A

LAKSHMIRATTAN COTTON MILLS

v.

COMMISSIONER OF INCOME-TAX, U.P.

September 3, 1968

B [J. C. SHAH, V. RAMASWAMI AND A. N. GROVER, JJ.]

Income-tax Act (11 *of* 1922), *ss.* 10(2)(*xv*), 66(1), (2) *and* (4)—*Termination of managing agency—No evidence of services done by managing agent—Payment of compensation for termination—If permissible deduction under s.* 10(2)(*xv*).

Questions not raised in application under s. 66(1) *and* (2)—*Jurisdiction of High Court to direct Tribunal to state case on such question under s.* 66(4).

C

The shares in the assessee-company were held in equal moieties by two families. Four members of each family, together, formed a partnership firm and by a managing agency agreement the assessee appointed the firm as its managing agent. In 1943, one of the families was represented in the firm by two women and two minors. The management of the assessee was carried on by two of the four members of the other family who were the partners in the firm. Those two members were also directors of the assessee-company. Disputes arose between the two families and the assessee terminated the managing agency with effect from September 30, 1944. Thereupon the members of the two families asserting that they, as partners of the firm were interested in the managing agency, claimed compensation from the assessee for wrongful termination of the agency. The dispute between the firm and the assessee was referred to arbitration, and in pursuance of the award the assessee paid Rs. 18,90,000 to the firm and Rs. 13,300 were disbursed as expenses of arbitration.

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The assessee claimed the payment of Rs. 19,03,300 as a permissible allowance under s. 10(2)(xv) of the Income-tax Act, 1922, but the Income-tax Officer, Appellate Assistant Commissioner and the Appellate Tribunal disallowed the claim. The assessee then filed an application under s. 66(1) for stating a case for the opinion of the High Court, but the Tribunal rejected the application. The assessee then moved the High Court under s. 66(2) for directing the Tribunal to state a case in respect of two questions. On the direction of the High Court, the Tribunal referred to the High Court the question: Whether there was material on which the Tribunal could have come to the conclusion that Rs. 19,03,300 were not spent by the assessee wholly and exclusively for the purpose of its business. The assessee, thereafter, filed another application before the High Court for referring *additional questions which were not incorporated in the applications under s.* 66(1) *or* (2); and the High Court, in purported exercise of the power under s. 66(4) directed the Tribunal to submit another statement with respect to the additional questions and the Tribunal complied with the order.

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At the hearing of the reference, the High Court was of the view that it had no jurisdiction under s. 66(4) to direct the Tribunal to submit the second statement and declined to record formal answers on the additional questions. On the original question, the High Court held that there was material on which the Tribunal could hold that the allowance claimed was not spent wholly and exclusively for the purpose of the assessee's business and confirmed the Tribunal's order.

H

In appeal to this Court, on the questions: (1) whether the High Court acted without jurisdiction, in calling for the second statement of case; and (2) whether there was material before the Tribunal to justify it in its conclusion. A

HELD: (1) In an application under s. 66(2), the High Court cannot order that a case be stated on questions which were not included in the application under s. 66(1). Power under s. 66(4), may be exercised to call for a supplementary statement only when the Court is satisfied that the statement in the case referred under s. 66(1) or (2) is not sufficient to enable it to determine the question raised by that statement. The power cannot be exercised for calling for another statement on questions not referred by the Tribunal. Therefore, the procedure followed by the High Court, in exercise of the power under s. 66(4), calling for an additional statement of case on questions which were not incorporated in the applications under s. 66(1) and (2) was irregular. [963 G-H; 964 D, H-965 A] B C

New Jahangir Vakil Mills Ltd. v. *C.I.T.* [1960] 1 S.C.R. 249; 37 I.T.R. 11 (S.C.) and *C.I.T.* v. *Scindia Steam Navigation Co.*, 42 I.T.R. 589, 609 (S.C.) followed.

The High Court, at the hearing of the reference, was justified in refusing to answer the additional questions, since, it may decline to answer a question referred pursuant to the direction of the High Court if the question could not have been raised because it was not incorporated in the application under s. 66(1). [965 B-C] D

C.I.T. v. *Smt. Anusuya Devi*, 68 I.T.R. 750 (S.C), followed.

