
(1999) 08 GAU CK 0029

In the Gauhati High Court

Case No : Income-tax Reference No. 13 of 1996

Commissioner of Income Tax

APPELLANT

Vs

Assam Asbestos Ltd.

RESPONDENT

Date of Decision : 17-08-1999

Acts Referred:

Income Tax Act, 1961 — Section 256, 37(2A)

Citation : (2000) 1 GLT 168 : (1999) 240 ITR 297

Hon'ble Judges : Brijesh Kumar, C.J.; P.C. Phukan, J

Bench : Division Bench

Advocate : G.K. Joshi, for the Appellant; A.K. Maheshwari and A. Devi, for the Respondent

Judgement

Brijesh Kumar, C.J.—This is an Income Tax reference at the instance of the Revenue in pursuance of an order passed by this court on January 29, 1996, in Civil Rule No. 4 (M) of 1995. The Income Tax Appellate Tribunal, Guwahati Bench, Guwahati, has referred the following questions :

"(1) Whether, on the facts and in the circumstances of the case, provision for expenses on foreign tour of the dealer amounting to Rs. 3,41,043 is an allowable business expenditure and if so, whether the Tribunal is correct in law in upholding the Commissioner of Income Tax (Appeals) order deleting the disallowances made ?

(2) If the answer to question No. 1 is in the affirmative whether such expenditure is in the nature of entertainment expenditure whose allowability is restricted as per provision of Sub-section (2A) of Section 37 of the Income Tax Act, 1961 ?"

2. We have heard Shri G. K. Joshi, appearing on behalf of the Revenue, and Shri A. K. Maheshwari, appearing for the assessee-respondent.

3. Briefly the facts giving rise to the questions referred are that the assessee claimed sales promotion expenses to the tune of Rs. 3,41,031 for the

assessment year 1987-88. According to the assessee, the expenditure was so incurred, on account of incentive payable to different registered dealers of the assessee on the basis of the sales made by them. The incentive was to be given to the dealers by way of tours to different countries as well as by way of gifts on achieving given targets fixed by the assessee-company. According to the assessee, 21 of its registered dealers had crossed the target to whom incentive by way of foreign tour was made admissible by adjustments made in the bills. The Deputy Commissioner of Income Tax, Assessment, Special Range-I, Guwahati, disallowed the claim of the assessee on account of sales promotion incentive scheme holding that there was no claim of general nature applicable to all the registered "dealers of the assessee-company. Different dealers were to achieve different targets fixed by the assessee by sending letters. It is also observed that time for making payment of the incentive amount was also not fixed and as a matter of fact part of the payment was made later on and not during the assessment year in which the benefit was claimed.

4. Aggrieved by the order passed by the assessing authority, the assessee-respondent filed an appeal before the Commissioner of Income Tax (Appeals), Guwahati. The appellate authority found that different targets were fixed for different dealers looking to their capacity and the area in which they had been operating and incentive was fixed commensurate with the same. It has been observed by the Commissioner of Income Tax (Appeals) that the expenditure thus incurred in providing sales incentive to the dealers was in the nature of sales promotion expenditure. It has also been found that it was an ascertained liability and not contingent and, therefore, the assessee rightly claimed the benefit of sales promotion expenditure. Thus addition of Rs. 3,41,031 was deleted. The order passed by the Commissioner of Income Tax (Appeals) was upheld by the Income Tax Appellate Tribunal, Guwahati Bench, Guwahati, in the appeal filed by the Revenue. The Appellate Tribunal found that the liability provided was an ascertained liability and that the assessee was justified in claiming the deduction during the year. It was further observed that the liability accrued as soon as the dealers achieved the pre-determined target though the payments might have been made later. It has also been noted that because of the incentive given, the profitability of the assessee-company had considerably increased. With the above observations, the order passed by the Commissioner of Income Tax (Appeals) was confirmed. Ultimately, however, as indicated earlier, the said two questions have been referred for opinion of this court.

