

**(1979) 07 MAD CK 0057**

**In the Madras High Court**

**Case No :** Tax Case No"s. 443 of 1975 and 211 of 1976 (Reference No"s. 340 of 1975 and 146 of 1976)

Commissioner of Income Tax

APPELLANT

Vs

Aruna Sugars Ltd.

RESPONDENT

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**Date of Decision :** 11-07-1979

**Acts Referred:**

Income Tax Act, 1961 — Section 34, 34(3), 37(3)

Income Tax Rules, 1962 — Rule 6C

**Citation :** (1980) 123 ITR 619

**Hon'ble Judges :** Sethuraman, J;Balasubrahmanyam, J

**Bench :** Division Bench

**Advocate :** J. Jayaraman, for the Appellant; S. Narayanaswami and T.S. Ramu, for the Respondent

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## **Judgement**

Sethuraman, J.—The assessee is carrying on business in the manufacture of sugar in a place known as Pennadam, South Arcot District. The reference in T. C. No. 443 of 1975 relates to the assessment years 1968-69 and 1969-70, the relevant previous years being the years ending on 30th September preceding the assessment years. During the previous year for the assessment year 1968-69, the assessee incurred an expenditure of Rs. 12,944 and during the relevant previous year 1969-70, a sum of Rs. 12,009 had been incurred. The expenditure is said to relate to the maintenance of a guest house in the factory premises. The assessee's administrative office is situate in Madras, and periodically there are visits of the assessee's employees and directors and others. We have no idea as to the exact nature of the expenditure or the details thereof. The assessee claimed these two amounts as deduction in the respective assessment years. The ITO took the view that the expenditure on the maintenance of guest house could be allowed as deduction only if such maintenance was for the benefit of the employees and if a register in the prescribed form had also been maintained. The assessee started maintaining the register only from first of February, 1967, The ITO was of the view that the provisions of Rule 6(c) had not been complied with

and he, therefore, disallowed the amounts. The AAC, on appeal, confirmed the disallowance. Thereafter the assessee appealed to the Tribunal. After referring to the relevant provisions, the Tribunal came to the conclusion that the building was not in the nature of a guest house and that the expenditure incurred therein did not fall within the scope of Section 37(3) of the I.T. Act, 1961, so as to be disallowed in the manner done by the I.T. authorities. On this point, the question that has been referred runs as follows :

" Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the expenditure of Rs. 12,944 for the assessment year 1968-69 and Rs. 12,009 for the assessment year 1969-70, incurred in relation to the building at Pennadam, was not expenditure on the maintenance of residential accommodation in the nature of a guest house and was, therefore, an admissible deduction ? "

2. Section 37 of the Act provides for the allowance of any expenditure laid out or expended wholly and exclusively for the purpose of the business. Sub-section (3) is an exception to this general allowance, and it runs as follows :

" Notwithstanding anything contained in Sub-section (1), any expenditure incurred by an assessee after the 31st day of March, 1964, on advertisement or on maintenance of any residential accommodation including any accommodation in the nature of a guest house or in connection with travelling by an employee or any other person (including hotel expenses or allowances paid in connection with such travelling) shall be allowed only to the extent, and subject to such conditions, if any, as may be prescribed. "

3. The relevant rule prescribing the conditions for the allowance is Rule 6(c). Under that rule the allowance in respect of expenditure incurred by an assessee on the maintenance of residential accommodation in the nature of guest house is limited to the amount laid out or expended on the maintenance of a guest house or guest houses specified in the said rule. Clause (3) of the rule provides that no allowance is to be made in respect of expenditure incurred on the maintenance of any residential accommodation in the nature of a guest house unless the assessee maintained a register showing the following particulars, namely:

(1) the name and address of every employee and, in the case of an assessee being a company, of every director of the company, who had stayed in the guest house ;

(2) whether his stay in the guest house was for the purpose of the business or profession of the assessee;

(3) the date of his arrival at the guest house and the date of his departure therefrom;

(4) the amount, if any, paid by him towards his lodging and boarding in the guest house.

