(2012) 09 DEL CK 0242

In the Delhi High Court

Case No : ITA 98, 113 and 143 of 2010

Commissioner of Income Tax APPELLANT

Vs

Samsung India Electronics Ltd. RESPONDENT

Date of Decision : 03-09-2012

Acts Referred:
Income Tax Act, 1961 — Section 260A, 37(2), 43A

Citation : (2012) 09 DEL CK 0242

Hon'ble Judges : S. Ravindra Bhat, J;R.V. Easwar, J

Bench : Division Bench

Advocate : Suruchi Aggarwal, for the Appellant; Satyen Sethi and Mr. Arta Trana Panda, for the Respondent

Final Decision : Dismissed

Judgement

R.V. Easwar, J.—These are three appeals filed by the revenue u/s 260A of the Income Tax Act, 1961 (''Act'', for short) and they relate to

the assessment years 1996-97, 1997-98 and 1998-99. They are directed against the common order passed by the Income Tax Appellate

Tribunal (''Tribunal'', for short) on 28.11.2008 in cross appeals filed by the assessee and the revenue. The assessee is a company dealing in

consumer durables such as televisions, cameras, video recorders, washing machines, refrigerators, etc.

ITA 143/2010

2. In ITA 143/2010, the only substantial question of law is whether, on the facts and in the circumstances of the case, the Tribunal is right in law in

holding that the assessee was entitled to the allowance for entertainment expenditure incurred on its employees. The assessee incurred deduction of

Rs. . 4,85,305/- as entertainment expenditure. It was claimed by the assessee that 35% of the aforesaid amount represented expenditure incurred

on the food and beverage for the employees while they were entertaining the assessee''s customers on behalf of the assessee. This amounted to Rs.

. 1,69,857/-. In calculating the allowance for entertainment expenses u/s 37(2) of the Act, the assessee deducted the allowance claimed in respect

of the employees from the total entertainment expenditure incurred and applied the limits for deduction prescribed by the Section on the balance

amount and calculated the disallowance on account of entertainment expenditure accordingly. The Assessing Officer, however, took the view that

no allowance in respect of the entertainment expenditure incurred on the employees could be granted and accordingly reworked the disallowance

at Rs. . 2,37,653/- in the following manner :

The CIT (Appeals) having allowed the assessee''s claim, the revenue preferred an appeal to the Tribunal which endorsed the decision of the CIT

(Appeals).

3. A perusal of the order of the Tribunal shows that it has considered the claim of the assessee that 35% of the expenditure incurred on

entertainment is attributable to the entertainment of the employees while they were entertaining the assessee''s customers to be reasonable and

therefore such portion of the expenditure has to be excluded at the threshold and the limits prescribed by Section 37(2) have to be applied only on

the balance of expenditure. This is not an unreasonable view of the section. The question as to how much is to be attributed to the entertainment of

the employees is a matter of esteem. We are, therefore, answer the question in the affirmative, in favour of the assessee and against the revenue.

ITA 113/2010

4. This relates to the assessment year 1997-98. The first question relates to the computation to the disallowance of entertainment expenses u/s

37(2). We have already answered a similar question in ITA 143/2010 in favour of the assessee. The controversy being the same, this question is

decided in favour of the assessee and against the revenue.

5. The second question of law is whether the Tribunal was right in holding that the assessee is entitled to the depreciation on the increase in the cost

of fixed assets due to fluctuation in the foreign exchange rate. During the relevant previous year, the liability to pay foreign exchange for the machinery purchased by the assessee went up by Rs. . 35,699/- on account of adverse exchange rate fluctuations. Treating this amount as part of

the cost of the assets, the assessee claimed depreciation of Rs. . 4,462/- on the additional cost represented by the aforesaid law. The claim was

rejected by the Assessing Officer on the ground that mere increase in the law on account of adverse exchange rate fluctuations cannot be taken

note of for the purpose of calculating depreciation and that the adjustment to the cost of the asset can be made only at the time of actual payment

of the increased foreign exchange and not on notional basis. On appeal the CIT (Appeals) directed the Assessing Officer to allow the depreciation

as claimed.

