
(2003) 02 BOM CK 0093

In the Bombay High Court

Case No : IT Ref. No. 621 of 1987 & Income-tax Reference No. 621 of 1987

Commissioner of Income Tax

APPELLANT

Vs

Walchandnagar Industries Ltd.

RESPONDENT

Date of Decision : 06-02-2003

Acts Referred:

Income Tax Act, 1961 — Section 256, 35B, 35B(1), 37(2A)

Citation : (2003) 262 ITR 212 : (2003) 128 TAXMAN 649

Hon'ble Judges : S.H. Kapadia, J; J.P. Devadhar, J

Bench : Division Bench

Advocate : R.V. Desai and P.S. Jetley, instructed by K.B. Rao, for the Appellant;
V.B. Patel, for the Respondent

Final Decision : Partly Allowed

Judgement

S.H. Kapadia, J.—The following questions of law have been referred to us for our opinion u/s 256(1) by the Tribunal at the behest of the Department. The reference pertains to the assessment year 1978-79.

"(i) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee was entitled to deduction u/s 35B of the Income Tax Act, 1961, on the guarantee commission of charges of Rs. 5,91,015 paid to E.C.G.C. on commission of Rs. 8,37,862 paid to Tata Exports and on 75 per cent. of the proportionate administrative expenses of Rs. 2,54,356 ?

(ii) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in deleting the addition of Rs. 29,983 made u/s 37(2A) of the Income Tax Act on account of entertainment expenditure incurred by the assessee ?

(iii) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the excess price of sugar collected over and above the control price fixed by the Government for the assessment year 1978-79, was not taxable as income of the assessee for said assessment year ?"

Facts :

2. The assessee is a public limited company engaged in the business of manufacture of industrial machinery required for manufacture of sugar. The assessee claimed weighted deduction u/s 35B on three items, viz., guarantee commission paid to the Export Credit Guarantee Corporation amounting to Rs. 5,91,015; Rs. 8,37,862 paid as commission to Tata Exports for monitoring and doing liaisoning work outside India ; and the assessee has claimed weighted deduction on account of proportionate administrative expense. These three items concerning weighted deduction u/s 35B are covered by question No. 1 quoted above. The weighted deduction on the above three items was disallowed. The assessee went in appeal to the first appellate authority, where the claim of the assessee stood allowed. This decision was affirmed by the Tribunal. Therefore, the Department has come by way of a reference u/s 256(1) of the Income Tax Act as it stood at the relevant time.

3. As regards question No. 2 is concerned, it may be stated that the Income Tax Officer came to the conclusion that the assessee was entitled to claim entertainment expenditure u/s 35B. However, the Income Tax Officer found that the entertainment expenditure was very lavish and, therefore, he curtailed that expenditure by invoking Section 37(2A) of the Act and, consequently, he added back Rs. 29,983 as income. Being aggrieved, the assessee went in appeal to the first appellate authority who deleted the addition on the ground that Section 37(2A) had no application as Section 37(2A) would apply only if Section 37(1) is applicable. At this stage it may be pointed out that since the Income Tax Officer had concluded that Section 35B of the Act stood attracted, the assessee did not prefer any appeal against that finding of the Income Tax Officer. Moreover, the Department did not go in appeal against that finding of the Income Tax Officer. What was challenged in the appeal by the assessee was only disallowance of a sum of Rs. 29,983 u/s 37(2A). Therefore, the finding of the Income Tax Officer that Section 35B was applicable to this case became final. On this point, the Tribunal concurred with the findings given by the first appellate authority. Therefore, the Department has come by way of reference seeking our opinion on question No. 2, which only states as to whether the Tribunal was right in law in deleting the addition of Rs. 29,983 u/s 37(2A) on account of entertainment expenditure.

