INDIAN OXYGEN LIMITED

v.

THEIR WORKMEN

December 9, 1971

[C. A. VAIDIALINGAM AND K. K. MATHEW, JJ.]

Payment of Bonus Act, 1964 s. 6—Bonus paid in respect of accounting year not to be deducted from gross profit for computing direct taxes—Dividend declared during accounting year—Whether to be deducted from reserves shown at commencement of accounting year—Doubtful debts' whether rightly treated as part of reserves—Bonus paid in respect of year preceding the accounting year to be deducted from gross profits—Set on, directions as to.

For its accounting year 1964-65 the Indian Oxygen Ltd. was liable to pay bonus under the Payment of Bonus Act 1965. The accounts of the company for the said year were passed on February 12, 1966. The company calculated bonus at the rate of 17.58% of the total annual wages or salary plus Dearness Allowance and declared the said amount payable by notice dated March 23, 1966. The workmen demanded a higher rate of bonus. The resulting industrial dispute was referred to the National Industrial Tribunal. The Tribunal fixed the rate of bonus at 20%. Against the decision of the Tribunal appeals were filed in this Court. The questions that fell for consideration were: (i) whether the tribunal was right in calculating the direct taxes after deducting the amount of bonus payable for the accounting year 1964-65 from the gross profits; (ii) whether the Tribunal was justified in deducting the amount earmarked for distribution of dividends from the reserves shown in the balance sheet at the commencement of the accounting year even though the dividend had not been declared at the commencement of the accounting year; (iii) whether the Tribunal was justified in treating the amount shown against doubtful debts as part of the reserves; (iv) whether the Tribunal while calculating direct taxes was justified in not taking into account the bonus paid for the year 1963-64; (v) whether the directions given by the Tribunal regarding set on were justified.

HELD: (i) In *Metal Box Co.* this Court laid down that an employer is entitled to compute his tax liability without deducting first the amount of bonus, he would be liable to pay, from and out of the amount computed under ss. 4 and 6 of the Act. After the above decision Parliament enacted the Payment of Bonus (Amendment) Act 1969. Parliament at that time was fully aware of the principle laid down by this Court that the tax liability has to be worked out by first working out the gross-profits and deducting therefrom the prior charges under s. 6 but not the bonus payable to the employees. Nevertheless Parliament did not make any change in the Act enacting that a different method is to be adopted for computing the direct taxes. If Parliament intended to make a departure from the principles laid down by this Court in *Metal Box Co.* that bonus amount should be calculated after a provision for tax was made and not before a provision to that effect would have been incorporated by the Amendment Act. That not having been done, the law as laid down by this Court in *Metal Box Co.* and reaffirmed by two later decisions namely *William Jacks & Co. Ltd.* and *Delhi Cloth and General Mills Co.* still holds the field. It follows that the view of the National Tribunal that bonus must be deducted from the gross-profits before income-tax is calculated, was not correct. [826 F-G; 829 C-F]

A Further the view of the Tribunal that the tax concessions by way of rebate that an employer will get under the Indian Income-tax Act on the bonus found to be payable has also to be taken into consideration in dividing the surplus between the workmen and the company, was also erroneous in view of the fact that the Act which is a self contained Code has prescribed the manner in which available surplus and the allocable surplus are to be calculated. [829 G]

B *Metal Box Co. of India Ltd.* v. *Workmen,* [1969] 1 S.C.R. 750, *Workmen of William Jacks & Co. Ltd.* v. *Management of William Jacks & Co.* [1971] 1 L.L.J. 503 and *Delhi Cloth & General Mills Co. Ltd.* v. *Workmen* [1971] 2 S.C.C. 695, applied.

(ii) The relevant accounting year in the present case was October 1, 1964 to September 30, 1965. In its balance sheet as on September 30, 1964 the appellant had shown a sum of Rs. 2,35,07,686 reserves. Similarly in its balance sheet as on September 30, 1965 apart from showing its reserves on that date, it had also shown a sum of Rs. 2,35,07,686 as reserves at the commencement of the accounting year. On December 5, 1964 a notice was issued regarding holding of the Annual General Meeting on February 12, 1965. The dividend was paid on March 9, 1965. From the notice calling for the General Meeting the Directors' Report and balance sheet as on September 30, 1964 it was clear that a sum of Rs. 43,68,000 out of the General Reserve of Rs. 2,35,07,686 had been set apart and was to be appropriated for payment of dividend for the previous year 1963-64. In the circumstances the Tribunal correctly applied the provisions of s. 6(d) of the Act read with item 1 cl. (iii) together with the material part of the Explanation to the Third Schedule of the Act when it deducted the sum earmarked to be paid as dividend, *i.e.,* Rs. 43,68,000 from the General Revenue at the beginning of the accounting year, *i.e.,* Rs. 2,35,07,686 for the purpose of determining the return on Reserves. The fact that the dividend had not been declared at the commencement of the accounting year was not material. In no case will a company be able to declare a dividend for the year ending September 30, 1964 on the morning of October 1, 1964. Once the Directors have, on the basis of auditor's report and other materials decided to declare a particular amount as dividend and have set apart the required amount from the General Reserve, it must relate back to the date of the commencement of the accounting year. [830 G-H; 832 C-F; 833 A-C]

(iii) The Tribunal was justified in holding that the appellant was not in order in deducting Rs. 55,127 under the head 'doubtful debts' an item of expenditure. It was perfectly justified in adding back the amount in computing the gross profits. The creation of such an amount is really a reserve and not a provision as contended by the appellant. The appellant itself in its breach up had distinguished bad debts from doubtful debts. [834 F-835 B]

Textile Machinery Corpn. Ltd. v. *Workmen,* [1960] 1 L.L.J. 34, applied.

