
(1979) 08 DEL CK 0030

In the Delhi High Court

Case No : Income-tax Reference No. 69 of 1971

Siddho Mal and Sons

APPELLANT

Vs

Income Tax Officer

RESPONDENT

Date of Decision : 02-08-1979

Acts Referred:

Citation : (1980) 122 ITR 839

Hon'ble Judges : V.S. Deshpande, C.J.; Harish Chandra, J

Bench : Division Bench

Advocate : P.N. Chopra and P.S. Baijal, for the Appellant; B.N. Kirpal and M.L. Verma, for the Respondent

Judgement

Harish Chandra, J.—On an application u/s 66(1) the Indian I.T. Act, 1922, the Income Tax Appellate Tribunal, Delhi, has sent us a statement of the case and referred for our opinion the following question :

" Whether, on the facts and in the circumstances of the case, the Tribunal is justified in holding that the agreement with the minors was made not for reasons of commercial expediency or legitimate business needs, but for purely diversion of profits, and that the payment of Rs. 68,540 is not an admissible revenue deduction ? "

2. Relevant facts are that the assessed is a firm dealing in paper and stationery. It filed a return showing a total income of Rs. 2,62,445. The account books and the statement of accounts showed a trading account for the import of tissue paper from China against the license for import for Rs. 1,50,000. Upon receiving the license the assessed entered into an agreement dated September 27, 1958, with Sarvashri Pawan Kumar and Subodh Kumar, minors, through their guardians for the payment of commission on loans of Rs. 93,181 and Rs. 1,09,022, respectively, which amounts had already been lying in deposit with the assessed-firm and on which an interest at 7 1/2% per annum was being paid. In this account, the cost of the tissue paper came to Rs. 2,53,298. A sale of Rs.

4,56,934 yielded a profit of Rs. 1,29,300. This account was debited with Rs. 68,540, being the commission paid to Sarvashri Pawan Kumar and Subodh Kumar in equal shares.

3. Sarvashri Pawan Kumar and Subodh Kumar are minor sons of two brothers, Sarvashri Devender Kumar and Lalit Kumar, who are two of the partners of the firm. The other two partners are Shri Kapoor Chand, another brother, and Shri Sidhoo Mal, father of the three brothers. It is this payment of commission which has been disallowed u/s 10(2)(xv) of the Indian I.T. Act, 1922, and which is the subject-matter of the present reference.

4. The ITO noted the following facts :

(a) The agreement dated September 27, 1958, was actually entered into.

(b) The amount of commission was actually paid to the minors.

(c) The amount taken on loan from the minors was actually used for financing the project of the import of paper from China.

(d) Sarvashri Pawan Kumar and Subodh Kumar are sons of two partners and closely related to the other two.

(e) They are minors.

(f) The minors were being paid interest at 7 1/2% per annum on the amounts kept by them with the firm.

(g) On September 27, 1958, when the firm entered into an agreement with the minors through their guardians to retain Rs. 93,181 and Rs. 1,09,022 for payment of commission, the firm had the following amounts :

Rs. Fixed deposit 4,95,000 Cash in bank 43,559 ----- 5,38,559 -----

(h) The import was completed during the accounting year ended on July 7, 1959, and the position of the ready funds with the firm was as under on that date :

Rs.

Chinese tissue paper a/c 2,53,253

Fixed deposit with the bank 3,00,000

Cash with banks 5,074

5,58,327

(i) Smt. Sita Devi, wife of one of the partners, also had a deposit of Rs. 2,65,000 with the firm but she was not given any extra interest or commission for continuing to keep this money with the firm.

(j) In addition to the interest at 7 1/2% per annum the commission paid to the minors works out to a return of 40% on the amount deposited with the firm.

(k) Shri Kapoor Chand, partner of the firm, stated before the ITO that if funds were arranged by way of an overdraft from the bank instead of being taken from the minors "overall charges would have touched the figure of 12% on account of interest and godown charges, etc."

5. On the basis of the above and other facts noted by the ITO, he came to the conclusion that the firm would have definitely not entered into this deal with any outsider and the transaction in respect of which a commission of Rs. 68,540 was paid to the minors was " nothing but a collusive device to reduce tax liability in the hands of the partners by drifting away the funds to the minors by which incidence of taxation under all the statutes would be far lower ".

6. The amount of commission, i.e., Rs. 68,540, was, Therefore, disallowed. The assessed appealed against the order of the ITO. After going through the facts and the pleas of the assessed, the AAC came to the conclusion that there was no evidence whatsoever to show that there was any intention on the part of the minors of withdrawing the amount already lying in deposit with the firm and that, Therefore, the agreement of September 27, 1958, under which they were paid a commission of Rs. 68,540 amounting to a return of 40% on the amount of deposit already bearing interest at 7 1/2% " was not prompted by legitimate business considerations ".

