COMMISSIONER OF INCOME-TAX, CALCUTTA, NOW WEST BENGAL III

v.

IMPERIAL CHEMICAL INDUSTRIES (INDIA) PRIVATE LTD.

February 20, 1969

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

Indian Income-tax Act, 1922, *ss.* 3, 10(2) *(xv) and* 66(1)—*Assessee appointed sole selling agent of principal—Compensation paid to former selling agents through accounts of assessee—Compensation paid through assessee's accounts whether deductible expenditure—Payment whether expenditure laid out for purposes of business—Payment whether under overriding title—Tribunal's finding of fact that compensation was not paid by assessee under any agreement with principal cannot be interfered with by High Court when question not referred to it.*

The Imperial Chemical Industries (Export) Glasgow was a subsidiary of Imperial Chemical Industries London. With effect from 1st April 1948 the former terminated the services of four selling agents in India and in their place appointed the respondent company (another subsidiary of the Imperial Chemical Industries, London) as their sole selling agents. The four former selling agents were to be paid compensation for the termination of their services and this was done through the accounts of the respondent. In its income returns for the years 1949-50, 1950-51, 1951-52 and 1952-53 the respondent showed as its income the net amount of commission arrived at after deducting from the gross commission the compensation paid to the former selling agents. The Income-tax Officer in his order for the year 1951-52 held that the said deductions were not permissible. His order was confirmed by the Appellate Assistant Commissioner and the Income-tax Appellate Tribunal. The Tribunal held that there was no agreement between the Imperial Chemical Industries (Export) Glasgow and the respondent company casting on the latter the liability to pay the compensation to the former selling agents out of the commission earned by it; the Tribunal further said that even if there was an agreement it was not acted upon. In reference under s. 66(1) of the Indian Income-tax Act, 1922 the High Court took the opposite view and held that the claim made by the respondent company was allowable. The revenue appealed to this Court. The questions that fell for consideration were : (i) whether the High Court was justified in interfering with the Tribunal's finding of fact on a question not referred to it; (ii) whether the compensation amounts paid by the respondent to the former selling agents were expenditure laid out wholly and exclusively for the purpose of business; (iii) whether the income in question was diverted before it reached the respondent by virtue of an overriding title.

HELD : (i) It is well-established that the High Court is not a Court of Appeal in a reference under s. 66(1) of the Act and it is not open to the High Court in such a reference to embark upon a reappraisal of the evidence and to arrive at findings of fact contrary to those of the Appellate Tribunal. It is the duty of the High Court while hearing the reference to confine itself to the facts as found by the Appellate Tribunal and to answer the question of law in the context of those facts. It is true that the finding of fact will be defective in law if there is no evidence

A to support it or if the finding is perverse. But in the hearing of a reference under s. 66(1) of the Act it is not open to the assessee to challenge such a finding of fact unless he has applied for the reference of the specific question under s. 66(1). [809 B-D]

In the present case the assessee had in its applications under s. 66(1) expressly raised the question about the validity of the finding of the Appellate Tribunal as regards the agreement but the question was not B referred by the Appellate Tribunal to the High Court and the contention of the assessee with regard to the question must be deemed to have been rejected. The assessee did not thereafter move the High Court under s. 66(2) of the Act requiring it to call for a statement of the case on that specific question. The High Court was therefore in error in embarking upon a reappraisal of the evidence before the Appellate Tribunal and setting aside the finding of the Appellate Tribunal that there was no C agreement as claimed by the assessee for the payment of compensation to the former selling agents out of its own commission and that if there was such an agreement it was not acted upon. [809 F-H]

India Cements Ltd. v. *Commissioner of Income-tax*, 60 I.T.R. 52, *Commissioner of Income-tax* v. *Sri Meenakshi Mills Ltd.*, 63 I.T.R. 609 and *Commissioner of Income-tax, Bombay City I* v. *Greaves Cotton & Co. Ltd.*, 68 I.T.R. 200, applied.