(iv) The Tribunal was justified in holding that in calculating direct taxes the bonus for the accounting year 1963-64 though paid during the accounting year 1964-65 should not be taken into account. As the bonus year must be taken as a unit, bonus paid for the previous accounting year from and out of the profits of the said previous year does not come into the picture. [836 E]

(v) On a proper computation even the bonus already paid by the company at 17.58% was on the big side. It follows that the direction of

the National Tribunal regarding set on based as it was on the rate 20% bonus fixed by the Tribunal, could not be accepted. [836 F-G] A

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 415, 813 and 1302 of 1967.

Appeals by special leave from the award dated January 20, 1967 of the National Industrial Tribunal, Calcutta in Reference No. NIT-1 of 1966. B

G. B. Pai and *D. N. Mukherjee,* for the appellant (in C.A. No. 415 of 1967) and respondent No. 1 (in C.As. Nos. 813 and 1302 of 1967.

Janardan Sharma and *Indira Jaisingh,* for respondent No. 1 (in C.A. No. 415 of 1967), the appellants (in C.A. No. 813 of 1967) and respondent No. 2 (in C.A. No. 1302 of 1967). C

K. R. Chaudhuri, for respondent No. 3 (in C.A. 415 of 1967).

C. L. Dudhia, C. G. Nadkarni, K. L. Hathi and *P. C. Kapur,* for respondent No. 4 (in C.As. Nos. 415 and 813 of 1967) and the appellants (in C.A. No. 1302 of 1967). D

Janardan Sharma, for the intervener.

The Judgment of the Court was delivered by

Vaidialingam, J. All these appeals, by special leave, are directed against the Award dated January 20, 1967 of the National Industrial Calcutta in Reference No. NIT-1 of 1966. Civil Appeal No. 415 of 1967 is by the Company regarding the disallowance of certain items by the Tribunal for arriving at the available and allocable surplus for calculating bonus to be paid for the accounting year 1964-65. E F

Civil Appeals Nos. 813 and 1302 of 1967 are by the two Unions representing the workmen, against that part of the Award rejecting the claim of the Unions for adding back certain items for the purposes of calculating the rate of bonus to be paid by the appellant Company.

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As mentioned earlier, the year of account is 1964-65, which is October 1, 1964 and ending September 30, 1965. The appellant Company was incorporated under the Indian Companies Act, in 1935 and was made into a public company in 1958. It is a venture of the British Oxygen Company incorporated in England and the English Company still holds a little over 66% of the shares of the Indian Company. The main products of the Company are production of industrial gases like oxygen, dissolved acetylene, nitrogen and hydrogen and also electrodes and H

A welding equipment and medical equipment. The Company has been paying bonus to its workmen from 1948; and since then it has been paying bonus by agreements with the union. The bonus, so paid, has been more or less at five months basic wages, subject to a minimum and maximum as per the agreement. For the year in question, 1964-65, there was no agreement, as the Payment of B Bonus Act, 1965 (hereinafter to be referred as the Act) came into force. Ther is no controversy that this is the first accounting year, in respect of which the bonus is to be paid under the Act.

The accounts of the Company were passed at the Annual General Meeting held on February 12, 1966. The Company C calculated bonus at the rate of 17.58% of the total annual wages or salary plus Dearness Allowance and declared the said amount payable by notice dated March 23, 1966. The Company originally worked out the allocable surplus under the Act for the said year at Rs. 30,35,958. As the sum of Rs. 1,72,69,770 was the total salary and wages including Dearness Allowance payable D for the said year, the allocable surplus worked out at 17.58% of the said total wage bill and hence bonus was declared at that rate.

The Unions protested against the rate of bonus declared by the Company and demanded a substantial increase in the quantum of E bonus. The claim by the Indian Oxygen & Acetylene Employees' Federation was for payment of bonus equal to eight months' basic wages subject to a minimum of Rs. 400/-. Another union, National Federation of Indian Oxygen Workmen, Jamshedpur, claimed bonus at the maximum rate of 20% provided under the Act. A third union, also the Bombay Labour Union, claimed bonus at the maximum rate of 20%. A fourth union, Indian F Oxygen Employees Union of Rajawadi, Bombay, demanded bonus at 25% of the total earnings or at six months' basic wages, whichever was higher.

As attempts at settlement failed, a strike notice was given by some of the Unions. Originally, there was a reference of the G dispute by the Government of West Bengal to a Tribunal. Later on, this order of reference by the State Government was cancelled and the Central Government by order dated July 7, 1966 referred the dispute for adjudication to the National Industrial Tribunal at Calcutta. The question referred was as follows :

H "Whether the workmen are entitled to a higher bonus than 17.5 per cent for the year 1964-65 as offered by the management? If so, what should be the quantum of bonus for the said year?"

Though the question referred was regarding the claim for higher bonus than 17.5 per cent, all parties were agreed that the appellant Company had actually offered and paid as bonus for the said year at 17.58 per cent. It is on this basis that the dispute also was adjudicated by the National Industrial Tribunal.

Though originally, the appellant, as mentioned earlier, had calculated the allocable surplus in the sum of Rs. 30,35,958, during the proceedings before the Tribunal, they recomputed the amount and filed a revised statement Ex.4, by which the allocable surplus was worked out at only Rs. 23,30,396. This reduced figure was explained by the appellant Company as due to omission in the previous statement, to add back certain items in computing the gross profits and higher figure for income-tax.

All the unions very strenuously contested both the calculations of the Company. According to the unions, in the balance sheet and profit and loss accounts of the Company various items of expenses have been inflated. Details of such inflation were given by them. The unions also contested the amount of direct taxes shown in the statement of the Company. It was the further case of the unions that if there is a proper computation, the allocable surplus would be very much higher than 50 lacs as against the figure of Rs. 30,35,958 shown in the original calculation and miserably reduced in the subsequent calculation Ex.4.

