PETITIONER:
CROMPTON PARKINSON (WORKS) PRIVATELTD., BOMBAY

Vs.

RESPONDENT:
ITS WORKMEN AND OTHERS

DATE OF JUDGMENT:
06/05/1959

BENCH:
DAS, SUDHI RANJAN (CJ)
BENCH:
DAS, SUDHI RANJAN (CJ)
BHAGWATI, NATWARLAL H.
DAS, S.K.
GAJENDRAGADKAR, P.B.
WANCHOO, K.N.

CITATION:
1959 AIR 1089 1959 SCR Supl. (2) 936
CITATOR INFO :
R 1960 SC 819 (14)
RF 1969 SC 612 (23)

ACT:
Industrial Dispute-Bonus-Gross Profits-Expenditure, when may be disallowed-Service Fee-Whether allowable expenditure-Available Surplus-Bonus, deducted as prior charge-Propriety of.

HEADNOTE:
Initially the appellant was a 100% subsidiary of the British company, Crompton Parkinson Ltd. In 1947 an agreement called " Technical Aid Agreement " was concluded between the two companies under which the appellant agreed to pay to the parent company 5% Of the net value of its sales every year as service fee for the use of their patterns, valuable designs, technical aid, benefit of research and ancillary services and facilities. As the appellant obtained the benefit of the parent company's technical knowledge and research it did not maintain a separate research establishment on which it would otherwise have had to spend far more than the service fee it paid. The agreement had received the approval of the Government; the income-tax authorities had, every year, allowed the service fee as legitimate expenditure ; and the remittances to the parent company had been sanctioned by the Reserve Bank of India. In the claim for bonus by the workmen, the Tribunal, in calculating the gross profits, pruned down the allowable expenditure on account of the service fee to one fourth on the grounds that the amount of service fee paid was excessive and beyond the requirements of commercial necessity and that a large part of the payment was in the nature of capital expenditure. In calculating the available surplus the Tribunal deducted as a first charge 4 1/2 months basic wages as bonus before deducting depreciation and income-tax contrary to the terms of the Full Bench formula.
Held, that the entire amount of service fee paid ought to have been allowed as proper expenditure. Unless it was definitely found that a purported expenditure was sham or

had been made with the express object of minimising the profits with a view to deprive the workmen of their bonus, the Tribunal could not substitute its own judgment as to what was or was not commercially justified in place of that of the appellant and its directors. The service fee was a genuine expenditure and represented a binding contractual obligation which could legally be enforced against the appellant and a breach thereof may have had serious consequences affecting its business.
Held further, that the Tribunal acted wrongly in deducting
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bonus as a prior charge even before the recognised items of prior charges. Such departures from the Full Bench Formula by Tribunals were to be deprecated.
Associated Cement Companies Ltd. v. Its Workmen, C.A. Nos. 459 and 460 of 1957, decided on 5-5-59, followed.

JUDGMENT:
CIVIL APPELLATE JURISDICTION: Civil Appeals Nos. 756 & 757 of 1957.
Appeal by special leave from the Award dated January 8, 1957, of the Industrial Tribunal, Bombay, in 1. T. Ref. Nos. 109 and 147 of 1956.
C. K. Daphtary, Solicitor-General of India, Y. A. Palkhivala and S. N. Andley, for the appellant.
Rajani Patel and Janardan Sharma, for the respondents.
1959. May 6. The Judgment of the Court was delivered by
DAS, C. J.-These are appeals by special leave filed by Crompton Parkinson (Works) Private Ltd. (hereinafter referred to as the company) against that part of the award made in References (IT) Nos. 109 and 147 of 1956 by the Industrial Tribunal, Bombay, on January 8, 1957, which concerns the demand of its workmen for bonus for the company's financial year 1954-55. That award was published in the Bombay Government Gazette of January 17, 1957, in Part IL at pages 351-364.
The material facts and circumstances leading upto the said award, as they appear from the evidence placed on record before the Tribunal, may shortly be stated as follows:- The company was incorporated in India in the year 1937. The registered office of the company is at Bombay. The authorised capital of the company is Rs. 75 lacs divided into 75,000 ordinary shares of the value of Rs. 100 each. Out of the authorised capital, shares of the value of Rs. 60 lacs have been issued, subscribed and fully paid. At its inception the company was 100% subsidiary of the well known British company named Crompton Parkinson Ltd. (hereinafter called the Parent company). In 1937
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the company commenced its business which was and is to manufacture electrical equipment such as transformers, motors, fans, starters and switch gears and to sell the same in the market. All the goods, which the company manufactures, are manufactured wholly in accordance with patterns, designs, specifications and technical processes developed by and belonging to the Parent company which the latter makes available to the company. The company's products are sold under the trade names and marks belonging to the Parent company, namely, " Crompton Parkinson ", " Crompton ", " Parkinson " and " C. P. ". Between 1937 and 1947 the company's business is said to have been in a stage of development and progress and it is admitted that the Parent company made no charge for the several services and