6. The revenue carried the matter in appeal before the Tribunal and accepted the decision of the CIT (Appeals) following the judgment of this

Court in Commissioner of Income Tax Vs. Woodward Governor India Pvt. Ltd., . In that judgment, it was held that the increase on account of

fluctuations in the rate of foreign exchange prevailing on the last day of the financial year is not notional or contingent and has to be adjusted in the

actual cost of assets in terms of Section 43A, in the year in which there is variation in the exchange rate, irrespective of the date on which it is paid.

7. This issue now stands concluded by the judgment of the Supreme Court in Commissioner of Income Tax, Delhi Vs. Woodward Governor India

P. Ltd., in which the judgment of this Court was affirmed. The question having been concluded by the judgment of the Supreme Court (supra) we

answer the substantial question of law in favour of the assessee and against the revenue.

8. The next question of law is whether payment made by the assessee to the UP State Electricity Board (UPSEB) for laying electric transmission

lines in the assessee''s premises represents revenue expenditure or capital expenditure.

9. The amount paid by the assessee is Rs. . 26,67,106/-. In the books of account the expenditure was shown as pre-operative expenses. The

claim was made by the assessee in the appeal filed before the CIT (Appeals) by way of an additional ground which was admitted and adjudicated

upon. The CIT (Appeals) admitted the ground for adjudication and held, on merits, that the transaction lines were not owned by the assessee and the property in them remained with the UPSEB. This, according to the CIT (Appeals), was one of the conditions under which the UPSEB supplied

power through the transmission lines. It was held by him following the judgment of the Supreme Court in Empire Jute Co. Ltd. Vs. Commissioner

of Income Tax, that there was no enduring advantage to the assessee and that the payment represented expenditure in the revenue field and was

deductable.

10. The revenue carried the matter in appeal before the Tribunal. The Tribunal, on the facts, held that the judgment of this Court in Commissioner

of Income Tax Vs. Saw Pipes Ltd., was applicable and accordingly agreed with the CIT (Appeals).

11. In our opinion, the question of law has to be answered in favour of the assessee in view of the judgment of this Court cited above. That was

also a case where expenditure was incurred by the assessee for laying of electricity transmission lines, which did not become the property of the

assessee. It was held that the expenditure did not bring in any enduring benefit and was deductible as revenue expenditure. Accordingly, the

question of law is answered in favour of the assessee and against the revenue.

ITA 98/2012

12. This appeal relates to the assessment year 1998-99. The first question of law is whether the Tribunal was right in endorsing the decision of the

CIT (Appeals) deleting the addition of Rs. . 1,20,88,657/- towards value of the closing stock. The facts relating to this question are briefly that in

the profit and loss account the assessee had deducted the aforesaid amount from the value of the closing stock and declared only the net amount of

Rs. . 38,02,59,482 as the value. When asked to explain, the assessee submitted that it makes a provision for defective stock at the end of the year

and this is divided into four types of stock namely, category sale, defective but not repairable, demo stock and write off for special value rates. It

was also submitted that in the case of category sale, a provision of 35% on dealer price is made on the assumption that the sale price would only

be 65%. In the case of defective but repairable stock, a provision is made on account of estimated repairable stock. In the case of demo stock it

was written off in three years at 25%, 50% and 100% in the third year. In the fourth category fell VCDs, video recorders etc. which remained unsold for more than one year and these are written off in two years. They were accordingly, valued at 37.5% of the cost.

13. The Assessing Officer did not accept the assessee''s explanation. According to him the assessee is a multinational having strong presence in

more than 40 countries and it spends a fortune in establishing this brand name. Even granting the pace at which technology develops in the field of

consumer durables it is not possible to accept the claim that the goods produced by the assessee become junk in a short period of a year or six

months. The Assessing Officer also noted that the stock had not become defunct or unsalable and that there was no method to justify the reduction

in the value of the stock as was done by the assessee. Accordingly, he refused to allow the provision for defective stock and added the amount of

Rs. . 1,20,88,654/-.