The National Industrial Tribunal, in its Award has disallowed certain claims made by the appellant Company. It also disallowed certain extreme claims made by the unions. Ultimately, it fixed the available surplus in the sum of Rs. 65,29,507. On this basis it fixed the sum of Rs. 39,17,704 as the allocable surplus being 60% of available surplus. As the allocable surplus so fixed was more than 20% of the annual wage bill of Rs. 1,72,69,770, the bonus was fixed by the Tribunal at the maximum rate of 20%. It further gave a direction that a set on of Rs. 4,63,750 is to be carried forward. In the end the Tribunal made an Award that the workmen are entitled to a higher bonus than 17.58% for the accounting year 1964-65 and fixed the quantum of bonus so payable at the maximum rate of 20%, with a further direction that there should be a set on to be carried forward of Rs. 4.63,750.

In Civil Appeal No. 415 of 1967, certain items which the Company claimed to be added back to the net profit, shown in the profit and loss account, for arriving at the gross-profits and which have been rejected by the Tribunal are in controversy. Further, there is also a controversy, in the said appeal, regarding certain deductions sought to be made from the gross-profits for the purpose of arriving at the allocable surplus and which have

A not been allowed by the Tribunal. But the major item in controversy in the appeal of the Company is regarding the manner in which the calculation of direct taxes have to be made under the Act.

Though the Unions support the Award of the Tribunal, in so B far as it is against the Company, their grievance in their appeals Nos. 813 and 1302 of 1967 relates to the Tribunal's declining to add back certain further items in calculating the gross-profits and permitting the Company to deduct from the gross-profits certain items for arriving at the allocable surplus.

There are several items, which, according to the Unions, C should have been either added back to the gross-profits or should not have been deducted from the gross-profits to arrive at the allocable surplus. We are not referring in detail to the various items, referred to in the two appeals of the Unions, as their counsel have represented before us that if the claim of the Company regarding the manner in which the computation of direct taxes, D is accepted, by this Court, they are not pressing their appeals.

In order to appreciate the points in controversy we are giving below the statement, which will show the calculations of the Company, as well as the computation made in the Award.

"COMPUTATION OF ALLOCABLE SURPLUS FOR THE E YEAR ENDED 30-9-1965.

	Appellant Company's computation		Computation as per the award	
1. Net profit as per P & L Account	67,74,315			67,74,315
F 2. **Add back**				
(*a*) Bonus for 64-65	30,00,000		30,00,000	
(*b*) Depreciation	70,44,600		70,44,600	
(*c*) Direct taxes	1,04,00,000		1,04,00,000	
(*d*) Development rebate	5,00,000		5,00,000	
(*e*) Other reserves provision for doubtful G debts		2,09,44,600	55,127	2,09,99,727
3. Add back also				
(*a*) Bonus paid for previous year	25,21,347		25,21,347	
(*b*) Donations in excess H of incometax	4,569		4,569	
[(*c*) Capital expenditure				
(*i*) Patent fees			10,000	

(*ii*) Plant transfer charges			72,516	
(*iii*) Disalowable rent		25,25,960	74,000	26,82,432
4. Gross profits		3,02,44,831		3,04,56,474
5. Less				
(*a*) Depreciation	76,10,540		76,10,540	
(*b*) Development rebate	6,11,425	82,21,965	6,11,425	82,21,965
		2,20,22,866		2,22,34,509
6. Less direct taxes				
(*a*) Income-tax at 55% of the balance	1,21,12,576		1,04,68,219	
(*b*) Surtax	14,67,236		9,39,802	
(*c*) Additional income-tax	54,600	1,36,34,412	54,600	1,14,62,621
		83,88,454		1,07,71,888
7. (*a*) Return on paid up capital at 8·5% on Rs. 3,64,00,000	30,94,000		30,94,000	
(*b*) Return on reserves at 6% on Rs. 2,35,07,686	14,10,461	45,04,461	11,48,381	42,42,381
Balance		38,83,993		65,29,507
8. Allocable Surplus		23,30,396		39,17,704
9. Bonus at 20% on annual wages amounting to Rs. 1,72,69,770				34,53,954
10. Set on to be carried forward				4,63,750

In the Award, the Tribunal has given its computation as well as the manner in which direct taxes have been calculated for the year 1964-1965.

At this stage we may indicate that while the Company computed the direct taxes on the gross-profits, before deducting any amount on account of bonus, the Tribunal has calculated the taxes, after deducting the amount of bonus from the gross-profits. A decision on this really depends upon the construction of certain provisions of the Act, having due regard to the principles laid down by this Court.

We have stated earlier that the claim for bonus is for the year 1964-65, i.e., from October 1, 1964 to September 30, 1965. There is no controversy that for this period bonus is to be calculated under the Act, which had become applicable. The Company worked out the allocable surplus under the Act and paid a sum of Rs. 30,35,958 as bonus for the said year. If that calculation

A is correct, there is no controversy that the amount represents 17.58% of the total wages earned by the eligible employees during the said accounting year. Later on, the appellant Company in view of the provisions of the Finance Act, 1966 recomputed the allocable surplus and fixed it in the sum of Rs. 23,30,396. It is the claim of the Company that they paid bonus at a higher B percentage than is warranted under the Act. There is also no controversy that the Annual Wage Bill of the employees throughout the country was Rs. 1,72,69,770. Though the claim of the Company was that they paid bonus at a higher percentage, its Chief Executive, Finance, M.W. 1 has given evidence to the effect that the Company would not seek to recover the excess amount paid. C Before us also, Mr. G.B. Pai, learned counsel for the appellant Company represented, that even, if on the basis of the decision of this Court, it is found that bonus at a higher percentage has been paid to the employees, the appellant Company will not seek to recover any excess amount paid. That is, even if after accepting any of the contentions of the appellant. Company, it is found that D bonus is payable at a percentage lesser than the rate, at which it has been paid, the excess amount will not be recovered from the employees, nor adjusted in any other manner.