7. In the result, the appellate authority upheld the disallowance of this expense u/s 10(2)(xv) of Indian I.T. Act, 1922.

8. The assessed appealed against this to the Income Tax Appellate Tribunal and among other pleas the learned counsel for the assessed stressed that the assessed was in pressing need of funds and the agreement dated September 27, 1958, was arrived at to avoid the contingency of the withdrawal of funds by the minors.

9. Having considered the facts and pleas, the Tribunal affirmed the concurrent findings of the ITO and the AAC that the payment of commission was not made for reasons of commercial expediency or legitimate business interest and, Therefore, disallowed the same.

10. Thereupon, a Bench of the Income Tax Appellate Tribunal, Delhi, allowed an application of the assessed u/s 66(1) of the Indian LT. Act, 1922, and by order dated January 15, 1971, referred for our opinion the question already set out above.

11. Shri P. N. Chopra, learned counsel for the assessed, contends that the tax authorities have erred in law in disallowing the commission paid under the aforesaid agreement because, according to him, once it is shown that the agreement was really entered into and the payment under the agreement was actually made coupled with the fact that the money in respect of the use of which the commission was paid was actually used for business purposes, the requirements of Section 10(2)(xv) are complied with and the payment cannot be

disallowed in law under the aforesaid provision. Learned counsel stressed that the tax authorities were not required to predicate upon the necessity of the transaction in question nor could they apply subjective standards as to whether the payment of commission was reasonable or otherwise as they were required to look at it from the point of view of the assessed.

12. In order to examine the contentions of the learned counsel for the assessed, let us examine the provision itself :

" any expenditure (.....not being in the nature of capital expenditure or personal expenses of the assessed) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation. "

13. The words falling for interpretation in the above provision are "expended wholly and exclusively for the purpose of the business..... "

14. It may be recalled that the aforesaid words were borrowed and employed in the Indian Act by the Indian Income Tax (Amendment) Act, 1939, from the English Income Tax Act, 1918, corresponding to Section 137 of the English Act of 1952. Before 1939, the words in the Indian Act were "any expenditure.....incurred solely for the purpose of earning such profit or gain ". The language of the amended Section 10(2)(xv) has been retained in the corresponding provision in the I.T. Act, 1961, i.e., in Section 37 thereof.

15. The word " wholly " in the above provision refers to the quantum of expenditure but the word " exclusively " appears to refer to the motive, objective and purpose of the expenditure and, in our opinion, gives jurisdiction to the concerned authorities to examine the expenditure from this standpoint and the contention of the learned counsel for the assessed that on the findings of the ITO contained in paras, (a), (b) and (c) above, the law did not permit him to proceed to scrutinise the expenditure further, is not tenable or acceptable. Let us see how this provision has been interpreted.

16. One of the early decisions on the subject is that of a Division Bench of the Punjab High Court in Hotz Trust, Simla Vs. The Commissioner of Income Tax, East Punjab, . The court considered the amount paid as salaries by the Hotz Trust, Simla, to Mr. Robert Hotz, Miss Florence Hotz and Mr. Edwin Hotz who were also beneficiaries under the trust. The ITO had allowed Rs. 1,200 to Rs. 1,600 per month against the claim of Rs. 2,000 per month to each one of them. At page 159, the Division Bench of the court observed as under:

" Mr. Indar Dev Dua's contention is that it was for the assessee-trust to determine what remuneration the assessee-trust should pay to its employees for the services rendered by them and considering that it was not disputed that there was an agreement between the assessed trust and the employees to pay Rs. 2,000 per mensem to each of them, the Tribunal was not entitled to challenge the amount paid by the assessed trust to its servants for their services on the ground of excess or over-generosity in the amount.

In my judgment, the contention raised is not covered by the reference and, in any case, for the reasons given JETHABHAI HIRJI AND CO. Vs. COMMISSIONER OF INCOME TAX, BOMBAY CITY., , the contention put in this form is wholly unacceptable to me.

Mr. Dua then contends that there was no material upon which the conclusions arrived at by the Tribunal have been based. As pointed out above, the Income Tax Appellate Tribunal has proceeded upon the circumstances of the case and has come to the conclusion that the increase in the salaries of Miss Florence Hotz and Mr. Edwin Hotz from Rs. 1,200 to Rs. 2,000 was not justified by business considerations. In other words, the Tribunal has found that the allowance claimed cannot be said to be an expenditure laid out or expended wholly and exclusively for the purposes of business. The claim of the assessed being a claim of exemption of an amount u/s 10(2)(xv) of the Act, the burden of proving the necessary facts in that connection was on the assessed. That burden has not been discharged.

