(1991) 01 SHI CK 0006

In the High Court Of Himachal Pradesh

Case No : Income-tax Reference No. 2 of 1977

Commissioner of Income Tax APPELLANT

Vs

Mohan Meakin Breweries Ltd. RESPONDENT

Date of Decision : 14-01-1991

Acts Referred:
Income Tax Act, 1961 — Section 37(2A), 37(2B)

Citation : (1991) 192 ITR 134 : (1991) 2 ShimLC 169

Hon'ble Judges : P.C. Balakrishna Menon, C.J;Devinder Gupta, J

Bench : Division Bench

Advocate : Inder Singh, for the Appellant; K.D. Sood, for the Respondent

Judgement

Devinder Gupta, J.—The Income Tax Appellate Tribunal, Chandigarh Bench, has referred the following two questions of law to this court u/s 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") :

"1. Whether the Tribunal was right in law in holding that the expenses amounting to Rs. 49,750 under the heads ''Hotel bills'', Travelling and taxi expenses'' and ''Presentation items'' for the assessee''s guests, suppliers and customers fell outside the purview of the provisions of Section 37(2B) of the Income Tax Act, 1961 ?

2. Whether the Tribunal has rightly held that Rs. 25,250 as expenditure incurred on eating facilities by the assessee to its customers did not constitute entertainment expenditure within the meaning of Section 37(2B) ?"

2. The facts necessary, in brief, are that the assessee who is carrying on the business of manufacture and sale of beer, Indian-made foreign liquor, malt, breakfast food and soft-drinks, etc., and has a number of branches at various places, filed its return for the assessment year 1972-73 on August 9, 1972, declaring an income of Rs. 2,11,30,600. Assessment u/s 143(3) of the Act was done on January 25, 1974, on an income of Rs. 2,17,39,290. The assessee debited an amount of Rs. 2,58,387 as expenditure under the head

"Entertainment" in its various branches and claimed that an amount of Rs. 1,29,193 was allowable as business expenditure and that the balance of Rs. 1,29,193 not allowable, in view of Sub-section (2B) of Section 37 of the Act, being in the nature of entertainment expenditure. The Income Tax Officer disallowed the entire claim of Rs. 2,58,387 on the ground that the expenses in question were either on the guest houses maintained by the assessee or on food and refreshment to its customers, suppliers and others coming to it in connection with the business activities. The matter was taken up in appeal by the assessee, to the Appellate Assistant Commissioner who held that, out of the assessee''s claim of Rs. 1,29,193 (half of the amount of Rs. 2,58,387), a sum of Rs. 75,000 represented expenses for the purpose of business and, accordingly, allowed a sum of Rs. 75,000 out of the said expenses. The assessee accepted the decision in appeal but the Revenue came up in further appeal before the Tribunal which upheld the decision of the Appellate Assistant Commissioner by dismissing its appeal and holding that the amount of Rs. 75,000 constituted business expenses. It took the view that the expenses amounting to Rs. 49,750 under the head "Hotel expenses, travelling and taxi expenses and presentation items for the company''s guests, suppliers and customers" fell outside the purview of the provisions of Sub-section (2B) of Section 37 and for the balance amount of Rs. 25,250, it held that the same was not hit by the provisions of the said sub-section as the expenses represented eating facilities provided by the assessee to its customers and the expenses such as these did not constitute entertainment expenses within the meaning of the provisions of Sub-section (2B) of Section 37 of the Act. The Tribunal, while upholding the allowance of Rs. 25,250, placed reliance upon a decision of the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., .