From the chart, given above, the Tribunal has computed the allocable surplus in the sum of Rs. 65,29,507 and fixed the bonus at the rate mentioned in the Award. The main controversy under this E head centres round the question whether the Tribunal should have estimated the amount of direct taxes on the balance of gross-profits as worked out under ss. 4 and 6 of the Act, but without deducting bonus, as contended by the appellant Company or whether the Tribunal was justified in deducting the amount of bonus from the gross-profits before calculating the tax as urged on behalf of the F Unions.

The contention of the appellant Company in brief is as follows: The Scheme of the Act clearly indicates that gross-profits are first to be calculated and certain prior charges are to be deducted therefrom. One of the prior charges under s. 6 is "direct tax". The tax is to be calculated by reference to the profits as they emerge G at the stage when deduction of prior charges begins. After the prior charges are deducted from the gross-profits, the balance left over is the available surplus. 60% of the available surplus represents the allocable surplus payable as bonus to the employees. At the stage of calculating the tax, bonus does not come into the picture as the same is ascertained after deducting the tax. Hence H the order of the Tribunal holding that bonus, which is payable on the profits of the year in question, i.e., 1964-65, should be deducted from the gross-profits for the purpose of computation of income-tax under s.6(c) of the Act, is eroneous. In this connection

Mr. G. B. Pai, learned counsel for the appellant, has referred us to certain provisions of the Act and in particular to the decision of this Court in *Metal Box Co. of India Ltd.* v. *Their Workmen*(1). A

According to the Unions bonus for both the years 1963-64 and 1964-65 included in the profit and loss account of the appellant Company and added back for computation of gross-profits have to be deducted for ascertaining the taxable income for the year 1964-65. They have made reference to the debate in Parliament at the time of the passing the Act. In particular Mr. Dudhiya, learned counsel for the fourth respondent, whose contentions have been accepted by the learned counsel for other respondents, has urged that the decision in *Metal Box Co.*(1) has not considered several relevant matters, which, if taken into account, would clearly indicate that the intention of Parliament was that direct tax is to be computed after deducting the bonus payable for the relevant accounting year. The counsel, therefore, urged that the decision of this Court in *Metal Box Co.*(1) should be reconsidered. B C

The National Tribunal considered the question whether the provision for bonus in question in the sum of Rs. 30,00,000 and the bonus paid to the employees in respect of the previous accounting year, namely, Rs. 25,21,347, which have been added in the Company's statement in computing the gross-profits under the Act should or should not be deducted from the gross-profits before Income-tax is computed. It is the view of the Tribunal that the bonus for the previous accounting year 1963-64 is payable out of the profits of the said previous year and that amount cannot be deducted in calculating the Income-tax of the accounting year 1964-65. But it accepted the contention of the Company that in order to ascertain the gross-profits, bonus which is found payable on the profits for the year 1964-65 can be added back to the net profit shown in the Profit and Loss Account, but rejected its contention that the tax liability is to be computed without deducting the said amount. The Tribunal has further held that it has to take into account the concession by way of rebate which an employer is entitled to get under the Income-tax Act on the amount of bonus paid to workmen. On this basis the Tribunal held that a rough calculation shows that the allocable surplus will exceed 20% of the Annual Wage Bill and that the maximum statutory bonus of 20% must be subtracted from the gross-profits before the Income-tax is calculated. It is now necessary to refer to the provisions of the Act, as it stood at the material date, without the amendment effected to it in 1969. D E F G

Under section 1(4), the Act has effect in respect of the accounting year commencing on any day in the year 1964 and in H

(1) [1969] 1 S.C.R. 750.

A respect of every subsequent accounting year. Section 2 contains definitions of various expressions. The expressions "allocable surplus" "available surplus" "direct tax" "gross-profits" and the "Income-tax Act" are defined in clauses 4, 6, 12, 18 and 19 respectively. As the appellant Company is not a Banking Company, its gross-profits, in respect of any accounting year, is to be calculated under
B s. 4(b) in the manner specified in the Second Schedule. The "available surplus" in respect of any accounting year, as provided under s. 5, is the gross-profits for that year, after deducting therefrom the sums referred to in section 6. Section 6 enumerates the various sums which are to be deducted from the gross-profits as prior charges. We are concerned with the relevant provision in
C Cl. (c) which is as follows :

> "Section 6. The following sums shall be deducted from the gross profits as prior charges namely, :—
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> * * * * * *
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> (c) subject to the provisions of section 7, any direct tax which the employer is liable to pay for the
> D accounting year in respect of his income, profits and gains during that year."

Section 7 deals with the method of calculation of direct tax payable by an employer "for the purpose of cl.(c) of section 6." Section 11 fixes the maximum amount of bonus at 20% of the salary or wage. Section 15 deals with set on and set off of allo-
E cable surplus in the circumstances mentioned therein. Section 19 fixes the time limit for payment of bonus.

As the entire scheme of the Act, as well as the principle to be adopted for ascertaining the direct tax, have been considered by this Court in certain decisions, to which we will refer presently, it is not necessary for us to cover the ground over again. In
F *Metal Box Co. of India Ltd.* v. *Their Workmen*(1), one of the questions that arose for consideration was the method of working out the direct taxes under the Act. The Company in that case claimed that direct taxes are to be worked out under s. 6(c) on the gross-profits worked out under s. 4, less the prior charges allowable under s. 6, namely, depreciation and development
G rebate, but without deducting from such balance, the bonus payable by the Company in the particular accounting year. The Tribunal, in that case, had accepted the said claim of the Company. On behalf of the workmen it was contended before this Court that the said manner of calculation of direct taxes was contrary to the scheme and provisions of the Act. According to
H the workmen, the Tribunal must start its calculation from the net profits shown in the Profit and Loss Account, which would have

(1) [1969] 1 S.C.R. 750.

made provisions for direct taxes and then deduct from the gross-profits calculated under s. 4 the prior charges permissible under s. 6. The provisions for direct taxes made in the Profit and Loss Account would have been computed after deducting from gross receipts, such deductions, allowances, reliefs and rebates etc. as are permissible under the Income-tax Act. It was the further case of the workmen that the bonus amount payable during a particular year would have been deducted from the gross-receipts, as without such deduction, the Profit and Loss Account would not reflect the true net profit of an employer.

