Calcutta High Court
Commissioner Of Income-Tax vs Shaw Wallace And Co. Ltd. on 22 August, 1989
Equivalent citations: 1991 190 ITR 455 Cal Author: A K Sengupta

Bench: A K Sengupta, B P Banerjee
JUDGMENT Ajit K. Sengupta, J.

1. In this reference at the instance of the Revenue, the following question of law has been referred to this court for its opinion under Section 256(1) of the Income-tax Act, 1961, for the assessment year 1976-77 :

"Whether, on the facts and in the circumstances of the case, the additional payment to the assessee's employees by way of ex gratia or puja or customary bonus in excess of the bonus payable under the Bonus Act, 1965, was an admissible deduction under Section 36(1)(ii) of the Income-tax Act, 1961 ?"

2. The facts leading to this reference are as under :

The assessee company is engaged in the business of manufacturing pharmaceutical and industrial gelatine. During the relevant previous year, the assessee-company paid bonus to its employees at 8.33%. In addition thereto, it also paid another sum of Rs. 74,206 to its employees by way of ex gratia payment calculated at 8.17%. The Income-tax Officer did not allow deduction in respect of the said sum of Rs. 74,206 claimed as business expenditure on the ground that similar payment was disallowed in the immediately preceding year also.

3. On further appeal, it was submitted on behalf of the assessee-company before the Commissioner of Income-tax (Appeals) that this additional payment by way of ex gratia was made to the employees with a view to avoid labour trouble which could have brought the production to a complete halt since the workers were not satisfied with the payment of statutory bonus calculated at 8.33% payable under the Payment of Bonus Act, 1965. The Commissioner of Income-tax (Appeals), however, held that the payment of Rs. 74,206 was nothing but in the nature of bonus, although it was termed as ex gratia payment. Referring to the provisions of Section 36(1)(ii), the Commissioner of Income-tax (Appeals) held that the additional payment of Rs. 74,206 being in excess of the amount of bonus payable under the Payment of Bonus Act, 1965, the same was not allowable as a business expenditure in computing the total income of the assessee-company for the assessment year 1976-77.

4. On further appeal by the assessee-company before the Income-tax Appellate Tribunal, reference was made to a memorandum of settlement executed between the assessee-company and its employees whereunder, the aforesaid sum of Rs. 74,206 was agreed to be paid by way of ex gratia in addition to the minimum bonus payable at 8.33% under the provisions of the Payment of Bonus Act, 1965. It was further submitted that the limit provided under the first proviso to Section 36(1)(ii) was applicable only in respect of the bonus payable under the Payment of Bonus Act, 1965, and that it did not include customary and other kinds of payments. In any event, the additional payment by way of ex gratia having been made by the assessee company in business interests and on grounds of

commercial expediency, the same was, in any event, allowable under Section 37 of the Income-tax Act, 1961. The Tribunal held and observed that, on a plain reading of Section 36(1)(ii) read with the first proviso thereto, it was clear that if an employer pays bonus to its employees based upon profit and/or production, the amount so paid must not exceed the amount payable under the Payment of Bonus Act, 1965. Otherwise, the excess would be disallowed under the said section. But if the employer paid any other bonus to its employees, the restriction imposed by the first proviso to Section 36(1)(ii) was not applicable and the assessee was entitled to full deduction in respect of such payment.

5. Referring to the memorandum of settlement reached between the assessee-company and its employees, the Tribunal further observed that the additional payment of Rs. 74,206 calculated at 8.17% was made by the assessee-company to its employees only to keep good relations with its workers, to buy industrial peace and save the industry from strikes and lock-outs. This was customary and in consonance with the commercial practice adopted by others and, therefore, the payment of such bonus was clearly saved by the second proviso to Section 36(1)(ii). Referring to an alternative submission of the assessee-company, the Tribunal also held that Section 36(1)(ii) is concerned only with the bonus coming within the purview of the Bonus Act, 1965. If the assessee paid any other bonus, as in the present case, for maintaining good employer-employee relations and keeping industrial peace, such additional sum by way of ex gratia was not covered by the Payment of Bonus Act, 1965, and the same was also allowable under Section 37 of the Income-tax Act, 1961. Even otherwise, the Tribunal held that the assessee was entitled to deduction of the said sum having regard to the fact that such additional amount was paid not only during the year under reference, but also in the earlier years. The payment having been made wholly for business considerations and on ground of commercial expediency and since similar payments were also made in the earlier years, the same was of the nature of a customary payment and was, therefore, admissible under Section 37 of the said Act, if not under Section 36(1)(ii). In this view of the matter, the Tribunal allowed the assessee's appeal and directed the Income-tax Officer to allow deduction of the said additional sum of Rs. 74,206 paid by the assessee-company by way of ex gratia to its employees during the calendar year 1975 corresponding to the assessment year 1976-77.

