
(1987) 03 KL CK 0044

In the High Court Of Kerala

Case No : Income-tax Reference No's. 105 and 106 of 1981

Commissioner of Income Tax

APPELLANT

Vs

Commonwealth Trust Ltd.

RESPONDENT

Date of Decision : 25-03-1987

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1987) 166 ITR 732

Hon'ble Judges : T. Kochu Thommen, J; K.P. Radhakrishna Menon, J

Bench : Division Bench

Advocate : P.K.R. Menon, for the Appellant; P.S. Narayanan, for the Respondent

Judgement

K.P. Radhakrishna Menon, J.—At the instance of the Revenue, the following questions have been referred for the opinion of this court:

"1. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding that the pension paid to Mr. William Rae is an expenditure wholly and exclusively laid out for the purpose of business ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding that "no other element of personal enrichment or favour or extra-commercial considerations came into play" in the payment of pension to Mr. William Rae and is not the above finding wrong and unreasonable ?

3. Whether, on the facts and in the circumstances of the case, and in view of the dictum laid down in Seshasayee Bros. (Travancore) Private Ltd. Vs. Commissioner of Income Tax, is not the payment of pension merely an ex gratia payment by the assessee-company in consideration of the past services of Mr. Rae to the company ?"

2. Question No. 2 is not framed properly and, therefore, the same has been recast as follows :

" Whether, on the facts and in the circumstances of the case, the Tribunal is right

in law and fact in holding that "no other element of personal enrichment or favour or extra-commercial considerations came into play" in the payment of pension to Mr. William Rae ?"

3. Essential facts required to decide the point arising for consideration are : The assessee is a public limited company. It has been assessed by assigning the status, non-resident. It carries on business in India. It owns six tile factories, a handloom textile unit, a powerloom textile factory and a hosiery factory. It has an office in London. While computing the assessable income for the years of assessment 1969-70 and 1970-71, the assessing authority allowed the claim of the assessee for deduction of a sum of Rs. 18,000 (? 1,000 per year), representing the pension amount paid to one of its former managing directors, Mr. William Rae.

4. On the basis of the information received, the assessments were reopened. While doing the reassessment, the assessing authority disallowed the above payments made to Mr. William Rae for the reason that the payments were not made with the object of facilitating the carrying on of the business of the assessee or as a matter of commercial expediency.

5. The appeal filed against the above order of the assessing authority was dismissed by the Appellate Assistant Commissioner of Income Tax, Calicut, by annexure-B order. The second appeal filed against the order of the Appellate Assistant Commissioner, however, was allowed by the Appellate Tribunal by annexure-C order. The above questions arise out of annexure-C order of the Tribunal.

6. We shall state the law first. Expenditure incurred in connection with payment of pension, gratuities and other voluntary payments to employees are deductible provided it is established that the payments were made for sound commercial purposes and with the object of facilitating the carrying on of the business. The fact that a third party other than the assessee is also benefited by the expenditure would not make it an expenditure not deductible u/s 37 of the Income Tax Act. It should, however, be established that the payment was made in pursuance of a scheme for payment of such amounts, or the payment was made as a matter of practice which affected the quantum of salary of the employee or the employee was having an expectation of getting the said payment. In other words, it should be established that the payment was made as a matter of practice which affected the quantum of salary or there was an expectation by the employee of getting the payment or the said payment was made on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business. (See *Gordon Woodroffe Leather Manufacturing Co. Vs. The Commissioner of Income Tax, Madras*, , *Sassoon J. David and Co. Pvt. Ltd., Bombay Vs. Commissioner of Income Tax , Bombay*, and *Seshasayee Bros. (Travancore) Private Ltd. Vs. Commissioner of Income Tax*,).

7. These tests have to be read disjunctively. (See *Sassoon J. David and Co. Pvt.*

Ltd., Bombay Vs. Commissioner of Income Tax , Bombay,). An assessee will accordingly be declared eligible for the deduction of the payment aforesaid as an expenditure falling u/s 37 provided he successfully establishes any one of the tests mentioned above.