facilities given by it to the company. In the year 1947, after the company's business had been established on a firm footing, an agreement was concluded between the two companies in order to provide, on a long term basis, for the continuance of the technical assistance and service and other facilities afforded by the Parent company on which the company was wholly dependent. That agreement, which is said to be of a type commonly executed between the manufacturing and industrial concerns in India and their respective associates, parents or affiliates abroad and generally known as " Technical Aid Agreements " is said to have received the approval of the Government of India to promote the industrial development of the country. That agreement was actually executed on August 12, 1947, and provided that for a period of 20 years the Parent company would render to the company various facilities and services, including, amongst others, the following :

(1) the use of the latest designs, manufacturing information and production methods discovered and developed by Crompton Parkinson Ltd.;

(ii) the fullest information and advice as to the most suitable machine tools and production machinery and equipment and as to the correct operation and use thereof;

(iii) the supply at cost of machinery, equipment,,

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raw materials and manufacturing parts. Under this facility the appellants obtain the benefit of bulk purchase terms under which Crompton Parkinson Ltd. purchase their raw materials;

(iv) the benefit of the knowledge and experience of Crompton Parkinson Ltd.'s executive in all matters relating to technical, mechanical and financial management;

(v) the service of the Crompton Parkinson Ltd.'s experts and technical personnel;

(vi) facilities for training of selected employees of the petitioners in Crompton Parkinson Ltd.'s Works, and

(vii) licence to use on the appellants' products the world-famous trademarks, "Crompton Parkinson", " Crompton ", " Parkinson " and " C. P. " belonging to Crompton Parkinson Limited."

In lieu of all royalties, licence fees and other considerations usually allowed for services and facilities of this kind, the company agreed to pay to the Parent company service fee calculated at the rate of 5% of the net value of the sales made by the company from year to year. For the year 1954-55 the company had actually paid the amount of service fee and the same, after deducting the Indian income-tax, had been remitted to the Parent company. Shortly after the execution of the aforesaid agreement, 26% of shares of the company were acquired by Messrs. Greaves Cotton Co. Ltd., which is an Indian Company and the company ceased to be a 100% subsidiary of the Parent company. It is said that when negotiations for the aforesaid agreement were going on negotiations were also in progress for the transfer of shares to the Indian company and that the latter was apprised of the terms of the proposed agreement and approved of the terms of payment of 5% of the net value of sales.

On August 25, 1955, the General Engineering Employees Union representing the workmen who are respondents Nos. 1 and 2 submitted certain demands to the company. No agreement having been arrived at, the matter was referred to the Conciliation Officer. As

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no settlement was arrived at as a result of the conciliation proceedings, the Conciliation Officer submitted his report

to the Government of Bombay under sub-s. 4 of s. 12 of the Industrial Disputes Act, 1947. The Government of Bombay,' after considering the said report and in exercise of the powers conferred on it by sub-s. 5 of s. 12 of the Industrial Disputes Act, 1947, made an order on August 6, 1956, referring the disputes between the company and its workmen (other than those of the Watch and Ward staff) over their demands mentioned in the schedule to that order for adjudication to the Tribunal from whose award the present appeals have been filed. This reference was marked as (IT) No. 109 of 1956. By another order made on October 10, 1956, the Government of Bombay referred the disputes between the company and its workmen belonging to the Watch and Ward staff over the latter's demands mentioned in the schedule to that order for adjudication to the same Tribunal. That reference was marked as (IT) No. 147 of 1956.

