
(1958) 02 PAT CK 0002

In the Patna High Court

Case No : Misc. Judl. Case No's. 679 and 680 of 1955

Dharamvir Dhir

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 12-02-1958

Acts Referred:

Income Tax Act, 1961 — Section 10(2)(iii), 10(2)(xv), 66(2)

Citation : AIR 1958 Patna 325 : (1959) 35 ITR 769

Hon'ble Judges : V. Ramaswami, C.J.; R.K. Choudhary, J

Bench : Division Bench

Advocate : S.N. Dutta and Shankar Kumar, for the Appellant; Tarkeshwar Prasad, for the Respondent

Judgement

V. Ramaswami, C.J.—In Miscellaneous Judicial Case No. 679 of 1950 the assessee is Sri Dharamvir Dhir. who carries on the business of coal-raising under an agreement with the Bengal Nagpur Coal Company limited. The assessment year is 1947-48 and the accounting year is from 1-1-1946, to 31-12-1946. The assessee is an employee of Messrs. Karamchand Thapar and Brothers Limited, and for the accounting year he was paid a salary of Rs. 10,572/-. The assessee had also an income to the extent of Rs. 500/- from certain shares in joint Stock Companies.

The contract for raising coal is dated 20-12-1945, but the assessee actually commenced the business of coal raising from 1-1-1946. There was an agreement between the assessee and the Mohini Thepar Charitable Trust (hereinafter called the trust) on 25-2-1946, by which the Trust agreed to advance to the assessee a sum of Rs. 1 1/2 lakhs on payment of interest at the rate of 6 per cent per annum and also an additional amount equal to 11/16th of the profit. The terms of the agreement are contained in a letter dated 25-2-1946, written by the assessee to the Board of Trustees. The letter of the assessee reads as follows:

"(1) That the trust would finance me up to Rs. 1 1/2 lakhs to enable me to carry on the said coal-raising contract business taken by me from Bengal Nagpur

Company Limited. -

(2) That the coal raising contract would be carried in accordance with the policy from time to time mutually agreed upon between me and the Managing Trustee of the Trust and that no change or deviation therein would be permitted to be made by me without a previous consent of the said Managing Trustee and all monies lent and advanced under this arrangement shall be spent solely for this business.

(3) That the trust shall be at liberty to call back the money at any time due and outstanding from me and to stop further finances on giving me a week's notice and in case of breach of terms and conditions of the loan forthwith.

(4) That notwithstanding the limit of Rs. 11/2 lakhs fixed for the total maximum amount of advance it will be at the absolute discretion of the trust to withdraw the facility and stop future advances on giving one week's previous notice and in case of breach of any of the terms and conditions of the loan, without any such notice.

(5) That the trust would not be responsible for any losses or damages that may be sustained or incurred by me in respect of the said contract. The responsibility of such losses etc. will be exclusively mine.

(6) That the trust would be supplied with monthly statement of accounts supported by vouchers. The accounts will be audited by a firm of Auditors to be nominated by the trust.

(7) That in consideration of the trust having agreed to finance my said contract business up to Rs. 1 1/2 lakhs I have agreed to pay to the Trust interest on the amount from time to time owing to the trust in respect of the monies to be advanced as above at the rate of 6% per annum in addition to a sum equivalent to 11/16th of the net profits of this business of mine.

(8) That all stores, stocks in trade, out-standings and book debts and other assets in the above business both present and future shall stand charged and be a security for due repayment of the monies due to the trust in respect of principal and interest and/or otherwise under this arrangement.

(9) I shall, whenever required by the Trust execute an irrevocable power of Attorney in favour of the Trustees authorising them to collect all the bills due from the Bengal Nagpur Coal Company Limited under the said coal raising contract or due from other parties relating to sale of coal and further authorising them to demand, sue and prosecute all actions, suits or proceedings and to recover and receive, give effectual receipts for the amounts of bills due from Bengal Nagpur Coal Company Limited or from other parties".

The trust was created on 18-6-1940 by L. Karamchand Thapar, who was the settlor and at the same time the managing trustee. It was claimed by the assessee that a sum of Rs. 72,963/12/- was paid out of the profits of the coal

raising business to the managing trustee in terms of Clause (7) of the agreement. The claim of the assessee was based on Section 10 (2) (iii) of the Income Tax Act as interest payable to the trust on monies borrowed for the purpose of the business, and an alternative claim was also put forward that the amount represented partly interest and partly expenditure incurred wholly for the purpose of the business u/s 10 (2) (xv) of the Income Tax Act.

