
(1984) 03 P&H CK 0028

In the Punjab And Haryana At Chandigarh

Case No : Income-tax Reference No's. 118 and 119 of 1976 and Income Tax Case No's. 31 and 32 of 1977

Ess Ess Kay Engineering Co. Pvt. Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 20-03-1984

Acts Referred:

Income Tax Act, 1961 — Section 256(2), 37, 40

Citation : (1985) 151 ITR 636

Hon'ble Judges : Rajendra Nath Mittal, J;M.M. Punchhi, J

Bench : Division Bench

Advocate : G.C. Sharma, D.K. Jain, D.N. Banerjee and S.S. Mahajan, for the Appellant; Ashok Bhan and A.K. Mittal, for the Respondent

Judgement

Punchhi, J.—This order shall dispose of Income Tax References Nos. 118 and 119 of 1976 as also Income Tax Cases Nos. 31 and 32 of 1977.

2. The assessee, M/s. Ess Ess Kay Engineering Company (P.) Ltd., is a private limited company which was incorporated on April 22, 1964. It carried on business in the manufacture of electrical goods such as switches and plugs. The managing director of the company Shri S.S. Khosla had 60 shares of Rs. 100 each in it. A director named Shri M. M. Khosla, son of Shri S. S. Khosla, had 180 shares of Rs. 100 each in it. Another director, Shri K. S. Khosla, son of Shri S. S. Khosla, has 700 shares of Rs. 100 each in it but his directorship was up to March 31, 1966. Yet another director, Smt. Sumitra Khosla, wife of Shri S. S. Khosla, had 160 shares of Rs. 100 each. The total shares were thus 1,100 and the paid-up capital was Rs. 1,10,000.

3. Prior to April 1, 1965, the company did not have any sole selling agents and it marketed its goods directly through the distributors. The list of distributors was approved by a resolution of the board of directors on January 21, 1965. On February 11, 1965, a firm under the name and style of M/s. Kay Engineering Sales Corporation came into existence. It was constituted by four persons,

namely, Shri K. S. Khosla, son of Shri S. S. Khosla, holding 10 per cent. shares, Smt. Sumitra Khosla, wife of Shri S. S. Khosla--20 per cent. shares, Smt. Shakuntla Khosla, wife of Shri M. M. Khosla, son of Shri S.S. Khosla--35 per cent. shares and Smt. Kamla Kapur, daughter of Shri S.S. Khosla--35 per cent. shares. Each partner in the firm had, respectively, a connection with the company, inasmuch as Shri K.S. Khosla was a director up to March 31, 1966, Smt. Sumitra Khosla was a director, Smt. Shakuntla Khosla was the daughter-in-law of the managing director and wife of a director and also herself a director and Smt. Kamla Kapur was the daughter of the managing director, sister of another director and herself a director. So, the connection was obvious.

4. By a resolution dated April 1, 1965, the company appointed the firm, M/s. Kay Engineering Sales Corporation, as its sole selling agents and a letter of appointment was issued for the purpose the same day. It had terms and conditions, which are reproduced below :

"1. That you are appointed as our sole selling agents from April 1, 1965, for a period of five years.

2. That you are appointed our sole selling agents for all our products throughout the country.

3. That for export business of our products, you will have no jurisdiction over the overseas market, but you will have to book orders from Nepal, Bhutan and Sikkim.

4. That you will make use of our distributors in various territories for further expansion of our sales and for combating false propaganda of the rival concerns.

5. That you will be entitled to a commission of 5% on the net sales of our products, i.e., after deducting trade discount, freight, sales tax or central sales tax, distributors' commission and any claim of short supply, breakage in transit and undercharge, etc., etc.

6. That the selling price will be fixed by us and all orders booked by you or by your sub-agents will be subject to our acceptance. We reserve the right to supply the order in full or in part and to alter the quantity of any items according to the availability.

7. That you are required to sign an agreement deed in connection with the above arrangements.

8. That if at any time we are in need of funds, you will arrange the same on your credit.

9. That you will be required to show concrete justification for your appointment by your exertion in increasing the sale of our products."

In terms of the letter of appointment, a regular deed of agency was also executed between the assessee and the firm on January 3, 1966.