In dealing with the above contentions, this Court, in the above decision, has referred to the views expressed by this Court on earlier occasions that the deduction by way of Income-tax is not the actual amount payable, but what would be notionally payable on the profits determined under the Full Bench Formula. This Court further considered the question whether the concept of notional tax liability adopted for a long time, has been altered or given the go-bye by Parliament in enacting ss. 6(c) and 7. After a very elaborate reference to the scheme of the Act and in particular to ss. 4 to 7 read with the Second Schedule, this Court ultimately accepted the contention of the Company that the tax liability is to be worked out by first working out the gross-profits and deducting therefrom the prior charges under s. 6, but not the bonus payable to the employees. This Court further observed as follows :

> "If Parliament intended to make a departure from the rule laid down by courts and tribunals that the bonus amount should be calculated after provision for tax was made and not before, we would have expected an express provision to that effect either in the Act or in the Schedules."

This decision has categorically laid down that an employer is entitled to compute his tax liability, without deducting first the amount of bonus, he would be liable to pay, from and out of the amount computed under ss. 4 and 6.

After the decision of this Court in *Metal Box Co.*(1) Parliament enacted the Payment of Bonus (Amendment) Act, 1969, (hereinafter to be referred as the Amendment Act). Section 2 of the Amendment Act, added a proviso to s. 5 of the Act. Similarly section 3 of the Amendment Act deleted in s. 7 of the Act, the opening words "for the purpose of cl. (c) of s. 6 any direct tax payable by the employer" and substituted the words "any direct tax payable by the employer."

(1) [1969] 1 S.C.R. 750.

A In *The Workmen of William Jacks and Co. Ltd. Madras* v. *Management of William Jacks and Co. Ltd., Madras*(1), one of the questions that arose for consideration related to the correctness of the method adopted by the Company therein in calculating the amount of Income-tax, without taking into account the bonus which would be payable to the workmen for the relevant year. B It was urged on behalf of the Union that the Income-tax should be calculated after taking into account the bonus. This contention again was rejected by this Court relying on its previous decision in *Metal Box Co.*(2). The principle laid down in *Metal Box Co.*(2) was approved and reiterated. That principle, we have already pointed out, is that the Income-tax liability is to be C worked out by first working out the gross-profits and deducting therefrom the prior charges under s. 6, but not the bonus payable to the employees in a relevant accounting year. It is significant to note that in *William Jacks and Co.*(1) the Union referred to the Amendment Act and strongly urged that the principle laid D down by this Court in *Metal Box Co.*(2) regarding the method of computing direct tax has been modified by the Legislature. This Court, in the said decision referred to the provisions of the Amendment Act, and observed that no amendment has been effected to s. 6, and that the amendment in s. 7 is only to the effect that the principles laid down therein are to be applied not E only in respect of s. 6(c) but also to other sections of the Act. It was further stated that the change in s. 7 became necessary because of certain amendments effected in s. 5 by making certain additions, which referred to direct taxes including Income-tax. It was further held that the amendment in s. 5, has no bearing on the question whether Income-tax, to be taken into account in calculation, should be worked out after taking into account the bonus F payable under the Act or without having regard to it. Ultimately, this Court wound up the discussion on this point as follows :

> ".....Consequently, there is no reason for us to differ from the view expressed by this Court in *Metal Box Co.*(2). This ground of challenge also, therefore, fails."

G Therefore, it will be noted that the principle laid down in *Metal Box Co.*(2) regarding the manner of computation of direct tax has been reiterated and reaffirmed in *William Jacks and Co.*,(1) and it has also been further pointed out that the Amendment Act had made no change whatsoever on this aspect.

H The same question again came up for consideration before this Court in *Delhi Cloth and General Mills Co. Ltd.* v. *Workmen*(3)

(1) [1971] 1 L.L.J. 503. (2) [1969] 1 S.C.R. 750.
(3) [1971] 2 S.C.C. 695.

The workmen therein again contended that many of the observations in *Metal Box Co.*(1) were obiter and that the said decision should not be followed as a precedent for determination of the question regarding the manner in which direct taxes have to be computed. Again, after a very elaborate consideration of the scheme of the Act, this Court rejected the contention of the Union, and observed as follows :

> "Strong reliance was placed by learned counsel for the appellant on the decision of this Court in *Metal Box Co.* v. *Workmen.* Counsel for the respondents made valiant efforts to persuade us to hold that many of the observations therein were obiter and as such the case should either be distinguished or be not followed as a precedent for the determination of the question before us. While no doubt the dispute in that case was somewhat different from the one which we have to resolve and there are some distinguishing features in that case, namely, that the Court was not called upon to examine the computation of the figures of gross profits, etc., for an establishment which came within the proviso to Section 3, the observations bearing on the question of the computation of direct tax under Section 6(c) of the Act are certainly in point. It was pointed out there at p. 775 :
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> "What Section 7 really means is that the Tribunal has to compute the direct taxes at the rates at which the income, gains and profits of the employer are taxed under the Income-tax Act and other such Acts during the accounting year in question. That is the reason why Section 6(c) has the words "is liable for" and the words "income, gains and profits". These words do not, however, mean that the Tribunal while computing direct taxes as a prior charge has to assess the actual taxable income and the taxes thereon."
>
> With respect, we entirely agree with the above observation and in our view no useful purpose will be served by referring to the other observations bearing on a question with which we are not directly concerned."

This decision again reiterates the principle laid down in *Metal Box Co.*(1).

In view of the fact that the two later decisions, *William Jacks and Co.*(2) and *Delhi Cloth and General Mills Co.*(3) have approved and adopted the principles laid down by this Court in

(1) [1969] 1 S.C.R. 750. (2) [1971] 1 L.L.J. 503.
(3) [1971] 2 S.C.C. 695.