(2) (a) The burden of proof lay upon the assessee to prove that the expenditure was incurred wholly and exclusively for its business. In the present case, the remuneration payable under the managing agency agreement was for a two-fold consideration (i) for the service rendered in promoting the assessee; and (ii) for rendering services to the assessee as managing agent. But there was no evidence that any specific functions were entrusted to the managing agent. A recital in the managing agency agreement authorising the agent to do certain acts would not be a substitute for evidence that those acts were done. The management of the assessee was in fact carried on by two members of one of the families, both before and after the termination of the managing agency; and the members of the other family (women and minors) had no effective voice in the management. Even the two members who were managing the affairs of the assessee were doing so not as partners of the firm but in their capacity as directors of the assessee-company. There was no reliable evidence before the Tribunal, and the Tribunal was justified in reaching the conclusion that the firm did not render any service to the assessee as its managing agent. If no service was in fact rendered by the managing agent, the remuneration must be regarded as exclusively payable for the service rendered in promoting the assessee. But expenditure incurred for remunerating persons who had promoted a company is not in law a revenue expenditure admissible under s. 10(2)(xv). Therefore, compensation payable to the managing agent for termination of the managing agency could not be said to be expenditure incurred wholly and exclusively in the interest of the business of the assessee. [965 D, F-G; 966 F-G; 967 B-D; 968 B-D] E F G H

(b) There was no evidence and not even an attempt was made to explain how the affairs of the company would have been prejudiced by the disputes between the two families. The Tribunal found, on the evidence before it, that the disputes were personal to the two families and

A did not and could not prejudicially affect the business of the assessee or put any hindrance in its normal day to day working, and that there was no necessity for terminating the agency and for paying compensation on that ground. [965 G-H; 968 A-B]

(c) It was not suggested that the affairs of the assessee were mismanaged. Hence, even if one of the families threatened to apply for the appointment of a receiver for the management of the assessee company no receiver would have been appointed for the management of the assessee. Therefore, it was unlikely that such a futile threat was taken into account for determining the managing agency, necessitating the payment of compensation. [967 G-H]

There was thus ample material on which the conclusion of the Tribunal was based. The Tribunal considered all the relevant evidence and its finding could not be said to be based on mere surmises and conjectures. [968 H]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2139 of 1966.

Appeal by special leave from the judgment and order dated July 27, 1965 of the Allahabad High Court in Income-tax Reference No. 586 of 1961.

S. T. Desai and *J. P. Goyal,* for the appellant.

B. Sen, R. N. Sachthey and *B. D. Sharma,* for the respondent.

The Judgment of the Court was delivered by

Shah, J. In proceedings for assessment of tax for the year 1945-46 the Lakshmirattan Cotton Mills—hereinafter called 'the Company'—claimed allowance under s. 10(2)(xv) of the Income-tax Act, 1922, of Rs. 18,90,000 paid by it as compensation for termination of the managing agency of the firm Beharilal Kailashpat and Rs. 13,300 incurred as expenditure in respect of arbitration proceedings in connection with the determination of compensation. The Income-tax Officer disallowed the claim. The order was confirmed by the Appellate Assistant Commissioner and by the Income-tax Appellate Tribunal. The High Court of Allahabad in a reference under s. 66(2) of the Income-tax Act, 1922, held that there was material on which the Tribunal could hold that the allowance claimed was not spent wholly and exclusively for the purpose of the company's business.

The facts which give rise to the reference require to be stated in some detail. The Company was incorporated in 1934. The shares of the Company were held in equal moieties by members of two families, who may for the sake of convenience be referred to as "Singhanias" and "Guptas". Under a deed dated August 3, 1934, Singhanias and Guptas formed a partnership to carry on, in the name of Beharilal Kailashpat, several businesses including the business of Secretaries, Treasurers and Agents of the Company. By agreement dated May 2, 1935, the Company appointed

Beharilal Kailashpat as its managing agents. The firm then consisted of eight partners—four belonging to the family of Singhanias and the other four belonging to the family of Guptas. Under the Articles of Association of the Company two *ex-officio* directors were to be nominated by Beharilal Kailashpat. Clause 2 of the managing agency agreement read as follows :

"In consideration of the agreement hereinbefore contained on the part of the firm and in further consideration of the firm having promoted the Company, the Company hereby promise and agree with the Firm and its Members for the time being .—

(a) That the Firm shall be the Agents of the Company for a period of ninety-nine years and thereafter until they shall resign or until they are thereafter removed from their office as Agents of the Company by a majority of three-fourths of the shareholders of the Company.

(b) The Firm shall receive from the Company a commission at the rate of two per cent on the sale price of all the cotton, yarn and cotton cloth manufactured and sold by the Company and a commission of one per cent on the sale proceeds of all materials, yarns and fabrics manufactured from wool, jute, silk and other fabrics, and sold by the Company, and a commission of ten per cent on the gross profits after deducting all expenses but before deducting depreciation, made by the Company from its ginning or pressing operations independently of the usual *adat* commission, exchange and interest payable to their branch firms or agents and *adatias* appointed by them outside Cawnpore for purchasing or selling any goods or commodities for or on account of the Company.

(c) The Company shall defray the expenses of maintaining a suitable office and such staff as the Firm may deem proper to transact the business of the Firm as Agents of the Company.

(d) In case the Company shall sell their Mill premises and machinery and the business thereof, the same shall be sold subject to the rights and claims of the Firm of the Agents of the Company as provided by this Agreement and the Memorandum and Articles of Association of the Company."

