
(1989) 11 CAL CK 0030

In the Calcutta High Court

Case No : Income-tax Reference No. 115 of 1981

Commissioner of Income Tax

APPELLANT

Vs

Machine Tools (India) Ltd.

RESPONDENT

Date of Decision : 08-11-1989

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1990) 84 CTR 103 : (1991) 190 ITR 220 : (1990) 53 TAXMAN 57

Hon'ble Judges : Suhas Chandra Sen, J; Bhagabati Prasad Banerjee, J

Bench : Division Bench

Advocate : A.N. Bhattacharjee, for the Appellant; R.N. Dutta, for the Respondent

Judgement

Suhas Chandra Sen, J.—The Tribunal has referred the following question of law u/s 256(1) of the Income Tax Act, 1961 :

"Whether, on the facts and in the circumstances of the case, the amount of Rs. 1,73,440 was allowable as a deduction from the income of the assessee ?"

2. The assessment year involved is the year 1974-75 for which the relevant year of account is the year ending December 31, 1973. The facts as stated in the statement of the case by the Tribunal are as under :

The assessee is a limited company carrying on business in machine tools and other allied products. On October 31, 1973, the board of directors of the assessee-company in their meeting decided to increase the subscribed capital of the company by a sum of Rs. 8,62,250 by issue of 51,735 ordinary shares of Rs. 10 each, in order to ensure that 60% of the increased subscribed capital would be in the hands of the Indian nationals. Evidently, this decision was taken to fulfil the aims and objects of the Foreign Exchange Regulation Bill which was on the anvil and later became an Act of Parliament. On October 31, 1973, i.e., on the same day, the board of directors passed a resolution to create two trusts--one for the benefit of senior employees, i.e., employees drawing monthly emoluments of Rs. 1,300 and over which is known as "MTIPL Senior Officers Benefit Trust", and

the other for the benefit of employees drawing gross monthly emoluments less than Rs. 1,300 and this is known as "MTIPL Employees Benefit Trust". The resolution passed by the board of directors in this behalf is reproduced as under :

"Resolved that a sum of Rs. 500 be and is hereby paid to Mr. K.N. Kapur, Mr. J.R. Bammi and Mr. J. Sanyal to hold, receive and take the same for ever upon the trusts and with and subject to the powers, provisions, agreements and declarations contained in the deed of trust relating to MTIPL Employees Benefit Trust to be entered into between the company of the one part and Mr. K.N. Kapur, Mr. J.B. Bammi and Mr. J. Sanyal, as trustees of the other part, a draft whereof is placed before the meeting and, for the purpose of identification, subscribed by the Chairman hereof."

3. The two trusts came into existence by two respective indentures dated December 17, 1973. Each of the trusts received Rs. 500 as the initial contribution made by the company in accordance with the resolutions already passed by the board of directors. On December 24, 1973, the directors decided to issue further shares in accordance with their earlier resolutions dated October 31, 1973. On the same day, the board of directors resolved that a sum of Rs. 86,220 should be paid as further contribution to each of the two trusts. The following resolution was passed :

"Resolved that a sum of Rs. 86,220 be and is hereby paid to Mr. S.T.B. Daruwala, Mr. E.M. Poonewala and Mr. F.R. Kanga to hold, receive and take the same for ever as trustees upon trust and with and subject to the powers, provisions, agreements and declarations contained in the deed of trust dated the 20th day of December, 1973, relating to the MTIPL Senior Officers Benefit Trust."

4. In consequence of the resolutions the amounts were paid to the two trusts. On the same day, i.e., on December 28, 1973, the trustees of both the trusts passed resolutions that they should purchase ordinary shares from the assessee of the value of Rs. 86,220 by each of them. The shares were accordingly allotted to the two trusts.