6. In the course of hearing before this court, Sri A. Bhattacharjee, learned counsel appearing for the Revenue, referred to the historical background leading to the enactment of the Payment of Bonus Act, 1965, and the various amendments made thereto from time to time. It was submitted by him that any payment made by an employer to its employees by way of bonus, whether statutory, customary or festival or otherwise was allowable as deduction in computing the income under the head "Profits or gains of business or profession" only if it was covered by the first proviso to Section 36(1)(ii) of the Payment of Bonus Act, 1965. This Act laid down the measure of reasonableness in regard to the payment of bonus and any payment in excess of what was admissible under the Payment of Bonus Act, 1965, could not be allowed in computing the business income of the assessee-company even when such payment was made in pursuance of an agreement or settlement with the employees. Learned counsel for the Revenue particularly referred to the provisions of Section 34 of the Payment of Bonus Act, 1965, which clearly provided that the provisions of this Act shall have overriding effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any terms of any award, agreement or settlement or contract of

service. The only exception that learned counsel for the Revenue mentioned was the one laid down in Section 31A of the Payment of Bonus Act, 1965, whereunder if an employer paid annual bonus to its employees linked with production or productivity in lieu of bonus payable under this Act, such payment was fully in accordance with law and no portion thereof could be disallowed under Section 36(1)(ii) of the said Act. In this case, it is an admitted position that there was neither any agreement, nor was the said additional sum of Rs. 74,206 paid by way of bonus linked with production or productivity and, therefore, the payment in question could not be saved by the provisions of Section 31A of the Payment of Bonus Act, 1965. Learned counsel for the Revenue further submitted that when the deduction for bonus was specifically covered by the provisions of Section 36(1)(ii) of hte Income-tax Act, 1961, the assessee could not claim deduction under the residuary Section 37 of the said Act. In this connection, learned counsel for, the Revenue referred to several decisions, namely, N. M. Rayaloo Iyer and Sons v. CIT [1954] 26 ITR 265 (Mad), J.K. Woollen Manufacturers (P.) Ltd. v. CIT [1963] 48 ITR 346 (All) Laxmandas Sejram v. CIT [1964] 54 ITR 763 (Guj) and CIT v. Tingri Tea Co. Ltd. .

7. Learned counsel for the Revenue finally submitted that the amendment made in 1975 in the Payment of Bonus Act, 1965, reflects the economic policy of the Government to encourage accumulation of profit for development of industry as also to encourage savings for better utilisation of funds in the interest of welfare of the society. Having regard to the aforesaid objective, learned counsel for the Revenue submitted that the additional payment of Rs. 74,206 by way of ex gratia was nothing but in the nature of bonus and the same being in excess of what was payable under the Payment of Bonus Act, 1965, no deduction should be allowed in view of the specific provisions laid down in the first proviso to Section 36(1)(ii) of the Income-tax Act, 1961, and, in the facts and circumstances of this case, the assessee-company cannot rely on the general provisions of Section 37, when the case was specifically covered by Section 36(1)(ii) of the said Act.

8. On behalf of the assessee, Dr. Pal, learned counsel supported the order of the Tribunal. He also placed reliance on the decision of the Kerala High Court in CIT v. P. Ali Kunju, M. A. Nazir Cashew Industries in support of his submissions.

9. We have considered the submissions made on behalf of the Revenue as well as of the assessee.

10. Section 36(1)(ii) of the Income-tax Act, 1961, reads as under :

''36.(1)(ii) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission ;

Provided that the deduction in respect of bonus paid to an employee employed in a factory or other establishment to which the provisions of the Payment of Bonus Act, 1965 (21 of 1965), apply shall not exceed the amount of bonus payable under that Act :

Provided further that the amount of the bonus (not being bonus referred to in the first proviso) or commission is reasonable with reference to-

(a) the pay of the employee and the conditions of his service ;

(b) the profits of the business or profession for the previous year in question ; and

(c) the general practice in similar business or profession."

11. It is by now well settled by several decisions of the Supreme Court that the Payment of Bonus Act, 1965, seeks to provide for bonus to persons employed in certain establishments and not in all establishments. The Bonus Act deals with only profit bonus and matters connected therewith and it does not govern customary, traditional or contractual or attendance bonus. Reference in this connection may be made to the decisions of the Supreme Court in Mumbai Kamgar Sabba v. Abdulbhai Faizullabhai , and Baidyanath Ayurveda Bhawan Mazdoor Union v. Management of Shri Baidyanath Ayurveda Bhawan (P.) Ltd. . What constitutes customary bonus was further explained by the Supreme Court in Upendra Chandra Chakraborty v. United Bank of India . In this case, the Supreme Court referred to its earlier judgment in Vegetable Products Ltd. v. Their Workmen , and laid down the following tests to determine what exactly is customary or festival bonus. The tests laid down by the Supreme Court are :

(1) that the payment has been made over an unbroken series of years ;

(2) that it has been paid for a sufficiently long period--the period has to be longer than in the case of an implied term of employment ;

(3) that it has been paid even in years of loss and did not depend on the earning of profits ; and (4) that the payment has been made at a uniform rate throughout.

12. In the instant case, the Tribunal has clearly recorded a finding of fact having regard to similar payments made by the assessee-company in the immediately preceding as well as earlier years that the payment in question had the character of customary bonus.