By cl. 3 of the agreement it was provided that in the event of the Company being wound up the managing agents Beharilal Kailashpat shall be entitled to receive compensation for loss of appointment as agents a sum equal to the amount earned by the firm during five years preceding the winding up of the Company. Beharilal Kailashpat were under cls. 3(f) and (g) to purchase all cotton, wool, machinery and stores that may from time to time be required for the use of the Company Mills and to sell the same and also to sell all loose or baled yarn, and cloth produced or manufactured at the Company's Mills. By cl. (h) the managing agents were to exercise all the powers given to them by the Articles of Association of the Company. It was also provided that if the firm be not dissolved it shall be lawful for the firm to change its constitution, name or style from time to time, without thereby in any way affecting their appointment as agents of the Company.

From time to time the constitution of Beharilal Kailashpat was changed—some members ceased to be partners and new members entered the firm—without affecting the equal representation of Singhanias and Guptas. On February 15, 1943, a fresh deed of partnership of Beharilal Kailashpat was executed under which the four representatives of Singhanias were—(1) Smt. Ansuiya Devi; (2) Smt. Pushpavati Devi; (3) Vijaipat (minor) and (4) Ajaipat (minor) [Nos. (3) & (4) being minor sons of Lala Kailashpat Singhania]: the representatives of Guptas were—(1) Smt. Ramdevi; (2) Smt. Keshobai; (3) Lala Ram Rattan Gupta and (4) Lala Ram Prasad Gupta. Each of the family collectively held an eight annas share. Under the terms of this partnership deed it was agreed that Lala Ram Rattan Gupta a partner of the firm will be entitled to carry on business on behalf of the firm.

Disputes arose in 1943 between Singhanias and Guptas in regard to the management of the various businesses in which they were interested. These disputes were referred for adjudication to Thakur Kanhaiya Singh who made and published his award on January 18, 1944. Under the award the arbitrator allotted certain businesses exclusively to Singhanias and the rest to Guptas. In regard to the managing agency of the Company, the award directed that the Singhania group do withdraw from the Company, and the shares held by them be given to the Gupta group "at the rate of Rs. 2,000 per share" : that Padampat and his two brothers do resign from the Board of Directors, that the Singhania group be deemed to have retired from the partnership of the managing agency as from 25th January 1944 and that L. Ram Rattan Gupta along with his members of the group be entitled to continue the said managing agency business : that the name of Kailashpat be removed from the firm's name of Beharilal Kailashpat; that the profit and loss account of Beharilal

Kailashpat be made up to January 18, 1944, and that the amount due to either of the groups ascertained after providing for excess profits tax and income-tax liabilities be paid. Pursuant to the award the shares held by the Singhanias were taken over by the Guptas, and the name of the managing agency firm was changed to Beharilal Ramcharan. On March 31, 1944, the shareholders of the Company approved of the changes in the constitution of the managing agency firm.

Apparently Singhanias were not satisfied with the award made by Thakur Kanhaiya Singh and they commenced an action (Suit No. 31 of 1944) in the Civil Court at Kanpur, and claimed relief in respect of the termination of their interest in Beharilal Kailashpat, and in respect of certain other matters. There was correspondence between Singhanias and Guptas which it is unnecessary at this stage to refer. On September 19, 1944, at a meeting of the shareholders of the Company the firm of Beharilal Ramcharan which was brought into existence under a deed of partnership dated January 27, 1944, were appointed managing agents of the company. The Singhanias insisted that they remained interested in the managing agency and the Guptas asserted that under the award of Thakur Kanhaiya Singh the Singhania group had ceased to have interest in the managing agency and on retirement of the members of the Singhanias, the name of Beharilal Kailashpat was changed to Beharilal Ramcharan. The shareholders of the Company at their meeting held on September 19, 1944, also passed a resolution that the managing agents be dismissed from the office and the managing agency agreement be terminated with effect from September 30, 1944.

Thereafter the members representing the Singhanias claimed compensation from the Company for wrongful termination of the managing agency. The Guptas also made a claim for compensation and threatened to bring an action against the Company. By agreement dated October 19, 1944, the disputes between the Company and Beharilal Kailashpat were referred to the arbitration of Mr. K. M. Munshi with authority to decide two questions—(1) whether the termination of the managing agency and removal from the office of the managing agents of the firm of Beharilal Kailashpat and/or its alleged successor Beharilal Ramcharan was wrongful or not; and (2) if it was wrongful, to what compensation, if any, are the ex-managing agents entitled ? Before Mr. Munshi entered upon the reference, the award made by Thakur Kanhaiya Singh was modified by a supplementary award made by Thakur Kanhaiya Singh with the consent of the parties. Under the award so modified, it was provided that :

> "Regarding the claim of the retiring partners for a share in the goodwill of the said firm and in the value of the said Managing Agency the said I.R.C.M. Co.