D

(ii) In the absence of proof of the exact terms and conditions of the agreement it was not possible to accept the argument that the amount paid as compensation to the ex-agents was an 'expenditure laid out wholly and exclusively for the purpose of the business' under s. 10(2)(xv) of the Act. [810 D]

(iii) The assessee's documents suggested that the payment of compen- E sation was the exclusive liability of the I.C.I. (Exports) Ltd. and the assessee was not under a legal obligation to pay the amount of compensation to the outgoing agents. It was not established that the payment of compensation was by an overriding title created either by the Act of the parties or by the operation of law. An obligation to apply the income in a particular way before it is received by the assessee or before it has accrued or arisen to the assessee results in the diversion of income. An obligation to apply income accrued, arisen or received amounts merely F to the apportionment of income and the income so applied is not deductible. The true test for the application of the rule of diversion of income by an overriding title is whether the amount sought to be deducted in truth never reached the assessee as his income. [810 H-811 H]

Raja Bejoy Singh Dudhuria v. *Commissioner of Income-tax*, [1933] 1 I.T.R. 135, *P. C. Mullick* v. *Commissioner of Income-tax*, [1938] 6 I.T.R. 206 and *Commissioner of Income-tax, Bombay City II* v. *Sitaldas* G *Tirathdas*, 41 I.T.R. 367, applied.

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 1549 to 1552 of 1968.

Appeals from the judgment and order dated September 28, 1964 of the Calcutta High Court in Income-tax Reference No. 18 H 1961.

Sukumar Mitra, S. K. Aiyar, R. H. Dhebar, R. N. Sachthey and *B. D. Sharma*, for the appellant (in all the appeals).

M. C. Chagla, T. A. Ramachandran and *D. N. Gupta*, for the respondent (in all the appeals). A

The Judgment of the Court was delivered by

Ramaswami, J. These appeals are brought by certificate from the judgment of the Calcutta High Court dated 28th September, 1964 in Income Tax Reference No. 18 of 1961. B

The respondent (hereinafter called the assessee) is a private limited company incorporated in India and is a subsidiary of the Imperial Chemical Industries, London, which holds the entire share capital of the assessee. The business of the assessee consists mainly of acting as selling agents in India for a large variety C of goods such as chemicals, dyes, explosives etc., manufactured or purchased by its London principals and sold in India. The Imperial Chemical Industries (Export) Glasgow [hereinafter referred to as the I.C.I. (Export) Ltd.] is another subsidiary of I.C.I. London which holds the entire share capital of I.C.I. (Export) Ltd. The I.C.I. (Export) Ltd. had appointed as their selling D agents in India four companies, *viz.*, (1) Gillanders Arbuthnot & Co. Ltd., Calcutta, (2) Best & Co. Ltd., Madras, (3) Anglo-Thai Co. Ltd. Bombay and (4) Shaw Wallace & Co. Ltd. With effect from 1st April, 1948, the I.C.I. (Export) Ltd. terminated the services of the aforesaid selling agents and appointed the assessee as its sole selling agent. The I.C.I. (Export) Ltd. had agreed to E pay to the former selling agents compensation at the rate of two fifth, two fifth and one and two fifths of the commission earned by the assessee for the three years from 1st April, 1948. The compensation was paid to the four companies through the accounts of the assessee. For this purpose the *modus operandi* adopted was as follows :—The compensation payable to the former agents F was spread over a period of three years and on the assumption that the turnover was constant, the compensation payable to the selling agents was on an average, an amount equal to the 11/15th of the commission earned by the assessee at the normal rates. In order to arrive at the amount of commission to be credited to the assessee's profit and loss account each year the assessee in the first place credited the commission account and debited the I.C.I. G (Export) Ltd. account with the full amount of compensation earned by it at normal rates on sales effected during the year. Next, the assessee transferred from the commission account to a special reserve account called the 'Explosives Ex-Agents Compensation Reserve Account', the proportion payable to the ex-agents as compensation, namely, 11/15th (2/5+2/5+7/5= H 11/5 × 1/3 = 11/15) (leaving 4/15th towards commission account) so that funds might be accumulated for payment to the four companies from time to time.