5. For the assessment years 1967-68 and 1968-69, the assessee claimed a sum of Rs. 1,52,130 and Rs. 1,69,162, respectively, as payment made on mercantile basis to the firm as commission. During the course of the assessment proceedings, the ITO required the assessee to justify the payment of the aforesaid commission to the selling agents. An attempt was made for the purpose and it was claimed that the commission paid was allowable due to a variety of reasons. The ITO cross-examined a number of persons, including Shri K. S. Khosla, the only male partner of the agency firm. He also examined the evidence furnished by the assessee in support of its claim. He also took into account the various arguments of the assessee, but disallowed the payment of commission in respect of the two assessment years.

6. The assessee unsuccessfully appealed to the AAC in respect of both the assessment years. Against the consolidated order passed by him, the assessee went up in appeal before the Tribunal. The Tribunal too rejected the appeal by coming to the conclusion that there was no evidence on the record to establish that any specific services were rendered by the agency firm in order to justify the payment of commission credited to its accounts by the assessee-company during the relevant accounting periods. The Tribunal observed as under :

"We have heard the learned representatives of the parties at length and have gone through the records and, in our opinion, there is no evidence on record to establish the assessee's case that any specific services were rendered by M/s. Kay Engineering Sales Corporation in order to justify the heavy commission credited to its account by the company during the relevant accounting periods. Our conclusions are based on the following facts:

(i) The constitution of the assessee-company and that of the firm, M/s. Kay Engineering Sales Corpn., given in the foregoing paragraphs, clearly goes to show that the shareholders of the assessee-company and the partners of the selling agency firm are closely related to each other. Out of the four partners of the selling agency firm, the only male partner is Shri Khosla, S/o Sh. S.S. Khosla, managing director of the assessee-company, while the other three partners are ladies and are related to the managing director and the other directors of the company. The close relationship between the shareholders of the assessee-company and the partners of the selling agency firm is a very material factor in determining the genuineness of the payment of heavy commission to the selling agency firm during these two years, particularly in view of the other facts mentioned here-under:

(a) A perusal of the letter of appointment issued in the name of the sole selling agents with effect from April 1, 1965, shows that out of the various clauses of the said appointment letter, only the following clauses mention the performance of specific functions by the sole selling agents.

Clause 4 :--" That you will make use of our distributors in various territories for further expansion of our sales and for combating false propaganda of the rival

concerns." "That if at any time we are in need of funds, you will arrange the same on your credit."

Clause 9:--"That you will be required to show concrete justification for your appointment by your exertion in increasing the sale of our products." The other clauses of the letter of appointment are of general nature and do not entrust any specific duties on the sole selling agents. Now, out of the specific functions mentioned in the clauses quoted above, we find that clause 8 regarding the arrangement of funds has not been acted upon nor was it meant to be acted upon. No funds had ever been provided by the sole selling agents to the assessee-company. In fact, the capital contributed by the four partners of the sole selling agency firm was very petty and they were not in a position to advance any funds in this behalf to the assessee-company. Coming now to Clause 4, which mentions propaganda work to be done by the selling agency firm, we find from the records that no such functions have been performed by the selling agency firm. In any case, there is no evidence on record to show that the selling agency firm performed any propaganda work. Before us, the learned counsel for the assessee has pointed out to a circular letter issued by M/s. Kay Engineering Sales Corporation to the various dealers to press home his point of view that propaganda work was in fact done by the selling agency firm. We find from this circular letter that neither the letter is dated, nor signed by anybody. It is also not a printed letter, but only a cyclostyled one and, hence, it cannot be said with any amount of certainty that this circular letter was in fact issued by the selling agency firm and not by the assessee-company itself. This apart, we find that the assessee-company had already appointed a number of distributors for different territories and they were being paid substantial commission for undertaking the propaganda, publicity and canvassing of sales on behalf of the assessee-company. In these circumstances, the payment of a further overriding commission of 5% to the sole selling agents was not at all justified.

(b) Coming now to Clause 9 of the appointment letter, the learned counsel of the assessee had laid great emphasis on the fact that the sole selling agents rendered special services by way of canvassing of sales of goods manufactured by the assessee-company. However, we find that the selling agency firm did not book any orders, no sales were made by them nor were any advertisement charges in fact incurred by them to show that they indulged in the publicity of the sales of the goods manufactured by the assessee. There is also no evidence to show that the partners of the selling agency firm or its employees contacted the individual customers and propagated the sales of the assessee. On the other hand, we find that canvassing of the sales was being done by the various distributors who had already been appointed by the assessee-company and they were paid substantial commission for this purpose.