A Ltd. having terminated the said Managing Agency Agreement and the Managing Agents having claimed compensation for the said termination which they allege was wrongful and the dispute arising out of such claim having been referred to arbitration, it is agreed and awarded that any sum awarded as compensation in the
B said arbitration shall be paid to and retained by the continuing partners and that irrespective of the result of the said award and in any event they, *i.e.* the continuing partners shall pay to the retiring partners a sum of Rs. eight lacs as representing their share in the compensation for the premature and wrongful termination of the Managing Agency Agreement with the said firm.
C The above payments shall be in full satisfaction and discharge of all claims and demands whatsoever of the retiring partners on and to the assets, goodwill and contracts of the said firm including the Managing Agency Agreement with the L.R.C.M. Co. Ltd., and also in full satisfaction and discharge of the claim made
D by them against the Lakshmirattan Cotton Mills Co. Ltd., for compensation for the termination of the said Managing Agency."

On this modified award a consent decree was obtained in Suit No. 31 of 1944 filed by Singhanias.

Thereafter Mr. Munshi made an award on March 25, 1945,
E directing—

(1) That the termination of the managing agency of M/s Beharilal Kailashpat and their removal from the office of Managing Agents of the said company *i.e.* Laxmirattan Cotton Mills Co. Ltd. was wrongful.

F (2) That the said Laxmirattan Cotton Mills Co. Ltd. are liable to pay to the firm of M/s Beharilal Kailashpat a sum of Rs. 18.90,000 only as and by way of compensation for such wrongful dismissal.

(3) That the said Laxmirattan Cotton Mills Co. Ltd. to pay to party of the third part, that is to say,
G L. Ramrattan Gupta and Lala Ramprasad Gupta sons of L. Beharilal, and Smt. Keshobai, wife of L. Ramgopal, the said sum of Rs. 18,90,000 only, with interest thereon at the rate of 3 per cent. per annum from the date hereof.

(4) That the said company do pay the said parties
H of the 2nd part and of the 3rd part their respective costs of the reference and the arbitration proceedings (which included fees of Rs. 10,000) to Mr. K. M. Munshi.

Payment was thereafter made by the Company in pursuance of this award of Rs. 18,90,000 to Beharilal Kailashpat and Rs. 13,300 were disbursed as expenses of arbitration. A

The Income-tax Officer rejected the claim of the Company to treat as a permissible allowance under s. 10(2)(xv) of the Income-tax Act, 1922, the amount of Rs. 19,03,300. He held that the expenditure incurred was not connected with the business of the Company and in any event it was capital expenditure. In appeal the Appellate Assistant Commissioner held that the payment was made "for some improper purpose . . . . . not connected with the business". In further appeal before the Tribunal, counsel for the Company urged two arguments in support of the claim for allowance : B C

(1) that the main object in terminating the managing agency was to save the Company from loss which the Company would have suffered on account of the disputes between the two groups of partners of the managing agency firm; and

(2) that the Company was by the payment absolved from liability to the remuneration of the managing agents for the year of account and for future years also. D

The Tribunal held that before the termination of the managing agency agreement the affairs of the Company were administered by Lala Ram Rattan Gupta and Lala Ram Prasad Gupta, that even after the termination of the managing agency Lala Ram Rattan Gupta and Lala Ram Prasad Gupta continued to administer the affairs of the Company, and that on the materials on record it was not proved that the managing agents were performing any service to the Company. The Tribunal therefore held that the payment of the managing agency commission to the managing agents was not expenditure wholly and exclusively incurred for the purpose of the Company's business. The Tribunal also observed that the disputes between the two groups could in no way harm or cause hindrance to the "normal day-to-day working" of the Company. E F

Referring to the second plea the Tribunal observed that consideration for the appointment of the managing agents were-- (1) promotion of the Company; (2) rendering service to the Company : anything paid for promoting the Company was not admissible as a revenue deduction, and by making a consolidated payment to pay off such a liability the Company did not reduce the future revenue liability of the Company. G

The Tribunal in summarising the findings observed : H

"These disputes (between Singhanias and Guptas) were taken to the Court and (were) also referred to

A arbitration. After the first arbitration dated 18-1-1944, the Singhania group was not satisfied. Ultimately some sort of a settlement was arrived at through an arbitrator whose supplementary award forms the basis of the consent decree of the Court. Under this award each party had to pay the other large sums. Therefore, a device was adopted to provide funds in the hands of the parties at the expense of the company for the purpose of settling their individual accounts. In preparing the scheme the authors had made an effort to reduce the tax liability of the company by claiming the amount as a revenue deduction."

C The Tribunal also observed that the firm styled Beharilal Ramcharan was brought into existence in place of Beharilal Kailashpat, but it rendered no services as managing agents. The Tribunal accordingly rejected the claim of the Company for treating the compensation paid to the managing agents and the legal expenses in relation thereto as a permissible deduction in the computation of its total income.