Finding as I do that the finding of the Tribunal is supported by material on record, the question referred to this court for decision must be answered in the affirmative. "

17. In Swadeshi Cotton Mills Co. Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh (No. 1), , the Supreme Court considered the case of an assessed-company which had, by resolution of the shareholders, decided to give one per cent, of the net profits as commission to the directors. Repelling and rejecting the arguments put forward by the counsel for the assessed that the payment having been made in accordance with law and by a resolution of the shareholders, cannot be called in question in Income Tax proceedings, the court held on pages 59, 60;

" It is true that as between the directors and the company the resolution had a binding effect and the payment had to be legally made. But it is for the Income Tax Officer to decide whether the amount so paid to the directors was wholly and exclusively spent for the purpose of the business within the meaning of Section 10(2)(xv) of the Income Tax Act. It is an erroneous proposition to contend that as soon as an assessed has established two facts, i.e., 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. But, as observed by this court in Eastern Investments Ltd. Vs. Commissioner of Income

Tax, West Bengal, , the final conclusion on the admissibility of an allowance claimed is one of law. It is for example open to the assessed to contend that the decision arrived at by the Income Tax authorities was based on no evidence at all. If the assessed satisfies the court that the decision of the Income Tax authorities is based on no evidence then the question at issue becomes one of law and the court would be entitled to say that the decision of the Income Tax Officer is defective in law. But, as we have already stated, it is not open to the assessed to contend that merely because of existence of an agreement between the employer and the employee and the fact of actual payment, the Income Tax Officer must hold that the payment was made exclusively and wholly for the purpose of the business. It is manifest that the Income Tax Officer is entitled to examine the circumstances of each case to determine for himself whether the remuneration paid to the employee or any portion thereof was properly deducted u/s 10(2)(xv) of the Income Tax Act. "

18. The above decision was followed in Lachminarayan Madan Lal Vs. Commissioner of Income Tax, West Bengal, . In this case, the payment in respect of which the deduction was claimed had been made to a selling agency firm. The Tribunal found, (i) that on the day the selling agency agreement was executed, the firm had not come into existence; (ii) that the ladies, members of the firm, had no prior business experience ; (iii) that the only male adult partner in the firm was a partner in another manufacturing concern situate at a place quite distant from the place where the selling agency business is said to have been carried on ; (iv) that the business of the selling agency firm was the same as that of the assessed ; (v) that the selling agency firm had no godown of its own nor any transport vehicles. On these findings, the Tribunal reached the conclusion that the selling agency firm was not genuine and the agreement was only a make-believe arrangement and that it was merely a device to minimise the assessed's tax liability.

19. After considering a number of earlier decisions of the Supreme Court, Dhirajlal Girdharilal Vs. Commissioner of Income Tax, Bombay, , Commissioner of Income Tax, West Bengal II Vs. Rajasthan Mines Ltd., , Commissioner of Income Tax, Gujarat Vs. A. Raman and Company, , Commissioner of Income Tax, Punjab Vs. Indian Woollen Textile Mills, and Commissioner of Income Tax, West Bengal II Vs. Durga Prasad More, , the court concluded by holding as follows (p. 446 of 86 ITR):

" In our opinion, the facts of this case come within the rule laid down by this court in Swadeshi Cotton Mills Co. Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh (No. 1), . The question whether an amount claimed as an expenditure was laid out or expended wholly and exclusively for the purpose of the business has to be decided on the facts and in the light of the circumstances in each case. The mere existence of an agreement between the assessed 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 assessed'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 factors 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 of the Act.

For the reasons mentioned above, we are of opinion that the Tribunal was justified in not stating a case for the opinion of the High Court u/s 256(1) of the Act and the High Court was justified in not calling for a statement of case under Sub-section (2) of Section 256."

20. In *Bengal Enamel Works Ltd. Vs. Commissioner of Income Tax, West Bengal*, , the Supreme Court considered remuneration paid by the assessed to a technical adviser and taking into consideration that the taxing authorities had uniformly found that the remuneration agreed to be paid was influenced by "extra commercial considerations", it being much in excess of what was normally payable, rejected the criticism of the assessed that the Tribunal's finding was based on no evidence or was based on irrelevant considerations and held at page 123 :

" Where an amount paid to an employee pursuant to an agreement is excessive because of "extra commercial considerations", the taxing authority has jurisdiction to disallow a part of the amount as expenditure not incurred wholly and exclusively for the purpose of the business."

21. The earlier decision in *Swadeshi Cotton Mills Co. Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh (No. 1)*, was referred to and followed.