4. As far as question No. 3 quoted above is concerned, the facts are as follows: In the appeal before the first appellate authority, an additional ground was taken by the assessee as the Income Tax Officer had brought to tax, the difference between the levy price of the sugar and the amount allowed to be collected by the assessee as per the court's order. In this connection, it may be mentioned that the levy price fixed by the Government was challenged by the assessee by filing a writ petition in the Bombay High Court. According to the assessee, the levy price was understated. By an interim order passed by the Bombay High Court at the stage of admission, the assessee was permitted to charge and

collect the excess sale price pending hearing and final disposal of the writ petition and subject to the assessee furnishing bank .guarantee. The Assessing Officer taxed this excess sale price. In appeal the first appellate authority allowed the assessee to raise an additional ground and in the final hearing, the first appellate authority came to the conclusion that the excess sale price collected by the assessee over and above the levy price fixed by the Government, cannot be subjected to tax since the assessee did not get an unconditional and undisputed right to receive and appropriate the said excess. This order was confirmed by the Tribunal. Hence, this reference.

Scope of Section 35B :

5. Before coming to the findings, we would like to refer to Section 35B of the Income Tax Act as it stood at the relevant time. The said section concerns export markets development allowance. u/s 35B(1)(a) it is, inter alia, provided that where an assessee has incurred any expenditure referred to in Clause (b), not being in the nature of capital expenditure/personal expenses, such assessee shall be allowed a weighted deduction. Therefore, in this case, we are required to examine Clause (b) of Section 35B(1). Clause (b) contains items (i) to (ix). We are concerned with items (i), (ii) and (iii). Accordingly, Clause (b)(i) to (iii) is reproduced hereinbelow :

"35B. (1)--...

(b) The expenditure referred to in Clause (a) is that incurred wholly and exclusively on-

(i) advertisement or publicity outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business ;

(ii) obtaining information regarding markets outside India for such goods, services or facilities ;

(iii) distribution, supply or provision outside India of such goods, services or facilities, not being expenditure incurred in India in connection therewith or expenditure (wherever incurred) on the carriage of such goods to their destination outside India or on the insurance of such goods while in transit ;"

6. On reading items (i), (ii) and (iii) of Clause (b), it is clear that weighted deduction was admissible on certain types of expenditure incurred on specified activities. Under Clause (b)(i), weighted deduction was admissible on advertisement or publicity outside India in respect of the goods, services or facilities provided by the assessee in the course of its business. Similarly, under Clause (b)(ii), weighted deduction was admissible qua expenditure on obtaining information regarding markets outside India for goods, services or facilities mentioned in Clause (b)(i). If one reads item (i) with item (ii), the only requirement contemplated by the Legislature for admissibility of weighted deduction was that the activity stood carried- out outside India. If one contrasts items (i) and (ii) on the one hand with item (iii) of Clause (b) then one finds that

item (iii) deals with distribution, supply or provision of goods, services or facilities outside India and further that such expenditure should also be incurred outside India. Item (iii) of Clause (b) states that expenditure on distribution, supply or provision of goods, services or facilities should be out of India and further that expenditure incurred by the assessee should not be in India. Therefore, under item (iii) of Clause (b), there are two requirements, viz., that the activity of distribution, supply or provision should have taken place outside India, which is also the requirement in items (i) and (ii) of Clause (b). However, item (iii) imposes one more additional requirement, viz., that the assessee should have incurred the expenditure outside India. This second requirement is not there in items (i) and (ii) of Clause (b). It is for this reason that in every matter, one has to examine the activity in the context of each of the items in Clause (b). This is precisely what has been held in the case of Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., . In the said judgment, the Supreme Court has examined all the items (i) to (ix) of Clause (b) and after examining those items, it has held that some of the sub-clauses provide that the expenditure incurred in India shall not be allowed, whereas some of the sub-clauses do not insist on such requirement and, therefore, each of the sub-clauses should be applied after examining the nature of expenditure and the activity carried out by the assessee depending on the facts of each case. In our case, item (iii) of Clause (b) is not applicable. What is applicable is items (i) and (ii) because Tata Exports did the work of liaising and monitoring the turnkey project outside India. This is the finding given by the Tribunal. Out of the above three sub-clauses, it is only item (iii) of Clause (b) which insists on the aforestated dual requirement of activity being outside India and the expenditure not being incurred in India. The view which we have taken on items (i), (ii) and (iii) of Clause (b) is supported by the judgment of the Bombay High Court in the case of Commissioner of Income Tax Vs. Sahney Steel and Press Works (P.) Ltd., .

