

(1980) 11 MP CK 0021

In the Madhya Pradesh High Court

Case No : Miscellaneous Civil Case No. 149 of 1977

Commissioner of Income Tax

APPELLANT

Vs

Raj Kumar Mills Ltd.

RESPONDENT

Date of Decision : 24-11-1980

Acts Referred:

Income Tax Act, 1961 — Section 37(2B)

Citation : (1982) 135 ITR 811

Hon'ble Judges : R.K. Vijayvargiya, J;G.G. Sohani, J

Bench : Division Bench

Advocate : S.C. Bagadiya, for the Appellant; G.M. Chaphekar and S.M. Mahajan, for the Respondent

Judgement

Vijayvargiya, J.—By this reference u/s 256(1) of the I.T. Act, 1961 (hereinafter referred to as "the Act"), the Income Tax Appellate Tribunal, Indore Bench, Indore, has referred the following questions of law for the opinion of this court:

"(1) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in law in allowing deduction of the following two items from the computation of the total income:

Rs.

(i)

Compensation paid for short packing of controlled cloth

85,411

(ii)

Contribution paid for production of higher medium cloth

2,800

Total

88,211

(2) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in allowing deduction of Rs. 5,600 representing payment on account of shortfall in export performance from the computation of total income holding that such payments do not partake of the nature of penalty disallowable u/s 37 ?

(3) Whether the Appellate Tribunal was right in coming to the conclusion that the entire expenses of Rs. 8,000 disallowed by the ITO as entertainment expenses were not hit by the provisions of Section 37(2B) of the Income Tax Act, 1961 ?"

2. The material facts giving rise to this reference as set out in the statement of the case are as follows: The assessee is a public limited company dealing in the manufacture and sale of textiles. The assessment year involved is 1972-73 and the relevant accounting period ended on December 31, 1971. Under the Cotton Textiles (Control) Order, 1948, the assessee paid compensation of Rs. 85,411 for short packing of controlled cloth during the period January, 1971, to May, 1971. The assessee had also paid a sum of Rs. 2,800 for production of higher medium cloth. The assessee claimed the aforesaid two payments as admissible deductions in the computation of the total income of the assessee. The ITO disallowed both these items, but on appeal by the assessee they were allowed by the AAC. The Revenue preferred an appeal against the order of the AAC. The Tribunal confirmed the order of the AAC and dismissed the appeal.

3. The ITO also disallowed an item of Rs. 5,600 paid by the assessee on account of the shortfall in its export performance. The assessee was allowed to import 63 bales of American cotton subject to the condition that it would export cloth valued at Rs. 4,11,733 by March 31, 1971. As there was a shortfall in the export performance by a sum of Rs. 74,504 the assessee had to pay an amount of Rs. 5,600. The ITO disallowed this amount treating this amount to be a penalty for non-fulfilment of a statutory commitment. On appeal by the assessee, the order of the ITO was upheld by the AAC. On further appeal by the assessee, the Tribunal has allowed this item as a deductible expenditure.

4. The ITO had also disallowed a sum of Rs. 8,000 out of the general charges on the ground that the said amount pertained to entertainment and, therefore, was hit by Section 37(2B) of the Act. The AAC, on appeal by the assessee, upheld the order of the ITO. On further appeal by the assessee, the Tribunal came to the conclusion that the disallowance of Rs. 2,000 would be adequate and reasonable and, therefore, the disallowance was reduced from Rs. 8,000 to Rs. 2,000. At the instance of the Department, the Tribunal has referred the aforesaid question of law arising out of the order of the Tribunal for the opinion of this court.

5. As regards the item of Rs. 85,411 this amount was paid by the assessee as compensation for short packing of controlled cloth during the period January, 1971, to May, 1971. The Cotton Textiles (Control) Order, 1948, provided for a cash payment by way of assistance, i.e., a subsidy at specified rate, if a textile

mill manufactured controlled cloth in excess of the minimum quantity specified in the direction given under the aforesaid order. If there was a shortfall in the targeted quantity of controlled cloth to be produced, the mill had to make a payment to the Textile Commissioner at specified rates as provided, under the Control Order. The Tribunal found that the assessee received a sum of Rs. 10,36,198 as incentive for having packed excess quantity of controlled cloth during the period June, 1971, to December, 1971, and the assessee had duly shown as its taxable income the subsidy received from the office of the Textile Commissioner for the excess packing of controlled cloth. The assessee sought to deduct the compensation which the assessee was required to pay for short packing of controlled cloth in an earlier period in the accounting year in question. It is difficult to appreciate how the amount required to be paid on account of shortfall in packing of controlled cloth could not be deducted when the subsidy received by the assessee for excess production of controlled cloth was treated as its taxable income. The Tribunal placed reliance upon a decision of the Gujarat High Court in *Additional Commissioner of Income Tax, Gujarat Vs. Rustam Jehangir Vakil Mills Ltd.*, in which after examining the relevant provisions of the Cotton Textiles (Control) Order, 1948, the High Court held that the amount paid by the assessee was deductible. A similar view is taken by the Madras High Court in *Commissioner of Income Tax Vs. Vasantha Mills Ltd.*, . We are in respectful agreement with the view taken in the aforesaid decisions and are of the opinion that the Tribunal did not commit any error of law in holding that the amount of Rs. 85,411 paid by the assessee as compensation for shortfall in the packing of controlled cloth was deductible from the income of the assessee.