5. On the above facts, the assessee claimed before the Income Tax Officer that the trusts were created solely for the assessee's employees and that the contributions made by the assessee to the extent of Rs. 1,73,440 should be allowed as a deduction from out of the assessee's income. The Income Tax Officer, however, disallowed it on the ground :

"The sole purpose of making contribution to the trusts is to enable them to purchase the above equity shares issued by the assessee-company. No evidence was produced to show that any amount was spent by these two trusts for the benefit of the employees. The contribution has not been utilised for the welfare of the employees at all. The expenditure representing contribution to the two trusts was not laid out wholly and exclusively for the purpose of the business carried on by the assessee-company."

6. The assessee went up in appeal before the Commissioner of Income Tax (Appeals) who held :

"The assessee-company, it may be pointed out, did not offer by public issue or by insertion of newspaper advertisements 51,735 equity shares which the company decided to issue in the board of directors" meeting held on December 24, 1973. Out of 51,735 shares issued, the company allotted 25,000 shares to its employees, 9,491 shares to six individuals including five ladies and 17,244 equity shares to the two trusts created during the years. The balance-sheets filed in respect of MTIPL Employees Benefit Trust for the financial years ending March 31, 1974, to March 31, 1977, show that no income was derived by the trust for the first three years, viz., financial years 1973-74, 1974-75 and 1975-76, while for the year ending March, 1977, there was no expenditure in any of the four financial years 1973-74 to 1976-77. The position is more or less similar in respect of the other trust known as MTIPL Senior Officers Benefit Trust."

7. On further appeal, the Tribunal examined the nature and the contribution made by the assessee to the trusts. Ultimately, it recorded a finding of fact that the amount paid by the assessee to the two trusts did not form part of the nucleus of the trusts.

8. The Tribunal next examined the question whether in the light of the above findings, Atherton's case [1925] 10 TC 155 (HL) could apply. It held that Atherton's case would not apply but the facts of the case were more or less similar to those decided by the Bombay High Court. The Tribunal also rejected the contention of the Revenue that the amounts contributed by the assessee to the trusts were only donations. The Tribunal held that the amount was allowable u/s 37 of the Income Tax Act, 1961, on the ground that it was for the purpose of the welfare of its employees, and, therefore, the expenditure was laid out exclusively for the purpose of business. The argument of the Revenue that not a single paisa was actually spent for the employees' benefit and, therefore, it should not be allowed was also rejected. The Tribunal held that it was not for the assessee to find out how the money had been utilised by the party to whom the assessee gave it but it was from the standpoint of the view of the assessee that the allowability of the expenditure was to be decided. Therefore, it was held that the amount of Rs. 1,73,440 should be allowed as deduction from out of the income of the assessee.

9. There are certain unusual features in the trusts that were created, the way the trust funds were given to the trustees and also the manner of investment of the trust funds. The trust deeds have been annexed. The two trust deeds are both dated December 17, 1973.

10. In the second trust deed, the beneficiaries are employees who are drawing gross emoluments of less than Rs. 1,300 per month. The beneficiaries include not only the employees but also their wives, dependent children and also dependent parents and sons' widows. The trust fund that was handed over to

the trustees was Rs. 500 only. It is not clear whether the trustees were employees of the company or in any way connected with the company which was the settlor. But no remuneration has been provided for payment to the trustees,

11. The objects of the trust as set out in Clause (7) are, inter alia :

- (a) payment of tuition and other fees of the beneficiaries ;
- (b) payment of the tuition and other fees charged by the nurseries, schools, colleges or any other institutions imparting any academic, cultural or vocational education or training ;
- (c) payment of tuition fees charged by the tutor for special coaching ;
- (d) meeting the cost of books, stationery, uniforms, etc. ;
- (e) meeting the cost of transport to and from the place of education or training ;
- (f) meeting the cost of boarding and lodging of the beneficiaries in a boarding school and also the cost of meals of non-boarders ;
- (g) meeting the cost of travel in India and abroad for studies of the beneficiaries ;
- (h) establishing modern and general hospitals or clinics for the purpose of practice of modern medicine with up to date facilities ;
- (i) establishing modern and general hospitals and clinics ;
- (j) establishment of centres for advancement of education ;
- (k) setting up of libraries ;
- (l) providing holiday homes and gymnasiums ;
- (m) promoting sports activities like aquatic clubs, golf clubs, hiking clubs, flying clubs and other sports clubs.