3. The Commissioner of Income Tax sought a reference to this court and the Tribunal has referred the two questions reproduced above. Learned counsel appearing for the Revenue contended that having regard to the phraseology used in Sub-section (2A) and Sub-section (2B) of Section 37 of the Act and the wide amplitude of the words "expenditure in the nature of entertainment expenditure", the expenses in question are liable to be disallowed and, in support of this contention, reliance was placed by him on a decision of the Full Bench of the Kerala High Court in Commissioner of Income Tax Vs. Veeriah Reddiar, , which followed the decision of the Allahabad High Court in Brij Raman Dass and Sons Vs. Commissioner of Income Tax, , and also placed reliance upon CIT v. Gheru Lal Bal Chand [1978] 111 ITR 134 , Commissioner of Income Tax Vs. Khem Chand Bahadur Chand, Mysodet (Pvt.) Ltd. Vs. Commissioner of Income Tax, , Chandmull Rajgarhia v. CIT [1987] 167 ITR 433 and Phool Chand Gajanand v. CIT [1989] 177 ITR 265 , which have followed the decision of the Full Bench of the Kerala High Court in Commissioner of Income Tax Vs. Veeriah Reddiar, .

4. Learned counsel for the assessee contended that the expenditure incurred by the assessee is not liable to be disallowed under Sub-section (2A) or Sub-section

(2B) of Section 37 of the Act as the expenditure was not on a lavish or an extravagant scale but was in the nature of a bare necessity and by way of ordinary courtesy and, in support of this contention, placed reliance upon a decision of the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., and upon Commissioner of Income Tax, Vidarbha And Marathwada Vs. Shah Nanji Nagsi, , Commissioner of Income Tax, Karnataka Vs. Corporation Bank Ltd., , Addl. Commissioner of Income Tax Vs. Maddi Venkataratnam and Co. Ltd., , Commissioner of Income Tax Vs. Karuppuswamy Nadar and Sons, , CIT v. Lakhmichand Muchhal [1982] 134 ITR 234 and Devichand Bastimal and Bhanwarlal Manakchand Vs. Commissioner of Income Tax, which have followed the decision of the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., .

5. The question which falls for consideration before us is as to whether the amount in question spent by the assessee would come within the expression "expenditure in the nature of entertainment expenditure" occurring in Sub-section (2A) and Sub-section (2B) of Section 37 of the Act. To examine and answer the question, it would be necessary for us to go into the legislative history of Section 37 of the Act and the object underlying the introduction of Sub-section (2B) of Section 37 of the Act.

6. Any amount spent by an assessee for the entertainment of its business constituents and customers was an allowable expenditure under the head "Profits or gains" of any business, profession or vocation carried on by an assessee by virtue of Section 10(2)(xv) of Indian Income Tax Act, 1922, on the ground that such hospitality and entertainment is extended wholly for the purposes of promotion of the business of the assessee. With a view to curb the tendency on the part of companies and their directors and executives to entertain on a lavish scale at the expense of the company and thereafter claim the same as entertainment expenses, a proviso was inserted in the year 1961 in Section 10(2)(xv) which provided that no expenditure in the nature of entertainment expenditure shall be allowed in the case of an assessee, other than a company, and, in the case of companies, it provided a deduction on a slab basis and a ceiling was put on such expenditure depending on the profits and gains of the business. This amendment was sought to be inserted in the Act by the Finance Bill of 1961 which became an Act on and with effect from April 1, 1962. The second step was taken in the year 1967 by the Taxation Laws (Amendment) Act, 1967, which came into force on and with effect from October 1, 1967, when Sub-section (2A) was introduced in Section 37 of the Act whereby, in the case of assessees other than companies also, a ceiling on such expenditure was fixed. By the Finance Act, 1968, an Explanation (which is now Explanation 7) was added to Sub-section (2A) with effect from April 1, 1968, so as to expand the scope of the restrictions with a view to cover and include the expenses incurred by an assessee granting entertainment allowance to its employees or other persons and also the expenditure incurred by an employee or other persons for the purposes of the assessee''s business otherwise than out of an allowance paid by

the assessee. The next step in this direction was taken by the Finance Act of 1970, by inserting Sub-section (2B) in Section 37, which prohibited deduction of any "expenditure in the nature of entertainment expenditure" incurred within India by any assessee after February 28, 1970. Sub-section (2B) of Section 37, reads as under (see Commissioner of Income Tax Vs. Jeskaran Bhuvalka, :

"(2B) Notwithstanding anything contained in this section, no allowance shall be made in respect of expenditure in the nature of entertainment expenditure incurred within India by any assessee after the 28th day of February, 1970."

