Subhodhchandra Popatlal Vs. Commissioner of Income-tax/Excess Profits Tax, Bombay North, Kutch and Saurashtra, Baroda

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Court : Mumbai

Decided On : Aug-28-1953

Reported in : AIR1954Bom234; (1953)55BOMLR959; ILR1954Bom397

Judge : Chagla, C.J. and ;Tendolkar, J.

Acts : Income-tax Act, 1922 - Sections 10, 10(2), 10(2)(X) and 10(2)(XV); Code of Civil Procedure (CPC), 1908

Appeal No. : Income-tax Ref. No. 10 of 1953

Appellant : Subhodhchandra Popatlal

Respondent : Commissioner of Income-tax/Excess Profits Tax, Bombay North, Kutch and Saurashtra, Baroda

Advocate for Def. : G.N. Joshi and ;Nusserwanji Engineer, Advs.

Advocate for Pet/Ap. : N.A. Palkhiwala, Adv.

Judgement :

Chagla, C.J.

1. The question that arises in this reference is whether certain emoluments paid to one Sarabhai, who is an employee of the assessee firm, was a permissible deduction. It appears that this employee was in the service of the assessee firm for the Samvat year 1900. Ho was acting as the manager and from 1990 to 1997 he was paid a salary and varying bonuses. Up to 1995 the bonuses paid to Sarabhai were allowed by the taxing department, but from 1996 when the bonuses went up to Rs. 22,751, the Income-tax Officer refused to allow the full bonus and allowed only a part of it. Then the case of the assessee firm is that in 1993 an agreement was arrived at under which Sarabhai was to be paid a salary and a certain commission on profits, and in respect of Samvat years 1998. 1999, 2000 and 2001 a claim was made by the assessee firm that as the emoluments were paid to Sarabhai under an agreement, whatever was paid was a permissible deduction.

This claim was rejected by the taxing authorities and ultimately the Tribunal also refused to allow the full amount of the emoluments to which Sarabhai was entitled under the alleged agreement. The view taken by the Tribunal was that the agreement relied upon by the assessee firm was not a genuine agreement. It also took the view that the emoluments were not reasonable under Section 10(2)(x). It further took the view that even if the deduction claimed fell under Section 10(2) (xv), the basis for decision under Section 10(2) (xv) was the same as the basis for decision under Section 10(2)(x), and the Tribunal held that even under Section 10(2) (xv) the amount spent was not a reasonable amount. On this decision of the Tribunal various questions have been submitted to us for our opinion. In the view that we take, many of the questions have become unnecessary to decide.

2. The first Question is whether it is possible to take the view that the case of the assessee firm falls under Section 10(2) (xv). Section 10(2) (x) deals with a special case where a sum is paid to an employee over and above his salary as bonus or commission for services rendered. Section 10(2)(xv) deals with a case where an expenditure is laid out or expended wholly or exclusively for the purpose of business, and according to well established canons of construction when a statute deals with a special case, it is not permissible to contend that the special case would also fall under the general provision in the statute. Section 10(2) (xv) deals with all those cases of expenditure laid out or expended wholly or exclusively for the purpose of business which do not fall under any other Sub-section of Section 10(2).

When an expenditure falls under Section 10(2)(x) in the sense that it is an expenditure in the nature of bonus or commission paid to an employee for services rendered, then its validity can only be determined by the test laid down in Section 10(2)(x) and not the test laid down in Section 10(2)(xv). Perhaps Mr. Palkhiwala is right that the question of reasonableness does not arise in the case of Section 10(2) (xv). If the Court is satisfied that an expenditure is laid out or expended wholly and exclusively for the purpose of the business, then the question of reasonableness would be a question of commercial expediency which must be determined by business men and not by taxing authorities. But when we turn to Section 10 (2) (x), every bonus or commission is not a permissible deduction; it is only bonus or commission which is of a reasonable amount.

3. It was attempted to be argued by Mr. Palkhiwala that Section 10(2) (x) only deals with cases where a payment is made to an employee 'ex gratia', but when there is a legal obligation to pay, then the case docs not fall under Section 10(2)(x), and he points out that in this case Sarabhai was entitled to his emoluments not 'ex gratia' but under an agreement. For the purpose of this argument we will assume that the agreement relied upon by the assessee firm was a genuine agreement and that under the agreement Sarabhai was entitled in law to receive the remuneration and emoluments fixed under that agreement.