5. Shri G. K. Joshi, appearing for the Revenue, has submitted that there is no dispute in so far as question No. 1 is concerned which may be answered in the affirmative. A perusal of the first question, as referred, shows that an answer is required, as to whether the amount of expenses on foreign tour of the dealers was allowable business expenditure, if so, whether the Tribunal was correct in law in upholding the order passed by the Commissioner of Income Tax (Appeals) deleting the disallowance made by the assessing authority. According to learned counsel, the latter part, viz., disallowance deleted by the Commissioner of

Income Tax and upheld by the Tribunal was not correct. The expenditure incurred is allowable business expenditure but not in full.

6. The submission which has been advanced by Shri G. K. Joshi is that allowability of the business expenditure for sales promotion would be restricted or controlled by Sub-section (2A) of Section 37 of the Income Tax Act, 1961, since the expenditure which has been allowed for the foreign tours of the dealers is an expenditure in the nature of entertainment, Therefore, it is submitted that question No. 2 is also to be answered in the affirmative restricting the allowability of the expenditure within the limits as provided u/s 37(2A) of the Income Tax Act. Section 37 of the Income tax Act reads as under :

"37. (1) Any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

(2) Notwithstanding anything contained in Sub-section (1), any expenditure in the nature of entertainment expenditure incurred by any assessee during any previous year commencing on or after the 1st day of April, 1992, shall be allowed as follows :

(a) where the amount of such expenditure does not exceed ten thousand rupees, the whole of such amount ;

(b) in any other case, ten thousand rupees as increased by a sum equal to fifty per cent, of such expenditure in excess of ten thousand rupees."

Explanation.-. . ."

7. Since the matter pertains to the assessment year 1987-88, it is rightly pointed out that the position of the provisions contained in Section 37(2A) prior to the amendment of April 1, 1993, would be applicable to the case. It is submitted that at the relevant time Sub-sections (1), (2) and Sub-section (2A) and Explanations (i) and (ii) were in operation. The provisions as they stood at the relevant time read as under :

"37. (1) Any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

(2) Notwithstanding anything contained in Sub-section (1), no expenditure in the nature of entertainment expenditure shall be allowed in the case of a company, which exceeds the aggregate amount computed as hereunder :

(i) on the first Rs. 10,00,000 of the profits and gains of the business (computed before making any allowance u/s 33 or section 33A or in respect of

entertainment expenditure) at the rate of 1 per cent, or Rs. 5,000, whichever is higher ...

(2A) Notwithstanding anything contained in Sub-section (1) or Subsection (2), no allowance shall be made in respect of so much of the expenditure in the nature of entertainment expenditure incurred by any assessee during any previous year which expires after the 30th day of September, 1967, as is in excess of the aggregate amount computed as hereunder :

(i) on the first Rs. 10,00,000 of the profits and gains of the business or profession (computed before making any allowance u/s 32A or section 33 or section 33A or in respect of entertainment expenditure) at the rate of 1/2 per cent, or Rs. 5,000, whichever is higher ; . . .

Explanation-- For the purposes of this Sub-section, "entertainment expenditure" includes-

(i) the amount of any allowance in the nature of entertainment allowance paid by the assessee to any employee or other person ;

(ii) the amount of any expenditure in the nature of entertainment expenditure [not being expenditure incurred out of an allowance of the nature referred to in Clause (i)] incurred for the purposes of the business or profession of the assessee by any employee or other person ;

(iii) 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. . . "

8. In view of the above provisions it has been vehemently urged that any expenditure which is in the nature of entertainment expenditure, its allowability as business expenditure would be restricted by Sub-section (2A) along with the Explanations. Learned counsel for the Revenue has relied upon certain decisions to indicate certain expenditure which have been treated to be in the nature of entertainment expenditure.

9. In *Brij Raman Dass and Sons Vs. Commissioner of Income Tax*, it was found that expenditure incurred for providing tea, lassi, jalpan, etc., to customers would be governed by Section 37(2A) of the Income Tax Act, 1961, and could be allowed to the limit of Rs. 5,000 as provided under the said provision. It has further been observed that the word "entertainment" would have different meaning for the purposes of different enactments and that the word "entertainment" used in Section 37 would include all expenditures incurred in connection with the business on the entertainment of customer and constituents. It may consist of providing refreshment or may consist of providing some other sort of entertainment.