D

The Company submitted an application under s. 66(1) of the Income-tax Act, 1922, for submitting a statement of case and prayed that seven questions set out in the application be referred to the High Court. The Tribunal rejected the application holding that no question of law arose out of the order of the Tribunal, and that the questions sought to be raised by the Company "were E pure questions of fact". The Company then moved an application in the High Court of Allahabad requesting that the Tribunal be directed to state a case in respect of two questions :

"(1) Whether in the circumstances of the case the expenditure made by the assessee company for the purF pose of getting rid of the Managing Agents was not the expenditure admissible under s. 10(2) (xv) of the Income-tax Act ?

(2) whether there was any or sufficient evidence to justify the Tribunal to hold that no services whatever were rendered by Managing Agents to the assessee G Company under the Managing Agency Agreement and that therefore nothing was payable to the Managing Agents in respect of such services ?"

The High Court directed the Tribunal to state a case on questions of law arising out of its order. Pursuant to this order, the Tribunal on December 29, 1954, submitted the following question :

H "whether there was material on which the Tribunal could have come to the conclusion that Rs. 19,03,300 were not spent by the assessee company wholly and exclusively for the purpose of its business ?"

The Company was apparently dissatisfied with the question referred by the Tribunal and filed a petition in the High Court praying that certain questions set out in the application be decided along with the question already referred and the Income-tax Appellate Tribunal be directed to amend the statement of case and to refer the additional questions also to the High Court for decision. The High Court in purported exercise of the power under s. 66(4) of the Indian Income-tax Act, called upon the Tribunal to submit another statement of case on the following questions :

"1. Was there any material for the finding--

(a) that the managing agents had rendered no service to the assessee company;

(b) that Lala Ram Rattan Gupta and Lala Ram Prasad Gupta were acting *qua* their position as Directors and not as partners of the managing company;

(c) that a device was adopted to provide funds in the hands of parties at the expense of the company for the purpose of settling their individual accounts and that the payment of the amount in question was made only as a part of this device;

(d) that the disputes between the partners of the managing agency firm could not, in any way, have affected the carrying on of the normal business of the company; and

(e) that the company gained nothing by terminating the managing agency agreement ?

2. Whether the whole or any part of the sum of Rs. 18,90,000 was paid by the company to the managing agents having promoted the company ?

3. What was the true nature of the payment of the sum of Rs. 18,90,000 by the company to the managing agents on a correct interpretation of the managing agency agreement ?

4. Whether the sum of Rs. 18,90,000 together with the sum of Rs. 13,300 paid as expenses of litigation or any part thereof was an expenditure incurred wholly and exclusively by the company for purposes of its business and as such it was an allowable deduction?"

The Tribunal complied with the order and submitted another statement of the case setting out in detail the materials on which

A the various findings which were sought to be incorporated in the questions were founded.

At the hearing of the reference the High Court was of the view that the Court had no jurisdiction under s. 66(4) of the Income-tax Act to direct the Tribunal to submit second statement of case and the questions in addition to the one submitted B before the Tribunal "could not legally have come before the High Court", since the earlier statement of the case was not quashed, nor was it returned to the Tribunal; and the Court in calling upon the Tribunal to submit another statement of case did not act in conformity with the provisions of sub-s. (4) of s. 66 of the Income-tax Act. In the view of the High Court a comparison of C the question originally framed with the questions referred with the second statement of case by the Tribunal showed that the second set of questions were not parts of, or included in, the former question but were substantially different : some of the questions in the view of the High Court were pure questions of fact, some of them were overlapping, and the questions were D different from the two questions mentioned in the application under s. 66(2), and that on the application submitted by the Company, even if it be treated as an application for calling for a statement of case under s. 66(2), the only question that the Court could call upon the Tribunal to refer was Question No. 1(a) submitted with the second statement of case. The High Court then observed that they were under a duty to refuse to answer E questions which did not arise out of the order passed by the Tribunal or were not included in the application under ss. 66(1) and (2). But out of deference to the order previously passed the Court proceeded to consider and set out reasons in support of the answers to the questions referred if those questions were required to be answered. The High Court said that on the question there F was evidence that no change had taken place for carrying on the company's business after the termination of the agreement. Questions 1(b), 1(c), 1(e) and (2) & (3), the High Court observed, were not incorporated in the applications under ss. 66(1) & (2) and Question 1(d) was not mentioned in the application under s. 66(2), and those questions did not arise out of the order of the Tribunal. Further, the High Court observed, G Questions 1(b), 1(c), 1(d), 1(e) and (2) could not be answered in favour of the assessee, and Question (3) was irrelevant and need not be considered. In the view of the High Court Question (4) consisted of two limbs : whether the payment of Rs. 18,90,000 was made for the purpose of the company's business, and whether the payment for that purpose amounted to H revenue expenditure. The first, in the view of the High Court, was a question of fact and the second though a mixed question of law and fact did not arise for determination unless the first limb was answered in favour of the Company, and that in any

event if the question were to be reduced to the form whether there was any material for the finding that the payment was not an expenditure incurred wholly and exclusively for the purpose of the company's business, the answer must be against the Company. A