8. It is in this backdrop the point requires to be dealt with. Certain facts are admitted. Mr. William Rae was the managing director of the company till April 5, 1949. From April 6, 1949, to September 30, 1949, he was joint managing director. On October 1, 1949, he retired. Thereafter, it is said, he had been retained as a consultant for one year, on a remuneration of ₹ 250. There is nothing on record to show whether there was any written order appointing him as consultant. On May 9, 1950, the assessee entered into an agreement with Mr. William Rae. As per the agreement, the assessee was bound to pay Mr. Rae an annual fee of ₹ 2,000 which, however, was later reduced to ₹ 1,000. On going through this agreement, the assessing authority opined that in the absence of a scheme for pension to retired directors, the payment could be considered only as an ex gratia payment.

9. It is not disputed, and for that matter it cannot be disputed, that there was no scheme or any practice creating any legal obligation on the assessee to pay any pension or such similar benefits to a managing director on his retirement, while Mr. William Rae was in service. After the retirement of Mr. William Rae, a supplementary pension scheme conferring certain retirement benefits was introduced. This scheme was brought into force with effect from January 1, 1950. Mr. William Rae, therefore, was not eligible to get any benefit under the supplementary scheme also. The assessee, in these circumstances, entered into a separate agreement with Mr. William Rae and got the benefit of the supplementary scheme extended to Mr. William Rae also. To put it pithily, Mr. William Rae was not eligible for pension, going by the schemes aforesaid. The evidence available on record would show that Mr. William Rae, while functioning as managing director or joint managing director, had no expectation of getting the pension. It cannot also be said that the payment was made as a matter of practice which affected the quantum of salary Mr. Rae was receiving while in service. There is also nothing to show that Mr. Rae, as a matter of fact, was receiving a low salary in the expectation of getting pension on retirement. For that matter, there is no evidence to show that this payment was made for the purpose of facilitating the carrying on of the business of the company, or as a matter of commercial expediency.

10. The above position notwithstanding, the Tribunal, we should say, on surmises and conjectures, has found thus :

".....Just because Mr. William Rae had retired from the company's service, it does not mean anything. He perhaps lost his pensionary benefit under the second scheme only because of the delay in the finalisation of the second scheme. And the time-lag between retirement and agreement with Mr. William Rae is not of a long duration. It is only a short period. That goes to show that the

assesses ordinarily might have had intention to give the benefit of pension to Mr. William Rae while in service itself even before retirement, that it was not possible to do it at that time and that, that omission was made good by this agreement. If we view the three documents, the two schemes and the agreement with Mr. William Rae together as a whole, at least one thing becomes clear that it was not a favour done to any particular individual and that it was in the background of a genuine desire to give pensionary benefits to most of its employees that this agreement was entered into. This agreement is only a step in furtherance of that genuine intention of the assessee. The two schemes and the agreement have to be viewed as a single transaction. This agreement has to be construed as a step to complete the scheme of pensionary benefits. That is sufficient to enable the assessee to justify the claim for deduction. From these facts and circumstances, it becomes clear to us that it is a business expenditure because no other element of personal enrichment or favour or extra-commercial considerations came into play."

11. In this connection, it should be remembered that the agreement by which the supplementary scheme granting pensionary benefit to the managing director was extended and made applicable to Mr. William Rae came into being only after the retirement of Mr. Rae. This circumstance would show positively that there did not exist either a practice or a scheme making it obligatory that the assessee should pay a retiring managing director, pension or any other retirement benefits. If that be so, it cannot be said that the payment was made on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business. We, therefore, are of the view that the above findings are liable to be eschewed while considering the point in issue.

12. It is thus clear that the assessee has not been successful in establishing that the payment was made as a matter of practice which affected the quantum of salary or that the employee had the expectation of getting this pension or that the payment was made on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business. We are, therefore, of the view that the assessing authority had rightly held that the pension paid to Mr. William Rae was not an allowable deduction u/s 37.

13. For the reasons stated above, we answer question No. 1 in the negative, i.e., against the assessee and in favour of the Revenue. The other questions do not warrant any answer in the light of the answer given to question No. 1.

14. We direct the parties to bear their respective costs in these tax referred cases.

15. A copy of this judgment under the seal of the High Court and the signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.