A *Metal Box Co.*(1) that decision holds good and governs the principles to be applied to the case on hand. We are not persuaded by the request made by Mr. Dudhiya that the decision in *Metal Box Co.*(1) has to be reconsidered. In fact we have already pointed out that even the effect of the Amendment Act has been considered by this Court in *William Jacks and Co. Ltd.*(2) and B it has been held that the Amendment Act has made no change in the principles laid down by this Court in *Metal Box Co.*(1).

It is rather significant to note that the Amendment Act was passed, after the decision of this Court in *Metal Box Co.*(1). Parliament at that time was fully aware of the principle laid down by C this Court that the tax liability has to be worked out by first working out the gross-profits and deducting therefrom the prior charges under s. 6, but not the bonus payable to the employees. Nevertheless, Parliament did not make any change in the Act enacting that a different method is to be adopted for computing direct taxes. If the Parliament intended to make a departure from the principle laid down by this Court in *Metal Box Co.*,(1) that bonus amount D should be calculated, after a provision for tax was made and not before, a provision to that effect would have been incorporated by the Amendment Act. That not having been done, the law as laid down by this Court in *Metal Box Co.*(1) and reaffirmed by the two later decisions, referred to above, still holds the field.

E One must in fairness state that the National Tribunal in the case before us, was for the first time applying the provisions of the Act and it did not have the benefit of the decision of this Court in *Metal Box* Co.(1). From what is stated above, it follows that the view of the National Tribunal that bonus must be subtracted from the gross-profits before Income-tax is calculated, is not F correct.

Before closing the discussion on this aspect, it is necessary to point out that the view of the National Tribunal that the tax concession by way of rebate that an employer will get under the Income-tax Act on the bonus found to be payable has also to be taken into consideration in dividing the surplus between the work- G men and the Company, is also erroneous in view of the fact that the Act, which is a self-contained Code has prescribed the manner in which available surplus and the allocable surplus are to be calculated.

The second claim made by the Company related to deduction of Rs. 14,10,461 from the gross-profits as Return on reserves at H 6% on Rs. 2,35,07,686. As against the amount claimed by the Company, the National Tribunal has allowed a sum of

(1) [1969] 1 S.C.R. 750.

(2) [1971] 1 L.L.J. 503.

Rs. 11,48,381. This claim of Return on reserves made by the Company was based on s. 6, clause (d) read with Item 1 Cl. (iii) together with the material part of the Explanation to the Third Schedule of the Act. Section 6 enumerates the various sums which are to be deducted from the gross-profits as prior charges. Section 6(d) runs as follows :

> "Section 6 : The following sums shall be deducted from the gross-profits as prior charges, namely :
>
> * * * * * *
>
> (d) such further sums as are specified in respect of the employer in the Third Schedule."

In the Third Schedule there are three columns. As the appellant is a Company other than a Banking Company, the relevant item is Item No. 1, of Column I and clause (iii) of Column 3, which are as follows :

Item No.	Category of employer	Further sums to be deducted
1	2	3
1.	Company, other than a banking company.	* * * * * * (*iii*) 6 per cent of its reserves shown in its balance-sheet as at the commencement of the accounting year, including any profits carried forward from the previous accounting year.

The material part of the Explanation in the Third Schedule is as follows :

> "The expression "reserves" occurring in column (3) against Item No. 1(iii) * * * shall not include any amount set apart for the purpose of :
>
> * * * * *
>
> (iii) payment of dividends which have been declared....."

We have already referred to the fact that the relevant accounting year with which we are concerned is October 1, 1964 to September 30, 1965. In its balance-sheet as on September 30, 1964, the appellant had shown a sum of Rs. 2,35,07,686. as reserves. Similarly, in its balance sheet as on September 30, 1965, apart from showing its reserves as on that date, it had also shown a sum of Rs. 2,35,07,686 as reserves at the commencement of the accounting year. In view of these circumstances the claim for Return at 6% of this amount has been made by the Company.

A The National Tribunal, on the other hand, though accepting the figure as correct, held that from the reserves shown in the balance-sheet a sum of Rs. 43,68,000 has been earmarked and paid as dividend for the year ending September 30, 1964, and, therefore, this amount will have to be deducted from the reserves shown at the commencement of the accounting year 1964-65. B After so deducting this amount, the Tribunal fixed the reserve at the commencement of the accounting year in the sum of Rs. 1,91,39,686. It allowed 6% Return on this amount and thus arrived at the sum of Rs. 11,48,381, as against the claim of the Company in the sum of Rs. 14,10,486.

C This method of approach by the National Tribunal is attacked by Mr. G. B. Pai on the ground that it is clearly contrary to the provisions referred to above. According to him the amount claimed as reserve has been shown in the balance-sheet "as at the commencement of the accounting year" *i.e.* October 1, 1965. So according to him the essential requirement of cl. (iii) in Column 3 relating to Item No. 1 in the Third Schedule is D satisfied. In the said amount shown as reserve, the appellant Company will not be entitled to include any amount which is governed by the Explanation in the Third Schedule. So far as Item No. 1(iii) of the Third Schedule is concerned, in order to attract the Explanation, the amount should have been set apart for the purpose of payment of dividend which have been declared.

E In this case, the counsel pointed out, no amount has been set apart for payment of dividend; nor has any payment of dividend been declared as on October 1, 1964. Therefore, going by the clear wordings of the relevant provision, the counsel criticised, the deduction by the Tribunal of the dividend declared for the year 1963-64 some time during the accounting year, 1964-65. F

Mr. Dudhiya, learned counsel for the Unions, pointed out that the approach made by the Tribunal is correct. The counsel pointed out that on no occasion will dividend be declared for the accounting year ending September 30, 1964, on October 1, 1964, which is the beginning of the relevant accounting year now under G consideration. The counsel referred us to the notices issued calling for the general meeting of the shareholders as well as the declaration made by the Directors regarding setting apart of the necessary amounts in the General Reserve for payment of dividend for the year 1963-64. He further pointed out that though dividend for the year 1963-64 was actually paid only some time H in March, 1965, the appellant is not entitled to claim Return on the entire amount shown as Reserve on October 1, 1964 as it is from and out of that Reserve that the dividend for the previous year has been paid.