10. In Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., , the question under consideration was as to whether providing ordinary meals to up-country farmers coming to town, to supply goods to the company which was a business necessity and customary was an entertainment expenditure so as to be limited u/s 37(2A) of the Income Tax Act or not. It was held not to be expenditure in the nature of entertainment expenditure. It was observed that no strait-jacket formula could be provided as to what kind of expenditure would be entertainment expenditure, but some broad tests have been laid down to provide guidelines to determine the nature of expenditures to be entertainment expenditures, It was further observed that the meaning of the term "entertainment" is to receive and treat with hospitality or entertaining guests in a friendly, generous way. It was further held that if it was on a lavish scale, it may amount to entertainment, but not if it was bare necessity.

11. In Commissioner of Income Tax Vs. Veeriah Reddiar, , it was held that entertainment should be taken to mean hospitality of any kind extended by the assessee directly in connection with his business or profession and, hence, the expenditure incurred by the assessee on the supply of cigarettes, coffee, etc., to its customers would clearly fall within the description "entertainment expenditure". While recording disagreement with the view taken by the Gujarat High Court in the case of Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., , it has been held (page 618) :

"As already observed by us, having regard to the legislative history of the provisions contained in Sub-sections (2A) and (2B) which we have traced, and the significant use of the expression "expenditure in the nature of entertainment expenditure" in both the sub-sections, it is obvious that the intention of Parliament was to bring within the scope of those sub-sections all expenditure incurred by an assessee on hospitality of any kind extended to the clients, customers or constituents directly in connection with the business or profession of the assessee."

12. In Central Paints Ltd. Vs. Commissioner of Income Tax, , it was held that an expenditure incurred on entertaining the customers and business constituents to lunches and dinners in posh hotels was rightly disallowed as the expenditure was not in the nature of routine refreshments given to customers and business constituents within the premises of the assessee-company.

13. Shri A.K. Maheswari, learned counsel appearing for the assessee, submitted that the expenditure incurred by the assessee cannot be termed as expenditure on entertainment or of the like nature. It was by way of sale incentive given to the dealers of the assessee on the basis of the weight of products sold at the rate of Rs. 30 per metric tonne. The company had fixed the target for different dealers on the attaining of which the dealers were eligible for incentive by way of gifts and foreign tours, only those who could achieve the target were entitled to the same and not others. Hence, the expenditure incurred could not be restricted by Sub-section (2A) of Section 37 of the Income Tax Act. Yet another submission

which is made is that only questions of law can be referred for the opinion of the High Court and not the questions of fact and no such questions have been raised before the Revenue authorities, the plea of application of Sub-section (2A) of Section 37 cannot be entertained.

14. So far as the question raised by the assessee that only a question of law can be raised, there cannot be any dispute about the same, nor has the said proposition been disputed by the Revenue. The assessee, however, in support of the said contention has placed reliance on a decision reported in Commissioner of Income Tax Vs. George Williamson (Assam) Ltd., It has been held that the validity of a finding arrived at by the Tribunal regarding expenses incurred, if not challenged, it cannot be entertained in the reference. In the present case, however, no such finding has been challenged that the assessee spent the amount on the foreign tour of its dealers on their achieving the given target. The question which requires consideration is whether this would be an expenditure on entertainment or of the like nature so as to be allowable only to a limited extent under Sub-section (2A) of Section 37. In our view, it would not be challenging the finding of fact. The question relating to applicability of a provision of law on given findings of fact as recorded by the authorities, would be undoubtedly, a question of law.

15. Learned counsel for the assessee has provided references of a number of cases on the point of allowability of business expenditure and as to what amounts to business expenditure. In the present case, it has not been denied by the Revenue that the expenditure incurred by the assessee is business expenditure. On the other hand, it has been submitted that question No. 1 may be answered in the affirmative. Hence, we need not discuss those decisions, namely, Commissioner of Income Tax, Delhi Vs. Delhi Safe Deposit Company Limited, ; The Additional Commissioner of Income Tax, M.P. Vs. Kuber Singh Bhagwandas, ; The Delhi Cloth and General Mills Co. Ltd. Vs. The Commissioner of Income Tax, New Delhi, and R.G.S. Industries Vs. Commissioner of Income Tax, relied on by the counsel for the assessee.

