on the next Rs. 1,20,00,000 of the profits and at the rate of 1/4%

gains of the business (computed in the manner

aforesaid)

(iv) on the balance of the profits and gains of the nil.

business (computed in the manner aforesaid)

40. Amounts not deductible.--Notwithstanding anything to the contrary in Sections 30 to 39, the following amounts shall not be deducted in

computing the income chargeable under the head " Profits and gains of business or profession".--...

(c) in the case of any company--

(i) any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or to a person who

has a substantial interest in the company or to a relative of the director or of such person, as the case may be.....

14. It may incidentally be mentioned that Section 37 is to the same effect as Section 10(2)(xv) of the Indian Income Tax Act, 1922, and Section

40(c)(i) is also to the same effect as Section 10(4A) of the Indian Income Tax Act, 1922. Therefore, in order to be entitled to deduction as

allowance u/s 37 of the Act the expenditure must be laid out wholly and exclusively for the purpose of the business or profession. If it was found

that an expenditure was incurred wholly and exclusively for the purpose of the business then it was not for the revenue to determine the

reasonableness of that expenditure incurred. It was so held in the case of The Newton Studios Ltd., Madras Vs. The Commr. of Income Tax,

Madras, . It was held by the Madras High Court, in that case, that it was not open to the Income Tax authorities to adopt a subjective standard of

reasonableness of the amount paid and in order that an expenditure might be one incurred wholly aud exclusively for the purpose of earning profit,

it was not necessary to show that it was incurred of necessity. It was sufficient if it was incurred voluntarily and on the ground of commercial

expediency and in order to indirectly facilitate the carrying on of the business and the test of commercial expediency was required to be applied to

determine whether the expenditure was wholly and exclusively laid out for the purpose of the business. The reasonableness of expenditure should

be considered from the point of view of the business and not from the point of view of an outsider including the Income Tax Officer. The revenue

had no power to examine what they thought reasonable and to say that the expenditure was necessary. Soon thereafter there was the introduction

of Section 10(4A) of the Income Tax Act and about the scope of the new section, which is in similar terms to Section 40(c)(ii), there are

expressions of judicial opinions. It was held by this court in the case of MERCANTILE EXPRESS CO. (PRIVATE) LTD. Vs.

COMMISSIONER OF Income Tax, CALCUTTA, AND OTHERS., , the effect of Section 10(4A) of the Indian Income Tax Act, 1922, was

given by the Finance Act, 1956. After the introduction of the said sub-section it was for the Income Tax Officer to decide whether remuneration

paid to a director was excessive or unreasonable and if there was no suggestion that the Income Tax Officer had travelled beyond the provisions

laid down in the section, legitimate business needs of the company and the benefit derived by or accruing to the company therefrom and there was

also no suggestion that the decision of the Income Tax Officer was arbitrary or capricious, no question of law could be said to arise from the

decision of the Income Tax Officer for reference to the High Court. This court observed that the result of the introduction of the new section was

to get round the effect of the provision of the previous decision u/s 10(2)(xv) and similar expression used in Section 12(2) of the Indian Income

Tax Act, 1922, reflected in the decision of the The Newton Studios Ltd., Madras Vs. The Commr. of Income Tax, Madras, and Eastern

Investments Ltd. Vs. Commissioner of Income Tax, West Bengal, .

15. In the case of Commissioner of Income Tax, Madras Vs. Raman and Raman Ltd., , the Madras High Court observed that Section 10(4A) of

the Indian Income Tax Act, 1922, was not merely clarificatory of Section 10(2)(xv) as it would come into play even where the expenditure was

wholly and exclusively laid out for the purpose of the business as discretion was given to the revenue to see whether the allowance was excessive

or reasonable in the case of a closed company. u/s 10(2)(xv) there was no discretion, according to the Madras High Court, on the revenue and

once it was shown that a certain amount was wholly and exclusively laid out for the purpose of the business, there was no option for the

department but to grant the allowance.

16. Therefore, it is first necessary in this case to determine whether the expenditure was wholly and exclusively necessary for the purpose of the

business of the assessee. That naturally would depend upon the facts and circumstances of each case.

17. In the case of Commissioner of Income Tax, Bombay Vs. Walchand and Co. Private Ltd., , the Supreme Court observed that in applying the

test of commercial expediency or determining whether an expenditure was wholly and exclusively laid out for the purpose of the business,

reasonableness of the expenditure had to be adjudged from the point of view of the businessman and not of the revenue. It was open to the

Tribunal to come to the conclusion either that the alleged payment was not real or that it was not incurred by the assessee in the character of a

trader or that it was not laid out wholly and exclusively for the purpose of the business of the assessee and to disallow it. But it was not the function

of the Tribunal to determine the remuneration, which in their view, should be paid to an employee of the assessee. An employer in fixing the

remuneration of the employees was entitled to consider the extent of his business, the nature of the duties to be performed and the special aptitude

of the employee, future prospects of extension of the business and a host of other related circumstances. It was erroneous to think that the

increased remuneration could only be justified if there was a corresponding increase in the profits of the employer.

