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**(1996) 07 AP CK 0080**

**In the Andhra Pradesh High Court**

**Case No : Case Referred No. 12 of 1988**

Commissioner of Income Tax

APPELLANT

Vs

Andhra Sugars Ltd.

RESPONDENT

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**Date of Decision :** 04-07-1996

**Acts Referred:**

Income Tax Act, 1961 — Section 256(2), 30, 31, 32, 33

**Citation :** (1997) 93 TAXMAN 676

**Hon'ble Judges :** Syed Shah Mohammed Quadri, J;B. Sudershan Reddy, J

**Bench :** Division Bench

**Advocate :** S.R. Ashok, for the Appellant; C. Kodandaram, for the Respondent

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## **Judgement**

Syed Shah Mohammed Quadri, J.—This is a reference u/s 256(2) of the income tax Act, 1961 ("the Act"), at the instance of the revenue. The following question was referred to this Court for opinion : Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is justified in law in upholding the deduction allowed in respect of entertainment expenditure to the extent of Rs. 29,040 ?

After hearing the arguments of both sides, we are of the view, the question needs to be re-cast and we reframe the same as under :

Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is justified in law in upholding the deduction allowed in respect of expenditure to the extent of Rs. 29,040 ?

It may be necessary to note the facts giving rise to this question. The respondent-assessee is a public limited company registered under the Companies Act, 1956. In the assessment year 1976-77, it incurred an expenditure of Rs. 30,040 for providing tea, coffee, etc., to the customers, staff and technicians and claimed the same as permissible deduction. The ITO being of the view that it falls under the "entertainment expenditure"; disallowed the same. But on appeal, the Commissioner (Appeals) held that it cannot be treated as "entertainment

expenditure"; however, it reduced the expenditure to Rs. 29,040 as allowable deduction. On appeal by the revenue, the Tribunal, referring to its earlier order in respect of the same assessee for the earlier assessment year, dismissed the appeal on 6-3-1981. It is from that order of the Tribunal that the abovesaid question arises.

2. Mr. S.R. Ashok, the learned standing counsel for the petitioner, contends that by virtue of amendment of Explanation 2 to sub-section (2A) of section 37 of the Act, even the expenditure made by way of hospitality, falls within the meaning of "entertainment expenditure" and that being so, it cannot be allowed.

3. Mr. C. Kodandaram, the learned counsel for the assessee, on the other hand, contends that the amendment was in force only for a limited period and that in any event the expenditure is not an "entertainment expenditure" and that has been accepted by both the appellate authority and the Tribunal; therefore, it cannot be brought under Explanation 2 to sub-section (2A) of section 37.

Explanation 2, referred to above, was inserted by the Finance Act, 1983, retrospectively with effect from 1-4-1976. We may, with advantage, read that provision here, which is as follows :

Explanation 2 - For the removal of doubts, it is hereby declared that for the purpose of this sub-section and sub-section (2B), as it stood before the 1st day of April, 1977, "entertainment expenditure" includes expenditure on provision of hospitality of every kind by the assessee to any person, whether by way of provision of food or beverages or in any other manner whatsoever and whether or not such provision is made by reason of any express or implied contract or custom or usage of trade, but does not include expenditure on food or beverages provided by the assessee to his employees in office, factory or other place of their work.

On a perusal of the Explanation, it becomes clear that the "entertainment expenditure" would now include provisions of "hospitality" of every kind by the assessee to any person, whether by way of provision of food or beverages or in any other manner whatsoever and whether or not such provision is made by reason of any express or implied contract or custom or usage of trade, but it does not include expenditure on food or beverages provided by the assessee to his employees in office, factory, etc.

4. For computing total income chargeable to income tax under the head "Profits and gains of business or profession", various deductions specified under sections 30 to 36 of the Act are permissible. Section 37 is a residuary provision and sub-section (1) permits deduction of any expenditure which is laid out or expended wholly and exclusively for the purpose of the business or profession; however, three categories of expenditure are excluded from the purview of section 37(1) - (i) expenditure of the nature described in sections 30 to 36; (ii) expenditure in the nature of capital expenditure; and (iii) expenditure of the nature of personal expenses. The object of sub-sections (2), (2A) and (2B), is to curb ostentatious

expenditure on "entertainment" by scaling down the expenditure on entertainment to make it a permissible deduction. Speaking for the Supreme Court, His Lordship Justice Verma in CIT v. Patel Bros. & Co. Ltd. [1995] 215 ITR 165/81 Taxman 156 explained the import of the said provisions thus :

... the general provision in section 37 is that any expenditure laid out or expended wholly or exclusively for the purposes of the business or profession shall be allowed but no expenditure in the nature of entertainment expenditure shall be allowed as stated in sub-sections (2) and (2A) in excess of the amount specified. For claiming deduction of the business expenditure according to the general rule, the test of commercial expediency is applied but exclusion is made of any expenditure which is in the nature of "entertainment expenditure". Without anything more, it means that an expenditure incurred for commercial expediency or usage of the trade is a permissible deduction unless it partakes of the character of an entertainment expenditure, in which case the permissible limit is specified....

Then the question arises, what is meant by "entertainment expenditure"? In the said case, His Lordship has also elucidated the meaning of the expression "entertainment expenditure". It is pointed out that the expression is of wide import and that in the context of sub-section (2A) it must be construed strictly and not expansively and that ordinarily "entertainment" connotes something which may be beneficial for mental or physical well-being but is not essential or indispensable for human existence; offering an ordinary meal, a bare necessity, would be "hospitality" but not "entertainment". It is observed that unless the definition of "entertainment" includes "hospitality", the ordinary meaning of that expression cannot include "hospitality" and for that reason the expenditure incurred in extending customary hospitalities by offering ordinary meal as a bare necessity, is not "entertainment expenditure".

From the above discussion it follows that prior to insertion of Explanation 2 to section 37(2A), enlarging the meaning of the said expression "entertainment expenditure" by including "hospitality" within its ambit, expenditure on extending hospitality, was not within the ordinary meaning of "entertainment expenditure", but after 1-4-1976 even expenditure on "hospitality" is brought within the enlarged meaning of that expression by Explanation 2 to sub-section (2A) of section 37. We have already pointed out above that in this case, the allowability of the expenditure relates to the assessment year 1976-77, therefore, the explanation will be attracted and the expenditure on "hospitality" will be within the meaning of "entertainment expenditure" and, therefore, it will not be an allowable deduction.

It has already been noticed above that the expenditure on food or beverages provided by the assessee to his employees in office, factory, etc., will not fall even within the enlarged meaning of the expression "entertainment expenditure" given by the said Explanation 2.

5. In the instant case, however, the expenditure was incurred for providing tea, coffee, etc., to the customers, staff and technicians. From the above it is clear that partly the expenditure on the hospitality was incurred on the customers and partly on the employees. That expenditure was not segregated to show as how much was incurred on the customers and how much was spent on the employees and in the very nature of things, in our view, it cannot be so segregated. In our view, when the expenditure on food or beverages provided by the assessee to his employees in office, factory or other places of their work as well as to the customers, such an expenditure does not fall within the enlarged meaning of "entertainment expenditure" in Explanation 2. In this view of the matter, we answer the abovesaid question, as re-framed, in the affirmative, i.e., in favour of the assessee and against the revenue. The reference is accordingly answered. No costs.