16. It has next been submitted that the expenditure incurred by the assessee on the foreign tours of its dealers is neither expenditure on their entertainment nor of the like nature. Reliance has been placed upon a decision reported in Commissioner of Income Tax Vs. Eskaps (I) Pvt. Ltd., . The assessee was a company on behalf of foreign buyers of jute and jute goods. On the visits of, their representatives to this country for the purpose of business, experts from different jute mills were invited. The subject of quality control of. jute and jute goods was to be discussed. For that purpose they were all invited to a dinner at Grand Hotel, Calcutta. The expenditure incurred on the dinner was disallowed u/s 37(2B) of the Income Tax Act as entertainment expenditure. It was held that where the representatives had come from different European countries and experts from different jute mills were also invited, the dinner arranged for discussion at Grand Hotel, Calcutta, would not be an expenditure in the nature of

entertainment expenditure. It was held that a dinner arranged for the purpose of discussion may have some element of hospitality, but every case of hospitality may not amount to entertainment in the sense it is understood. It was held that the dinner was held for promotion of business and not for social hospitality or entertainment. Hence, it could not be disallowed by consideration of hospitality, private or social. Yet in another case cited by learned counsel, namely, Delhi Cloth and General Mills Co. Ltd. Vs. Commissioner of Income Tax, , it has been held that the transport, boarding, lodging, etc., to foreign guests for inauguration function could not be termed as entertainment expenditure.

17. So far the legal position emerging from the different cases referred to above is concerned, learned counsel for the Revenue, Shri G. K. Joshi, has given much stress upon the decision in the case of Brij Raman Dass and Sons Vs. Commissioner of Income Tax, , decided by the Allahabad High Court and the decision in the case of Commissioner of Income Tax Vs. Veeriah Reddiar, , a Full Bench decision of the Kerala High Court and on that basis it has been argued that any expenditure whatsoever in connection with carrying on business providing any refreshment, meal, tea, coffee or cigarette, etc., would be an expenditure covered by the expression "expenditure on entertainment or of the like nature". The Kerala High Court decision in the case of Commissioner of Income Tax Vs. Veeriah Reddiar, , the Full Bench disagreed with the decision of the Gujarat High Court in the case of Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., .

18. We, however, find that the expression "entertainment expenditure or expenditure of the like nature" came to be considered by the Supreme Court in the case of CIT v. Patel Brothers and Co. Ltd. [1995]215ITR165(SC) . In this case the view taken by the Allahabad High Court in the case of Brij Raman Dass and Sons Vs. Commissioner of Income Tax, , has been reversed and the view taken by the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., was affirmed except the broad guidelines which were also laid down in the decision, which were found to be not necessary to be laid. In the case before the Supreme Court, the matter related to the expenditure incurred in providing ordinary meals to customers coming in connection with business. It was held that it was a bare necessity and could not be termed as "entertainment". It was further held that before the insertion of Explanation 2 to Section 37(2A) of the Act, an expenditure incurred for commercial expediency or usage of the trade is a permissible deduction unless it partakes of the character of entertainment expenditure, in which case, the permissible limit is specified. Any expenditure incurred on customers or clients cannot be termed as entertainment expenditure. The Supreme Court further observed, "generally, "entertainment expenditure" is an expression of wide import". However, in the context of disallowance of entertainment expenditure it must be construed strictly and not expansively. Ordinarily, "entertainment" connotes something which may be beneficial for the mental or physical well being but is not essential or indispensable for human existence. An ordinary meal would be a necessity,

hence expenditure incurred for providing meals to the outstation customers would not be expenditure on entertainment. The object of Sub-section (2A) of Section 37 of the Act is to disallow any lavish expenditure in the form of business expenditure as explained by the Supreme Court. It is also held that the safest test for determination as to whether the expenditure incurred amounts to expenditure on entertainment or not will depend upon the facts of each case.