On September 10, 1956, a statement of claim was filed by the Genera Secretary, General Engineering Employees Union, on behalf of the workmen (other than those of the Watch and Ward staff) in Reference (IT) No. 109 of 1956 claiming, inter alia, that all workmen should be given bonus either (i) equivalent to 331 % of their earnings during 1954-55 or (ii) a prorate bonus equivalent to their six months' basic wages, basic wage being calculated at the daily rate of pay which the workmen drew on June 30, 1955, and bonus being given without attaching any conditions. In the statement of claim the Union contended: (i) that during the year 1954-55 the company had made huge profits, (ii) that the company's business had expanded by leaps and bounds and production had mounted up very much and the company had made huge profits and (iii) that the wages paid to its employees fell terribly short of the living wage standard and extremely out of any reasonable proportion to the tremendously high salaries paid to the company's officers. The Union requested the Tribunal to take into consideration the company's practice, inter alia, of writing off

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of very substantial amounts as service fees to the Parent company.

The company filed its written statement in reply to the statement of claim filed by the Union in Reference No. (IT) 109 of 1956. While agreeing that it had made reasonable progress, the company did not admit that the progress had been as rapid or phenomenal as the Union had suggested. The company stated that it had been able to accumulate only small reserves, that, in spite of its increased turnover, its profit for the year in question was quite low on account of stiff competition, that the wages paid to the workmen compared favorably with those paid by similar concerns, that they paid to the Parent company a service fee as consideration for the use of their patterns, valuable designs, technical aid, benefit -of research and ancillary services and facilities. For the purposes of the reference, the company filed a copy of its audited balance-sheet and profit and loss account for the year 1954-55 as a confidential exhibit. In the said profit and loss account, service fee of 5% so paid for the year was shown as an item of expenditure.

The Union on behalf of the workmen belonging to the Watch and Ward staff filed a statement of claim in Reference (IT) No. 147 of 1956 regarding certain special claims of those workmen to which the company replied by its written statement. It is not necessary to refer to that statement of claim by the Union or the company's written statement, for they are not relevant to the question of bonus.

In the course of hearing of the References, which were taken up together, the workmen, through their counsel, submitted to the Tribunal, amongst other things, that the payment of the said service fee by the company was not justified and that the same should be disallowed as an item of expenditure for the purpose of calculating bonus payable to the workmen for the year 1954-55. The Tribunal thereupon called upon the company to bring on record by an affidavit all relevant facts and circumstances relating to the payment of service fee. The company submitted that it was not open to the workmen to question an item of
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expenditure actually incurred and paid in the course of business or to request that such an item. already debited to the accounts, which had duly been audited and passed, should be disallowed. The company submitted that in any event the said payment was fully justified and reasonable. However, in compliance with the Tribunal's directions, the company on December 18, 1956, filed an affidavit affirmed on December 14, 1956, by Shri V. V. Dhume. the Secretary to the company setting forth the relevant facts and circumstances relating to the payment of the said service fee. At the further direction of the Tribunal, a copy of the agreement dated August 12, 1947, was also filed by the company. Shri V. V. Dhume was examined before the Tribunal and his oral testimony was also recorded.

The material provisions of the said agreement have already been summarised above. From the affidavit and the oral evidence of Shri V. V. Dhume referred to above, it is clear that all the goods which the company manufactures are manufactured wholly in accordance with the patterns, designs, specifications and technical -processes developed by and belonging to the Parent company which it makes available to the company and that the company's products are sold exclusively under the trade names and marks belonging to the Parent company. There can be and is no dispute that the company has thus at its disposal the benefit of the Parent company's accumulated knowledge and experience, technical data and goodwill and the reputation attaching to its products. It is clear upon the evidence on record that the manufacture of specialised electrical goods and equipment of the types produced by the company is a highly specialised business of a very competitive nature requiring the use of the most up to date technique. In order to keep abreast with the latest development in the field of manufac-ture of this kind of equipment, the company will ordinarily have to maintain its own research laboratories and specialised staff to develop new methods and innovations and processes. The company, however, does not maintain a separate research establishment -Of its own but obtains the benefit of the Parent
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company's invaluable services under the said agreement. According to Shri V. V. Dhume the service fee paid by the company to the Parent company constitutes, in a substantial measure, a mere reimbursement of expenses incurred by the latter in the maintenance and operation of its research department and rendering of facilities to the company. Shri V. V. Dhume further stated that, had the company to maintain its own research department to provide such service and facilities, the annual expense of the company would have far exceeded the service fee actually paid by it to the Parent company. It also appears from the affidavit of Shri V. V. Dhume that the independent shareholders of the company who had acquired 26% shares of the company about the time when

