Supreme Court of India
Commissioner Of Income-Tax vs Patel Brothers & Co. Ltd, Etc. Etc on 9 May, 1995
Equivalent citations: 1995 AIR 1829, 1995 SCC (4) 485
Author: J S Verma
Bench: Verma, Jagdish Saran (J)

PETITIONER:
COMMISSIONER OF INCOME-TAX

Vs.

RESPONDENT:
PATEL BROTHERS & CO. LTD, ETC. ETC.

DATE OF JUDGMENT09/05/1995

BENCH:
VERMA, JAGDISH SARAN (J)
BENCH:
VERMA, JAGDISH SARAN (J)
SINGH N.P. (J)
MUKHERJEE M.K. (J)

CITATION:
1995 AIR 1829 1995 SCC (4) 485
JT 1995 (5) 364 1995 SCALE (3)650

ACT:

HEADNOTE:

JUDGMENT:

THE 9TH DAY OF MAY,1995 Present:

Hon'ble Mr.Justice J.S.Verma Hon'ble Mr.Justice N.P.Singh Hon'ble Mr.Justice M.K.Mukherjee Mr.B.B.Ahuja, Sr. Adv. Mr.B.S.Ahuja, Ms.A.Subhashini, Mrs.A.K.Verma, Mr.A.Subba Rao, Mr.S.K.Mehta, Mr.Dhruv Mehta, Mr.K.R.Nagaraja, Mr.M.G.Ramachandran, Mr.S.C.Patel, and Ms.Janki Ramachandran, Advs. with him for the appearing parties.

J U D G M E N T The following Judgment of the Court was delivered:

IN THE SUPREME COURT OF INDIA CIVIL APPELLATE JURISDICTION CIVIL APPEAL NOS. 1455-57 OF 1976 Commissioner of Income-tax .... Appellant vs.

Patel Brothers & Co. Ltd. .... Respondent [WITH S.L.P.(c) Nos. 1804-1805, 4257 of 1977, C.A. Nos. 6142 of 1990, 1075-1078 of 1976, S.L.P.(c) No. 1374 of 1977, C.A. No. 872 of 1976, S.L.P. (c) Nos. 1385 of 1977, 8865 of 1979, Tax Ref. Case Nos. 4-6 of 1979, S.L.P. (c) No.655 of 1977, C.A.No.5662 of 1995 (@ S.L.P.(c) No. 9255 of 1981), 12475 of 1985, C.A. No.2116 of 1977, C.A.No.5663 of 1995 (@ S.L.P.

(c) No. 2318 of 1979), C.A. Nos.33, 34-35, 36, 37, 38-39, 40, 41, 42, 43-44, 45 of 1978, 698 of 1977, S.L.P. (c) No. 478 of 1981, C.A.Nos.1322 of 1978, 3433-34 of 1991, 1850 of 1975, 831, 832, 1585-88, 2436, 1077, 1075-76, 1079, 1092, 1103-04, 1120 of 1977, 118 of 1984, 6137 of 1990, S.L.P.(c) No. 745 of 1978, C.A. Nos. 2519 of 1980, 1746 of 1984, Tax Ref. Case No. 3 of 1979, C.A. No.2900 of 1977, S.L.P.(c) No. 8357 of 1983, and C.A. Nos. 2397-98 of 1977, 1581-82 of 1977, and Tax Ref. Case No. 4 of 1977].

JUDGMENT J.S.VERMA.J.:

These appeals and the connected matters involve for decision the common question of law relating to the meaning of "entertainment expenditure" in Section 37(2A) of the Income-tax Act, 1961 (hereinafter referred to as "the Act") during the relevant assessment years. The decision of the Gujarat High Court in Commissioner of Income-tax, Gujarat vs. Patel Brothers & Co. Ltd., [1977] 106 I.T.R. 424 (Guj.), on this point is challenged by the revenue in these appeals by a certificate granted under Section 261 of the Act. The connected matters involve the same point. All cases relate to the period prior to 1.4.1976 from which date only Explanation 2 inserted in sub-section (2A) of Section 37 by the Finance Act, 1983 was applied retrospectively, even though sub-section (2A) was inserted w.e.f.1.10.1967 by Taxation Laws (Amendment) Act, 1967.

The material facts in these appeals illustrative of all connected matters, are these: The relevant assessment years are 1969-70, 1970-71 and 1971-72 of which the corresponding previous years ended on September 30, 1968, September 30, 1969 and September 30, 1970 respectively. The assessee, a limited company, claimed kitchen expenses of Rs.22,301/-, Rs.25,979/- and Rs.28,620/- respectively for these assessment years as expenses incurred for providing meals to its employees and its customers in the ordinary course of its business as customary trade usage. The Income-tax officer disallowed the expenditure to the extent of Rs.10,101/-, Rs.12,979/-, and Rs.17,305/- respectively corresponding to the expenses incurred for meals provided to the customers even though it was found that the meals were ordinary and not in any manner lavish. The assessee preferred an appeal to the Appellate Assistant Commissioner against the partial disallowance of this expenditure. The Appellate Assistant Commissioner held that the meals were bare necessity having regard to the nature of business and, therefore, the Income-tax officer was directed to grant that allowance. The matter then went in appeal to the Tribunal which confirmed the order of the Appellate Assistant Commissioner. At the instance of the revenue, the Tribunal referred to the High Court for its decision two questions of law, namely, (1) Whether, on the facts and in the circumstances of the case, the expenditure in question was in the nature of entertainment expenditure in law?