22. In *The Commissioner of Income Tax, Kerala, Ernakulam Vs. The Travancore Sugar and Chemicals Ltd.*, , the Supreme Court, dealing with the test of commercial expediency, held at page 10 as follows :

" In considering the nature of the expenditure incurred in the discharge of an obligation under a contract or a statute or a decree or some similar binding covenant, one must avoid being caught in the maze of judicial decisions rendered on different facts and which always present distinguishing features for a comparison with the facts and circumstances of the case in hand. Nor would it be conducive for clarity or for reaching a logical result if we were to concentrate on the facts of the decided cases with a view to match the colour of that case with that of the case which requires determination. The surer way of arriving at a just conclusion would be to first ascertain by reference to the document under which the obligation for incurring the expenditure is created and thereafter to apply the principle embalmed in the decisions of these facts. Judicial statement on the facts of a particular case can never assist courts in the construction of an agreement or a statute which was not considered in those judgments or to ascertain what the intention of the legislature was. What we must look at is the contract or the statute or the decree, in relation to its terms, the obligation

imposed and the purpose for which the transaction was entered into."

23. This decision was followed in Commissioner of Income Tax, Punjab, Haryana, J. and K., H.P. and Union Territory of Chandigarh Vs. Panipat Woollen and General Mills Co. Ltd., . In this case, the court was considering whether a particular payment under an agreement styled as selling agency agreement was deductible expense under the aforesaid provision.

24. At page 74, the court held :

" It is well settled that the court in order to construe an agreement has to look to the substance or the essence of it rather than to its form. A party cannot escape the consequence of law merely by describing an agreement in a particular form though in essence and in substance it may be a different transaction."

25. On page 76, the court held :

" Even so whatever be the commercial considerations, it is difficult to hold that the commercial expediency dictated the assessed-company to allow itself to be completely overshadowed by its selling agents so as to pay them not only for the services rendered but also allow them to share profits, control the manufacture of the goods and the programme thereof and also to share the losses. The test of commercial expediency cannot be reduced in the shape of a ritualistic formula, nor can it be put in a watertight compartment so as to be confined in a strait-jacket. The test merely means that the court will place itself in the position of a businessman and find out whether the expenses incurred could be said to have been laid out for the purpose of the business or the transaction "was merely a subterfuge for the purpose of sharing or dividing the profits ascertained in a particular manner. It seems to us that on ultimate analysis the matter would depend on the intention of the parties as spelt out from the terms of the agreement or the surrounding circumstances, the nature or character of the trade or venture, the purpose for which the expenses are incurred and the object which it sought to be achieved for incurring those expenses."

26. In Amritlal and Co. Pvt. Ltd. Vs. Commissioner of Income Tax, Central, Bombay, , a Division Bench of the Bombay High Court considered the argument of the assessed that a commission paid to the two directors and four salesmen under a resolution of the company should be allowed as a deduction without any further scrutiny. The court held that the mere fact that indeed casts a duty on the ITO to examine and scrutinise an expenditure so as to be satisfied that the same has been incurred exclusively for the purposes of business before allowing it as a deduction and in doing so he must take into consideration the totality of circumstances. Thus, an expenditure is to be allowed if it satisfied the test of commercial expediency and commercial expediency has to be judged from the point of view of the assessed who knows best how his business has to be run but such a point of view has to be a prudent and reasonable point of view which is free from apparent taint of excessiveness, collusiveness or colourable discretion. Thus, on the one hand it is not for the ITO to judge whether the assessed could

have avoided or reduced a particular expenditure but, on the other, an unreasonably high or excessive expenditure would normally and correctly caution the ITO to examine it more carefully and if combined with other circumstances it leads to the conclusion that the motive behind the expenditure is to unduly benefit some one, the ITO is well within his rights to come to a finding that the expenditure is not exclusively for the purposes of business.

27. In order to dissuade us from this opinion, the learned counsel for the assessed has first relied upon a judgment of the Supreme Court in *Eastern Investments Ltd. Vs. Commissioner of Income Tax, West Bengal*, . The expenditure in this case had been disallowed on a finding that by the transaction the taxable income of the company had been reduced, that there was complete identity of the person who brought about the transaction and benefited from the same and that the transaction was more in his interest than that of the company. The court noted that there was not even an allegation of fraud and held on page 7 thus:

" On a full review of the facts it is clear that this transaction was voluntarily entered into in order indirectly to facilitate the carrying on of the business of the company and was made on the ground of commercial expediency. It, therefore, falls within the purview of Section 12(2) of the Income Tax Act, 1922, before its amendment in 1939. "

28. In our view, the judgment does not apply to the facts of this case as here, even though the ITO has not used the word " fraud " he has come to a finding of excessiveness and collusiveness in respect of the payment of commission made to the minors.

29. The learned counsel for the assessed has then relied upon the judgment of the Supreme Court in *Jugal Kishore Baldeo Sahai Vs. Commissioner of Income Tax, U.P., Lucknow*, . The court considered a claim for deduction for a payment made by an HUF to the karta and, at page 243, held:

" In our view, if a remuneration is paid to the karta of the family under a valid agreement which is bona fide and in the interest of, and expedient for, the business of the family and the payment is genuine and not excessive, such remuneration must be held to be an expenditure laid out wholly and exclusively for the purpose of the business of the family and must be allowed as an expenditure u/s 10(2)(xv) of the Act."