the " Technical Aid Agreement " was executed had willingly accepted that agreement. Apart from the fact that the agreement had received the approval of the Government of India in the Ministry of Finance as well as in the Ministry of Commerce and Industry, the income-tax authorities have from year to year allowed the full amount of the service fee paid by the company to the Parent company as an expenditure incurred wholly and exclusively for the purposes of the company's business. Likewise every payment and remittance made by the company representing the service fee to the Parent company has been sanctioned by the Reserve Bank of India ever since 1947. The payment of the service fee no doubt represents a binding contractual obligation on the company which can be legally enforced against it and a breach thereof on the part of the company may well lead to the cancellation thereof by the Parent company as a result whereof the company will be deprived of the services and facilities obtained by it under the agreement and may even be prevented from carrying on its business. There was no serious cross-examination of Shri V. V. Dhume regarding these matters by counsel appearing for the workmen and no substantive evidence on these questions was led by the workmen.

The Tribunal made its award in both the References on January 8, 1957. As regards the service fee,

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the Tribunal held (i) that the amount of service fee paid by the company to the Parent company was excessive and beyond the requirements of commercial necessity and was allowable as an expense only as to one quarter thereof and (ii) that in any event even if the commercial necessity of the payment could not be challenged, a large part of the payment was in the nature of capital expenditure and that only the balance, being in fact a quarter thereof, was allowable as revenue expense for the purpose of determining the surplus available for the payment of bonus to the workmen. Thus, as regards the service fee, the Tribunal in its award proceeded to "prune it down ". In the actual calculations made by the Tribunal for determining the available surplus according to the bonus formula appearing in what has been marked as confidential exhibit T-1, the Tribunal has allowed only Rs. 2 lacs out of the total of Rs. 7.67 lacs actually paid as service fee and added back Rs. 5.67 lacs to the profits. It will also be noticed from that confidential exhibit T-1 that the Tribunal has deducted as a first charge 4 1/2 months' basic wages as bonus before depreciation as well as tax, on no better ground than that, in the view taken by it, income-tax should not be deducted as a prior charge on the gross profits in preference to bonus. In so doing the Tribunal has not, quite clearly, followed but has made variations in that formula. The bonus formula enjoins the Tribunals to arrive at the available surplus after providing for certain prior charges mentioned therein and then to determine, after taking into consideration all material circumstances, how that available surplus should be distributed' between the three interests, namely, the industry, the shareholders and the workmen. To deduct bonus as a prior charge even before the recognised items of prior charges appears to us to put the cart before the horse. Such a process is certainly not giving effect to. the bonus formula but amounts to ad hoc determination which may vary according to the length of the proverbial foot of the Lord Chancellor and is bound to lead to chaos and industrial unrest. The bonus formula was evolved by

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the Labour Appellate Tribunal as far back as 1950 and it has been generally approved by this Court in more decisions than one and what is more it has worked fairly satisfactorily. In our judgment in the,' appeals of Associated Cement Companies Ltd. v. Its Workmen (1) we have deprecated such departure from the bonus formula by individual Tribunals, for clearly such departure is not conducive to the harmonious and peaceful relations between the workmen and their employers.

The only other question which calls for our decision is the correctness of the Tribunal's award as to the service fees. The conclusion of the Tribunal on that point is founded on the ground that the test of " commercial necessity " applied by the income-tax authorities for determining whether the expenditure was allowable under s. 10(2)(xv) of the Indian Income-tax Act should also be applied by the Tribunal. The Tribunal evidently overlooked the fact that the income-tax authorities are entitled to apply the test of commercial necessity by reason of the express provisions of s. 10(2)(xv) which authorise them to arrive at the taxable income, profits and gains after making allowance for expenditures laid out and expended wholly and exclusively for the purpose of the business. There is no such provision in the Industrial Disputes Act. In tile absence of cogent and compelling evidence leading to the definite conclusion and finding that a purported expenditure was sham or had been made with the express object of minimising the profits with a view to deprive the workmen of their bonus, it is no part of the duty of an Industrial Tribunal to substitute its own judgment as to what was or was not commercially justified in the place of the judgment exercised by the company and its Directors in whom. in law the management of the company is confided. The Tribunal has completely overlooked the fact that the company's accounts bad been duly audited by its auditors who were duly appointed by the company and that the said auditors had duly certified

(1) [1950].S.C.R 925.