(ii) It was emphasised before us that due to the appointment of sole selling agents, the sales of the company had increased considerably and this fact clearly goes to show that specific services were carried on by the selling agency firm.

We, however, find that even after the termination of the sole selling agency with effect from March 31, 1970, the sales of the assessee-company continued to rise year after year. This is evident from the following position :

A"sst. Year

Sales

Remarks

1966-67

25,44,819

Selling agency firm in existence.

1967-68

30,42,714

do.

1968-69

33,83,149

do.

1969-70

37,23,250

do.

1970-71

45,32,350

do.

1971-72

49,81,054

Selling agency firm terminated.

1972-73

50,81,108

do.

1973-74

53,49,240

do.

1974-75

66,20,523

do.

From the above statement, it is obvious that even after the termination of the sole selling agency on March 30, 1970, the sales of the company continued to increase. The turnover of the assessee-company during the years in which the selling agency firm was in existence and even later on was not mainly due to the efforts of the sole selling agency firm.

(iii) Before the authorities below as well as before us, a lot of emphasis was laid on the fact that the sole selling agency firm appointed two travelling agents, namely, Shri Yodha Ram and Shri S. K. Puri, who undertook extensive tours to various parts of the country and propagated the sales of the goods manufactured by the assessee-company. It was also pointed out that these selling agents used to send daily progress reports to the head office, which, in turn, used to send the reports to the assessee-company. We, however, find from the following facts that the contention of the assessee is not supported by any evidence.

(a) No appointment letters to these agents, namely, Shri Yodha Ram and Shri S. K. Puri, were produced to show whether these persons were appointed by the selling agency firm or by the assessee-company.

(b) In spite of various opportunities allowed by the Income Tax Officer, these selling agents were not produced before the Income Tax Officer on the ground that they had left the services of the selling agency firm and their present whereabouts were not known. Enquiries made by the Income Tax Officer at the addresses given by the assessee also did not reveal their whereabouts in order to establish their existence. The letters issued by the Income Tax Officer to these persons were received back from the postal authorities unserved.

(c) No letter of authority is said to have been given by the selling agency firm to the travelling agents authorising them to contact the various dealers of the company.

(d) Some distributors who were examined by the Income Tax Officer stated that these agents, namely, Shri Yodha Ram and Shri S. K. Puri, never visited them.

(e) The T.A. Bills of the travelling agents were neither prepared nor signed by them and, hence, their authenticity is open to question.

(f) Some daily progress reports produced by the assessee before the Income Tax Officer do not establish that these were sent by the travelling agents to the selling agency firm or that they were directly sent by these agents to the assessee-company. In the absence of any receipt register or despatch register allegedly kept by the selling agency firm, it cannot be said that these progress reports were routed through the selling agency firm.

(g) No orders were, admittedly, booked by these travelling agents nor is there any evidence to show that they have done any propaganda work in canvassing the sales of the goods manufactured by the company.

(iv) According to the assessee, the sole selling agents were paid overriding commission at the rate of 5% of the net sales made by the company, but from the copies of the accounts of the selling agency firm as appearing in the books of account of the assessee in respect of the various years, we find that although the sole selling agency was terminated by the assessee as on March 31, 1970, a sum of Rs. 4,51,364 was still payable by the assessee to the said firm on this date. We have also gone through the copy of accounts of M/s. Kay Engineering Sales Corporation in the books of account of the assessee during the period after March 31, 1970, and find that even as late as on August 30, 1975, a sum of Rs. 2,25,596 was still payable by the assessee to the said firm. This fact clearly goes to show that the funds alleged to have been passed over to the sole selling agency firm were not in fact made available to the said firm but were utilised by the assessee-company for its own business.

(v) Another aspect of the case which we have noticed is that the sole selling agency firm was constituted by four partners out of which three were ladies. The only male partner was Shri K. S. Khosla who was twenty years and five months old at the time of the execution of the sole selling agency agreement with the assessee-company. The firm, M/s. Kay Engineering Sales Corporation, came into existence only on February 11, 1965, without any previous experience in canvassing or propagation of sales. Thus the payment of a heavy commission during the years under consideration to a firm with little experience in the conduct of sales having three lady partners and a male partner with insufficient experience leaves no doubt in our minds that the setting up of the sole selling agency firm was only a device to reduce the incidence of taxation of the assessee-company.