A The year of account of the assessee is from 1st October to 30th September every year. As a result of the above method of accounting, the following figures appeared in the assessee's books of accounts :—

B		Gross Commission	Transfer to Reserve for compensation	Net Commission
		Rs.	Rs.	Rs.
	1st April 1948 to 30th September 1948 ..	2,91,396	2,03,503	87,893
	Year ending 30th September 1949	7,67,294	5,41,526	2,25,768
	Year ending 30th September 1950 ..	7,52,204	5,29,284	2,22,920
C	Year ending 30th September 1951 ..	10,20,922	4,00,052	6,20,870
	TOTAL	28,31,816	16,74,365	11,57,451

For the assessment years 1949-50, 1950-51, 1951-52 and 1952-53 the assessee showed the net amounts of commission earned on the selling agencies by the I.C.I. (Export) Ltd. adding a D foot note that the amounts were arrived at after deducting the amount of compensation payable to the out-going agents. By his order dated 28th January, 1957 for the assessment year 1951-52 the Income Tax Officer held that the deductions were not permissible. In an appeal preferred by the assessee the Appellate Assistant Commissioner confirmed the assessment by his order dated E 25th November, 1957. The assessee took the matter in further appeal to the Appellate Tribunal which dismissed the appeal. The Appellate Tribunal held that there was no justification for the absence of a written agreement between the I.C.I. (Export) Ltd. and the assessee when the former selling agencies were terminated and the assessee was appointed as the sole selling agent. It was F observed that the assessee was not collecting any commission on behalf of the outgoing agents and it was not their legal obligation to pay compensation to the out-going agents. If the assessee was not entitled to more than 3/5th of commission during the first two years, it should have credited that amount whereas the assessee had actually credited four-fifteenth on a notional basis G which was not in consonance with the arrangement. The conclusion reached by the Appellate Tribunal was that "there was no agreement between the assessee and the I.C.I. (Export) Ltd. and if there was one it was not acted upon". It was held by the Appellate Tribunal that the payment of compensation was not because of an overriding title created either by the act of the parties or by operation of law.

H At the instance of the assessee the following question of law was referred to the High Court under section 66(1) of the Income-Tax Act, 1922 (hereinafter called the Act) :—

"Whether the inclusion by the Income Tax Officer of Rs. 2,03,503, Rs. 5,41,526, Rs. 5,29,284 and Rs. 4,00,052 in the assessment for the years 1949-50, 1950-51, 1951-52 and 1952-53, for relevant accounting years ending the 30th Sept. 1948, 1949, 1950 and 1951 respectively in the computation of the total income of the assessee is justified and correct?" A B

The High Court answered the question in the negative in favour of the assessee holding that the inclusion of the amount of compensation in the total income of the assessee for the relevant assessment years was not justified.

On behalf of the appellant it was contended that the High Court had no legal justification for interfering with the finding of the Appellate Tribunal that there was no proof of the agreement between the assessee and the I.C.I. (Export) Ltd. with regard to the quantum of commission to be paid to the assessee for the period between 1st April, 1948 and 31st March, 1951. On this point reference was made by Mr. Chagla to (a) the letter dated 11th March, 1947 from the I.C.I. (Export) Ltd. to M/s. Gillanders Arbuthnot & Co., (b) the affidavits of Mr. W. A. Bell and Mr. J. W. Donaldson and (c) the letter dated 3rd January, 1958 of M/s. Lovelocke and Lewes, Chartered Accountants, Calcutta. It was argued that these documents established that there was an agreement between the I.C.I. (Export) Ltd. and the assessee, that for the period 1st April 1948 to 31st March, 1951 the assessee was entitled to receive as its commission only the amounts representing the difference between the normal rates of commission and the compensation payable to the former agents during that period. The Appellate Tribunal had considered all these documents and reached the conclusion that there was no agreement between the I.C.I. (Export) Ltd. and the assessee and 'if there was one it was not acted upon'. The Appellate Tribunal remarked that the letter dated 11th March, 1947 from the I.C.I. (Export) Ltd. set forth only the terms and conditions subject to which the selling agencies of the out-going agents were terminated. It was silent on the crucial question of commission to be paid to the assessee during the three years from the date of its appointment as sole selling agent. The affidavits of Mr. Bell and Mr. Donaldson were produced for the first time before the Appellate Assistant Commissioner. The affidavits were made many years after the crucial date of the appointment of the assessee as the sole selling agent of the I.C.I. (Export) Ltd. The affidavits did not mention the amount of commission to be paid to the out-going agents and the affidavits were also not consistent with the entries in the books of accounts of the assessee. The letter of M/s Lovelocke and Lewes was produced at a very late stage during the hearing of the appeal before the Tribunal and even otherwise the C D E F G H