30. We do not see how the principle, that Hindu law does not prohibit the HUF making the payment of a remuneration to a karta and that, Therefore, such a prohibition cannot be read into the I.T. Act so as to disallow the same u/s 10(2)(xv) of the Act, laid down in the above decision, can be pressed in aid by the learned counsel for the assessed, particularly when the court has, in the above dictum, clearly required the payment to be not only genuine but also " not excessive ".

31. In Commissioner of Income Tax, Bombay Vs. Walchand and Co. Private Ltd., , heavily relied upon by the learned counsel for the assessed, the court was considering a claim for deduction of the increased remuneration paid to the directors which had been disallowed by the ITO, who was of the view that since the increase was not reflected in the increase in the profits of the assessed, it was not expenditure which could be justified as laid out wholly or necessarily for the purposes of the business. The Appellate Tribunal modified the order, observing thus (p. 383): " It was not for the Income Tax Officer to run the assessed's business and to fix the salary of every member of the staff. That, however, does not mean that it is open to an assessed to allow unreasonable rise in the salaries without a valid reason. It may amount to giving a gift in the garb of a salary ". The court, at page 384, approved of the above observations of the Tribunal but confirmed the finding of the High Court that rejection of a part of the claim was not based on any evidence. The court further observed at page 385 thus :

" The Income Tax Officer Was of the view that there was no adequate increase in the earnings of the assessed, for the increase in remuneration Was not reflected in the increase in profits of the assessed and that it appeared that, as compared to the previous years, the business profits disclosed by the assessed has fallen by Rs. 2 lakhs and, Therefore, the increase in expenditure could not be justified as laid out wholly and necessarily for the purposes of the business. But an employer in fixing the remuneration of his employees is entitled to consider the extent of his business, the nature of the duties to be performed, and the special aptitude of the employee, future prospects of extension of the business and a host of other related circumstances. The rule that increased remuneration can only be justified if there be corresponding increase in the profits of the employer is, in our judgment, erroneous."

32. Even though the expenditure was allowed, we do not see how this judgment, the true ratio of which is affirmation of the observations of the Tribunal, quoted above, is of any assistance to the contentions of the assessed because so long as the ITO has the jurisdiction to go into the reasonableness of an increased expenditure, the assessed cannot contend such scrutiny as illegal or unwarranted interference with his judgment in the matter. Undoubtedly, in doing so, the ITO cannot employ an arbitrary index and a rule that increased remuneration can only be justified if there be corresponding increase in the profits, is bad for such arbitrariness.

33. The learned counsel for the assessed has next relied upon the judgment of the Supreme Court in Shahzada Nand and Sons Vs. Commissioner of Income Tax, Patiala, , on the judgment of the propriety of a payment, i.e., consideration of commercial expediency, being left to be decided by the assessed and not by the subjective standard of the assessing authority. That was a case of the payment of commission to any employee and the deduction was claimed u/s 36(1)(ii) of the I.T, Act, 1961, and the court held, on page 364 :

"Section 36, Sub-section (1), clause (ii), does not postulate that there should be any extra services rendered by an employee before payment of commission to him can be justified as an allowable expenditure. What it requires is only this, namely, that commission paid to an employee should be for services rendered by him. "

34. We do not see how this decision helps to advance the case of the assessed for freedom to judge and decide what is commercial expediency particularly when, in the same judgment, the court observes, on page 364 itself:

"There must be some services rendered by an employee and where commission is paid for the services so rendered, Section 36, Sub-section (1), clause (ii) would apply and the commission to the extent to which it is found reasonable would be an allowable expenditure under that provision."

35. And, again, on the same page :

" Of course, the circumstance that no additional services are rendered by an employee would undoubtedly be of some relevance in determining the reasonableness of the amount of commission but it would have to be considered along with other circumstances and the question whether commercial expediency justified the payment of commission would have to be judged in the light of all the circumstances existing at the material time."

36. The learned counsel for the assessed has then contended that the ITO erred in taking into consideration the relationship of the partners with the minors, beneficiaries under the agreement, and has relied upon a judgment of a Division Bench of the Madras High Court in Ramanlal Kamdar Vs. Commissioner of Income Tax, , where the court observed (p. 498):

" The circumstances that the partners of the selling agents are relations of the partners of the assessed-firm cannot cloud the issue....."