(vi) After the appraisal of the entire evidence on record and in view of the detailed reasons discussed in the foregoing paragraphs, we are of the opinion that no services were rendered by the sole selling agency firm in order to justify the payment of a commission amounting to Rs. 1,52,130 and Rs. 1,69,162, during the assessment years 1967-68 and 1968-69, respectively. The expenditure claimed by the assessee-company by way of payment of commission to the extent indicated above was, therefore, not for the purpose of its business and was, thus, rightly disallowed by the authorities below. We may, in this connection, refer to the decision of the Supreme Court in *Swadeshi Cotton Mills Co. Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh (No. 1)*, wherein their Lordships have held that merely because of the existence of an agreement between the assessee and its employees for payment of certain remuneration and the fact of the actual payment, the Income Tax Officer is not bound to hold that the payment was made exclusively and wholly for the purpose of the assessee's business. Their Lordships further held that although there may be

such an agreement in existence and the payment might have been made, it is still open to the Income Tax Officer to consider all the relevant factors and determine for himself whether the remuneration paid to the employee or any portion thereof is properly deductible u/s 10(2)(xv) of the Indian Income Tax Act, 1922 (corresponding to Section 37(1) of the Income Tax Act, 1961). In coming to the above conclusion, their Lordships observed as under (page 60) :

"It is an erroneous proposition to contend that as soon as an assessee has established two facts, viz., the existence of an agreement between the employer and the employee and the fact of actual payment, no discretion is left to the Income Tax Officer except to hold that the payment was made wholly and exclusively for the purposes of the business. Although the payment might have been made and although there might be an agreement in existence, it would still be open to the Income Tax Officer to take into consideration all the relevant factors which will go to show whether the amount was paid as required by Section 10(2)(xv). The question as to whether an amount claimed as expenditure was laid out or expended wholly and exclusively for the purpose of such business, profession or vocation has to be decided on the facts and in the light of the circumstances of each case. "

To the same effect is the decision of the Supreme Court in *Madhowji Dharamshi Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, Bombay*, . In the above case, the finding arrived at by the Tribunal that the transactions entered into and the agreements made by the assessee with the selling agents and the managing agents and the resolutions passed were "all sham and colourable transactions with a view to appropriate the funds of a flourishing concern to their own use by those who controlled the assessee-company, its managing agents and selling agents", was approved by their Lordships by holding that this finding of the Tribunal was amply borne out from the evidence on record and no question of law arose out of the order of the Tribunal.

7. Now, in the present case, there is sufficient material on record as discussed in the foregoing paragraphs, to hold that no specific services were rendered by the firm, M/s. Kay Engineering Sales Corporation, and the said firm was set up only as a device to fritter away the profits. The payment in question was clearly unreasonable having regard to the legitimate business needs of the company and the benefits derived by it therefrom. It is true that from the juristic point of view, the company was a legal personality entirely distinct from its members and the company was capable of enjoying rights and being subjected to the duties which were not the same as those enjoyed or borne by its members. But in certain exceptional cases, the court was entitled to pierce the veil of corporate entity and pay regard to the economic realities behind the legal facade. In this connection, a reference is invited to the decision of the Supreme Court in *Juggi Lal Kamalapat Vs. Commissioner of Income Tax, U.P.*, . As already discussed in the earlier paragraphs, the sales of the company increased from year to year even when the selling agency firm was not in existence and, in these circumstances, the

expenditure in question was not laid out wholly and exclusively for the purpose of the business of the assessee-company.

8. During the course of the arguments, the learned counsel for the assessee has submitted that the Income Tax Officer has built up his case u/s 40(c) and in doing so he has given up his case u/s 37(1) and this shows that Section 37(1) is not applicable to the present case. We do not agree with the proposition of the learned counsel for the simple reason that the Income Tax Officer has clearly held that the expenditure incurred by the company in the alleged payment of commission was not allowable as deduction u/s 37(1) of the Income Tax Act, 1961. It has been held by their Lordships of the Supreme Court in *Lachminarayan Madan Lal Vs. Commissioner of Income Tax, West Bengal*, that the mere existence of an agreement between the assessee and its selling agents or payment of certain amounts as commission, assuming there was such payment, does not bind the Income Tax Officer to hold that the payment was made exclusively and wholly for the purpose of the assessee's business. Although there might be such an agreement in existence and the payments might have been made, it is still open to the Income Tax Officer to consider the relevant facts and determine for himself whether the commission said to have been paid to the selling agents or any part thereof is properly deductible u/s 37(1) of the Act. In the present case, the Income Tax Officer has considered all the relevant facts and come to the conclusion that the payment in question was not exclusively and wholly laid out for the purpose of the assessee's business and, hence, was not an allowable deduction within the meaning of Section 37(1) of the Income Tax Act, 1961. We, therefore, uphold the disallowance of the commission of Rs. 1,52,130 and Rs. 1,69,162 for the assessment years 1968-69 and 1969-70, respectively."