4. Sub-section (3) of Section 37 contemplates two categories of accommodation maintained by a company. One is residential accommodation and the other is accommodation in the nature of a guest house. In other words, the maintenance of residential accommodation is a wider category and the provision includes within it the maintenance of accommodation in the nature of a guest house. Ordinarily, in these guest houses maintained, three kinds of personnel stay. The first category consists of the directors of the company and its employees ; the second category consists of Government officials who visit the factory in the course of their work under the customs law, sales tax law, labour laws, etc., and the third category consists of other persons, some of whom may even be persons connected with the company either by way of sellers of sugarcane or purchasers of sugar in a case like this. The section itself does not in any manner specify the kind of maintenance expenditure that is liable to be allowed. The extent and the conditions of allowance are only to be prescribed. Rule 6C(1) prescribes the allowance with reference to the maintenance of residential accommodation in the nature of a guest house. Rule 6C(1) does not apply to any residential accommodation which is not in the nature of a guest house. With reference to residential accommodation in the nature of a guest house, there are various provisions made. The guest house or houses must be at the principal place of business of the assessee in India or it must be in a place where manufacture is carried on or industrial establishment is maintained. The assessee, in the latter case, must be engaged in the manufacture of goods employing not less than 50 whole-time employees throughout the relevant year. Where the assessee maintains a guest house or guest houses at any place other than the principal place of business or where the guest house is maintained in a place other than the place where the factory is established or where the industrial establishment is maintained, then such guest house or guest houses must have been exclusively used by employees while on leave. Provision has also been made for the maintenance of guest house by a banking company at Bombay or by any other assessee at Delhi and at not more than two other places in India which may be the capital of a State Government or in any other place which is of direct importance to the business or profession of the assessee.

5. A perusal of Rule 6C would show that it specifies the places where the guest houses have to be maintained and it also prescribes that if the guest house is in a place other than the principal place of business or factory premises, then it should be exclusively used by the employees. As regards the maintenance of residential accommodation, Clause (2) prescribes that the expenditure incurred on the maintenance of such accommodation should not directly or indirectly result in the provision of any benefit or any amenity or perquisite to an employee exceeding 20 per cent. of the salary due to such an employee in respect of the period of his occupation. Clause (3) requires the maintenance of a register describing the particulars specified therein as a condition precedent for the allowance.

6. In the present case, it is common ground that the assessee had not produced

the registers as contemplated by Clause (3) of Rule 6C. Though the assessee has maintained the guest house at the factory premises or at the principal place of its business, the expenditure on the maintenance of the guest house is not liable to be allowed only because the assessee had not complied with the provisions of Clause (3) of Rule 6C.

7. The assessee tried to get over this difficulty by contending that it is not a guest house at all and that, therefore, it does not come within the scope of Section 37(3). We have, therefore, to examine as to what a guest house is. The term has not been defined in the Act. The dictionary meaning of " guest house " is " an inn, a home separate from a main dwelling for the use of guest ". In the Shorter Oxford Dictionary, 3rd Edn., the meaning of " guest house " is given as " an inn--A house or apartment for the reception of strangers or guests ". From the language of Rule 6C it appears that the rule-making authority considered that even the employees of a company would be guests because provision is made for the category of employees who would use the guest house in places other than the principal place of business of the assessee or the factory premises of the assessee. In such cases, as already seen, the guest house must be maintained exclusively for the benefit of the employees (see Clause (d) of Rule 6C). However, with reference to the factory premises as in this case, there is no restriction on the category of persons who alone could stay in it. This stands to reason, as in a case like this, where the factory is located away from any urban locality and where the normal facilities available for food or accommodation, cannot be had, it is necessary in the interests of the business of the company to maintain a guest house. As is sometimes graphically put, a company has no body to be kicked or soul to be damned and, therefore, the company has to function only through its directors and its employees. In a case where the assessee maintains a guest house exclusively for the directors and other employees, through whom alone it can carry on business, it cannot be stated that these personnel can be taken to be outsiders so as to be called guests. Thus, in our opinion, where the guest house is maintained, either in the principal place of business or in a place where the factory is located, for the directors and other employees of the company who have to visit it for the purpose of the company's business, then any expenditure incurred for the maintenance of such accommodation cannot be brought within the scope of Section 37(3). Further, in such a case, an occasional stay by a person who visits the factory for the purpose of its business cannot also be called a guest. Any official visiting the factory for the purpose of enforcing the laws applicable to the factory cannot also be described as an outsider so that any accommodation used by him in connection with the company's work, can be treated as accommodation in the nature of a guest house. It is only with reference to the other categories, like strangers, that the accommodation which is maintained can be correctly called a guest house. In other words, the meaning of the term " guest house " as a place for the reception of strangers appears to have been accepted by the rule-making authority as the rules envisage employees staying in these premises. If

employees were considered to be strangers such a provision would not have been made. It is necessary to bear in mind the legal position that the rule-making authority cannot expand the concept of the word " guest"" so as to include employees if the word did not comprehend such employees. Thus, employees are not strangers so as to be guests. The result is that unless the guest house is intend for use by a complete stranger, it cannot be called a guest house which falls within the scope of Section 37(3).