A letter merely explains the method of accounting adopted by the assessee and did not carry the matter any further. In the circumstances, the Appellate Tribunal held that there was no agreement between the assessee and the I.C.I. (Export) Ltd. and if there was any such agreement it was not acted upon. It is manifest that the finding of the Appellate Tribunal on this question is a finding B on question of fact and the High Court was not entitled to interfere with this finding. It is well established that the High Court is not a Court of Appeal in a reference under s. 66(1) of the Act and it is not open to the High Court in such a reference to embark upon a reappraisal of the evidence and to arrive at findings of fact contrary to those of the Appellate Tribunal. It is the duty of the C High Court while hearing the reference to confine itself to the facts as found by the Appellate Tribunal and to answer the question of law in the context of those facts. It is true that the finding of fact will be defective in law if there is no evidence to support it or if the finding is perverse. But in the hearing of a reference under s. 66(1) of the Act it is not open to the assessee to challenge such a finding of fact unless he has applied for the reference of the D specific question under s.66(1). In *India Cements Ltd.*. v. *Commissioner of Income Tax*(1) it was held by this Court that in a reference the High Court must accept the findings of fact reached by the Appellate Tribunal and it is for the party who applied for a reference to challenge those findings of fact, first, by an application under s. 66(1). If the party concerned has failed E to file an application under s. 66(1) expressly raising the question about the validity of the finding of fact, he is not entitled to urge before the High Court that the finding is vitiated for any reason. The same view has been expressed by this Court in *Commissioner of Income Tax* v. *Sri Meenakshi Mills Ltd.*(2) and *Commissioner of Income Tax, Bombay City I* v. *Greaves Cotton & Co. Ltd.*(3). F In the present case the assessee has in his application under s. 66(1) expressly raised the question about the validity of the finding of the Appellate Tribunal as regards the agreement but the question was not referred by the Appellate Tribunal to the High Court and the contention of the assessee with regard to the question must be deemed to have been rejected. The assessee did not thereafter move the High Court under s. 66(2) of the Act requir- G ing it to call for a statement of the case on that specific question. We are therefore of opinion that the High Court was in error in embarking upon a reappraisal of the evidence before the Appellate Tribunal and setting aside the finding of the Appellate Tribunal that "there was no agreement as alleged in the affidavits of Mr. W. A. Bell and Mr. J. W. Donaldson" and "if there was such H an agreement it was not acted upon".

(1) 60 I.T.R. 52.

(2) 63 I.T.R. 609.

(3) 68 I.T.R. 200.

It was argued by Mr. Chagla that even if the agreement was not established, the amount paid by the assessee as compensation to the ex-agents was an expenditure laid out wholly and exclusively for the purpose of the business and as such is allowable under s. 10(2)(xv) of the Act. The contrary view point was urged on behalf of the appellant. It was pointed out that the assessee was acting as the agent of the I.C.I. (Export) Ltd. for the payment of compensation to the ex-agents and the payment was made not in the character of a trader but in the character of the agent of its principal. The contention of the appellant was that the assessee got the right to sell goods after 1st April 1948 and for getting that right the assessee parted with a portion of its commission for the first two years after 1st April 1948 and paid very much more than the commission earned in the third year. This position was borne out by the accounts of the respondent which show that the assessee received the commission at full rates and out of it created a reserve account of which these compensations were made to the ex-agents. We have already referred to the finding of the Appellate Tribunal that no agreement between the assessee and the I.C.I. (Export) Ltd. has been proved. In the absence of proof of the exact terms and conditions of the agreement it is not possible to accept the argument of the assessee that the amount paid as compensation to the ex-agents was an "expenditure laid out wholly and exclusively for the purpose of the business" under s. 10(2)(xv) of the Act.