9. The assessee approached the Tribunal for referring eight questions of law as set out in the statement of the case said to have arisen from the appellate order of the Tribunal. The Tribunal, however, referred only one question to this court for opinion which is to the following effect:

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the expenditure of Rs. 1,52,130 and Rs. 1,69,162 for the assessment years 1967-68 and 1968-69, respectively, by way of payment of commission to M/s. Kay Engineering Sales Corporation, was not laid out wholly and exclusively for the purposes of assessee's business ?"

The aforesaid question is the subject-matter of Income Tax References Nos. 118 and 119 of 1976. The assessee, thereafter, approached this court by filing the Income Tax Cases Nos. 32 and 33 claiming mandamus from this court for questions which had not been referred by the Tribunal for opinion. These four matters were placed before a Division Bench consisting of M. R. Sharma and S. S. Kang JJ. and it was ordered on November 2, 1981, that the Income Tax Tribunal should submit a better statement of the case indicating therein, how the questions of law claimed by the assessee are questions of fact or of law, as the

case may be. Thus, a better statement was required to be submitted time-bound. In obedience thereto, the Tribunal has made a better statement. The questions sought to be raised by the assessee and the answers given by the Tribunal in the better statement may well be juxtaposed :

1. Whether, on the facts and in the circumstances of the case, the learned Appellate Tribunal did not err in basing its decision on the provisions of section 37(1) of the Income Tax Act, 1961, where the learned ITO made and the learned Appellate Assistant Commissioner upheld the disallowance of the selling commission u/s 40(c) of the Act ?

The first question is based on an assumption that the Income Tax Officer had disallowed the claim u/s 40(c) of the Income Tax Act. The Tribunal, however, found from the order of the Income Tax Officer that he had held the expenditure as not allowable u/s 37(1) of the Income Tax Act. The Appellate Assistant Commissioner upheld the disallowance having regard to the circumstances of the case and in view of the reasons given by the Income Tax Officer at

length in the assessment order. Thus, the assumption made in this question itself is wrong and appears to be based on merely a mention of section 40(c) in the orders of the lower authorities. The Tribunal's finding is based on the basic finding of the lower authorities and this is clear from the order of the Tribunal itself. Hence, this question being based on a wrong assumption is not referred to the Honourable High Court.

2. Whether the learned Appellate Tribunal did not err in law in not accepting the legal position that the application of section 40(c) of the Income Tax Act, 1961, both by the learned AAC and the ITO in disallowing the payment of selling commission ipso facto excluded consideration of the applicability of section 37(1) of the Act ?

Question No. 2 refers to another aspect of the same question. In view of the clear indication by the Income Tax Officer that the expenditure was not allowable u/s 37(1), the finding of the Tribunal that the Income Tax Officer disallowed the claim u/s 37(1) is obvious and self-evident and in view of this, question No. 2 is also not referred to the Honourable High Court.

3. Assuming that the learned Appellate Tribunal had held the payment of the selling commission disallowable also under the provisions of section 40(c) of the income tax Act, 1961, whether it did not err in law in ignoring the fact that the said commission was paid to a firm which is neither a shareholder nor a person having substantial interest in the appellant company and, consequently, the provisions of section 40(c) were inapplicable ?

Question No. 3 does not arise out of the order of the Tribunal as the conclusion of the Tribunal is based on the appreciation of evidence and application of principles laid down u/s 37(1) of the Income Tax Act. In view of this, question No. 3 is also not referred for the opinion of the Honourable High Court.

4. Whether the learned Appellate Tribunal was legally correct in holding that the firm of

Question No. 4 refers to a finding of the Tribunal and the basis of that finding is given in detail in the

selling agents was set up with a view to fritter away the appellant's profits, notwithstanding that the said firm had been consequently assessed as a "registered firm" in respect of its income derived from the appellant company ?

order of the Tribunal. The finding of the Tribunal in this regard is clearly a finding of fact and this question is, therefore, not referred for the opinion of the Honourable High Court.