12. The first trust is for the benefit of the employees drawing gross emolument of Rs. 1,300 per month or more. The terms and conditions of the second trust are similar to those of the first trust and the object clause of the trust deed contains more or less similar objects of charity. No remuneration has been provided for the trustees and it is not clear from the trust deed or from any other document whether the trustees were employees of the company or in any way connected with the company.

13. The assessee-company has paid a total amount of Rs. 1,73,440 to the two trusts. The amount has been allowed as deduction. The question is whether such deduction is permissible.

14. On behalf of the assessee, it has been contended that the two trusts were set up for the welfare of the employees of the company. The company has given money to these two trusts. The money will be utilised for the benefit of the employees of the company. There is no reason to disallow these expenditures as

deduction from the income of the assessee in the relevant year of account.

15. The facts of the case go to show that the assessee-company was what is known as a FERA company. It had to dilute its shareholding as a result of the amendment made in Section 29 of the Foreign Exchange Regulation Act. The Tribunal has taken note of the fact that the decision to increase share capital in the hands of the Indian nationals was taken to fulfil the aims and objects of the FERA Bill which was on the anvil and later became an Act. On October 31, 1973, the board of directors decided to increase the subscribed capital of the company by a sum of Rs. 8,62,250 by issue of 51,735 ordinary shares of Rs. 10 each. On the very same day, the board passed a resolution to create two trusts for the benefit of the employees.

16. Both the trusts came into existence by deeds dated December 17, 1973. On December 24, 1973, the directors decided to issue further shares in terms of their earlier resolution dated October 31, 1973. On the very same day, the board resolved that a sum of Rs. 86,220 should be paid as further contribution to each of the two trusts. On the same day, that is, on December 24, 1973, the trustees of both the trusts passed a resolution to the effect that they should purchase ordinary shares from the assessee of the value of Rs. 86,220. The assessee-company did not make any public issue or insertion in the newspaper advertising the sale of 51,735 equity shares. The shares were allotted to various parties including the two trusts. On December 24, 1973, the capital fund of the two trusts was Rs. 500 each. The company not only decided to allot shares to the two trusts but also by a resolution decided to provide the trusts with the purchase price of the shares. There is considerable force in the point made by the Income Tax Officer that the money was given to the two trusts only for the purpose of purchasing shares of the company. There is also substance in the contention made before the Commissioner of Income Tax and also the Tribunal that nothing was really spent for charity. The charitable objects could not be fulfilled by allotment of the shares. The company provided money to the trustees only for the purpose of purchasing shares of the company. The facts of the case go to show that on December 24, 1973, the company decided to increase its share capital, allot the shares to certain specified parties including the two trusts and also decided to give monies to the trustees for purchasing the shares. On that very date, the trustees decided to invest these monies in the shares of the settlor company itself.

17. The Tribunal overlooked this aspect of the matter altogether. Whether the money was spent for the welfare of the employees directly or indirectly or whether the object of creating the two trusts was really to retain control over the shares of the company and at the same time comply with the FERA regulation is a matter that should have been investigated in greater detail. But this was not done. However, no specific question has been raised challenging the decision of the Tribunal in this regard. The only question that has been raised was whether the amount was allowable as a deduction. In view of the inferences of fact that

have been drawn by the Tribunal which are not under challenge, the answer to the question must be in the affirmative and in favour of the assessee. The Tribunal has come to the conclusion that the expenditure incurred by the assessee was for the purpose of welfare of its employees. The Tribunal held: "To keep the employees loyal and also make them work sincerely it is necessary for the assessee to look to their welfare. It is for the purpose of their welfare that the assessee contributed the amounts and, therefore, there is a close nexus and an intimate connection between the expenditure incurred by the assessee and business expediency".

18. In view of these findings of fact which are not under challenge, the question is answered in the affirmative and in favour of the assessee.

19. There will be no order as to costs.

Bhagabati Prasad Banerjee, J.

20. I agree.