In our opinion, there is considerable force in the contention of Mr. Dudhiya. Going by a strict interpretation of the language of the provisions relied on by Mr. G. B. Pai, his argument, no doubt, looks attractive. But from the other proceedings, to which we will refer immediately, it will be seen that the approach made by the Tribunal is correct. In the Schedule to the balance-sheet as on September 30, 1964, the appellant Company has shown a sum of Rs. 1,23,00,000 as General Reserve. It has further shown a sum of Rs. 43,68,000 as the amount transferred to appropriation account for payment of dividend subject to tax in respect of the previous year, namely, 1962-63. It has also shown a sum of Rs. 63,00,000 as added to the General Reserve during the year ended Septembr 30, 1964. On December 5, 1964, a notice was issued regarding holding of the Annual General Meeting on February 12, 1965. One of the items in the agenda for the said meeting was to declare dividend. It is further stated in the said notice that the dividend to be declared at the meeting will be payable on or before March 9, 1965, to those members whose names are on the Company's Register of Members as on February 12, 1965. In the Directors' Report accompanying the notice, it is stated that a sum of Rs. 43,68,000 has been appropriated "for payment of dividend for the previous year" (paid during the year). The reference to the "previous year" obviously is to the accounting year ended September 30, 1964. It is also clear that the amount so appropriated for payment of dividend is to be paid "during the year" namely, 1964-65. It is also stated that this amount for payment of dividend has been transferred from the General Reserve. The notice further states that the Directors recommend payment of dividend for the year ended September 30, 1964 at 12% subject to deduction of tax at the appropriate rate and that the said payment will absorb Rs. 43,68,000, out of the General Reserve.

It will be seen that from the notice calling for the General Meeting, the Directors' Report and the balance-sheet, referred to above, that a sum of Rs. 43,68,000 out of the General Reserve of Rs. 2,35,07,686 has been set apart and is to be appropriated for payment of dividend for the previous year 1963-64. In no case will a Company be able to declare a dividend for the year ending September 30, 1964 on the morning of October 1, 1964. Therefore, it is clear that from the Reserve shown at the commencement of the accounting year *i.e.* October 1, 1964, a sum of Rs. 43,68,000 has to be deducted as per the Explanation to the Third Schedule, as the said amount must be considered to have been set apart for payment of dividend. No doubt, Mr. Pai urged that the notice calling for a General Meeting on February

A 12, 1965 was issued on December 5, 1964 and that the dividend was actually declared only on a later date and in fact the dividend was paid only as late as March 9, 1965. Therefore, he pointed out that in any event it cannot be considered that the said amount has been set apart for payment of dividend which have been declared.

B It is not possible to accept this contention of Mr. Pai. Once the Directors have, on the basis of the auditor's report and other materials, decided to declare a particular amount as dividend and have set apart the required amount from the General Reserve, it must relate back to the date of the commencement of the accounting year. The mere fact that dividend was actually paid only on March 9, 1965, in this view, is of no consequence. Therefore, the National Tribunal was perfectly justified in allowing interest at 6% only on the sum of Rs. 1,91,39,686. Therefore is no controversy that 6% Return on this amount, as correctly stated in the Award, is the sum of Rs. 11,48,381.

D Another amount that has been added back by the Tribunal to the net profits shown in the Profit and Loss Account is the sum of Rs. 55,127/-. According to the appellant this amount represents doubtful debts and as such the Tribunal should not have added back the same. In this connection Mr. G. B. Pai, learned counsel for the appellant, drew our attention to s. 211 of the E Companies Act, 1956, which provides for the Form and Contents of balance-sheet and Profit and Loss Account. He also invited our attention to Part II and Schedule Six of the same Act regarding the requirements as to Profit and Loss Account as well as to Part III regarding the interpretation of the expressions contained in Parts I and II of the said Schedule. He has also F referred us to the auditor's report for the year ending September 30, 1965 and also to certain passages in Pickles and Dunkerley on Accountancy.

All the above matters were relied on by the learned counsel to support his contention that the doubtful debts have been properly excluded by the Company in computing the gross-profits. G Here again, it is not possible to accept the contention of Mr. Pai. In the Profit and Loss Account for the year ended September 30, 1965, the appellant under the column Expenses, had given one item as Miscellaneous. Under this heading it had shown a sum of Rs. 71,71,072. Later on, under Ex. 3B, the appellant gave a break up of this amount. In particular, it is only necessary to H note that it had referred to two separate items, namely, Rs. 41,099 as bad debts and the sum of Rs. 55,127 as doubtful debts. This clearly shows that the appellant Company made a clear distinc-

tion between bad debts and doubtful debts. The claim of the appellant that this amount of Rs. 55,127; shown as doubtful debts is really a Provision and not a Reserve.

Mr. Pai has referred us to the decision in *Metal Box Co.*(1) to show that doubtful debts have been treated as Reserve. We have gone through the said decision. This Court had no occasion at all to express any opinion on this point as there appears to have been no controversy between the parties therein. This Court in *Textile Machinery Corporation Ltd.* v. *Their Workmen*(2) did not accept the claim of the management therein regarding certain amount treating it as a Reserve to meet possible losses in future. The Tribunal added back the said amount for determining the gross-profits. This Court in rejecting the contention of the management that the Tribunal was in error in adding back the said amount observed as follows :

> "It is true that some of the debts due to the appellant may not be fully realised but it is difficult to understand how the appellant can create a reserve solely for the purpose of meeting any possible losses on account of bad or irrecoverable debts and claim a deduction of this amount while determining the available surplus. The creation of such a reserve is wholly inconsistent with the Full Bench formula in question. There is, therefore, no substance in the argument that this amount should not have been added back."