8. In the present case, in the absence of any proper materials to show that the guest house had actually been used only by the directors or by the employees alone substantially and by the Government officials occasionally, we have to proceed on the basis that the guest house had been utilised by strangers also. In these circumstances the conclusion that has to follow is that the accommodation maintained is in the nature of a guest house falling within the scope of Section 37(3). The expenditure incurred in the present case would thus really fall within the scope of the expenditure contemplated by Section 37(3) and would qualify for an allowance only if it complied with the rules.

9. The learned counsel for the assessee cited certain decisions dealing with entertainment expenditure. But as pointed out by the Supreme Court in dealing with this very provision in *The Commissioner of Income Tax, Andhra Pradesh, Hyderabad Vs. Sirpur Paper Mills Ltd., Hyderabad*, , the expenditure on the maintenance of a guest house is wholly different from the expenditure in the nature of entertainment. Therefore, the decision bearing on the allowability or otherwise of entertainment expenditure would be of no assistance here. As far as the allowability of expenditure on a guest house is concerned, there is no reported decision so far on the ambit or scope of Section 37(3) in so far as it relates to expenditure on the maintenance of a guest house. Consequent on the assessee not complying with the rules, the disallowance as made by the I.T. authorities was proper. Therefore, the question has to be answered in the negative and in favour of the revenue.

10. The next question that has been referred runs as follows :

" Whether, on the facts and in the circumstances of the case, the assessee was entitled to allowance of development rebate having regard to the adequacy of the reserve as available taking into consideration the excess available in earlier years ? "

11. This question arises only for the assessment year 1969-70. The asses-see had claimed development rebate of Rs. 8,251 in respect of the new machinery installed during the accounting period. The ITO rejected the claim on the ground that the assessee had created no reserve in the accounts for the year ended 30th September, 1968, relevant for the said assessment year. The submission of the assessee was that in the earlier years they had created a larger reserve and that the surplus in the said reserve came to Rs. 72,028. As the relief claimed in this year was lower than this surplus, the assessee wanted the said amount to be

taken as reserve created for this assessment year to satisfy the requirements of the statute. The ITO rejected this submission also. The AAC, on appeal, confirmed the disallowance but when the matter came before the Tribunal, it held that the surplus in the development rebate reserve created in the earlier years was at the disposal of the assessee, that the assessee could have taken it away by a journal entry and brought it back into the reserve by another journal entry and that the net result would be the same. In the view of the Tribunal, all these exercises in accountancy would become a meaningless formality and, therefore, it directed the ITO to deduct the same. It is this aspect of the matter that is referred to as stated above.

12. Section 34 prescribes conditions for depreciation allowance and development rebate, allowable u/s 33. Section 34(3) provides that the deduction referred to in Section 33 shall not be allowed unless an amount equal to seventy five per cent. of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to a reserve account to be utilised by the assessee during a period of 8 years next following for the purpose of the business of the undertaking. The business purpose would not include, (a) distribution by way of dividends, or (b) remittances outside India of profits, or (c) for the creation of any asset outside India. There is an Explanation which provides that the deduction referred to in Section 33 should not be denied by reason only that the amount debited to the profit and loss account of the relevant previous year and credited to the reserve account aforesaid exceeds the amount of the profit of such previous year as arrived at without making the debit aforesaid. The Explanation was brought in to provide for cases where an assessee did not have adequate profits to create the necessary amount as a reserve. This provision enabled the creation of a reserve of the requisite amount in the absence of profits or adequate profits to cover the reserve. However, what is clear from the whole provision is that the reserve is to be created out of the profits of the relevant previous year and credited to a reserve account to be utilised by the assessee for the business. In the present case, there is no such debit to the profit and loss account of the relevant previous year. The Tribunal was, therefore, in error in directing the ITO to give the allowance. The presence of a larger amount in the development rebate reserve in an earlier year cannot be taken as satisfying the specific requirements of Section 34(3)(a), viz., of a debit to the profit and loss account of the relevant previous year.

13. The result is that the question referred has to be answered in the negative and against the assessee. The Commissioner will be entitled to, his costs. Counsel's fee Rs. 500 (one set).