After a detailed consideration the High Court held that the expenditure in question was not made wholly and exclusively for the purpose of the company's business, and was by way of distribution of profits, and being wholly gratuitous or "for some improper or oblique purpose outside the course of business management", it could not be treated as a permissible deduction. Against the order recorded by the High Court, this appeal has been preferred with special leave. B

We propose in the first instance to consider whether the High Court acted with jurisdiction in calling for a second statement of case on questions which were not incorporated in the applications under ss. 66(1) & (2) of the Act after the Tribunal had submitted a statement of case in response to the order under s. 66(2). Under s. 66(1) of the Income-tax Act, 1922, the assessee or the Commissioner may by application in the prescribed form within the period provided require the Appellate Tribunal to refer to the High Court any question of law arising out of such order and the Tribunal is enjoined by law to draw up a statement of case and refer it to the High Court. If on any application made under sub-s. (1) the Appellate Tribunal refuses to state a case on the ground that no question of law arises, the assessee or the Commissioner may, if he is not satisfied with the correctness of the decision of the Appellate Tribunal make an application to the High Court to require the Appellate Tribunal to state the case and to refer it to the High Court and on receipt of any such requisition the Tribunal shall state the case and refer it. If the High Court is not satisfied with the statement of case referred under sub-s. (1) & (2) of s. 66 and the facts are not sufficient to enable determination of question raised thereby, the Court may, in exercise of the power under sub-s. (4), refer the case back to the Appellate Tribunal to make such additions thereto or alterations therein as the Court may direct in that behalf. Under sub-s. (5) of s. 66 the High Court upon hearing any such case shall decide the question of law raised thereby. C D E F G

This Court in *New Jehangir Vakil Mills Ltd.* v. *Commissioner of Income Tax*(1) observed.

> "It is clear . . . . that the only question of law which the assessee or the Commissioner can require the Tribunal to refer to the High Court is 'any question of law arising out of the order of the Tribunal' . . . . . What has, therefore, to be looked at in the first ins- H

(1) [1960] 1 S.C.R. 249: 37 I.T.R. 11

A tance is whether the question of law thus required to be referred arises out of the order of the Tribunal. . . . . Section 66(2) which gives the power to the High Court to require the Tribunal to state the case and refer the question of law to it also proceeds on the same basis and even where the High Court exercises the power under section 66(2) it can only require the B Tribunal to state the case on any question of law arising out of such order. The scope and subject-matter of the reference under section 66(2) . . . . . is co-extensive with that of the reference under section 66(1) of the Act and the High Court has no power or jurisdiction under section 66(2) to travel beyond the C ambit of section 66(1). Section 66(2) comes into play only when the Tribunal refuses to state the case on the ground that no question of law arises and if the High Court is not satisfied of the correctness of the decision of the Tribunal, it has . . . . the power and jurisdiction to require the Tribunal to state the case D and refer the same to it.

. . . . . This statement of case which is based . . . . . on the facts which are admitted and/or found by the Tribunal may not contain sufficient material to enable the High Court to determine the question raised thereby and in that case the High Court under section E 66(4) is vested with the jurisdiction to refer the case back to the Tribunal to make such additions thereto or alterations therein as the Court may direct in that behalf only for the purpose of determining the questions referred to it. . . . . But section 66(4) does not enable the High Court to raise a new question of law which does not arise out of the Tribunal's order F and direct the Tribunal to investigate new or further facts necessary to determine this new question which had not been referred to it under section 66(1) or section 66(2) and direct the Tribunal to submit a supplementary statement of case. This power and jurisdiction which is vested in the High Court is to be exercised G within the four corners of section 66."

It is also well settled that in an application under s. 66(2) of the Income-tax Act the High Court cannot order that a case be stated on questions which were not included in the application submitted under s. 66(1). It was observed by this Court in *Commissioner of Income-tax* v. *Scindia Steam Navigation Co. Ltd.*(1)

H "..... the power of the Court to direct a reference under section 66(2) is subject to two limitations

(1) 42 I.T.R. 589, 609 (S.C.).

—the question must be one which the Tribunal was bound to refer under section 66(1) and the applicant must have required the Tribunal to refer it . . . . . It is, therefore, clear that under section 66(2), the Court cannot direct the Tribunal to refer a question unless it is one which arises out of the order of the Tribunal and was specified by the applicant in his application under section 66(1)."

The High Court was, therefore, incompetent to call upon the Tribunal to submit a statement of case on questions of fact or questions which were not incorporated in the application under s. 66(1).