The claim was disallowed by the Income Tax Officer on the ground that the agreement was not genuine and bona fide and that it was not prompted by ordinary business consideration. The assessee took the matter in appeal to the Appellate Assistant Commissioner, but the appeal was dismissed and the Appellate Assistant Commissioner confirmed the order of the Income Tax Officer, holding that the "interest" claimed by the assessee worked out to 409.1 per cent and not 50 per cent as stated by the Income Tax Officer and there was no justification for stipulating such an absurdly high rate of interest.

The assessee took the matter again in an appeal to the Appellate Tribunal, but the Appellate Tribunal dismissed the appeal, holding that the amount of Rs. 72,963/- was only a share of profits and that the amount could not be taken as expenditure laid out wholly and exclusively for the purpose of the business.

2. u/s 66 (2) of the Income Tax Act the Appellate Tribunal has submitted the following question of law for the opinion of the High Court:

"Whether on the facts and circumstances of this case Rs. 72,963/12/- was a revenue expenditure deductible u/s 10 (2) (iii) or u/s 10 (2) (xv) of the Indian Income Tax Act?"

3. In Miscellaneous Judicial Case No. 680 of 1955 the material facts are the same, but the figures are different. The assessment year is 1948-49 and the accounting year is the period from 1-1-1947, to 31-12-1947. The amount of profit paid by the assessee to the trust for this year is Rs. 76,526/-. In this case also the question of law submitted by the Appellate Tribunal u/s 66(2) of the Income Tax Act is in the following terms:

"Whether on the facts and circumstances of this case Rs. 76,526/1/3 was a revenue expenditure deductible u/s 10(2) (iii) or u/s 10(2) (xv) of the Indian Income Tax Act?"

4. In the course of hearing of these references Mr. S. N. Dutta on behalf of the assessee did not submit that the amounts in question could be deducted under the provisions of Section 10(2) (iii) of the Income Tax Act, but the learned Counsel pressed the argument that the amounts should be deducted u/s 10(2) (xv) as expenditure incurred by the assessee wholly and exclusively for the purpose of the business. The opposite viewpoint was presented by Mr. Tarkeshwar Prasad appearing on behalf of the Income Tax Department.

It was submitted that the payment of the amounts by the assessee was tantamount to sharing of profits and was not expenditure exclusively incurred for

the purpose of the business of the assessee. The question at issue, therefore, is -- what is the real nature of the transaction? Is it a contract for mere division of profits between the assessee exclusively for the purpose of business before the divisible profits are ascertained? The question at issue is one of substance and not one of form. I think that the answer to the question must depend on the language of the contract and the circumstances of each particular case and the question must also be determined on principles of ordinary commercial trading.

In the present case it is manifest from the terms of the agreement that the managing trustee is in a dominating position. It is expressly provided in Clause (3) that the trust shall be at liberty to call back the money at any time and to stop further finances on giving a week's notice. Under Clause (4) it is in the absolute discretion of the trust to withdraw the facility for credit and to stop future advance after giving a week's notice. Clause (8) provides that all stores, stock-in-trade, outstanding and book debts and other assets in the business shall stand charged and be a security for due repayment of the monies due to the trust.

Clause (5) states that the trust would not be responsible for any losses or damages sustained by the assessee in respect of the coal raising contract. It is also mentioned by the Appellate Tribunal in the statement of the case that the average amount of the loan advanced by the trust was Rs. 18,100/- and against a loan of such an amount it is absurd to make payment of a sum of Rs. 72,963/- in addition to Rs. 1,086/-. The payment of this amount would work out at more than 400 per cent of the capital advanced, and the principle of ordinary commercial trading would not countenance such an excessive payment.

In the course of hearing Mr. S. N. Dutta on behalf of the assessee said that the calculation of the Appellate Tribunal was wrong and that the average amount of capital provided by the trust for the accounting year was Rs. 44,192/-. Such an argument was apparently not advanced when the case was heard before the Appellate Tribunal and it is expressly stated by the appellate Tribunal in the last paragraph of the statement that the parties agreed that all the facts had been correctly stated in the case and there was no omission of any material fact. It is not, therefore, possible to accent the figure given by learned Counsel in the course of argument.

Even assuming that the figure given by learned Counsel is correct, the amount of profit paid works out at more than 170 per cent, which cannot, therefore, be said to be a proper payment in a commercial sense. It is also necessary to mention that the assessee was an employee of Messrs Karamchand Thapar and Brothers Limited and was receiving a remuneration of Rs. 10,000/- a year. I have already said that Karamchand Thapar was the settlor and at the same time was the managing trustee of Mohini Thappar Charitable Trust.