But even so it is difficult to understand why Section 10(2)(x) does not apply to a case where a bonus or commission is payable under an agreement. The expression 'bonus' is not used in the sense in which it was once understood, viz., an 'ex grstia' payment. It is used in the sense in which it is now understood, viz., a certain remuneration or emolument to which an employee becomes entitled on the satisfaction of a certain condition precedent, and if an employer were to agree with his employee that he will be entitled to a certain amount provided the business made profit, it would be a bonus, and the employee would be legally entitled to recover that amount. The same consideration applies to commission. Instead of an employer paying to an employee a fiat bonus, he may agree to pay a certain commission on profits or on production or on sales or whatever the agreement may be. But whether the payment of the bonus or commission is voluntary or contractual, if an employee is remunerated in the manner laid down in Section 10(2)(x), then such an emolument is a permissible deduction only if the emolument is of a reasonable amount, and, therefore, what we have to consider in this case, and what the Tribunal had to consider, was whether the amount to which Sarabhai was entitled under the alleged agreement was a bonus or commission of a reasonable amount.

4. Now, the Legislature itself has laid down the tests to determine whether a bonus or commission is of a reasonable amount, and the tests laid down by the Legislature are that while determining the question whether a bonus or commission is of a reasonable amount, the Tribunal determining it must pay attention to '(a) the pay of the employee and the conditions of his service, (b) the profits of the business for the year in question, and (c) the general practice in similar businesses.' All these three factors have to be taken into consideration. It is not sufficient to take one or two of these factors into consideration. The Legislature has made it clear that in determining the reasonableness of the bonus or commission, all the three factors should be at the same time taken into consideration, and it is after such a consideration that a determination must be arrived at as to the reasonableness of the bonus or commission.

We find from the statement of the case that at different places the Tribunal has considered the pay of the employee, it has considered the profits of the business for the year in question, and it has considered the general practice in similar businesses. But unfortunately the Tribunal has taken the view, which is clearly

stated in the order, that what is reasonable has to be determined not with reference to each one of the considerations mentioned in Clauses (a), (b) and (c) of Section 10(2)(x). Therefore, according to the Tribunal, if according to a consideration specified in Clauses (a) itself the amount of bonus or commission was not reasonable, then it would be open to the Tribunal to hold that it is unreasonable, cut it down, and not take into consideration the factors mentioned in Clauses. (b) and (c).

Now that, with respect to the Tribunal, is a totally erroneous view of the law. It may be that considering the factor referred to in Clauses (a) the commission or bonus may be unreasonable, it may be that taking the factor mentioned in Clause (b) again the commission or bonus may be unreasonable; but if the Tribunal Were at the same time to consider the factor mentioned in Clause (c) and pay attention to all the factors at the same time under Clauses (a), (b) and (c), the Tribunal may come to the conclusion that the bonus or commission or any portion of it was a reasonable bonus or commission: and therefore it is not a proper legal approach to determine the reasonableness of the commission or bonus by considering one or two of the three factors mentioned by the Legislature separately without considering all of them together.

5. In view of this approach of the Tribunal, we must hold that the Tribunal has misdirected itself in law in disallowing a part of the remuneration paid to Sarabhai. We would, therefore, ask them to decide what is the proper remuneration which should be allowed to Sarabhai, taking into consideration all the factors mentioned in Clauses (a), (b) and (c) of Section 10(2)(x). They will consider the evidence in the light of the judgment delivered by us and they will decide the reasonable remuneration on such evidence and such materials as are before them, having considered the evidence and the materials in the light of the factors mentioned by the Legislature in Clauses. (a), (b) and (c) of Section 10(2) (x).

6. Turning to the questions, the first is unnecessary. The answer to the second question is : Clause (x) of Section 10(2) applies and not Clauses (xv). With regard to question No. 3, we would answer the first part in the affirmative. The second part does not arise because it would be for the Tribunal in the light of the judgment to direct ic-self properly in law and to consider the evidence in the manner indicated by us in the judgment. Question No. 4 does not arise.

7. No order as to costs.

8. Reference answered.