

(1993) 03 CAL CK 0050
In the Calcutta High Court

Case No : Income-tax Reference No"s. 91 of 1990 and 1 of 1992

Commissioner of Income Tax

APPELLANT

Vs

Bata India Ltd.

RESPONDENT

Date of Decision : 05-03-1993

Acts Referred:

Income Tax Act, 1961 — Section 37(3A), 40A(8)

Citation : (1993) 201 ITR 884

Hon'ble Judges : Shyamal Kumar Sen, J;Ajit K. Sengupta, J

Bench : Division Bench

Judgement

Ajit K. Sengupta, J.—Those two references--one u/s 256(1) of the Income Tax Act, 1961, and the other u/s 256(2) of the said Act--both at the instance of the Revenue, arise out of the appellate order of the Tribunal for the assessment year 1984-85. The following questions have been referred to this court :

Income Tax Reference No. 91 of 1990 u/s 256(1) of the Act :

" Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in law in holding that the sum of Rs. 6,31,76,886 paid as commission to wholesale dealers and retail agents was not sales promotion expenses and, therefore, not disallowable u/s 37(3A) of the Income Tax Act, 1961 ?"

Income Tax Reference No. 1 of 1992 u/s 256(2) of the Act :

" 1. Whether in interpreting Section 37(3A) of the Income Tax Act, 1961, as effective from April 1, 1984, the Tribunal is justified in holding that only wasteful expenditure incurred on items like advertisement, publicity, etc., are covered by the provision and not expenditure on actual services received by the assessee when Section 37(3A) read with Section 37(3B) of the Income Tax Act, 1961, includes within its fold expenditure incurred on running and maintenance of aircraft and motor cars and payments made to hotels also ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is justified in holding that the expenditure on commission and discount to wholesale dealers and agents amounting to Rs. 6,31,76,886 is not covered by Section 37(3A) of the Income Tax Act, 1961 ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal is justified in holding that the expenditure of Rs. 1,87,411 on miscellaneous advertisements is not covered by Section 37(3A) of the Income Tax Act, 1961 ?

4. Whether, in view of the fact that before the Commissioner of Income tax, the assessee admitted that, to a large extent, the amount of Rs. 9,94,891 represented interest relatable to the security deposits made by the employees, the Tribunal was justified in not agreeing with the finding of the Commissioner that the point should be restored to the Assessing Officer to consider the applicability of Section 40A(8) of the Income Tax Act, 1961 ?"

2. The only question referred in Income Tax Reference No. 91 and questions Nos. 1 and 2 in Income Tax Reference No. 1 of 1992 touch one and the same issue, namely, whether commission and discount allowed to wholesale dealers and retail agents fall within the import of the expression "sales promotion" occurring in Section 37(3A) of the Act. The fact is that, for the assessment year 1984-85, the previous year being the calendar year 1983, the Assessing Officer disallowed a sum of Rs. 23,33,638 u/s 37(3A) and computed the total income at Rs. 4,52,49,050.

3. Subsequently, the Commissioner of Income Tax called for and, on examination of the records of assessment, found that the assessee had claimed and was allowed expenditure of Rs. 6,31,76,886 as commission paid to wholesale dealers and retail agents. The Commissioner of Income Tax was of the view that the above amount was covered by the expression " sales promotion " u/s 37(3A) of the Act and, therefore, 20 per cent. of the same was to be disallowed. He has also observed that, in the absence of statutory definition of the term " sales promotion ", any expenditure for effecting sales, such as, sales organisation, commission paid to salesmen, etc., and whatever expenses which were in connection with sales would constitute an expenditure on " sales promotion ". He, accordingly, directed the Assessing Officer to recompute the total income of the assessee after applying his mind to the expenditure in question " by relating this to the provision of Section 37(3A) of the Act".