Findings :

(a) On question No. 1:

As stated above, the assessee has claimed weighted deduction u/s 35B on the guarantee commission charges paid by it to the Export Credit Guarantee Corporation amounting to Rs. 5,91,015. In the case of Commissioner of Income Tax Vs. Jaipur Metals and Electricals Ltd., , it has been held that the guarantee charges were payable by the assessee to the Export Credit Guarantee Corporation of India, a Government of India undertaking for getting information regarding credit worthiness and reputation of its foreign constituents and in the circumstances, the assessee was entitled to weighted deduction u/s 35B(1)(b) (ii). This judgment squarely applies to the facts of our case. Accordingly, this sub-question is answered in favour of the assessee and against the Department.

As regards the next sub-question which relates to commission paid to Tata Exports, the Tribunal has given a categorical finding of fact to the effect that the business deal was brought about through negotiations of Tata Exports. That, the

contract concerned was a turn-key contract and Tata Exports had monitored the work outside India and it is for that job that commission was paid at 5 per cent. on f. o. b. rate. The sale of plant and machinery was to take place outside India. In the case of Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., , it has been held that when a claim for weighted deduction is made, it is for the assessee to satisfy the Income Tax Officer that the expenditure falls under any of the sub-clauses of Clause (b) of Section 35B(1) of the Income Tax Act. That, in order to get the deduction, the assessee has to prove that the expenditure was incurred during the previous year wholly and exclusively for the purposes set out in Clause (b) of Section 35B(1). That, there cannot be any blanket allowance of the expenditure nor can there be any blanket disallowance and every case has to be discussed specifically and the expenditure must be found to be of a nature mentioned in one of the sub-clauses. That if the expenditure does not fall in any of the sub-clauses then it cannot be allowed as deduction. At this stage, it may be pointed out that Mr. R.V. Desai, learned senior counsel for the Department, argued before us that all the sub-clauses pertain to activities outside India and further that even the expenditure should be incurred outside India. He contended that both the tests must be fulfilled. He contended that in the present matter, Tata Exports was in India and payment was made by the assessee to Tata Exports by way of commission in India. He submitted that Tata Exports was only a middleman and, therefore, the commission paid to Tata Exports did not come within the ambit of any of the above sub-clauses. In this connection, he also placed reliance on the judgment of the Supreme Court in Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., , in which it has been held that payment of commission to the middleman will not fall u/s 35B(1)(b)(ii). In this connection, he also relied upon Section 35B(1)(b)(iii) which states that expenditure which qualifies for deduction in connection with distribution, supply or provision outside India of such goods, services or facilities. In view of Section 35B(1)(b)(iii) it was argued that not only should the expenditure be incurred on an activity outside India, but even the actual expenditure should be incurred outside India and in the absence of any one of the two tests, weighted deduction u/s 35B(1)(b) cannot be granted. We do not find any merit in this argument. In the case of Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., , a middleman approached the assessee in India for purchase of its goods for and on behalf of the foreign buyer, the assessee agreed to sell his goods to the middleman who obtained commission. In the circumstances, the Supreme Court concluded that Section 35B(1)(b)(ii) was not attracted. In the present case, as found by the Tribunal, commission was paid to Tata Exports for monitoring and doing liaisoning work outside India. The activity was carried out in the foreign country and not in India. Secondly, in the case of Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., , the Supreme Court has categorically laid down that the various sub-clauses of Clause (b) deal with different situations. That some of the sub-clauses provide that if the expenditure is incurred in India, it cannot be allowed. But, in some of the sub-clauses, this requirement is not