37. There is no doubt that relationship by itself, without more, cannot lead to the inference of excluding the possibility of a payment being wholly and exclusively for the purpose of business. Dealing with relatives in contrast with or in preference to strangers is neither prohibited by law nor can be tabooed. Indeed, it is natural to do so but this does not give a license to cover up dishonest transactions or impermissible transfers. As has been said, the courts and authorities are not to wear blinkers to overlook or condone the passing off of public revenue to one's own kith and kin by subterfuge or clandestine or clever devices clothed in legalistic, jargon. Instead it is their duty to lift the veil of apparent legality and get to the truth or substance of a transaction to deal with it in accordance with law. It is only appropriate, indeed normal, that dealings involving transfer of funds to near and dear ones need to be, looked into with care and caution and necessary inferences drawn if there are abnormalities attaching to such transactions.

38. We do not read the one line quotation from the aforesaid judgment as laying

down any contrary principle. In fact, the learned judges have in the same judgment recalled the judgment of the Supreme Court in Commissioner of Income Tax, Madras Vs. Chari and Chari Ltd., , where it was, held (p. 404) :

" In considering whether the expenditure to remunerate a person for services rendered is allowable u/s 10(2)(xv), the Income Tax Officer must have regard to all the circumstances, such as, the nature and special character of the service, the practice, if any, in the trade for payment of a percentage of profit to an employee in similar circumstances, the qualifications of the employee for rendering the service, the amount, if any, paid by the assessed to another person for rendering similar service, the normalcy of the allowance having regard to the practice in the trade, the existence of any other extraordinary and abnormal circumstances in the arrangement or special reasons or circumstances which may suggest that the transaction was abnormal and the like. "

39. We may also refer to a judgment of the Madras High Court in A. Natesa Iyer Vs. The Commissioner of Income Tax, in which a Division Bench of that court considered a claim for deduction of the amount of salary and bonus paid by the assessed to his son who was found to have just finished his intermediate course in college. A part of the remuneration was disallowed by the ITO and the matter came ,up for the consideration of the court.

40. The court noted that a boy just out of the college, merely carrying out the directions of his father in the management of the business, was paid a salary of Rs. 1,000 per mensem and bonus of about 3 to 4 months when his co-employees, competent and experienced, were paid salaries from Rs. 100 to Rs. 200 a month and the business was far from progressing prosperously and came to the conclusion (p. 807):

" In these circumstances the inference is irresistible that the assessed paid his son the amounts claimed by way of deduction only out of family feeling, and not for his ability and capacity in earning the income of the business. The largeness of the payment is so great having regard to the scope and income of the Pollachi business that it almost raises a presumption that it is not payment of remuneration. We are unable to say that the department was not justified in allowing portions of the salary, as being not incurred for the purpose of earning the profits of the business. "

41. The court further proceeded to observe (p. 805):

" The fixation and payment of salary arises out of the terms of employment between the employer and the employee. Nothing prevents an employer being liberal and even lavish in the matter of his paying wages or salary to the employed staff, and indeed it is his sole prerogative over which the court has no domain or jurisdiction. But the Indian Income Tax Act has its own code in the matter of allowing deductions of expenses and payments in computing the business income of an assessed. A payment of salary as such could not be a permissible deduction unless the payment can be said to have been incurred

wholly and exclusively for the purpose of the business. The assessed must satisfy the department that it was necessary to have incurred the salary expenses to carry on the business and to earn the income there from. He must also establish that the payment of salary was essential for the purpose of business and was not motivated by non-commercial considerations such as piety, benefaction or mere love and affection. There must be correlation of the work done by the employee to the remuneration received by him. Any amount which the assessed may pay alleging it to be remuneration or salary over and above the requirements of the business for the purpose of its being carried on efficiently would be excessive remuneration from the point of view of the departmental authorities who owe a duty to estimate and apportion that amount of payment as would fall within the language of Section 10(2)(xv) of the Act.

Payment of salary in excess of the needs of the business cannot be justified as a proper revenue charge on the income. The taxing authorities have a difficult task to perform when they have to determine whether a salary payment in whole or in part is expended wholly and exclusively for the business. Does the payment represent a fair measure of remuneration for services rendered ; is it within the limits of commercial prudence of a reasonable businessman conducting a business of that magnitude ; does the capacity, ability and skill of the employee deserve the salary paid--these are a few pertinent questions, which if answered may lead to a satisfactory solution of the problem of permissible deduction. Business needs and requirements and the quantum of salary disbursements cannot be nicely and evenly balanced on delicate scales. The department should not use the scissor to prune salary payment to reach absurdly low levels, disregarding the potent factor that the assessed has the privilege and latitude to run his business in the way he likes. A dictatorial assumption and a doctrinaire approach to the problem should of course be avoided. "

42. In *Haji K. Assainar Vs. Commissioner of Income Tax, Kerala*, , a Division Bench of the Kerala High Court considered a claim for deduction of a sum paid as remuneration to the son of a sister-in-law of the assessed under an agreement of employment. Having regard to the tender age and poor academic qualifications of the relative and other circumstances, the ITO found that the payment in question could not be regarded as expenditure " laid out or expended wholly and exclusively for the purpose of the assessed's business ". In the view of the ITO, the payment was motivated by considerations other than commercial expediency.