14. On an appeal the CIT (Appeals) allowed the assessee''s claim as follows :

I have considered the matter carefully. I have also seen the list of defective damages and other types of stocks which have been duly inspected and

certified as also the price marked down by the concerned technicians for each item as per details submitted. This is not a case of creating

provisions for defunct or defective stocks but actual reduction in value of stock due to reasons as certified by the company''s experts. I, therefore,

hold that the A.O. erred in his view that the reduced value of stock was on account of a provision for unascertained and contingent liability when

on verification it is found that they are actual defective or damaged stock necessitating reduction in pricing. The addition therefore, is unjustified and

accordingly deleted. (Relief Rs. . 1,20,88,654/-).

15. The revenue carried the matter in appeal before the Tribunal. The Tribunal confirmed the decision of the CIT (Appeals) in the following words

:

32. In the appeal filed by the revenue, ground has been taken for deleting addition of Rs. . 1.20 crores made by the A.O. on account of reduction

in value of closings stock of finished goods. We have considered the rival contentions and found from the record that since the starts of its

operation in the assessment year 1996-97, the assessee company was consistently valuing the defective stock at the realizable value being lower

then cost. Similar write down in the valuation of such stock was allowed by the department in the assessment year 1996-97 and 1997-98.

However, during the year under consideration, by disturbing the method of valuation, the A.O. made addition. Jurisdictional High Court in case of

Commissioner of Income Tax Delhi-II, N. D. Vs. Bharat Commerce and Industries Ltd., , upheld the order of the tribunal alone claiming the loss

arising out of valuation of slow moving raw material as estimated realizable value. Since the finding recorded by the CIT (A) has not been

controverted by Ld. D.R., we, therefore, do not find any reason to interfere in the finding of CIT (A) for deleting the addition on account of

valuation of closing stock of finished goods in respect of its defective/obsolete stock.

We have considered the facts and the submissions. The revenue has accepted similar claims in the assessment made for the assessment years

1996-97 and 1997-98. A consistent method of valuing the stock has been adopted by the assessee. It was also accepted by the revenue. It

would, therefore, be improper to allow the revenue to change its position only for one year, which would upset the method of valuation of the

stock for a particular year thereby resulting in a distorted version of the profits. The method of valuation of closing stock can be disturbed only if it

is found that the method followed is such that true profits and gains cannot be deduced there from. These are basic principles in income tax law

and need no repetition or citing of authority. In the case of Commissioner of Income Tax Delhi-II, N. D. Vs. Bharat Commerce and Industries

Ltd., cited by the Tribunal the loss arising out of the reduced valuation of slow moving raw material on the basis of estimated realisable value was

held allowable. We do not find any infirmity in the orders passed by the CIT (Appeals) and the Tribunal on this point, having regard to the method

adopted by the assessee consistently. We accordingly answer the question of law in favour of the assessee and against the revenue.

16. The second question of law is whether the Tribunal was right in law in confirming the decision of the CIT (Appeals) deleting the disallowance

of the brand building and dealer loyalty expenditure. In the books of account the assessee treated the expenditure of Rs. . 6,93,81,635/- as

deferred revenue expenditure. The expenditure consisted of Rs. . 1.60 crores on brand building, Rs. . 5.01 crore on dealer loyalty and Rs. . 0.31

crores on others. The Assessing Officer noted that the assessee had entered into an agreement with Samsung Electronics Company Ltd. of Korea,

which is the parent company under which a part of the expenditure inured for the benefit of the brand ""Samsung"" and therefore the expenditure

cannot be said to be wholly and exclusively incurred for the purpose of the assessee''s business. He accordingly disallowed the entire expenditure

of Rs. . 6,93,81,635/-.