there. In the present case, we are concerned with Section 35B(1)(b)(i) and (ii), which only stipulates one condition, viz., that the expenditure should have been incurred on an activity of obtaining information regarding markets outside India and also advertisement/publicity outside India for goods, services and facilities, which the assessee provides in the course of its business. In the circumstances, the judgment of the Supreme Court in Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., has no application. Thirdly, one has to keep in mind Sub-clause (iii) in contradistinction to Sub-clauses (i) and (ii). Sub-clause (iii) specifically states that expenditure incurred on distribution, supply or provision outside India of goods, services or facilities, not being expenditure incurred in India, shall be entitled to weighted deduction. Such a condition is not contemplated by Sub-clause (i) or (ii). It is for this reason that the Supreme Court has held in Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., that some of the sub-clauses provide that if the expenditure is incurred in India, it cannot be allowed, but in some of the sub-clauses, this requirement is not there. We accordingly hold that as far as Sub-clauses (i) and (ii) are concerned, there is no requirement for the expenditure to have been incurred outside India. Lastly, it may be pointed out that the word "middleman" is of a very wide import. In the case of Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., , the assessee was approached by the middleman in India. The middleman approached the assessee in India for purchase of goods on behalf of the foreign buyer. Therefore, the judgment of the Supreme Court, on the facts, in Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., will not apply. We may also mention that in this case, Tata Exports had monitored the work outside India; that they did the work of liaising. Therefore, on the facts, the judgment in Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., will not apply. Accordingly, this sub-question is answered in favour of the assessee and against the Department.

Now coming to the next sub-question of question No. 1, it may be pointed out that the assessee claimed administrative expenses based on proportionate export sales. Out of the total sales, the percentage of export sales in each case was worked out and the percentage was calculated out of head office administrative expenditure, IMDA administrative expenses and supervision expenses amounting in all to Rs. 2,54,356. The Tribunal granted 75 per cent. of Rs. 2,54,356 as weighted deduction u/s 35B(1)(b)(i) to (viii). In the case of Commissioner of Income Tax, Delhi Vs. Stepwell Industries Ltd. and etc. etc., , the Supreme Court has held that the assessee was not entitled to this deduction. It was held that such administrative expenses do not come under any of the sub-clauses. To the same effect is the judgment of the Supreme Court in the case of Commissioner of Income Tax (CNTL), Ludhiana Vs. Hero Cycles Pvt. Ltd., Ludhiana, . In the circumstances, on this sub-question we hold that the assessee was not entitled to weighted deduction of 75 per cent. of Rs. 2,54,356 as such administrative expenses do not fall within any of the sub-clauses of Clause (b) of

Section 35B(1). Therefore, this sub-question is answered in the negative, i.e., in favour of the Department and against the assessee.

This completes our findings on the main question No. 1.

(b) On question No. 2 :

Question No. 2 has been quoted hereinabove. As per the question referred to us, the opinion sought is on a very limited point, viz., whether the Tribunal was right in ordering deletion of Rs. 29,983 u/s 37(2A) of the Income Tax Act on account of entertainment expenditure incurred by the assessee. The Income Tax Officer found that the assessee was entitled to deduction u/s 35B for entertainment expenditure. However, the Income Tax Officer invoked Section 37(2A) to limit that expenditure and, consequently, he added Rs. 29,983 to the income of the assessee. The assessee was not aggrieved by the order of the Income Tax Officer to the effect that the assessee was entitled to deduction u/s 35B. The assessee was only aggrieved by the second part of the order of the Income Tax Officer limiting the entertainment expenditure u/s 37(2A) of the Act. Therefore, the assessee went in appeal to the Commissioner of Income Tax (Appeals) only on a limited ground of the addition made by the Income Tax Officer u/s 37(2A) of the Act. The Department did not go in appeal against granting of weighted deduction by the Income Tax Officer u/s 35B and, therefore, to that extent, the finding of the Income Tax Officer became final. Before us, it was argued by learned counsel appearing on behalf of the Department that entertainment expenditure can never come u/s 35B of the Act and, therefore, the Tribunal erred in deleting the addition u/s 37(2A) of the Act. We would have examined this question raised by the Department if the Department had carried the matter in appeal to the Commissioner of Income Tax (Appeals). However, the Department did not prefer the appeal to the Commissioner of Income Tax (Appeals). Further, no such question has been referred to us. In the circumstances, we cannot now permit the Department to raise a new ground for the first time before us on the scope of Section 35B vis-a-vis entertainment expenditure. However, it is clear that Section 37(2A) can only apply if Section 37(1) is applicable. In the circumstances, question No. 2 is answered in the affirmative, i.e., in favour of the assessee and against the department.