4. The assessee challenged the above order in appeal before the Appellate Tribunal and contended that sales commission was paid to wholesalers or agents for the actual services rendered by them. This was part of sale expenses. The Tribunal agreed with the view that trade discount and commission paid for services actually rendered cannot be treated as " sales promotion expenses " u/s 37(3A) of the Act. In the view of the Tribunal, only wasteful expenditure incurred on items like advertisement, publicity, etc., could be treated as sales promotion expenses u/s 37(3A) of the Act. The Tribunal, accordingly, vacated the finding of

the Commissioner of Income Tax relating to the application of Section 37(3A) of the Act to the amount paid as trade discount and sales commission.

5. We have heard the rival contentions. The Revenue's case is that Section 37(3A) of the Act has application to any expenditure that a trader has to incur for the purpose of effecting sales. We fail to be persuaded by such an extreme proposition. The import of the expression "sales promotion", in the context of Section 37(3A), has already been examined by us in Commissioner of Income Tax Vs. The Statesman Ltd., where the judgment was delivered on October 10, 1991. The facts there are on all fours with the present case except that the commission was paid to the distribution agents for the newspaper. But the fundamental unity is that, in both cases, commission had to be paid to maintain the distribution or selling net. In the aforesaid case, it was held that the expression "sales promotion", though of wide amplitude and undefined, is to be understood in its meaning in the setting in which it occurs. Sales promotion necessarily involves an element of advertisement and publicity. A manufacturer of a product may intend to further the popularity of his product by advertising or by several other means like promotional methods. But the cost incurred in the ordinary course of sale of the product will not come within the purview of the expression "sales promotion". In this connection, it was observed in Commissioner of Income Tax Vs. The Statesman Ltd., :

"The expression "sales promotion" is preceded by the words "advertisement" and "publicity" in Clause (i) of Sub-section (3B) of Section 37. Here, the legal maxim ejusdem generis is of aid. The maxim serves to restrict the meaning of a general word to things or matters of the same genus as the preceding particular words. In this connection, the following passage from Salmond on Jurisprudence (12th edition), page 135, is worth quoting :

"This, however, is only the application of a commonsense rule of language : if a man tells his wife to go out and buy butter, milk, eggs and anything else she needs, he will not normally be understood to include in the term "anything else she needs" a new hat or an item of furniture."

The lucid illustration explains the said maxim. Thus, where the statute imposes restriction on advertisement, publicity and sales promotion, the expression "sales promotion" cannot include the selling expenses incurred in the ordinary course of the business. It only restricts such expenses as are of like nature as advertisement and publicity. The payment of commission to the news agents who constitute the distribution net sustaining the circulation of the newspaper is the ordinary selling cost. They can be said to be the very infrastructure of the business of newspaper publication. Such expenses, by no means, can pertain to activities partaking of the nature of sales promotion. The import of the expression "sales promotion" has to be understood as such activities as take their colour from the preceding words "advertisement" or "publicity". The payment of commission can, by no means, be said to be either advertisement or publicity. It is the expenses of a sales network. ... In our view, therefore, the

expenditure incurred by way of commission to sales agents and advertisement agents are not the expenditure sought to be curtailed by the non obstante provisions of Section 37(3B), there being no ingredient of advertisement or publicity in remunerating the agents.

The view we have taken accords with the approach taken by the Board towards the scope of operation of the said provision. According to the Explanatory Notes issued by the Board, the expenditure which is avoidable or ostentatious in nature alone is sought to be curbed under the provisions. In these days of monopolistic competition, advertisements and publicity drives are carried by producing or manufacturing concerns to such an excess as warrants restraint by reason of the socially wasteful nature of such expenses. That is why the Board has explained that the provisions of Sections 37(3A) and 37(3B) have been brought in to eliminate avoidable and ostentatious expenses on advertisement, publicity and other sales drives of like nature.

This restriction cannot, therefore, operate on selling cost which is the ordinary and normal incident of business. The provision cannot be construed as restricting anything and everything connected with sales, such as transportation of goods for sale, collection of sale proceeds and so on."

6. In the present case also, it is not the case of the Revenue that the expenditure is of the nature of advertisement or other conspicuous mode of popularising the assessee's product. The expenditure here represents commission paid to wholesalers or agents. Such expenditure is an essential incident of any trade. Section 37(3A) attracts only wasteful expenditure incurred on advertisement, publicity, etc.