Having regard to the relationship between the parties and having examined the clauses of the agreement of the 25th February, 1946 between the assessee and

the board of trustee, I am of opinion that the real legal position in this case is that there is a joint adventure between the parties, a quasi-partnership which falls something short of partnership -- and that the arrangement between the parties was that the amount of profits should be ascertained and then they shall divide it up in certain specified proportions.

In such a case there is no payment amounting to business expenditure falling within the ambit of Section 10 (2) (xv) of the Income Tax Act and the payment of 11/16th of the profits under Clause (7) of the agreement to the trust by the assessee cannot be held to be expenditure solely and exclusively for the purpose of the business within the meaning of Section 10 (2) (xv) of the Income Tax Act. The view that I have taken as to the construction of the contract between the parties is borne out by a decision of the Judicial Committee in a similar case, the AIR 1931 165 (Privy Council) .

In that case the French Colonial Government had agreed to contribute land free of charge to the Pondicherry Railway Company to construct a railway and to pay it a subsidy and the Pondicherry Railway Company in turn covenanted to pay to the French Colonial Government a share of the profits. It was argued before the Judicial Committee on behalf of the Pondicherry Railway Company in that case that inasmuch as the Pondicherry Railway Company as a condition of making any profits must pay over one half of them to the French authorities and could never itself reserve the whole profits, the payment so made was of the nature of a rent payable by the company or a charge on the undertaking.

The argument was rejected by Lord Macmillan, who took the view that the contract between the parties showed that the French Colonial Government shall "participate in the success of the undertaking" and that any deduction by the company of what it pays to the French Colonial Government was not permissible. The material facts in the present case are of similar character.

5. The same principle has been reiterated by the Judicial Committee in the THE INDIAN RADIO AND CABLE COMMUNICATIONS COMPANY, LTD. Vs. THE COMMISSIONER OF INCOME TAX, BOMBAY PRESIDENCY and ADEN., .

In that case the appellant Company carried on in India the business of communication by wireless, while another company (the Communications Company) controlled two companies which carried on the business on communication by cable. It appears that the appellant company and the Communications Company entered into an agreement to the effect that their business in India should be combined and conducted by the appellant Company for a certain number of years. The communications company agreed to deliver all the plant, machinery, fittings etc., of their business in India to the appellant Company to be used by the latter during the period of the agreement and the latter agreed to pay one-half of its net profits for each of its financial year to the Communications Company.

It was held by the Judicial Committee in these circumstances that the half share

of the net profits payable by the appellant company to the Communications Company under the agreement was not of the nature of rent but was in truth payable as part of the consideration in respect of a number of different advantages which the appellants derived from the agreement. It was also observed by the Judicial Committee that the agreement was more like one of a joint adventure for a term of years than a lease and that the share of the profits thus paid by the appellant company was, therefore, not allowable as expenditure incurred solely for earning profits in assessing the income of the appellant company for purposes of Income Tax.

At page 277 (of ITR): (at pp. 192-193 of AIR) of the report Lord Maugham has stated as follows :

"Their Lordships have had the advantage of a learned argument on behalf of the appellants; but they have found themselves unable to come to a conclusion different from that of the High Court. It may be admitted that as Mr. Lister contended, it is not universally true to say that a payment the making of which is conditional on profits being earned cannot properly be described as an expenditure incurred for the purpose of earning such profits. The typical exception is that of a payment to a director or a manager of a commission on the profits of a company.

It may however, be worth pointing out that an apparent difficulty here is really caused by using the word "profits" in more than one sense. If a company having made an apparent net profit of ₹10,000 has then to pay ₹1,000 to directors or managers as the contractual recompense for their service during the year, it is plain that the real net profit is only ₹9,000. A contract to pay a commission at 10 per cent, on the net profits of the year must necessarily be held to mean on the net profits before the deduction of the commission, that is in the case supposed, a commission on the ₹10,000.

Their Lordships do not think that there is in the present case any sufficient ground for holding that the sum in question is of the nature of a rent. It is neither described as a rent, nor does the agreement contain several of the clauses which a lease of plant of such a character would naturally contain. Circumstances of greater importance are that the sum payable may be small or great or nothing a most unusual feature in the case of rent -- and that it is impossible to presume or infer that the half share of profits is being paid only as rent, or as a similar payment in consideration merely of the use of the plant the subject of the licence in Clause 3 of the agreement.