5. Whether there was material before the Tribunal to hold that the commission amounting to Rs. 1,52,130 paid to M/s. Kay Engineering Sales Corporation, Jullundur, was not expenditure wholly and exclusively incurred for the purposes of the business carried on by the assessee ?

Question No. 5 raises the question of existence of material on the basis of which the conclusion of the Tribunal is based. The material has been mentioned in detail in the order of the Tribunal. In view of this, question No. 5 cannot be referred to the Honourable High Court.

6. Whether it could be legally held the commission of Rs. 1,52,130 paid to M/s. Kay Engineering Sales Corporation, Jullundur, was not expenditure wholly and exclusively incurred for the purposes of the business carried on by the assessee within the meaning of section 37(1) of the Income Tax Act, 1961?

Question No. 6 is a question of law and we, therefore, propose to refer this question with slight modifications to bring out the controversy involved in the question.

7. Whether, in recording the finding that the sole selling agents had not rendered any concrete services to the assessee-company, the Tribunal has not ignored the relevant material and relied upon the irrelevant material and, consequently, whether the finding is not vitiated in law owing to irrelevant considerations ?

Question No. 7 challenges the finding of fact given by the Tribunal regarding the rendering of services by the selling agents. The material on which this finding of fact is based is clearly indicated in the order of the Tribunal. This question is, therefore, not referred for the opinion of the Honourable High Court.

8. Whether the decision of the Tribunal that the sum of Rs. 1,52,130 paid as selling agency commission to M/s. Kay Engg.

Question No. 8 cannot be referred to the Honourable High Court as it merely states that the order of the Tribunal is perverse or illegal.

Sales Corpn., Jullundur, is not allowable as a deduction in computing the assessable business income of the company is not perverse and illegal ?

The question of allowance of the expenditure is being referred for the opinion of the Honourable High Court and the material for the conclusion is indicated in detail in the order of the Tribunal. In the question, no basis is shown how the conclusion of the Tribunal could be treated as perverse. The basic finding of the Tribunal being that services were not rendered by the selling agents being a finding of fact, this question is not referred for the opinion of the honourable High Court for opinion.

In view of the above juxtaposition, question No. 6, as modified, has now been referred to this court for opinion. It is to the following effect :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the expenditure of Rs. 1,52,130 and Rs. 1,69,162 for the assessment years 1967-68 and 1968-69, respectively, by way of payment of commission to M/s. Kay Engineering Sales Corpn. was not laid out wholly and exclusively for the purpose of the assessee's business ?"

The learned counsel for the assessee pointed out that the ITO had held the provisions of Section 40(c) to be attracted and, as such, the said section being applicable to companies was in the nature of an exception to the general rule embodied in Section 37. It was stressed that the case had to be judged from the point (of view) of Section 40(c) alone and not u/s 37. On that basis, it was urged that all the questions sought by the assessee for reference to this court would become open, inclusive of those questions which were mixed questions of law and fact. On this stance, it was claimed that the mandamus application be allowed and the Tribunal directed to refer the questions left out to this court for opinion. We have heard the learned counsel for the parties at great length but we regret our inability to agree to the contention.

10. The ITO in the body of his order, while dealing with the applicability of Section 40(c), negated the claim of the assessee that Section 40(c) was applicable. But in the list of conclusions, the ITO, in conclusion No. 11, held the expenditure under the head "commission" not allowable u/s 37(1) of the I.T. Act and in the same breath observed that Section 40(c) was clearly attracted. Before the AAC, the question of applicability of Section 40(c) was again raked up, but he took the view that the payment of commission was totally unreasonable having regard to the legitimate business needs of the company and the benefit derived by it therefrom. The Tribunal's view on this aspect has already been reproduced earlier. It has reiteratingly in the better statement of the case clearly said that it had found from the order of the ITO that he had held the expenditure not allowable u/s 37 of the Act and that there was a mere mention of Section 40(c) in the orders of the lower officers, meaning thereby that there was no actual employment thereof.