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in the manner provided for by the Indian Companies Act, that the said accounts had been drawn up in conformity with the law and exhibited a true and correct view of the state of the company's affairs. The Tribunal has paid no attention to the fact, appearing in the evidence on record before him, that the income-tax department had allowed such service fee as legitimate revenue expense and the entire amount of the service fee was allowed as a deduction by income-tax authorities every year as a revenue expenditure wholly and exclusively incurred as a matter of commercial necessity of the company's business. Nor does the Tribunal appear to have adverted to the fact that the remittances to the Parent company were allowed by the Reserve Bank which always exercises close scrutiny on every payment made to non-residents with a view to prohibit payments which are not justified. Nor has the Tribunal taken note of the fact that the Ministry of Finance and the Ministry of Commerce and Industry have approved of the payment of the service fee as provided in the agreement. A conclusion drawn by the Tribunal without adverting to the evidence before it amounts to an error of law and cannot possibly be sustained. Further, the Tribunal appears to have been led away by three facts, namely, (i) that the company did not pay any service fee during the period 1937-47, (ii) that the agreement was executed on August 12, 1947, that is to say three days before the attainment of our independence and (iii) that at

the date of the agreement the company was a 100% subsidiary of the Parent company. As regards the first reason, the explanation may well be that during the period 1937 to 1947 the growth was still in a stage of development and growth. In any case,the fact that no fees had been charged during a particular 'period when the company was 100% subsidiary of the Parent company cannot reasonably be taken' as a reason for not allowing them in future. It will be recalled that negotiations were going on for the acquisition of a considerable block of shares by an Indian company simultaneously with the negotiations for the execution of the
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agreement and that in fact 26% of the shares were acquired by Messrs. Greaves Cotton Co. Ltd. Further, such service, fee has been paid year after year from 1947 right up to the bonus year in question. The second reason is equally unsustainable. The fact that a great constitutional change was envisaged may well and properly have been the reason for placing the legal relationship between the company and the Parent company on a firmer and permanent legal footing. The Tribunal seems to have overlooked the fact stated by Shri V. V. Dhume, that " the payment of the service fee for the services of this nature is quite a common feature in India ". The reasonableness and legality of the payment of such fee is also supported by the fact that the income-tax authorities and the Reserve Bank of India have not taken any exception to such payment. The last reason adopted by the Tribunal clearly overlooks the fact that shortly after the execution of the agreement about 26% of shares in the company were acquired by an Indian company and year after year ever since then these independent shareholders of the Indian company had willingly accepted the service agreement. Finally the award does not disclose any basis on which the Tribunal has purported to " prune it down " to one quarter of the amount actually paid by the company.

After a careful consideration of the evidence on record we have come to the conclusion that this part of the award concerning disallowance of the major portion of the service fees cannot be supported or upheld. The Tribunal in the award itself has pointed out, as already stated, that in case the whole of this service, fee is to be allowed, as we think it should be, then on that basis the available surplus would permit the payment of bonus of one month's basic wages to the workmen. The company has no objection to payment of bonus to the workmen amounting to one month's basic wages, subject to the conditions laid down in the award in this behalf and indeed it has done so since the date of the award. The result, therefore, is that we allow, these appeals to the extent that the award of the Tribunal:'be varied and modified by
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allowing only one month's basic wages to its workmen who are respondents to these appeals instead of 2 1/2 months' basic wages as provided in the award, subject, of course, to the conditions laid down in the award. Be it noted here that the company has paid this bonus to the respondents and nothing remains due and payable for bonus for 1954-55. Considering all circumstances of these appeals, we direct each party to bear its own costs of these appeals.

Appeal allowed in part.