No doubt, this Court was considering the question on the basis of the Full Bench formula; but in our opinion that principle applies with equal force to the case on hand even under the Act. In fact the above decision also shows that creation of such an amount is really a reserve and not a Provision, as contended by the appellant. Even apart from the above circumstances, there is a crucial fact that the appellant itself in its break-up has distinguished bad debts from doubtful debts. The Tribunal had not added back the amount shown by the appellant in the break-up sheet under the heading "bad debts". We may also refer to the evidence of Mr. Banerji, W.W.1, who was a Chartered Accountant. In chief examination he has stated that under the Act the amount claimed by the appellant as doubtful debts has to be added back for ascertaining the gross-profits. He has further stated that under the Income-tax Act. Provision for doubtful debts cannot be deducted in computing the net profits. On this point, so far as we could see, there is

(1) [1969] 1 S.C.R. 750. (2) [1960] 1 L.L.J. 34.

A no cross-examination on behalf of the Company. The Tribunal was justified in holding that the appellant was not in order in deducting Rs. 55,127 under the head "doubtful debts" as an item of expenditure. It was perfectly justified in adding back this amount in computing the gross-profits.

B The last point in controversy relates to three items shown as capital expenditure in Ex.4. Those items are: (1) Patent fees Rs. 10,000; (2) Plant transfer charges Rs. 72,516; and (3) Disallowable rent Rs. 74,000. The above three items were claimed by the appellant as revenue expenditure and hence should not be added back for ascertaining the gross-profits.

C So far as Plant transfer charges of Rs. 72,516/- is concerned, it is seen that though this was claimed as a revenue expenditure, Mr. K. B. Bose, appearing for the appellant, had conceded before the National Tribunal that this amount is an item of capital expenditure which should be added back. This concession has been recorded in the Award and it has not been D challenged before us on behalf of the appellant. Therefore, it follows that the Tribunal was justified in adding back this amount for ascertaining the gross-profits.

Similarly, regarding Patent fees of Rs. 10,000, the appellant's witness Mr. Basu, M.W. 1 has admitted in cross-E examination that Patent fees is also regarded as an item of capital expenditure. If that is so, the Tribunal was justified in adding back this amount also.

The same witness has also admitted that rent paid for godown for storing capital goods in the process of erection of a factory is not allowable as an item of revenue expenditure and that the F Income-tax authorities would treat the same as part of capital expenditure for erecting a factory. Therefore, from the evidence on the side of the appellant, it is clear that this amount also is an item of capital expenditure and has to be added back in computing the gross-profits.

G Similarly, Mr. Banjerji, Chartered Accountant, who gave evidence on the side of the Union, as W.W. 1, has also stated that the appellant itself originally added back in computing gross-profits the amount under Patent Fees, Disallowable Rent and Plant Transfer Charges and that it was only at a later stage that it claimed these items as revenue expenditure. Under these circumstances, the Tribunal was justified in adding back the H amount of Rs. 74,000/- under the heading Disallowable Rent.

So far as the calculation of Surtax is concerned, the Tribunal has held that the method of calculation made by the

Company in Ex. 4 is correct, but it has to be altered because the Income-tax calculated by it after deducting bonus was less. Now, that we are accepting the claim of the appellant that bonus should not be deducted for calculating direct taxes, it follows that the view of the Tribunal in this respect is not correct.

We have already pointed out that the National Tribunal has held that direct tax has to be calculated without taking into account the bonus paid for the year 1963-64 and the bonus payable for the accounting year 1964-65. So far as the bonus payable for the accounting year 1964-65 is concerned, we have already discussed the matter and held that the view of the Tribunal is erroneous. But, in our opinion, the Tribunal was justified in holding that in calculating direct taxes, the bonus for the accounting year 1963-64, though paid during the accounting year 1964-65 should not be taken into account, is correct. As the bonus year must be taken as a unit, bonus paid for the previous accounting year from and out of the profits of the said previous year does not come into the picture.

From the discusion above, it follows that except the error committed by the National Tribunal in the matter of computation of direct taxes after excluding bonus payable for the accounting year 1964-65, in all other respects it was justified in rejecting the various claims made by the Company. Even on the basis of the rejection of the claim of the appellant that the bonus paid for the previous accounting year 1963-64 has also to be taken into account for purposes of calculation of direct taxes, there is no controversy that on a proper calculation, the bonus to which the workmen will be entitled, will be very much less than 17.58% already given by the Company. Hence it is not necessary for us to recompute the figure, as the appellant has agreed not to claim a refund or in any other manner adjust or collect the excess bonus that has been already paid.

But it follows that the view of the Tribunal that the workmen are entitled to bonus at the maximum rate of 20% and the further direction regarding the set on to be carried forward, cannot be sustained. From the calculation given by us earlier, it will be seen that the National Tribunal had directed that a sum of Rs. 4,63,750 had to be carried forward as set on in the succeeding year. This direction has been given on its finding that the allocable surplus works out at more than 20% of the Annual Wage Bill. If that finding is correct, the direction regarding set on will be justified under s. 15 of the Act. But as we have already held that parties are agreed that on a proper computation, on the basis, indicated by us in the earlier part of

A the judgment, even the bonus already paid at 17.58%, will be on the high side, it follows that the direction of the National Tribunal regarding set on cannot be accepted.

In the view that we have taken about the appellant's claim regarding direct taxes, it has been represented by the counsel B appearing for the various unions that they are not pressing their appeals Nos. 813 and 1302 of 1967.

In the result, the Award of the National Tribunal is modified to the extent indicated above and Civil Appeal No. 415 of 1967 allowed in part. In other respects the said appeal will stand dismissed. Civil Appeals Nos. 813 and 1302 of 1967 are C dismissed as not pressed. There will be no order as to costs in all the appeals.

G.C.