43. The court relied upon and quoted with approval the observations of Chagla C.J. in *JETHABHAI HIRJI AND CO. Vs. COMMISSIONER OF INCOME TAX, BOMBAY CITY.*, thus (see *Haji K. Assainar Vs. Commissioner of Income Tax, Kerala*, :

".....it is erroneous to contend that as soon as an assessed has established these 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 be open to the Income Tax Officer to take into consideration various factors which would go to show whether the amount was paid as required by the section. For instance, the Income Tax Officer may take into consideration whether the moneys were paid to a near relation of the employer. He may take into consideration the extent of the business and the particular service rendered by the employee which called for a special remuneration at the hands of his employer. He may take into consideration the quantum of the payment made with a view to decide whether the payment was or was not grossly out of proportion to the work done by the employee. If after taking these factors into consideration he comes to the conclusion that the payment was not made wholly and exclusively for the purpose of the business of the assessee, it would be open to him either to disallow the whole sum or a part of the sum paid. The question whether a particular sum was expended wholly and exclusively for the purposes of such business must essentially be a question of fact to be determined by the Income Tax Officer. But it would be open to the assessed to contend, as it has been contended in this case, that the decision arrived at by the Income Tax Officer was based on no evidence at all. If the assessed satisfies the court that apart from the actual payment and existence of the agreement there were no other factors which were taken into consideration by the Income Tax Officer, then perhaps the court would say that the Income Tax Officer was not justified in coming to the conclusion that he did." "

44. The court concluded thus (see pp. 158 & 159 of 69 ITR) " Having regard to all these facts brought out in the evidence and to the circumstance that the person concerned is a relative of the assessed, the conclusion arrived at by the authorities below that the payment of the large amount in question by way of remuneration to Farooq was motivated not by considerations of commercial expediency but by considerations extraneous to the business, was fully warranted."

45. The learned counsel for the assessed has relied upon a recent judgment of the Supreme Court in *Sassoon J. David and Co. Pvt. Ltd., Bombay Vs. Commissioner of Income Tax , Bombay*, . In this case, the court was considering the payment of retrenchment compensation to certain employees which had been approved by the shareholders. The ITO had disallowed the expenditure because in his opinion the services had been terminated not because of business expediency but because " Tatas, the purchasers of the shares made it a condition under the agreement... " The disallowance was confirmed by the AAC and the Tribunal, each referring to the motive of reorganising the shareholding of the business, though conceding the benefit the transaction brought to the company. The court found that the circumstances showed " that the sum of money had been expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business ". On this finding, the court set aside the order of the High Court disallowing the deduction.

46. The court further considered the argument of the revenue that the expenditure was disallowable as a deduction because there was no necessity to incur it. After noticing that in the Bill leading to the enactment of the 1961 Act, there appeared the adjective "necessarily" between the other two adjectives, "wholly" and "exclusively" but on account of public protests, when Section 37 was finally enacted into law, the word "necessarily" came to be dropped, the court proceeded to hold at page 275 :

" Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessed can claim deduction u/s 10(2)(xv) of the Act even though there was no compelling necessity to incur such expenditure. "

47. In summing up, the court followed and affirmed the dictum in *The Commissioner of Income Tax, Bombay Vs. Chandulal Keshavlal and Co., Petlad*, .

48. This decision does very explicitly bring out that necessity of incurring an expenditure is not a consideration relevant to Section 10(2)(xv) of the 1922 Act or Section 37 of the 1961 Act. It also stresses that decisions for incurring an expenditure be left to the assessed but it does say in no uncertain terms that where an expenditure is traceable to an improper or oblique purpose, outside the course of business, then it is not deductible and it is only this which we wish to emphasise in not agreeing with the pleas, as put forward by the learned counsel for the assessed.

49. Having held that the ITO had jurisdiction to go into the circumstances attaching to the transaction in order to satisfy himself whether the expenditure in question qualified the test spelt out in Section 10(2)(xv) and having held that even after a finding in favor of the assessed about the existence of the agreement, the receipt of the loan and its utilisation in business, this jurisdiction is not exhausted, we may now consider the limited scope of review, of a finding of fact arrived at by the tax authorities.

50. In our opinion, it is not for us to go into the appreciation of evidence of circumstances attaching to a transaction to determine whether the ITO or the AAC or the Tribunal was justified in arriving at such a finding as this is wholly a question of fact and not of law and, Therefore, outside the scope of Section 256(2) of the I. T. Act.

51. Of course, whether an inference or conclusion can be reached from a given set of facts is a question of law and we would be justified in interfering with a conclusion of the taxing authorities if it is unsupportable or cannot be reached on the facts found, but not otherwise.