The sum is in truth made payable as part of the consideration in respect of a number of different advantages which the appellants derive from the agreement and not all of them can be shown to be of a purely temporary character. The agreement as a whole is much more like one for a joint adventure for a term of years between the appellant company and the communications company than one for a lease for that period. Speaking generally, receipts in respect of business

emanating from abroad are to be retained by the Communications Company while receipts arising in India are to be retained by the appellants and that irrespective of whether the messages are sent by cable or by wireless; and the net profits of the appellant company are to be divided.

Nor it is wholly immaterial to note that at the date of the agreement the appellant company was, and that it apparently still is, _ in some measure controlled by the Communications Company"".

6. Counsel for the assessee relied in support of his argument upon COMMISSIONER OF Income Tax, BOMBAY PRESIDENCY Vs. TATA SONS LTD., . In that case the assessees, namely, Tata Sons Limited, were the managing agents of Tata Iron and Steel Company Limited, and were entitled under their managing agency agreement to receive a commission based on profits. In the year 1924, Tata Iron and Steel Company Limited were in urgent need of funds. The assessees found a financier in Mr. Dinshaw and an agreement was entered into between the assessees, Tata Iron and Steel Company Limited and Mr. Dinshaw by which Mr. Dinshaw agreed to lend a crore of Rupees to Tata Iron and Steel Company Limited, on condition that the assessee gave and assigned to him as from the 1st of April, 1924, a share of 6 annas in the rupee in the commission and other remuneration which the assessees might be on-titled to recover from Tata Iron and Steel Company.

It was held by the Bombay High Court in these circumstances that the agreement on the part of the assessees to share their commission with Mr. Dinshaw was part of the terms on which they managed to obtain finance, and the payment to Mr. Dinshaw of his share of the commission was an expenditure incurred by the assessees solely for the purpose of earning profits and gains in the conduct of their agency business. I do not think that the ratio of this case has any application to the present case. The amount of loan advanced by Mr. Dinshaw was one crore of rupees and the amount of commission paid to Mr. Dinshaw was Rs. 2,94.303/- and at page 203 (of ITR): (at pp. 284-235 of AIR) of the report Beaumont C. J. has observed that the agreement made as to finance by the assessee was "the wisest which could be made in the circumstances" and that the agreement to share their commission with Mr. Dinshaw was justified in a commercial sense.

In the present case the material facts are different and I have already stated that the agreement of the assessee in the present case with the trust cannot be supported on the principle of ordinary commercial expediency.

7. Reference was also made on behalf of the assessee to VITHALDAS THAKORDAS AND COMPANY Vs. COMMISSIONER OF Income Tax BOMBAY., , in which the assessee a firm of partners, entered into an arrangement with the widow of V for the use of B's name for their bullion business. Under the arrangement, in consecration of the widow having agreed to allow the partners to use the name of V for the purpose of the partnership business, the partners

agreed to pay to the widow out of the net profits of the business in the first instance an amount equal to two-annas in the rupee of the net profits.

The partnership deed further provided that after payment of the aforesaid amount to the widow the balance of the net profits was to be divided between the partners in certain proportions. In the accounting year in question the assessee made a net profit of Rs. 40,470/- and the widow was paid Rs. 5,059/- being her share in the profits. In these circumstances, it was held by the Bombay High Court that a sum of Rs. 5,059/- paid to the widow was not an appropriation of the profits of the partnership after they had been ascertained and that the payment was a revenue expenditure wholly and exclusively incurred for the purposes of the business and was deductible under the Income Tax Act.

It is obvious that money paid by the partners for the use of the good will of the business is a permissible deduction u/s 10 (2) (XV) but the material facts of the present case are different and this principle has no application.

8. As I have already said, in a case of this description the question at issue is, is the payment one made by virtue of a contract to pay a share of profits simpliciter, or is the payment such which in the truth is deductible before the divisible profits are ascertained? There is a line to be drawn between these two classes of cases, and the question is, on which side of the line does the present case fall? For the reasons I have already expressed, I hold that the payment of Rs. 72,963/12/- in Miscellaneous Judicial Case No. 679 of 1955, and the payment of Rs. 76,526/ 1/3 in Miscellaneous Judicial Case No. 680 of 1955, cannot be held to be revenue expenditure deductible u/s 10 (2) (iii) or Section 10 (2) (xv) of the Income Tax Act, and the question referred to the High Court by the Appellate Tribunal in both these cases must be answered against the assessee and in favour of the Income Tax Department.

The assessee must pay the cost of these references. Hearing fee Rs. 250/- in each case-

R.K. Choudhary, J.

10. I agree.