7. Paragraph 27 of the Memorandum explaining the provisions in the Finance Bill, 1970, by which Sub-section (2B) was sought to be inserted in Section 37, reads as under (see [1970] 75 ITR 91) :

"With a view to curbing lavish expenditure on entertainment, it is proposed to make a provision for the disallowance of entertainment expenditure incurred in India after 28-2-1970 altogether in computing the profits and gains of business or profession, Entertainment expenditure incurred outside India will continue to be admissible as a deduction subject to the limits already provided in the law."

8. Clause 10 in the "Notes on Clauses" of the Finance Bill, 1970, by which Sub-section (2B) was inserted reads as under (see [1970] 75 ITR 73) :

"Sub-clause (b) seeks to insert a new Sub-section (2B) in Section 37 of the Income Tax Act and sub-clause (a) seeks to make a consequential amendment in the Explanation to Sub-section (2A) of that section. Under the proposed amendments, expenditure in the nature of entertainment expenditure incurred by any assessee within India after the 28th February, 1970, will be disallowed in its entirety in computing his income from business or profession."

9. While introducing the Finance Bill, 1970, the Finance Minister observed as under (see [1970] 75 ITR 25) :

"The only significant change is that all entertainment expenditure incurred in India in business and the professions will now be disallowed in computing profits. Similarly, expenditure on guest houses, other than holiday homes for the benefit of employees on leave, will be disallowed. Those who enjoy the hospitality of their business friends should now no longer find their sense of gratitude diminished by the thought that a part of the hospitality is really paid for by the Exchequer."

10. As we find, it is in this background that the object in inserting Sub-section (2B) to Section 37 of the Act was to put a curb on the tendency of extravagant and lavish entertainment by assessees thereby providing that all "expenditure in the nature of entertainment expenditure" incurred within India after February 28, 1970, was to be disallowed, We are concerned, in this case, with the assessment year 1972-73 and therefore, Sub-section (2B) of Section 37 would be fully applicable. It is pertinent to mention at this stage that, on and with effect from April 1, 1977, Sub-section (2B) of Section 37 was altogether omitted but the

Legislature in its wisdom reintroduced the same to a limited extent by the Taxation Laws (Amendment) Act, 1978, thereby providing a curb on expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. However, the amendment in the year 1978 has no concern with the entertainment expenditure at all. By the Finance Act, 1983, Explanation 2 was added to Sub-section (2A) of Section 37 which is to the following effect (see Commissioner of Income Tax, Tamil Nadu-V Vs. Workshop Trust, ;

"Explanation 2. -- For the removal of doubts, it is hereby declared that for the purposes 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."

11. In this background it will be necessary to examine the divergent views on the question of allowing entertainment expenditure.

12. The leading judgment which supports the assessee''s view, is that of the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., . Their Lordships, adverting to the dictionary meaning of the word "entertainment" and by placing reliance upon some English precedents by way of analogy, held as follows (at p. 441) :

"... We do not think that we would be justified in laying down any formula so as to provide a readymade answer to this problem ; but, in the context of the legislative intent evinced from the gradual evolution of the present provisions contained in Sections 37(2A) and (2B), we venture to indicate a few broad tests so as to facilitate a taxpayer to understand and the Revenue to determine the nature of entertainment expenses though in each case in the ultimate analysis it would be a question of fact depending on many factors, more particularly in the absence of a well-defined scheme in the Indian statute. The following broad tests, in our opinion, will provide a guideline to determine the nature of expenses allowed to be entertainment expenses :

(a) If the provision of food, drinks or any amusement to a client, constituent or customer is on a lavish and extravagant scale, or is of wasteful nature, it is entertainment per se.

(b) If the provision of food or drinks to a client, constituent or customer is in the nature of bare necessity, or by way of ordinary courtesy, or as an express or implied term of the contract of employment spelled out from long-standing practice or custom of trade or business, it will not amount to entertainment.