7. Mr. R. N. Bajoria, learned counsel for the assessee, also relied upon an earlier decision of this court in Commissioner of Income Tax Vs. Hindusthan Motors Ltd., . There, the Tribunal's decision that commission and brokerage paid to the agents of the assessee in that case, a manufacturer of automobiles, are not disallowable as expenditure of the type described by Section 37(3A), was upheld by this court saying that "sales promotion" must be construed ejusdem generis with the preceding two expressions, advertisement and publicity and, therefore, cannot connote the selling cost that a trader has to incur in the ordinary course of carrying on the business. Expenditure for sales promotion according to that decision should not be mistaken for expenditure incurred for sales simpliciter. A similar view has been taken by this court in Commissioner of Income Tax Vs. Sutlej Cotton Mills Ltd., .

8. Learned counsel for the assessee has also cited before us the decision of the Supreme Court in Dy. CST (Law), Board of Revenue (Taxes) v. Advani Oerlikon (P.) Ltd. [1980] 45 STC 32, which explains the true concept and character of trade discount. Trade discount represents reduction in the price itself. And, accordingly, the discount allowed to the wholesale dealers from the listed price cannot be considered as an expenditure at all. Thus, there was no scope,

according to learned counsel, of trade discount attracting the provisions of Section 37(3A) of the Act.

9. In our view, discount allowed to wholesale dealers from the listed retail price and commission paid to the selling agents do not come within the purview of Section 37(3A) inasmuch as trade discount merely represents lesser realisation of the sale price itself and the commission paid to selling agents are actual selling expenses.

10. For the reasons aforesaid, we answer the only question in Income Tax Reference No. 91 of 1990 and the first and second questions in Income Tax Reference No. 1 of 1992 in the affirmative and against the Revenue.

11. The issue involved in the third question in Income Tax Reference No. 1 of 1992 is whether the sum of Rs. 1,87,411 paid as contributions to various organisations during the puja and other festivals can be considered as sales promotion expenses attracting the provisions of Section 37(3A) of the Act. The facts are that the assessee has over one thousand retail shops throughout the country. During festivals and other occasions in the area where such retail shops are situated, the assessee has to make contributions to local puja and festival committees or organisations to avoid confrontation and for smooth running of its retail shops.

12. Mr. Bajoria, learned counsel for the assessee, submitted that these expenses are not for any advertisements and/or festoons or banners put up for the company's products in and/or during any such festivals or for any other advertising or publicity activity. The expenditure incurred by the assessee for advertisements and sales promotion expenses including those incurred during the festivals for putting festoons, banners or other publicity and advertisement have been separately considered by the Assessing Officer in the order of assessment and 20 per cent. of such expenditure has been disallowed u/s 57(3A) of the Act. Considering that such retail shops are over one thousand, the average expenditure per shop for the area at the highest would be only about Rs. 188 which cannot cover the bare minimum cost of any possible advertisement. The Tribunal has taken the view that such expenses cannot be considered as sales promotion expenses since such expenditure was not incurred with a view to promoting any sale. The allowability of the expenditure as such is not in dispute. The only question is whether 20 per cent. of such expenditure should be disallowed by treating it as sales promotion expenses u/s 37(3A) of the Act. By this expenditure which, as slated earlier, comes on an average at the highest to Rs. 188 per shop per area, no sales promotion activity was undertaken. No advertisement was published. By making such contributions to the puja or festival organisations, the assessee was merely ensuring smooth conduct of the business at its retail shops in the area and was not seeking to promote the market for its goods. In the question, the said sum has been wrongly referred to as "miscellaneous advertisements". As already stated, the amounts incurred for advertisements during festivals or other occasions by way of placard, festoons or

other forms of advertisements have been separately considered and 20 per cent. of such expenditure has been disallowed in the assessment itself. The nature of the said sum has again been stated by the Tribunal while not allowing reference on this question. The finding of the Tribunal that the expenditure in question was not for advertisement has not been challenged and the question as framed does not arise out of its order. In the circumstances, in view of the finding of the Tribunal that the expenditure was incurred for smooth running of the retail shops and not for advertisement or sales promotion, the question should be answered in the affirmative and in favour of the assessee.

