

(1993) 03 RAJ CK 0038

In the Rajasthan High Court

Case No : Income Tax Reference No. 86 of 1982

Sunil Synchem Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 31-03-1993

Acts Referred:

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

Citation : (1994) 205 ITR 298 : (1993) 1 RLW 492 : (1994) 3 WLC 383

Hon'ble Judges : K.C. Agrawal, C.J;V.K. Singhal, J

Bench : Division Bench

Advocate : M.M. Ranka and J.K. Ranka, for the Appellant; G.S. Bapna, for the Respondent

Judgement

V.K. Singhal, J.—The Income Tax Appellate Tribunal, Jaipur Bench, Jaipur, has referred the following question of law arising out of its order dated April 28, 1981, in respect of the assessment year 1977-78, u/s 256(1) of the Income Tax Act :

"Whether, on the facts and in the circumstances of the case, the learned Tribunal was correct in law in disallowing inaugural expenses of Rs. 22,863 ?"

2. The brief facts of the case are that the assessee-company claimed expenses of Rs. 1,01,934 under the head "Inaugural expenses". The Income Tax Officer allowed a sum of Rs. 79,071 which were in the nature of advertisement expenses. The Income Tax Officer disallowed the expenditure to the tune of Rs. 22,863 and rejected the contention of the assessee that the said expenses were incurred for popularising the company's products or for carrying on the business. It was submitted that a number of distinguished guests including Ministers, press parties as well as future customers were invited on the inauguration day and the expenses had been incurred on lunch, dinner and for payment of air tickets, etc. The claim of the assessee was rejected on the ground that the expenses were in the nature of entertainment and are not statutorily admissible u/s 37(2B) of the Income Tax Act, 1961. Against this order, an appeal was preferred to the

Commissioner of Income Tax (Appeals) and it was submitted that the company was incorporated on February 5, 1973, and the occasion of inauguration was on April 23, 1976, and the expenses incurred were wholly and exclusively for the purposes of business. The Commissioner of Income Tax (Appeals) held that the cost of lunch, travelling expenses paid to the guests and other items were incurred actually before the conduct of business and were not for the purposes of business. The claim was rejected.

3. In the second appeal before the Income Tax Appellate Tribunal, it was submitted that the production commenced on March 15, 1976, and the inaugural ceremony was performed on April 23, 1976, and, therefore, the expenses should be considered wholly and exclusively for the purposes of business. The Income Tax Tribunal came to the conclusion that expenditure incurred for inviting Ministers and other persons and other expenditure at the time of setting up of the business was on the ground of commercial expediency and in order to facilitate the carrying on of the business of the assessee. It was held that the decision in *The Additional Commissioner of Income Tax, M.P. Vs. Kuber Singh Bhagwandas*, is not applicable as no nexus has been established by the assessee between the expenditure incurred and commercial expediency. Relying on the decision of the Bombay High Court in the case of *Acc-Vickers Babcock Ltd. Vs. Commissioner of Income Tax, Bombay City II*, it was held that the inaugural expenses are not allowable.

4. Learned counsel for the assessee has submitted that the list of the expenses, which has been given at pages 50 to 54 of the paper book includes only Rs. 7,941.25 which was the amount paid for lunch charges and, at the most, the said amount could have been disallowed. But, in respect of other expenses which are in the nature of tent charges, photographs, air tickets, tax charges, etc., the Income Tax Appellate Tribunal has erred in considering the same as hit by Section 37 of the Act.

5. Reliance was placed on the decision of the Bombay High Court in *Commissioner of Income Tax, Bombay City-I Vs. Merck Sharp and Dohme of India Ltd.*, wherein the expenditure incurred on the foundation-stone laying ceremony was held allowable as business expenditure. The expenditure incurred in printing additional articles of association and the legal expenses incurred in connection with the alteration of the articles of the company were held to be allowable as business expenditure.

6. Reliance has also been placed on *Delhi Cloth and General Mills Co. Ltd Vs. Commissioner of Income Tax*, . In this case, the company had started its production in the soda plant on March 16, 1963. The production in the calcium chloride plant started on December 26, 1963, and the poly-vinyl chloride plant started production on January 27, 1964. The inauguration was held by the company after the said plants had been set up. The inauguration was held some time in April, 1964. It was held that, with a view to gain publicity, the inaugural function was held by the company. Relying upon the decision of the Bombay High

Court in the matter of Acc-Vickers Babcock Ltd. Vs. Commissioner of Income Tax, Bombay City II, referred to above, the deduction was allowed.

7. It is submitted by Mr. Ranka, learned counsel for the assessee, that the decision of the Bombay High Court reported in Acc-Vickers Babcock Ltd. Vs. Commissioner of Income Tax, Bombay City II, has wrongly been interpreted by the Income Tax Appellate Tribunal. In that case, the claim of Rs. 2,78,619 was made in respect of the inaugural function. The Income Tax Officer rejected the claim on the ground that the company got an enduring benefit by incurring this expenditure and a sum of Rs. 9,128 + 27,318 = 36,446 would in any case fall under the category of entertainment expenditure for which the maximum limit admissible was Rs. 5,000 and since the maximum limit has already been exhausted, the entire claim was liable to be disallowed. The Appellate Assistant Commissioner held that the expenditure was incidental to the carrying on of the assessee's business and no asset of any enduring benefit came into existence. The Income Tax Appellate Tribunal held that the expenditure was incurred wholly and exclusively for the purposes of the assessee's business and. only Rs. 9,128 which was in respect of hotel bills for lodging and boarding of guests in the hotel and Rs. 27,318 being catering charges of guests, were by way of entertainment expenditure and the same could not be allowed u/s 37(2). Applying the analogy of this case, it was submitted that only the expenditure which fell in the category of entertainment should have been disallowed and the rest of the expenditure should have been allowed.

8. We have considered the matter. Under Explanation 2 to Section 37(2A), it has been provided that, 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 April 1, 1977, entertainment expenditure includes expenditure on provision of hospitality of every kind by the assessee to any person, whether by way of provision on 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. Section 37(2) specifically provides that no expenditure in the nature of entertainment expenditure shall be allowed in the case of a company exceeding the limit given thereunder. If there is specific exclusion, then the general provision shall not be applicable. Even if the amount is allowable as business expenditure, even from that expenditure, the amounts which are in the nature of entertainment expenditure are specifically governed by the restrictions imposed under Sub-section (2) of Section 37 of the Act. The expenditure which are on hospitality or provision on food or beverages have to be excluded subject to the restrictions contained in the sub-section. The inaugural function of a unit is exclusively for the purposes of business and the business normally comes into existence before the inauguration which is only a formal function. In the present case also, the inauguration function was held on April 23, 1976, whereas the production had started on March 15, 1976, and, therefore, the expenses which

are in the nature of inaugural function have to be allowed subject to the restrictions imposed by Section 37(2) of the Act, We are, therefore, of the opinion that the expenditure which is in the nature of entertainment expenditure alone has to be excluded therefrom.

9. Accordingly, it is held that the Income tax Appellate Tribunal was not correct in law in disallowing inaugural expenses to the extent of Rs. 22,863. The list contains the expenses which are in the nature of entertainment and the deduction can be restricted only in respect of entertainment expenses. The matter shall be considered afresh by the Tribunal and the deductions out of Rs. 22,863 shall be allowed to the extent of the expenses which pertain to the inaugural function and do not form part of entertainment expenses.

10. Consequently, the reference is answered in favour of the assessee and against the Revenue.

11. No order as to costs.