

(1997) 10 MAD CK 0079
In the Madras High Court
Case No : Tax Case No. 371 of 1984

Commissioner of Income Tax

APPELLANT

Vs

P. Ramajayam

RESPONDENT

Date of Decision : 22-10-1997

Acts Referred:

Income Tax Act, 1961 — Section 17, 28, 56

Citation : (2004) 186 CTR 477

Hon'ble Judges : P. Thangavel, J; N.V. Balasubramanian, J

Bench : Division Bench

Advocate : C.V. Rajan, for the Appellant; None, for the Respondent

Judgement

N.V. Balasubramanian, J.—The following question of law has been referred to this Court by the Tribunal, Madras at the instance of the Revenue u/s 256(1) of the IT Act, 1961 :

"Whether, on the facts arid in the circumstances of the case, the Tribunal was right in holding that the agreement between the assessee and M/s Bata India Ltd. was not a mere contract of employment or a contract of service simpliciter but was a contract also for service and while the fixed salary was referable to the assessee's role as an employee, the commission and profits on repair and pedicure section contemplated in the agreement did not fall to be charged under the head "salaries" but under the head "Income from other sources" and therefore, the claim of the assessee for deduction of a sum of Rs. 11,450 being expenses incurred against the commission receipts from M/s Bata India Ltd. was allowable ?"

2. The assessee was engaged by M/s Bata India Ltd. under an agreement dt. 21st Dec., 1978, as manager of a retail shoe store of the company along with the repair and pedicure organisation in Coimbatore. The agreement designates the assessee as an employee and under the terms of the agreement, he was entitled to a fixed salary of Rs. 101 per week arid a commission on the retail sales

effected through the shoe staff at the rate of 1.60 per cent on shoes, accessories, toys, umbrella and banians. During the accounting year relevant for the asst. yr. 1981-82, the assessee received from his employer, the following amounts :

Rs. Salary 13,859 Commission 21,987 Dearness allowance 1,775 Bonus 3,363
AECD refund 146 Interest on loan account 720 Interest on AECD refund 16
41,866

The assessee, during the course of assessment proceedings for the asst. yr. 1981-82 claimed before the ITO that he has incurred the following expenses to earn the commission of Rs. 21,987 :

Rs. Advertisement 4,250 Small gifts to children (customers) 1,115 Taxi/
autorikshaw charges 4,865 Sweets to children 710 Telephone charges 310
Miscellaneous expenses 200 Total 11,450

The assessee contended before the ITO that only the net commission, after deducting the expenses of Rs. 11,450 should be assessed to tax. The ITO declined to allow the same on the ground that the agreement entered into between the assessee and M/s Bata India Ltd. was only a service agreement and the commission received by the assessee from his employer is a part and parcel of the salary received. The ITO was of the view that the commission was given by way of incentive to the assessee to sell more products of the company. He relied upon the salary certificate issued by the employer which showed that the commission received was salary. The ITO also examined the terms. of the agreement and came to the conclusion that the commission received by the assessee constituted a major portion of the remuneration paid and the salary paid to the assessee was very much on the low side. He further held that the assessee claimed the expenditure as deduction which were incurred without the approval from the employer as under Clause 21 of the agreement, if the assessee has done any work other than the duties assigned to him by the employer, he will not be entitled to any remuneration for the same. He, therefore, concluded that the commission received by the assessee was liable to be assessed under the head, "salary" and negated the claim of the assessee to deduct the expenditure from the amount of commission received.

3. The assessee preferred an appeal before the AAC. The AAC came to the conclusion that as per the service agreement entered into between the assessee and the employer, the assessee drew more amount as commission than his salary. The AAC, therefore, came to the conclusion that the assessee had to incur extra expenses and bestow more attention in improving the sales in the branch in which he was appointed as manager, The AAC, following the order of the Tribunal in the case of Rajendran v. ITO, held that even treating the commission as salary, the expenditure incurred by the assessee has to be taken into account, and it is only the net salary after deduction of the expenses incurred by the assessee in the business of the employer that was liable to be assessed. He,

therefore, directed the ITO to recompute the assessable commission after granting a deduction for a sum of Rs. 11,450 as claimed by the assessee.

4. Aggrieved by the order of the AAC, the Revenue preferred an appeal before the Tribunal, Madras. The Tribunal examined the terms of the agreement entered into between the assessee and the company, viz., M/s Bata India Ltd. and after examining the relevant clauses of the agreement, it came to the conclusion that the agreement entered into between the assessee and the company was not a mere contract of employment but was a contract for service. The Tribunal, therefore, held that the amount received by the assessee as salary would be taxable under the head "salary" but the amount received towards commission and profits on repair and pedicure section contemplated in the agreement was not liable to be charged under the head "salary", but charged either under the head "Income from business" or under the head "Income from other sources". In this view of the matter, the Tribunal held that the assessee would be entitled to deduct all expenditure incurred for earning the amount in arriving at the income of the assessee. The Tribunal thus upheld the order of the AAC allowing the deduction to the assessee.