11. Having pondered over the matter in every detail, we are of the view that the ITO's mentioning of Section 40(c) in conclusion No. 11 did not mean that the assessment had been framed u/s 40(c). Had it been so, a host of other factors

should have come into play, for, Section 40(c), extractedly, is in the following terms:

"40(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 ;

(ii) any expenditure or allowance in respect of any assets of the company used by any person referred to in Sub-clause (i) either wholly or partly for his own purposes or benefit,

if in the opinion of the Income Tax Officer any such expenditure or allowance as is mentioned in sub-clauses (i) and (ii) is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom, so, however, that the deduction in respect of the aggregate of such expenditure and allowance in respect of any one person referred to in Sub-clause (i) shall, in no case, exceed-

(A) where such expenditure or allowance relates to a period exceeding eleven months comprised in the previous year, the amount of seventy-two thousand rupees;

(B) where such expenditure or allowance relates to a period not exceeding eleven months comprised in the previous year, an amount calculated at the rate of six thousand rupees for each month or part thereof comprised in that period."

The provision has pregnant words. The ITO can opine such expenditure or allowance to be excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived or accruing to it therefrom. The expenditure even then has outer limits. It can even be rejected totally as unreasonable. Unlimited expenditure is not permissible in any event. And besides that, Section 40 starts with a non obstante clause by providing "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...." A negative language in the section rather downgrades a company in the matter of claiming business expenditure in case the expenditure is coverable u/s 40(c). In essence and spirit, it keeps Section 37 at its original pedestal. Subject to other qualifications as prescribed, Section 37 says that any expenditure laid out or expended wholly or 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". Unless an expenditure first gets qualified as an expenditure within the meaning of Section 37, that is to say, unless it can be shown expended wholly or exclusively for the purposes of the business or profession, it cannot be allowed in computing the

income chargeable under the relevant head. In case it satisfies this test, then it stands to get curtailed u/s 40(c), for, the non obstante clause therein clearly postulates that despite being allowable u/s 37, in the case of a company, it has to satisfy the test of Section 40(c) as well. So, in working analysis, Section 37 has to apply first and thereafter Section 40(c). As is plain from the order of the Tribunal, the expenditure had been held as not allowable u/s 37(1) of the Act by the ITO. That is the Tribunal's view and it being the final court of fact, no fault can be found with it. Had the ITO committed the error of employing Section 40(c) by bypassing Section 37, the Tribunal would have well been within its right to correct such an error. But, that is not the case here. The mere mention of Section 40(c) in the orders of the lower authorities has been taken to be parenthetical and not of any substance. On this analysis, we do not find any reason to allow the mandamus application of the assessee and thus the Income Tax Cases Nos. 31 and 32 are hereby rejected.

12. With regard to the question referred in the Income Tax References, the conclusion, recorded by the Tribunal is strikingly sharp. It has held that there was no evidence on the record to establish the assessee's case that any specific services were rendered by M/s. Kay Engineering Sales Corporation in order to justify the payment of commission credited to its account. The learned counsel for the assessee contended that the finding recorded by the Tribunal is couched in the language of Section 40(c), when it has employed expressions like "legitimate business needs" and "benefit derived". We find no such inter-mixing. The finding recorded is to express that the expenditure claimed has not been expended wholly or exclusively for the purpose of the business or profession. The finding is in accord with the spirit and language of Section 37. Our attention was also drawn to conditions Nos. 4, 7 and 8 of the agency whereunder it was claimed that due to the existence of the agency, the assessee had maintained business accounts and had even kept with itself the commission as loan under condition No. 8. Furthermore, it was contended that the firm was a genuine firm and both the firm and the assessee had in observance of maintaining of accounts in the mercantile system, shown respectively, income and expenditure of the commission in their account books. These arguments do not impress us, for, if a state of affairs had come about, it does not mean that a sum shown in the accounts as having been expended as commission is necessarily allowable u/s 37. The elaborate reasoning given by the Tribunal justifies its conclusion that there was no evidence on the record to show that any specific services were rendered by the agent firm. It is a pure finding of fact viewed from the angle of Section 37 of the Act. We are fortified in our view by the decisions of the Supreme Court in *Swadeshi Cotton Mills Co. Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh (No. 1)*, *Commissioner of Income Tax, West Bengal III Vs. Imperial Chemical Industries (India) (P.) Ltd.*, *Commissioner of Income Tax, Bombay City I Vs. Greaves Cotton and Co. Ltd.*, and *Aluminium Corporation of India Ltd. Vs. Commissioner of Income Tax, West Bengal*, .

13. For the view taken above, we answer the question referred in the affirmative,

that is, in favour of the Revenue and against the assessee. There shall, however, be no order as to costs in this case.