52. We find that this view is fully supported by numerous decisions, some of which we may refer to here.

53. In *The Commissioner of Income Tax, Bombay Vs. Chandulal Keshavlal and Co., Petlad*, , the Supreme Court considered the case of a managing agent,

assessed to which a commission of Rs. 8,09,114 had accrued under the agreement with the managed company but which had accepted Rs. 1,00,000 only and had forgone the balance. The dispute arose out of its claim for a deduction u/s 10 (2)(xv) of the Indian I.T. Act, 1922, for the amount forgone. The Appellate Tribunal found that the financial condition of the managed company was rather unsatisfactory and that the business of the two was so linked that it was in the interest of the assessed to ensure a sound financial position of the managed company. On those and other facts, the Appellate Tribunal found that forgoing of the commission was not a bounty. On this, the High Court held that the aforesaid finding was a finding of fact and " unless it can be suggested that there was no evidence to support the finding of fact, we are concluded by this finding of fact" and answered the question referred in favor of the assessed. The CIT preferred an appeal by special leave to the Supreme Court against it. After considering several earlier decisions, the court held on page 610 :

" The cases we have discussed above show that it is a question of fact in each case whether the amount which is claimed as a deductible allowance u/s 10(2) (xv) of the Income Tax Act was laid out wholly or exclusively for the purpose of such business and if the fact-finding tribunal comes to the conclusion on evidence which would justify that conclusion it being for them to find the evidence and to give the finding then it will become an admissible deduction. The decision of such questions is for the Income Tax Appellate Tribunal and the decision must be sustained if there is evidence upon which the Tribunal could have arrived at such a conclusion."

54. The dictum was applied to the finding of facts noted above and noting that there was enough material to sustain the finding, the appeal of the revenue was dismissed.

55. In *Swadeshi Cotton Mills Co. Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh (No. 1)*, , the Appellate Tribunal had found that the payment of commission was made to the directors for extra-commercial reasons and was not wholly and exclusively made for the purpose of business. The High Court had also come to the same view. The appeal of the assessed was dismissed holding that the appellant was unable to show that this finding was, in any way, vitiated in law.

56. We have already quoted from *Haji K. Assainar Vs. Commissioner of Income Tax, Kerala*, , where it was held that whether a particular sum was spent wholly or exclusively for the purpose of such business must essentially be a question of fact to be determined by the ITO.

57. In *Commissioner of Income Tax Vs. Raman and Raman (P.) Ltd.*, , a Division Bench of the Madras High Court followed an earlier judgment of the court reported as *Sri Krishna Tiles and Potteries (Madras) Private Ltd. Vs. Commissioner of Income Tax*, , and it held thus (p. 750 of 110 ITR) :

".....in cases where the order of the Income Tax Officer had been affirmed by

the Appellate Tribunal the High Court will not normally interfere with that view of the Tribunal unless the decision of the Income Tax Officer or the Tribunal was unreasonable or capricious."

58. In *Upper India Publishing House (P) Ltd. Vs. Commissioner of Income Tax, Lucknow*, , the Supreme Court held in no uncertain terms that whether an expenditure is excessive and unreasonable is essentially a question of fact and observed as under:

" The question whether a particular expenditure on rent is excessive and unreasonable or not is essentially a question of fact and does not involve any issue of law and hence we are of the view that the second question ought not to have been directed to be referred by the High Court. But if the second question could not form the subject-matter of a reference, then obviously the first question becomes academic, because Section 40A(2)(a) cannot have any application, unless it is first held that the expenditure on rent was excessive or unreasonable. We, accordingly, allow the appeal and set aside the order of reference made by the High Court."

59. In *Vishnu Agencies (P.) Ltd. Vs. Commissioner of Income Tax*, , the tax authorities disallowed a deduction in respect of Rs. 76,127 paid as commission to the sole selling agent on the finding that there was no evidence to prove that the agents had rendered any service to the assessed. The court answered the question in favor of the revenue and held at page 827:

" It cannot be said that the Tribunal has misdirected itself or omitted to consider any evidence or has relied on any irrelevant material in arriving at its conclusion."

60. Applying the aforesaid principle of non-interference with the findings of fact, unless the finding is vitiated for being not based on any evidence at all, we find that on the basis of the facts and circumstances found by the ITO, affirmed by the AAC and re-affirmed by the Tribunal, and set out in paras, (a) to (k) on pages...and...above, there was enough material for a conclusion that the payment of Rs. 68,540 as commission to the minors was not exclusively for the purposes of the business of the assessed.

61. The learned counsel for the assessed has not been able to show that the ITO and the other tax authorities misdirected themselves in any manner in coming to this conclusion and, Therefore, in disallowing the same as a deduction u/s 10(2) (xv) of the Indian I.T. Act, 1922. We, Therefore, are unable to interfere with the same and answer. the reference against the assessed. The reference is disposed of accordingly.