The Company in its application under s. 66(2) requested that a statement of case be called for in respect of only two questions. Thereafter the Company applied to the High Court for an order that other questions which were neither incorporated in the application under s. 66(1) nor in the application under s. 66(2) be submitted to the High Court. The High Court had no power, in our judgment, to grant that application. The power under s. 66(4) may be exercised to call for a supplementary statement only when the Court is satisfied that the statements in a case referred under sub-s. (1) or sub-s. (2) of s. 66 are not sufficient to enable it to determine the question raised by that statement. It does not confer a power to raise any additional questions or to call for a statement of case on questions not referred by the Tribunal. If it happens that the Tribunal makes an inadequate statement of case and does not submit all the questions of law arising out of the order of the Tribunal, the remedy of the aggrieved party is to proceed in the manner suggested by Kania, J. in *N. V. Khandvala* v. *Commissioner of Income-tax*(1):

"When a statement of case, with the question of law framed by the Tribunal, is filed in Court for disposal, if a party is aggrieved and wants to contend that certain further facts ought to be stated, or certain questions of law should be raised, he can make an application by way of notice of motion. That should be heard along with the case stated by the Tribunal for the Court's opinion. At that time the Court will consider whether the statement of case is complete for the question of law raised by the Tribunal. The Court can also consider whether on the case stated by the Tribunal the proper question is raised or not."

The power under s. 66(4) may be exercised when the High Court is not satisfied that the statements in a case referred are sufficient to determine *the question* referred thereby, it cannot be exercised for calling for another statement on questions not

(1) 14 I.T.R. 635, 637.

A referred by the Tribunal. The procedure followed by the High Court in calling for, in exercise of the power under s. 66(4), an additional statement of the case on questions which were not incorporated in the applications under ss. 66(1) & (2) was, in our judgment, irregular.

Correctness of an order of the High Court calling for a statement of case may be challenged at the hearing of the reference and the Court may decline to answer the question referred pursuant to the direction of the Court, if it did not arise out of the order of the Tribunal, or is a question of fact or is academic or could not have been raised because it was not incorporated in the application under s. 66(1); *Commissioner of Income-tax* v. *Smt. Anusuya Devi*(1). Counsel for the Company has therefore rightly confined himself to the question which was originally submitted by the Tribunal by order dated December 29, 1954, and has raised his argument on that question only.

The Company claims that the expenditure of Rs. 19,03,300 is a permissible allowance under s. 10(2)(xv) of the Indian Income-tax Act as expenditure wholly and exclusively incurred for the purpose of the business of the company. The burden of proof lay upon the Company to prove that the expenditure was incurred wholly and exclusively for the business of the Company. In the view of the Tribunal the management of the Company was being carried on by two members of the Gupta group who were acting as *ex-officio* directors. Even after the termination of the managing agency on September 30, 1944, those two members continued to carry on the management, and the Company appointed no managing agents till July 1947, when a private limited Company styled B. R. Sons Ltd., of which the members of the Gupta group were shareholders, was brought into existence. Singhanias were represented at the relevant time in the firm of Beharilal Kailashpat by two women and two minors who could not and did not take any effective part in the business of the partnership or in the management of the Company's business. The members of the Gupta group were managing the affairs of the Company, not as partners of Beharilal Kailashpat but in their capacity as directors of the Company, and there was no evidence that the firm of Beharilal Kailashpat rendered any services to the Company. After the termination of the managing agency, Lala Ram Rattan Gupta and Lala Ram Prasad Gupta were appointed directors of the Company and looked after the business of the Company.

The Tribunal held that the disputes between the Singhania group and the Gupta group were real, but the disputes were personal to the two families who constituted the firm, and the disputes did not and could not prejudicially affect the business of the Company. The Tribunal also found that the firm Beharilal

(1) 68 I.T.R. 750.

Ramcharan who were appointed managing agents on March 31, 1944, were not formally dismissed: but they merely drew remuneration under the agreement and rendered no service. There was no evidence that any specific functions were entrusted to the managing agents, besides those specified in the managing agency agreement, and it was conceded by the representative of the managing agents that after the termination of the managing agency agreement on September 30, 1944, "no change took place besides that Ram Rattan and Ram Prasad who were the *ex-officio* directors became ordinary directors". From these facts the Tribunal inferred that the managing agents as such rendered no service to the Company.

Counsel for the Company contended that the findings of the Tribunal were based upon mere surmises and conjectures and were in any event based on no evidence. He relied upon the last paragraph of the statement of case that the "Tribunal's real finding" on which the finding relating to the inadmissibility of the expenditure was based was that a device was adopted to provide funds in the hands of the parties at the expense of the Company for settling their individual accounts. Counsel also submitted that there was a mass of evidence which the Tribunal ignored in deciding whether the managing agents rendered any service. Our attention was invited to the terms of the managing agency agreement and also to assertions made in the correspondence between the Company and the Singhanias, and also to the finding recorded by the Income-tax Officer who observed that all circumstances pointed to the fact that "the managing agents were managing the affairs of the Company well. Hence if still they were removed from service the inference is clear that they were removed for some reasons not connected with business".