13. The admitted position is that the expenses are not any expenses on advertisement, publicity or any sales promotion. The expenses represent the contributions which the retail shops of the assessee had to pay to the organisers of local festivals. It is also not in dispute that the assessee has a large number of retail shops. Having regard to the extensive market and the numerous retail shops set up by the assessee for the sale of its products, the total expenditure of Rs. 1,87,411 is really a negligible amount. The crucial question is whether such contributions to the festival committees made by the various retail shops could be said to be sales promotion expenditure. It is a notorious fact that, in the festival months, the shops in this part of the country have to pay contributions towards community celebrations to keep the youths in the neighbourhood of the shop happy to ensure smooth conduct of the business. The expenditure can be said to be an expenditure required to maintain the business. No element is there in the expenditure that could be termed as sales promotion. It is not a payment to solicit new market for its goods, but to keep up good relations with the population in the close neighbourhood. It is a practical necessity in the ordinary carrying on of the business. Anyway, the necessity in the expenditure is a matter of nexus of the expenditure with the business. But it is not the case of the Revenue that the expenditure is not incidental to the business. The contention is that the expenditure being expenditure for promotion of sales, it should suffer a cut to the extent of 20 per cent. in terms of Section 37(3A). The Revenue has, however, singularly failed to make out a case that such contributions really can by any means partake of advertisement, publicity or sales promotion. Therefore, the question as framed does not require us to address ourselves to the task of deciding whether the expenditure is one as could be held to be wholly and exclusively laid out for the purpose of carrying on of the business. The question raises the question of applicability of Section 37(3A). On the facts of this case, we can safely hold that Section 37(3A) has no application to the expenditure in question. We, therefore, answer the third question in Income Tax Reference No. 1 of 1992 in the affirmative and against the Revenue.

14. The issue involved in the fourth question is whether 15 per cent. of the interest paid on security deposits received from shop managers should be disallowed u/s 40A(8) of the Act.

15. Mr. Bajoria, learned counsel, drew our attention to Section 40A(8) of the Act

which, inter alia, provides that 15 per cent. of the interest paid on loans or deposits should be disallowed. The case of the assessee which was accepted by the Tribunal is that the security deposits received from the shop managers did not fall within the definition of deposit given in the Explanation to the said Sub-section (8) of Section 40A. Clause (b) of the Explanation to the said Sub-section (8) defines " deposit" as under :

" " Deposit" means any deposit of money with, and includes any money borrowed by, a company, but does not include any amount received by the company

(vi) from an employee of the company by way of security deposit ; " (emphasis * added).

16. The shop managers are employees of the assessee. They are in charge of the various retail shops wherein retail sales in cash are made. By way of security for the cash handled at such retail shops, the shop managers are required to furnish security. The amount of such security varies depending upon the type of the shop of which the employee is appointed as the manager. The employee has no discretion but has to make such deposit in terms of the standing order of the assessee. Accordingly, the case is fully covered by Sub-clause (vi) of Clause (b) of the Explanation to the said Section 40A(8) and 15 per cent. of the interest paid on such security deposits cannot be disallowed under the said section.

17. It may be stated that the question as framed by the Revenue is not appropriate. The entire sum of Rs. 9,94,891 related to the interest paid on the security deposits to the said employees. The alleged admission referred to in the question has not been found by the Tribunal. The Tribunal found that the full details of such security deposit had been filed in the assessment proceedings. The submissions made before the Commissioner as recorded by him are sought to be misconstrued. What was submitted was that, in such security deposits, the element of loan was not at all involved and even if it was, the same was negligible. The fact that the shop managers are also employees is accepted in the question itself framed by the Commissioner.

18. For the reasons aforesaid, the fourth question is answered by saying that no part of the sum of Rs. 9,94,891 is to be disallowed u/s 40A(8) of the Act, if the same has been paid on the security deposits made by the shop managers who are the employees of the assessee and not otherwise.

19. There will be no order as to costs.

Shyamal Kumar Sen, J.

20. I agree.