6. Similarly, the assessee paid a sum of Rs. 2,800 on account of diversion of the assessee's capacity to the manufacture of medium and fine varieties of cloth. The Tribunal has found that the cotton textile industry had accepted the responsibility to supply in the quarter June, July and August, 1971, a quantity of 100 million square metres of controlled cloth and to achieve that purpose, a scheme was made which contemplated the grant of subsidy of 50 paise per square metre to those mills to whom quotas for the manufacture of controlled cloth were allotted and for the purpose of raising that subsidy, which would be of the order of Rs. 5 crores, a scheme was envisaged and contributions were called for from the cotton textile mills at the specified rates. The scheme provided that on production of higher medium "A" variety a contribution at the rate of six paise per square metre on certain part of the production would be payable as a contribution to the Cotton Textile Mills Federation. In pursuance of that scheme, the assessee paid the amount of Rs. 2,800. The Tribunal held that the payment was not in the nature of penalty and the assessee has paid it for the purpose of the carrying on of its business and it was laid out and expended wholly and exclusively for the purpose of the business of the assessee. In the circumstances, it cannot be said that the Tribunal committed any error of law in holding that the said amount was deductible from the income of the assessee.

7. The assessee claimed deduction of Rs. 5,600 paid by it on account of shortfall

in export performance. The assessee was allowed to import 63 bales of American cotton subject to the condition that it would export cloth valued at Rs. 4,11,733 by March 31, 1971. There was, however, a shortfall in the export performance by a sum of Rs. 74,504 and the assessee had to pay an amount of Rs. 5,600.

8. The learned counsel for the revenue strongly contended that this amount was paid by the assessee as a penalty and, therefore, the Tribunal committed an error in holding that this amount was also deductible from the income of the assessee. He placed reliance upon a decision of the Punjab and Haryana High Court in *Cineramas Vs. Commissioner of Income Tax*, . The contention of the learned counsel for the Revenue cannot be upheld. The Tribunal on an appreciation of the materials placed on record came to the conclusion that this amount was not paid by the assessee as a penalty for the infraction of any law and that the amount paid by the assessee cannot be termed as a penalty. The Tribunal held that the assessee made payment to the Export Promotion Council and the payment was made in the course of carrying on of the assessee's business and it was incurred wholly and exclusively for the purpose of business of the assessee. On this finding, it cannot be said that the Tribunal committed any error of law in holding that the said amount of Rs. 5,600 was deductible from the income of the assessee. The decision relied upon by the learned counsel for the Revenue is distinguishable on facts.

9. The ITO disallowed a sum of Rs. 8,000 out of the general charges. This amount was paid by the assessee by way of reimbursement to Shri Desai, the chief executive of the assessee. The Tribunal has found as a fact that the said amount was paid by the assessee to Shri Desai and that it was spent by him on the entertainment of trade clients. The Tribunal appears to have accepted the contention of the assessee that the amount was spent in providing tea, etc., to the customers visiting the mills of the assessee. In allowing the expenditure the Tribunal placed reliance upon a decision of the Gujarat High Court in *Commissioner of Income Tax, Gujarat II Vs. Patel Brothers and Co. Ltd.*, . However, the Tribunal reduced the amount taking into consideration the amount allowed by the Tribunal in the previous year. In *CIT v. Lakhmichand Muchhal* (Misc. Civil Case No. 15 of 1977, decided on 12-9-80) [since reported in [1982] 134 ITR 234, a Division Bench of this court has cited with approval the observations made by the Gujarat High Court in the aforesaid decision, as follows: (p. 235):

"...the term "entertainment" in the context of Section 37(2B) of the Act on its true construction and meaning would include the acts or practice of receiving and entertaining the strangers and friends ; but if the acts or practice of being hospitable in the sense of providing meals, drinks or other wants of guests are a part and parcel of the express or implied terms and conditions of business, trade or profession or on account of longstanding custom in such trade, business or profession, they would not amount to acts of entertainment. It was further held that hospitality shown on account of obligation of business arising as a result of

an express or implied contract or arising on account of the longstanding custom of a trade cannot amount to "entertainment".

10. The Tribunal did not commit any error of law in allowing the amount spent by the assessee in showing hospitality to its customers on account of the custom of the trade.

11. As a result of the discussion aforesaid, our answers to the questions referred to us are in the affirmative and against the revenue. In the circumstances, the parties shall bear their own costs of this reference.