It was finally contended on behalf of the respondent that by virtue of an overriding title the income was diverted before it reached the assessee, and so, the amount of compensation paid to the ex-agents did not form part of the income of the assessee. In other words, the contention was that the compensation payable to the ex-agents was diverted from the income of the assessee by an overriding title arising under the agreement between the assessee and the I.C.I. (Export) Ltd. The argument was stressed that the commission payable as compensation to the ex-agents did not form part of the income of the assessee. We are unable to accept this argument as correct. We have already pointed out that the finding of the Appellate Tribunal is that the precise terms of the agreement between the assessee and the I.C.I. (Export) Ltd. have not been established. In any event, even on the basis of the affidavits of Mr. Bell and Mr. Donaldson the payment of compensation to the ex-agents was apparently made by the assessee for and on behalf of the I.C.I. (Export) Ltd. The assessee's documents suggest that the payment of compensation was the exclusive liability of the I.C.I. (Export) Ltd. and the assessee was not under a legal obligation to pay the amount of compensation to the out-going agents. It is not established that the payment of compensation was by an overriding title created either by the act of the parties

A or by the operation of law. An obligation to apply the income in a particular way before it is received by the assessee or before it has accrued or arisen to the assessee results in the diversion of income. An obligation to apply income accrued, arisen or received amounts merely to the apportionment of income and the income so applied is not deductible. The true test for the application of B the rule of diversion of income by an overriding title is whether the amount sought to be deducted in truth never reached the assessee as his income. The leading case on the subject is *Raja Bejoy Singh Dudhuria v. Commissioner of Income Tax*(1) where the step mother of the Raja had brought a suit for maintenance and a compromise decree was passed in which the step mother was C to be paid Rs. 1,100 per month, which amount was declared a charge upon the properties in the hands of the Raja by the Court. The Raja sought to deduct this amount from his assessable income, which was disallowed by the High Court at Calcutta. On appeal to the Judicial Committee Lord Macmillan observed as follows :—

> "But their Lordships do not agree with the learned D Chief Justice in his rejection of the view that the sums paid by the appellant to his step mother were not 'income' of the appellant at all. This in their Lordships' opinion is the true view of the matter.
>
> When the Act by section 3 subjects to charge 'all income' of the individual, it is what reaches the indivi- E dual as income which it is intended to charge. In the present case the decree of the court by charging the appellant's whole resources with a specific payment to his step-mother has to that extent diverted his income from him and has directed it to his step-mother; to that extent what he receives for her is not his income. It F is not a case of the application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands".

Another case of the Judicial Committee is reported in *P. C. Mullick* v. *Commisisoner of Income Tax*(2), where, a testator appointed G the appellants as executors and directed them to pay Rs. 10,000 out of the income on the occasion of his addya sradh. The executors paid Rs. 5,537 for such expenses, and sought to deduct the amount from the assessable income. The Judicial Committee confirmed the decision of the Calcutta High Court disallowing the deduction and observed that the payments were made out of the H income of the estate coming to the hands of the executors and in pursuance of an obligation imposed upon them by the testator. The Judicial Committee observed that it was not a case in which

(1) [1933] 1 I.T.R. 135. (2) [1938] 6 I.T.R. 206.

a portion of the income had been diverted by an overriding title from the person who would have received it otherwise and distinguished *Bejoy Singh Dudhuria's* case(1). In *Commissioner of Income Tax Bombay City II* v. *Sitaldas Tirathdas*(2), Hidayatullah, J., speaking for the Court observed as follows :— A

> "There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable". B C D

In view of the principle laid down in these authorities we are of opinion that the payment of compensation by the assessee to the ex-agents was not by an overriding title created either by act of the parties or by operation of law. We accordingly reject the argument of Mr. Chagla on this aspect of the case. E

For the reasons expressed we hold that the judgment of the Calcutta High Court dated 28th September, 1964 should be set aside and the question referred by the Appellate Tribunal should be answered in the affirmative and against the assessee. The appeals are accordingly allowed with costs. One hearing fee. F

G.C. *Appeals allowed.*

(1) [1933] I.T.R. 135.

(2) 41 I.T.R. 367.