(c) On question No. 3 :

Now, coming to question No. 3, we may point out that the assessee had filed a writ petition in the Bombay High Court challenging the decision of the Government fixing the levy price of sugar on the ground that the levy price was fixed arbitrarily and that it has been understated. Pending the hearing and final disposal of the writ petition the assessee was allowed to collect the excess price of sugar over and above the levy price fixed by the Government during the assessment year 1978-79, subject to the assessee giving a bank guarantee, which was enforceable in the event of the writ petition being dismissed. In the case of Commissioner of Income Tax Vs. Sharda Sugar Industries Ltd., , the facts

were as follows. The assessee was engaged in the business of manufacture and sale of sugar. The Government of India fixed the price of levy sugar at Rs. 153.39 per quintal, inclusive of excise duty. By another notification dated December 14, 1973, the Government revised the price and fixed the same at Rs. 155.30 per quintal. Aggrieved by these two notifications, the assessee filed a writ petition in the Allahabad High Court, challenging the notifications. The High Court passed an interim order, pursuant to which the assessee was allowed to realise Rs. 18.38 per quintal of levy sugar in excess of the price fixed by the notification. The High Court directed the assessee to retain the amounts as deposits, pending final decision in the writ petition and subject to the assessee furnishing a bank guarantee. The Income Tax Officer treated the amount of excess collection made by the assessee as "income". It was held by the High Court, under the above circumstances, that the assessee's right to receive payment was in dispute and, therefore, no income accrued to the assessee. Consequently, the right to receive the amount was contingent or inchoate. In our view, the judgment of the Bombay High Court in Commissioner of Income Tax Vs. Sharda Sugar Industries Ltd., squarely applies to the facts of this case. However, Mr. Desai learned counsel appearing on behalf of the Department, contended that in view of the judgment of the Supreme Court in the case of The K.C.P. Limited Vs. Commissioner of Income Tax, Bangalore, , the judgment of the Bombay High Court in the case of Commissioner of Income Tax Vs. Sharda Sugar Industries Ltd., stood impliedly overruled. We do not find any merit in this argument. In that matter, the assessee manufactured sugar. The levy price of the sugar was fixed at Rs. 120.30 per quintal by the Government. The assessee had challenged the order by filing a writ petition in the Andhra Pradesh High Court. On March 31, 1970, the High Court passed an interim order permitting the assessee to sell sugar at the rate of Rs. 131.01 per quintal plus excise duty. The writ petition was dismissed on February 18, 1971. With the dismissal of the writ petition, the interim order passed by the Andhra Pradesh High Court stood vacated. However, the Supreme Court found that under the interim orders of the High Court, no liability was cast on the assessee to refund the amount to the purchasers of sugar from whom the excess amounts were realised and that the only effect of the interim order was that in future, the assessee could no longer charge the price of Rs. 131 plus excise duty and, consequently, the Supreme Court found that the excess amount continued to remain with the assessee for all times. Therefore, on the facts of that case, the Supreme Court ruled that if a receipt is a trading receipt, it would be taxable as income. In fact, the Supreme Court itself has distinguished the case before it from the judgments of various courts including the judgment of the Bombay High Court in the case of Commissioner of Income Tax Vs. Seksaria Biswan Sugar Factory Pvt. Ltd., , in which it has been held that the assessee was permitted to collect excess amount pursuant to an interim order, which was subject to several conditions and, therefore, the collection made by the assessee at increased rate was pursuant to an inchoate right of the assessee and, therefore, the amount collected at a higher rate did not constitute income as the right to receive payment was itself in dispute and,

therefore, no income arose. In the circumstances, the judgment of the Supreme Court in The K.C.P. Limited Vs. Commissioner of Income Tax, Bangalore, has no application to the facts of this case. Consequently, we answer question No. 3 in the affirmative, i.e., in favour of the assessee and against the Department.

Conclusion :

Accordingly, the reference is partly allowed. No order as to costs.