18. Similar views were expressed in the case of J.K. woolen Manufacturers Vs. Commissioner of Income Tax, U.P., . In the case of Bengal

Enamel Works Ltd. Vs. Commissioner of Income Tax, West Bengal, , the Supreme Court observed that where an amount paid to an employee

pursuant to an agreement was excessive because of ""extra-commercial considerations"", the taxing authority had jurisdiction to disallow a part of the

amount as expenditure not incurred wholly and exclusively for the purpose of the business. Indisputably an employer in fixing the remuneration,

according to the Supreme Court, of his employee was entitled to take into consideration the extent of his business, the nature of duties to be

performed, the special aptitude of the employee, the future prospects of the business and other related circumstances and the taxing authorities

could not substitute their own view as to the reasonable remuneration which should have been agreed to be paid to the employees. But the taxing

authority might disallow an expenditure claimed on the ground that the payment was not real or was not incurred by the assessee in the course of

his business or that it was not laid out wholly and exclusively for the purpose of the business of the assessee. According to the Supreme Court

thereby, the authority did not substitute his own view as to how the assessee''s business affairs should be managed, but proceeded to disallow the

expenditure because the condition as to the admissibility was absent. For the assessment years 1951-52 to 1953-54, the appellant-company had

claimed u/s 10(2)(xv) of the Indian Income Tax Act, 1922, deduction of the sums respectively of Rs. 52,947, Rs. 64,356 and Rs. 79,227 paid as

remuneration to one Dr. Ganguly as technical adviser under the terms of a resolution of the board of directors. A sum of Rs. 42,000 per year alone

was allowed and the balance was disallowed on the ground that the payment was influenced by ""extra-commercial considerations"". Dr. Ganguly

and his father-in-law were able to control the voting power in the board of directors. Dr. Ganguly was not trained in the technique of ""enameled-

ware"" and had no special qualification for the post. The remuneration agreed to be paid was much in excess of the amount normally payable and

also of what Dr. Ganguly was earning by practising his profession as a doctor of medicine. It was held by the Supreme Court that the disallowance

of the part of the remuneration was permissible u/s 10(2)(xv) of the Act. The Supreme Court referred to the decision in the case of Swadeshi

Cotton Mills Co. Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh (No. 1), and observed that in computing the taxable income of the

assessee whether an amount claimed as expenditure was laid out or expended wholly and exclusively for the purpose of the business, profession or

vocation of the assessee must be decided on the facts in the light of the circumstances of each case. The resolution of the assessee fixing the

remuneration to be paid to an employee and production of vouchers for payment together with proof of rendering services did not exclude an

enquiry whether an expenditure was laid out wholly and exclusively for the purpose of the assessee''s business. It was still open to the taxing

officers to hold tinder Section 10(2)(xv) of the Act--an agreement to pay and payment notwithstanding--that the expenditure was not laid out

wholly and exclusively for the purpose of business.

19. In this case we have noticed the facts upon which the Tribunal has relied.

20. The validity of the primary facts found by the Tribunal cannot be challenged and have not been challenged before us by the assessee.

Therefore, we must proceed on these facts. These facts were that the payments were made to a company which was the assessee''s holding

company or a company which could influence the assessee''s voting power or decision. This is not in dispute. It was contended that so far as the

Tribunal had held that the services rendered by the assessee was purely secretarial the said conclusion was an inferential conclusion and the same

was open for examination in the frame of the question that has been posed before us. In this connection reliance was placed on the decision in the

case of The Commissioner of Income Tax, Bihar and Orissa, Patna Vs. S.P. Jain, Without entering into any detailed examination of the said

decision we are of the opinion that the inference drawn by the Tribunal on the said agreement is a possible one. The other facts, as mentioned in

the beginning of the judgment, upon which the Tribunal has relied, cannot be termed as irrelevant and are not inferential findings. Therefore, having

regard to the facts and circumstances of the case, if the Tribunal has come to the conclusion that the entirety of the expenditure was not wholly and

exclusively for the purpose of the assessee"s business in view of the principles enunciated by the Supreme Court, we cannot say that such a

conclusion was not either possible in law or was a perverse conclusion on the facts of this case.

21. In this connection, before we conclude, we must note that counsel for the assessee referred us to several decisions on this point, namely, in the

cases of (1) Raman and Raman Ltd. Vs. Commissioner of Income Tax, Madras, Commissioner of Income Tax, Madras Vs. Chari and Chari Ltd.,

, (3) 5. S. Veeraiah Reddiar Vs. Commissioner of Income Tax, Travancore-Cochin, Bangalore, , (4) Craddock (H. M. Inspector of Taxes) v.

Zevo Finance Co. Ltd [1946] 27 TC 267 Sanjeevi and Co., Madras Vs. Commissioner of Income Tax, Madras, , (6) Commissioner of Income

Tax Vs. A.K. Das, , (7) J.R. Patel and Sons (P.) Ltd. Vs. Commissioner of Income Tax, Gujarat, , (8) Walchand and Co. Private Ltd. Vs.

Commissioner of Income Tax, Bombay City I, and (9) Shree Meenakshi Mills Ltd., Madurai Vs. Commissioner of Income Tax, Madras, . In the

view we have taken and the principles enunciated by the Supreme Court as mentioned before, it is not necessary to examine these decisions in

detail.

22. In the premises, question No. 2 must be answered in the affirmative and in favour of the revenue.

23. So far as question No. 3 is concerned, in view of the decision of this court in the case of Commissioner of Income Tax Vs. A.K. Das, , it must

be held that such a question was not competent in the application by the assessee at the instance of the revenue. We, therefore, decline to answer

such a question. In the facts and circumstances of the case, each party will pay and bear its own costs.

R.N. Pyne, J.

24. I agree.