5. The Revenue has come before us challenging the order of the Tribunal by seeking reference u/s 256 of the IT Act, 1961, and the question of law set out earlier has been referred to us.

6. Mr. C.V. Rajan, learned counsel for the Revenue submitted that the assessee was only an employee and the various clauses in the agreement clearly show that the assessee was only an employee entitled to receive a fixed salary and the commission received by him would partake the character of salary. He, therefore, submitted that the assessee was not entitled to the deduction from the salary income and apart from the deduction specifically provided by the Act, the assessee was not entitled to claim any other deduction. He relied upon a decision made by this Court in TC No. 131/97 dt. 22nd July, 1997, and submitted that the assessee was not entitled to the deduction of expenditure claimed. Learned counsel for the Revenue placed reliance on the decision of the Supreme Court in Gestetner Duplicators Pvt. Ltd. Vs. Commissioner of Income Tax, West Bengal, and submitted that the commission received by the assessee was salary. He submitted that to determine whether a person is an employee or an agent, it is necessary to find out the nature of the control and if the employer exercises a greater amount of direct control over the person employed, then the person can be regarded as . an employee. He, therefore, submitted that the terms of the agreement clearly show that the company had exercised control over the activities of the assessee as an employer and the assessee should be regarded only as an employee of the company.

7. The assessee was served, but there is no representation for and on behalf of the assessee.

8. We heard the arguments of the learned counsel for the Revenue, Mr. C.V.

Rajan and perused the records carefully. The question whether the commission received by the assessee is assessable under the head "Income from salary" or under the head "Income from business" or under the head "Income from other sources" has to be decided on the basis of the agreement entered into between the assessee and M/s Bata India Ltd.

9. As already stated, the relevant terms of the agreement have been reproduced in the order of the Tribunal. The agreement provides that the engagement shall commence from 21st Dec., 1978, until it is determined as hereinafter provided. The agreement also provides that the employee shall get a fixed salary and will be entitled to commission on retail sales effected under prescribed percentage on the sale of the shoes, accessories, toys, umbrellas and banians. The assessee was also entitled to profit of the repair work, provided he contributes to the company his share of 10 per cent of the turnover of the repair work. The assessee was also entitled to profit in the pedicure sector turnover. The agreement also stipulates that the assessee will be entitled to draw 100 per cent of his fixed salary and 90 per cent of the estimated commission less his contribution towards provident fund at the rate of 8 per cent on Income Tax quantum as indicated in the data sheet through the fortnightly statement, irrespective of his achievement. The agreement stipulates that if the assessee's estimated income falls short of 90 per cent of the estimated commission for no fault or negligence on his part, the company agreed to pay him up to 90 per cent of the estimated commission.

10. It is not necessary to refer to all the clauses, but it is necessary to notice that out of the sales proceeds achieved by the shop, the assessee has to meet all recurring charges and expenses necessary for carrying on sale of the shoes and other goods in the said shoe stores as well as for repair of footwear and for all pedicure jobs. The ratio of expenses to sales applicable to shoe stores is also mentioned in the agreement and the agreement also stipulates that the assessee shall pay from the sale proceeds, the salary approved by the company and the assessee shall maintain all such registers as contemplated by law from time to time. The agreement also provides that if at the end of the assessment, the expenses incurred by the assessee in the shop exceeds the prescribed ratio, the assessee should represent the case to the company supported by expense vouchers for the purpose of compensation, and if the shop manager approves the said expenditure, he will be entitled to the reimbursement of the expenditure. Otherwise, his compensation claim will not be paid. The agreement also provides that in case of any deduction in the amount of compensation claimed, the shop manager will be informed of the disapproval of the vouchers and the reasons therefor. The assessee was made responsible to properly look after the stock of shoes and other goods including furniture fittings and customer's articles as well as the advertisement accessories, etc. If there is any "dead stock" in the shoe stores due to unpopularity of designs or improper fittings, the same will be cleared at the instructions and cost of the company. But, if the articles were retained in spite of the manufacturing defects beyond a period of four weeks

from the date of delivery, the assessee was made responsible for the same, and such stock will be cleared by the assessee on his own account. The assessee was made responsible for the goods found in the store due to improper and negligent handling by the employee or other assistant. He is made responsible for the safe custody and good condition of all stocks, shoes and other goods, sale proceeds and other assets and properties of the company, etc. The agreement also stipulates that the assessee will have the general control over the said shoe stores and repair and pedicure organisation and all staff employed in the said shoe stores and repair and pedicure sections will be the employees of the company, but the assessee is authorised to employ cobblers as independent contractors in the attached repair shops. If there is any loss in the stores or in the repair and pedicure sections by fire, theft, burglary or breakage of plate glass, the assessee should investigate the matter immediately and settle the amount of loss estimated by local authorities. The assessee was obliged to furnish to the company all particulars about the fire, theft, burglary, etc. and he will be responsible if the company is of the opinion that such fire, theft, burglary or breakage had happened owing to the negligence or carelessness on the part of the assessee or any person acting under him.