13. In Indian Leaf Tobacco Development Co. Ltd v. CIT [1982] 137 ITR 827, this court has, inter alia, held that if an assessee makes ex gratia payment out of commercial expediency, such payments were allowable in working out the business income of the assessee,

14. In CIT v. Sivanandha Mills Ltd. [1985] 156 ITR 629, the Madras High Court, while rejecting a reference application made by the Revenue under Section 256(2) of the Income-tax Act, 1961, observed that Section 36(1)(ii) of the Act which has relevance only to bonus paid under the Bonus Act had no application to incentive bonus, attendance bonus or customary bonus which were not bonus paid under the Bonus Act. These payments were expenditure laid out wholly and exclusively for the purposes of the business and hence allowable under Section 37 of the Income-tax Act, 1961.

15. In CIT v. P. Ali Kunju, M. A. Nazir Cashew Industries [1987] 166 ITR 611, the Kerala High Court referred to the amendment made in Section 36 of the Income-tax Act, 1961, by the Payment of Bonus (Amendment) Act, 1976, with effect from September 25, 1975. It was by this amendment that

the present first proviso was enacted in Section 36(1)(ii) of the Income-tax Act, 1961, and the original proviso was retained with some addition of words as the second proviso. The Kerala High Court held that, as a result of this amendment, where bonus has been paid in accordance with the requirement of the Bonus Act to an employee covered by that Act, the amount so paid was without doubt an allowable deduction. On the other hand, if bonus or commission was paid to such an employee in excess of, or otherwise than, what was required to be paid under the Bonus Act, or if bonus or commission was paid to any employee not covered by the Bonus Act, the amount so paid was not automatically allowable as a deduction, but it may be allowed only upon the satisfaction of the Officer that it was a reasonable payment when considered in the light of Clauses (a) to (c) of the second proviso. Under these clauses, such payment would be regarded as reasonable only when it was justifiable by reason of the pay of the employee and the conditions of his service, the profits of the business or profession for the previous year in question and the general practice in similar business or profession. All the three conditions postulated under Clauses (a) to (c) of the second proviso must be satisfied in order that the payment which is not covered by the Bonus Act is regarded as reasonable so as to warrant allowance under Section 36(1)(ii). The two provisos must be read together to correctly understand the permissible deduction in terms of Clause (ii) of Sub-Section (1) of Section 36. The object of that clause is to encourage the management to pay bonus not only to the extent to which it is statutorily bound to pay to the employee, but also in excess of that limit, provided the payment is justified as a reasonable payment. The court felt that any other construction of the said section would be artificial and would not be in keeping with such a benevolent provision.

16. We are in respectful agreement with the aforesaid observations of their Lordships of the Kerala High Court. In this case, the Tribunal has specifically examined the additional payment of Rs, 74,206 by way of ex gratia calculated at 8.17% in the light of the three conditions laid down in the second proviso to Section 36(1)(ii) of the Income-tax Act, 1961, and has held that such payment satisfied those conditions.

17. Further, the additional payment of Rs. 74,206 in this case was made by way of ex gratia in terms of a memorandum of settlement arrived at by and between the assessee-company and its workmen. This memorandum of settlement was signed on October 10, 1975, under which it was specifically provided that in addition to the statutory bonus of 8.33% payable in accordance with the Payment of Bonus Act, 1965, the management would pay an additional amount of 8.17% of the wages payable to the permanent employees by way of ex gratia. The Tribunal has further recorded a finding of fact that this additional payment was made wholly and exclusively for business purposes to keep good relations with the workers, to buy industrial peace and save the industry from strikes and lock-outs. The assessee-company was running an industry and there can be no smooth running of the industry unless relations between the employer and the employees were good. The Tribunal, therefore, rightly observed that the additional amount of Rs. 74,206 was paid by the assessee-company in terms of the memorandum of settlement wholly and exclusively for the purposes of business and was, therefore, allowable as a business deduction under Section 37 of the Income-tax Act, 1961. We find ourselves in complete agreement with the views expressed by the Tribunal. We are also fortified in our view by the observations made by the Supreme Court in CIT v. Kalyanji Mavji and Co. [1980]
122 ITR 49 and we hold that the additional payment is allowable as a business expenditure even

under Section 37 of the Income-tax Act, 1961. In this view of the matter, it is not necessary to deal with the various cases cited by learned counsel for the Revenue, for, in our view, those cases do not deal with the controversy involved here.

18. We may add that by Section 11 of the Direct Tax Laws (Amendment) Act, 1987, two provisos to Section 36(1)(ii) laying down ceilings on the bonus to be allowed as deduction have been deleted with effect from April 1, 1989. Simultaneously, bonus payments have been covered by the provisions of Section 43B, so that these are allowed on actual payment basis. This amendment only indicates that the Legislature did never intend that the payment of bonus in whatever name it is called in excess of the amount of bonus prescribed under the Payment of Bonus Act, 1965, would not be allowable even if such payment is reasonable and has been made having regard to the commercial and business expediency and to maintain the target of production through sustained industrial peace.

19. For the foregoing reasons, the question in this reference is answered in the affirmative and in favour of the assessee.

20. There will be no order as to costs.

Bhagabati Prasad Banerjee, J.

21. I agree.