19. In the light of what has been discussed above, we may now consider as to whether expenditure incurred under the scheme as involved in the present case would amount to expenditure on entertainment or of the like nature or not. According to the scheme, the dealers of the assessee were given targets of sale. On achieving the target of sale, the dealers were to be given gifts or the opportunity of foreign tours. It also depended upon the amount of sale. From the very nature of the scheme it is apparent that the gifts or the foreign trips offered to the dealers had an element of reward on attaining certain achievement in the field of sale of goods of the assessee. It is quite common that by way of incentive, sales representatives or sales executives are rewarded on achieving or crossing the quota or target fixed for the sale to be made by them. Some times it is given in the shape of commission in cash on sales over and above the target and some times by giving awards and gifts. But before one may be entitled for the gift, award or the reward, he has to achieve certain target or cross the same. In our view, it does not have an element of hospitality or entertainment at all. On the part of the assessee it is providing incentive to its dealers to increase the sales in the field or market within the areas of their operation and so far the dealers are concerned, it is an award or reward to which they become entitled on achieving the target, by making some extra efforts, more than the efforts usually made.

20. If the target is not achieved, nothing is to be paid nor any gift is to be given nor any trip inside or outside the country. But on achieving the target, the liability of the assessee is ascertainable. There is an element of claim on the part of the dealers to rightfully ask for the same from the assessee and it partakes of the character of liability of the assessee to fulfil the promise made by giving the reward, on achieving the target. The reward may be in the shape of cash, gift or otherwise, as in the present case it is foreign trip which is in question. The nature of the reward would not change the character of the transaction, which would remain the same, namely, on the part of the assessee providing incentive to the dealers to achieve higher target of sale of his goods and expectation of award or reward on the part of the dealers. Merely because the reward is given in the manner that it may provide some pleasure, the expenditure would not partake of the character of "entertainment expenditure" or of in the like nature as used u/s 37(2A) of the Income Tax Act. From the different decisions referred to above, it is clear that there has to be an element of hospitality. Such an expenditure as involved in the present case as explained above is definitely different from the nature of expenditure involved in different cases relied on by the Revenue as referred to above. They are more or less incidental to the day-to-

day business activity. A customary meal to the clients or such facility is treated to be hospitality. What is sought to be excluded is wasteful, lavish expenditure in entertaining clients, customers or constituents. In the context of such matters, to us it appears that entertainment is an extended form of hospitality though the two may be mutually exclusive of each other for the purposes of Section 37(2A) of the Act. Therefore, the difference between the facts of the cases indicated above in which the term "entertainment" or "expenditure in the nature of entertainment" has been considered are entirely on different footing. Each case has to depend upon its facts. In the present case we find absence of the element of hospitality, much less extended hospitality so as to take the form of entertainment.

21. We have already observed that on achieving the given target, a dealer becomes entitled for the reward promised, which in the present case is in the shape of foreign trip, and it becomes the duty or liability of the assessee to fulfil it. It is reward or something earned by the dealer on making extra efforts for the purpose. It is in return for the extra effort made. Therefore, it is neither hospitality nor entertainment provided by the assessee. Whereas in the case of a bare entertainment of one's customers, clients or constituents there is no liability upon the assessee to entertain nor it creates any kind of right in the customer or the client to be entertained. A customer or a client cannot claim entertainment as of right, if not entertained. But in the transaction like the one in hand in terms of the scheme an element of right and liability accrues in favour of the dealer and against the assessee. At least a claim can be raised about it. It is also to be found that the expenditure is ascertainable on achieving the target. That being the position, in our view, the expenditure incurred by the assessee cannot be controlled, restricting its amount under Sub-section (2A) of Section 37 of the Income Tax Act. The expression "entertainment" or "expenditure in the like nature" is not to be given expansive meaning, but restrictive meaning in the context of Section 37(2A) of the Act according to the case of CIT v. Patel Brothers [1995]215ITR165(SC) .

22. In the result, the answer to question No. 1 is in the affirmative while the answer to question No. 2 is in the negative. The Income Tax authority rightly deleted the disallowance of the expenditure incurred by the assessee under the scheme and rightly set aside the order of the assessing authority to that extent.

23. There would be no order as to costs.