In reaching its conclusion the Tribunal considered all the relevant evidence. The Tribunal has referred to the order of the Income-tax Officer, to the terms of the managing agency agreement and also to the correspondence. The Tribunal primarily relied upon the facts that before and after the termination of the managing agency agreement, only two directors Lala Ram Rattan Gupta and Lala Ram Prasad Gupta carried on the business of the Company and no explanation was rendered before the Tribunal about the specific services rendered by the managing agents. They observed :

> "There is nothing on record to show or even to indicate the nature of the services rendered by them besides nominating directors to act as *ex-officio* directors. Whatever may be the functions assigned to the *ex-officio* directors, they were *qua* their position as directors. We have looked everywhere but we failed to have any indication as to the services rendered by the

A managing agents. Services are not rendered by merely entering into an agreement with the company to do the functions of the managing agents. There must be something more than that and we have not the least hesitation in saying that in the present case on the facts on record there is nothing to indicate that the managing
B agents as such rendered any service."

We are unable to hold that the finding that no services were rendered by the managing agents was based on "surmises and conjectures", or that it was based on no evidence. The burden of proving that services were rendered by the managing agents for earning the remuneration lay upon the Company, and if no
C reliable evidence was forthcoming, the Tribunal was competent to reach the conclusion it did.

The recitals in the agency agreement which authorised the managing agents to do certain acts could not be a substitute for evidence that those acts were done by the managing agents. Counsel for the Company made no effort to enlighten the Tribunal
D on how the business of the Company would have suffered by the quarrels between Guptas and Singhanias. Even prior to the termination of the contract of the managing agents of the Company, the Singhanias had no effective voice in the management of the firm. No representative of the Singhanias was on the Board of Directors prior to the termination of the contract. If in that
E state of evidence the Tribunal concluded that quarrels between the Guptas and Singhanias could in no way harm or put hindrance in the normal day to day working of the Company, the finding could not be again said to be based on surmises and conjectures.

F Counsel for the Company invited our attention to the threat by the Singhanias to move the Civil Court to appoint a receiver for the management of the Company, and contended that if a receiver was appointed for management of the Company, the affairs of the Company might possibly have been mismanaged. It is difficult to understand that because of the disputes between the two sets of partners of the managing agency firm, a civil court
G could have appointed a receiver to manage the affairs of the Company : a receiver may have been appointed of the remuneration payable by the Company, but not of the management. It is not suggested that the affairs of the Company were mismanaged. The management of the Company was conducted after September 30, 1944, in the same manner and by the same directors as it was
H originally conducted. A futile threat could not reasonably be taken into consideration, and was not apparently taken into account, for determining the managing agency agreement. This plea was apparently not even suggested before the Tribunal.

The burden of proving that the expenditure was incurred wholly and exclusively for the purpose of the business lay upon the Company and no evidence was led and not even an attempt was made to explain how the affairs of the Company would have been prejudiced by the disputes pending between the Singhanias and Guptas.

The remuneration payable under the managing agency agreement was for a two-fold consideration—(1) the services rendered by the managing agents in the promotion of the Company; and (2) for rendering services to the Company. Expenditure incurred for remunerating the persons who had promoted the Company was not in law a revenue expenditure admissible under s. 10(2)(xv) of the Income-tax Act and if no services were rendered by the managing agents, the remuneration must be regarded as exclusively payable for the services rendered by the managing agents in the promotion of the Company. The expenditure could not in the circumstances be said to be made wholly and exclusively in the interest of the business of the Company.

The Tribunal has stated in paragraph 30 of its order that under the award of Thakur Kanhaiya Singh each party had to pay the other large sums, and a device was adopted to provide funds in the hands of the parties at the expense of the Company for settling their individual accounts; and that "in preparing the scheme the authors had made an effort to reduce the tax liability of the Company by claiming the amount as a revenue deduction". The Tribunal appears to have reached this conclusion from the terms of the award of Thakur Kanhaiya Singh, the settlement between Singhanias and Guptas of the civil suit by consent decree dated January 11, 1945, by a supplementary award which provided for distribution of compensation which it was expected "would be receivable" for determination of the managing agency, and the ultimate award of Mr. K. M. Munshi which contained a mere bald decision and no reasons in support thereof. Whether this part of the judgment of the Tribunal is correct need not detain us in this case. If the amount paid was not expenditure incurred wholly and exclusively for the purpose of the business, it is unnecessary to consider whether a "device" was adopted to provide funds in the hands of the parties at the expense of the Company for the purpose of settling their individual accounts or for some other reasons. The question raised by the Tribunal for the decision of the High Court, it may be recalled, was whether there *was any material* on which the conclusion of the Tribunal could be justified, and, in our judgment, there was ample material on which the conclusion could be founded. The answer recorded by the High Court was, on the question referred by the Tribunal by their statement dated December 29, 1954, in our judgment.

A right. The High Court was also right in declining to record formal answer on the other questions.

No separate argument was advanced in regard to the amount of Rs. 13,300 which was incurred for the costs of the arbitrator and for the arbitraiton proceedings. No argument was also apparently raised before the High Court supporting the claim for that
B amount as a permissible allowance even if the claim for Rs. 18,90,000 was disallowed.

The appeal therefore fails and is dismissed with costs.

V.P.S. *Appeal dismissed.*