(c) If the provision of food or drinks to a client, customer or constituent is in a liberal and friendly way, it may amount to entertainment having regard to the place, item and cost of such provision.

(d) The provision of amusement to a client, customer or constituent by way of hospitality or otherwise will always be entertainment."

13. This judgment of the Gujarat High Court appears to be the basic judgment which seems to have found acceptance with some other High Courts as well, which supports the arguments of learned counsel for the assessee. A close scrutiny of the judgment would show that, instead of considering the compendious phrase "in the nature of entertainment expenditure", their Lordships adverted to find out the import and width of the word "entertainment" only. The Legislature, instead of using the word "entertainment" or "business expenditure", has used a much wider compendious phrase like "expenditure in the nature of entertainment expenditure" and, therefore, it is this wider phrase which deserves consideration and not the simple words "entertainment" or "business entertainment", as has been interpreted by the judges of the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., . On the Gujarat High Court''s view itself, hospitality which is on a lavish or extravagant scale is per se entertainment. On a lower scale, there may be extended hospitality, which may neither be necessarily lavish, nor exceptionally pleasurable. Even though it may be said that this, kind of hospitality does not strictly fall within the ambit of the word "entertainment", can it possibly be denied that it will come within the amplitude of the wider phrase deployed by the Legislature "in the nature of entertainment expenditure". Out of the four tests laid down in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., , (a) and (d) have been opined to be entertainment per se by the Full Bench itself and the tests (b) and (c), even though may not be strictly entertainment, would clearly come within the compendious phraseology deliberately used by Parliament. The observations to the effect that the provision of food or drink to a constituent or a customer will amount to entertainment only, that is, if it is on a lavish and extravagant scale or is of a wasteful nature and that every hospitality would not constitute entertainment are not borne out on the true interpretation of the word "expenditure in the nature of entertainment expenditure". The reasoning adopted in coming to the conclusion cannot be applied to each and every case. Something which may be regarded as an ordinary meal by a person may really be regarded as a lavish meal by a common man. Such considerations, as are contained in the four tests laid down, introduce a state of uncertainly in the meaning of the phrase used in a statute and has to be avoided. The other view which supports the Revenue is based upon two leading judgments, one of the Allahabad High Court in Brij Raman Dass and Sons Vs. Commissioner of Income Tax, and the other of the Full Bench of the Kerala High Court in Commissioner of Income Tax Vs. Veeriah Reddiar, . The Full Bench of the Kerala High Court, in Reddiar''s case, dissented from the view taken by the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co.

Ltd., . After considering the legislative history, it held as under (at p. 616) :

"The expression ''entertainment expenditure'' has not been denned in the Act. The words have, therefore, to be construed in accordance with their ordinary and natural meaning. Where the expression admits of more than one connotation the court will prefer that meaning which appears to it to be consistent with the context and setting in which the words have been used in the statute and which would conduce to effectuate the legislative intention. It is important to note that, instead of merely using the expression ''entertainment expenditure'', the words actually used by Parliament in Sub-sections (2A) and (2B) are ''expenditure in the nature of entertainment expenditure''. The latter expression is much wider in its content inasmuch as it would take within its scope not merely what can strictly be regarded as entertainment expenditure proper but also expenditure of allied nature partaking of some, though not all, of the characteristics of entertainment expenditure. It appears to us to be beyond doubt that the intention of Parliament in employing the additional words ''expenditure in the nature of was to cast the net sufficiently wide as to bring within the scope of the two sub-sections all types of expenditure in respect of which there can be said to be certain elements which invest them with the nature of entertainment expenditure . . . We are clearly of opinion that in interpreting the expression ''entertainment expenditure'' occurring in Sub-sections (2A) and (2B) of Section 37 of the Act the word ''entertainment'' should be taken to mean hospitality of any kind extended by the assessee directly in connection with his business or profession."