11. The terms of the agreement clearly show that the assessee had to incur certain expenditure in carrying out the obligations under the agreement and for earning the commission, and the company prescribed a limit for the expenditure to be borne by the company and if there is any excess expenditure, it has to be borne by the assessee personally subject to the condition that the company may approve the expenditure if they are supported by proper vouchers. He is also entitled to the profits on the repair work and pedicure turnover except for sharing a percentage thereof with the company. He is also entitled to share the expenditure with the company. The assessee is made in charge of the stock of goods, furniture and other things and any loss incurred has to be shared by the company and the assessee equally i.e., 50 per cent each. The assessee was given a control over the shoe stores and repair and pedicure sections and he was also authorised to engage cobblers as independent contractors. He was made personally liable to bear the losses for the damages if the company is of the opinion that the loss had been incurred due to any negligence or carelessness on the part of the assessee or any person working under him. The terms of the agreement clearly provide that the assessee is functioning in dual capacity, one as an employee and another under a contract for service. If the agreement is regarded as a contract for service, the assessee would not have been made to bear the expenditure and would not have been made to bear the loss suffered or damages. The assessee was given the control over the shoe stores and repair organisation and that clearly shows that the nature of the control over the assessee by the company is not so great to term him as employee of the company and we are of the opinion, he functioned as an independent contractor. The Tribunal, after considering the terms of the agreement, has come to the conclusion that the contract entered into between the assessee and the company

consists of two parts, viz., (1) contract of service, and (2) contract for service. In our view, the view of the Tribunal that the assessee had entered into a contract for service is a reasonable one and is in accordance with the decision reported in the case of *Simmons v. Health Laundry Co.* 1910 (1) KB 543. On the facts and circumstances of the case, the Tribunal has applied the correct law and has come to the conclusion that the contract entered into between the assessee and the company was not a pure contract of employment, but it is also a contract for service.

12. The question whether it is a contract of service or contract for service is the subject-matter of consideration in several decisions. It is necessary to refer to only two decisions in this context. In the case of *Commissioner of Income Tax, Uttar Pradesh Vs. Manmohan Das (Deceased)*, , the apex Court, after considering the decision of the Supreme Court in the case of *Dharangadhara Chemical Works Ltd. Vs. State of Saurashtra*, and the decision reported in the case of *Simmons v. Health Laundry Co.*, held that it is necessary in each case to determine what is the nature and extent of the control to establish the relationship of employer and employee. The nature of control with reference to the relationship varies from business to business and it is incapable to define with precision the nature of control required to establish the relationship of employer and employee. As pointed out in *Simmon's* case, cited supra, the greater the amount of control exercised over the person rendering the services by the person contracting that is a good ground to hold that it is a contract of service. The above proposition of law has been followed by this Court in the case of *CWT v. V.D. Ramalingam* (1995) 216 ITR 566.

13. Applying the principles of law laid down by the apex Court as well as this Court, we are of the opinion that the assessee in the instant case has a greater freedom in his activities and there is a minimum control by the company over the activities of the assessee. The services rendered in the pedicure organisation by the assessee can be regarded as being discharged in his capacity as an employee. The Tribunal, after considering the terms of the agreement, has come to the conclusion that the assessee has served in dual capacity, one as an employer and another under a contract for service. We do not find any reason to differ with the view expressed by the Tribunal and the salary amount received by the assessee from his employer should be, and was rightly assessed under the head "salary". Insofar as the amount of commission received by the assessee from the company is concerned, we are of the opinion that the commission arose as a result of the contract for service entered into by the company with the assessee. If it is a commission not referable to the assessee's role as an employee, in our view, the commission could be treated as assessable under the head "Income from business" or under the head "Income from other sources" and the Tribunal has found that there was no necessity on the part of the company to recover the expenditure claimed by the assessee. The Tribunal has come to a right conclusion that the assessee was entitled to deduction for all expenditure claimed in earning the commission and it is deductible for arriving at

the true income of the assessee. In this view of the matter, we answer the question of law raised before us in this case in the affirmative and against the Revenue. No costs.