17. On appeal the CIT (Appeals) noted that there is no concept of deferred revenue expenditure in income tax law and that since the assessee was

the exclusive dealer of Samsung products in India the entire benefit from the sales promotion and dealer loyalty would accrue exclusively to it and

therefore the expenses were revenue in nature. Having said that, the CIT (Appeals) observed that since both the assessee and the appellant

company in Korea benefited from the advertisements, 50% of the expenditure should be disallowed. He accordingly, allowed only 50% of the

expenditure.

18. Both the assessee and the revenue filed cross appeals before the Tribunal, the assessee challenging the disallowance of 50% sustained by the

CIT (Appeals) and the revenue challenging the relief of 50% granted by the CIT (Appeals). The Tribunal discussed the issue in paragraphs 26 to

29 and paragraph 35 of its order. The following are the findings of the Tribunal :

a) the assessee, in addition to its activities in consumer durables, had its own manufacturing facilities;

b) the expenditure was incurred to promote the brand and to increase its presence in the market so as to sell its entire production;

c) in terms of the agreement with the parent company, the advertisement expenditure amounting to Rs. . 13 crores was reimbursed by the parent

company in Korea since part of the expenditure inured to the benefit of the parent company;

d) due to the incurring of the expenses, the sales of the assessee had increased substantially as follows :

e) the reasonableness of the expenditure has to be seen from the point of view of the businessman and the mere fact that some part of the

expenditure inured to the benefit of another entity does not entitle the income tax authorities to disallow a part of the expenditure.

In coming to the aforesaid conclusion the Tribunal relied on the following judgments :

(i) Commissioner of Income Tax, Bombay Vs. Walchand and Co. Private Ltd.,

(ii) Commissioner of Income Tax Vs. Dalmia Cement (B.) Ltd.,

(iii) Sassoon J. David and Co. Pvt. Ltd., Bombay Vs. Commissioner of Income Tax , Bombay,

On this basis the Tribunal allowed the assessee''s appeal and dismissed the appeal filed by the revenue with the result that the entire expenditure of

Rs. . 6,93,81,635/- stood allowed.

19. We have considered the facts and the submissions. The finding of the Tribunal that a part of the advertisement expenditure is reimbursed by the

parent company is not under challenge. This itself should settle the issue in favour of the assessee because even if it is assumed that a part of the

expenditure inured for the benefit of the parent company, the assessee is getting compensated for it. The view that in any case, expenditure, the

benefit of which inures partly to the assessee and partly to another person, cannot be allowed as a deduction, we are afraid, is not the correct view

to take in law since it has been settled by a long line of cases that expenditure incurred by the assessee in the running of his business cannot be

disallowed merely on the ground that a part of the expenditure results in some benefit to a third party. The principle to be applied in such cases was

articulated by Lord Atkinson in Usher''s Wiltshire Brewery Ltd. Vs. Bruce (1914) 6 TC 399 (HL):

I confess I am unable to see upon what principle money designedly spent by the brewer with the sole and exclusive object of maintaining this

market place for his own goods, and promoting, through the action of the salesman, the sale of those goods therein, ceases to be an expenditure

wholly and exclusively for his (the brewer''s) trade because, incidentally, it may benefit the salesman.

Lord Sumner stated in the same case that the mere fact that to some extent the expenditure inures to the benefit of a third party cannot in law

defeat the effect of the finding as to the whole and exclusive nature of the purpose. This principle was applied in India by the Supreme Court in

Eastern Investments Ltd. Vs. Commissioner of Income Tax, West Bengal, , Commissioner of Income Tax, West Bengal Vs. Royal Calcutta Turf

Club, and The Commissioner of Income Tax, Bombay Vs. Chandulal Keshavlal and Co., Petlad, . Having regard to the legal position adumbrated

in the aforesaid cases we do not find any error of law in the approach adopted by the Tribunal. Accordingly, the question of law is answered in

favour of the assessee and against the revenue.

In the result, all the three appeals filed by the revenue are dismissed with no order as to costs.