14. The Bench differed from the view of the Gujarat High Court on the basis of the legislative history as traced above in the earlier part of this judgment and the significant use of the word "expenditure in the nature of entertainment expenditure" in both Sub-sections (2A) and (2B) of Section 37 and ultimately held that in interpreting the expression "entertainment expenditure" occurring in Sub-sections (2A) and (2B) of Section 37 of the Act, the word "entertainment" should be taken to mean hospitality of any kind extended by the assessee directly in connection with his business or profession.

15. A Full Bench of the Punjab and Haryana High Court in Commissioner of Income Tax Vs. Khem Chand Bahadur Chand, also agreed with the view of the Kerala High Court and held that the word "expenditure in the nature of entertainment expenditure" is of a much wider connotation. It dissented from the view of the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd., . The decisions of other High Courts on which reliance was placed by the Revenue also proceed on the reasoning adopted by the Kerala High Court in Commissioner of Income Tax Vs. Veeriah Reddiar, .

16. The matter can be viewed from another angle also. The controversy, in our opinion, has now been set at rest by the Legislature introducing Explanation 2 to Sub-section (2A) of Section 37 by the Finance Act of 1983 which was made effective with retrospective effect from April 1, 1976. The Explanation has been

introduced for the removal of doubts by way of a declaration defining entertainment expenditure to include expenditure on provision of hospitality of every kind. This Explanation can be safely used for considering the legislative intent. It is well settled that an Explanation added to a statutory provision is not a substantive provision in any sense of the term and as the plain meaning of the word itself shows, it is merely a mandate to explain or clarify certain ambiguities which may have crept in the statutory provision. It has been held by the Supreme Court in S. Sundaram Pillai and Others Vs. `R. Pattabiraman and Others, , that (p. 593) :

"... the objects of an Explanation to a statutory provision are --

(a) to explain the meaning and intendment of the Act itself,

(b) where there is any obscurity or vagueness in the main enactment, to clarify the same so as to make it consistent with the dominant object which it seems to subserve.

(c) to provide an additional support to the dominant object of the Act in order to make it meaningful and purposeful,

(d) an Explanation cannot in any way interfere with or change the enactment or any part thereof but where some gap is left which is relevant for the purpose of the Explanation, in order to suppress the mischief and advance the object of the Act it can help or assist the court in interpreting the true purport and intendment of the enactment, and

(e) it cannot, however, take away a statutory right with which any person under a statute has been clothed or set at naught the working of an Act by becoming an hindrance in the interpretation of the same."

17. From the legislative history and the introduction of Explanation 2, we are of the opinion that the Legislature always intended that entertainment expenditure includes expenditure on provision of hospitality of every kind by the assessee. It was in order to resolve the ambiguity that Explanation 2 was added. The intention of the Legislature cannot be ascertained from any statement by way of Notes on Clauses of a Bill or brevet and as has been stated, the duty of the court is to find the natural meaning of the words in a statute in the context in which they are used. It has always been considered permissible and even desirable for a court while interpreting a statute to take note of the history of the statute and the circumstances in which it was passed or the mischief at which it was directed. The reason is that the meaning which is to be given to a statute should be such as will carry out its object (See Chettian Veetil Ammad and Another Vs. Taluk Land Board and Others,).

18. Following the rule in Heydon''s case [1584] 76 E. R. 637, it appears to us that to construe the true import of Sub-section (2B) of Section 37 which starts with a non-obstante clause, it is not only legitimate but convenient to refer both to the former Income Tax Act and the state of uncertainty brought about due to

conflict of views between the different High Courts and that Explanation 2 seeks to provide a remedy by not only explaining but by removal of doubts declaring that entertainment expenditure includes expenditure or provision on 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,

19. In view of the above discussion, we have no hesitation in following the ratio of the decision of the Full Bench of the Kerala High Court in Commissioner of Income Tax Vs. Veeriah Reddiar, . We, accordingly, answer questions Nos. 1 and 2 in the negative, that is, in favour of the Revenue and against the assessee.

20. No costs.