(2) Whether, on the facts and in the circumstances of the case, the expenditure in question would be allowable only to the limited extent of Rs.5,000/- under section 37(2A) of the Income-tax Act, 1961, for each of the assessment years under reference?

Identical questions of law were referred for all the three assessment years.

The High Court answered both the questions in the negative since it was found on the facts by the Tribunal that indisputably the upcountry constituents of the assessee came to Ahmedabad for the purpose of business with the assessee and having regard to the nature and magnitude of the business of the assessee, it would be necessary for the assessee to make arrangements to provide meals to them while in Ahmedabad for business with it, as it was not the revenue's case that the assessee had spent the money for throwing lavish parties for its constituents. It had been found that the expenditure was for serving ordinary meals as a bare necessity of the business. Accordingly, the references were answered against the revenue and in favour of the assessee. These appeals are by certificate against that decision. The same question is involved for decision in the connected matters.

There is a conflict in the view taken by the High Courts on the main question. The view taken by the High Courts of Andhra Pradesh, Rajasthan, Madhya Pradesh and Karnataka is the same as that of the Gujarat High Court. The contrary view has been taken by the High Courts of Allahabad, Punjab & Haryana, Patna and Kerala. The decision of the Delhi High Court in Commissioner of Income-tax vs. Rajasthan Mercantile Co. Ltd.etc. etc.,[1995] 211 ITR 400 is in line with the Gujarat view. The difference in the views taken by different High Courts has led to one set of decisions against the revenue and another set in its favour. This is how in this court some appeals and other matters are by the revenue while the rest are by the assessees. As earlier stated, all these matters relate to the period prior to 1.4.1976 and, therefore, the decision is to be based on sub-section (2A) of Section 37 of the Act minus Explanation 2 inserted later. We would refer to the two sets of decisions after mentioning the rival contentions and the view taken by us.

The contention of Shri B.B.Ahuja, learned counsel for the revenue is that all kinds of hospitality is entertainment and, therefore, the entire expenditure incurred under this head, even for serving ordinary meals as a bare necessity, falls under sub-section (2A) of Section 37; and the expression "entertainment expenditure" in sub- section (2A) must be construed to mean from the inception as defined in Explanation 2 to sub-section (2A) of Section 37, since Explanation 2 is merely clarificatory. It was urged that for this reason insertion of Explanation 2 only w.e.f.1.4.1976 is immaterial and the expression "entertainment expenditure" in sub-section (2A) of section 37 must be so construed even for the period prior to 1.4.1976. In reply, Shri Harish Salve, learned counsel for the assessee contended that purposive interpretation of the provision must be made. It was urged that the purpose was to curb the tendency of incurring lavish expenditure and not customary hospitality extended by offering ordinary meals as a bare necessity since the traditional meaning of every hospitality is not entertainment. It was urged that the finding in all these cases was that the allowance claimed was only in respect of the expenditure incurred in providing ordinary meals as a bare necessity and not any lavish food.

Section 37, to the extent material, is as under: "37. General. - (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

(2) Notwithstanding anything contained in sub-section (1), no expenditure in the nature of entertainment expenditure shall be allowed in the case of a company, which exceeds the aggregate amount computed as hereunder:-

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 ***            ***                ***
    *(2A)   Notwithstanding    anything
contained in  sub-section  (1)  or  sub-
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section (2), no allowance shall be made in respect of so much of the expenditure in the nature of entertainment expenditure incurred by an assessee during any previous year which expires after the 30th day of September, 1967, as is in excess of the aggregate amount computed as hereunder:-

*** *** *** Explanation 1.-.....

***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.

**(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."

(emphasis supplied) * Sub-section (2A) was inserted w.e.f. 1st October, 1967 by the Taxation Laws (Amendment) Act, 1967.

** Sub-section (2B) was inserted w.e.f. 1st April, 1970 by the Finance Act, 1970.

*** Explanation 2 was inserted by the Finance Act, 1983 retrospectively w.e.f. 1.4.1976.

In Sampath Iyengar's Law of Income Tax, 8th Ed., vol. 2, reference is made to circular No. 372 dated December, 8, 1983 of the Board, (1984) 146 ITR st 31, wherein the scope and effect of the above amendments was explained as under:-

"Provision for curbing avoidable or ostentatious expenditure in business or profession- Section 37 - 30.

Section 37 of the Income-tax Act provides for deduction in the computation of taxable profits of any expenditure other than expenditure of the nature described in sections 30 to 36 and section 80VV, or expenditure in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business or profession carried on by the taxpayer. With a view to curbing certain categories of avoidable or ostentatious expenditure by assessees carrying on business or profession, the Finance Act has made certain amendments to section 37 of the Income-tax Act. The substance of these amendments is explained in paragraphs 31 to 34 hereunder.

Entertainment expenditure.- 31.1 For the removal of doubts regarding the scope of the expression "entertainment expenditure", the Finance Act has inserted a new Explanation for the purposes of sub-section (2A) of section 37 and also sub-section (2B) of that section as that sub-section stood before 1 April, 1977. The Explanation clarifies that "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, usage or trade. However, expenditure incurred in providing food or beverages by an employer to his employee in office, factory or other place of their work will not be regarded as entertainment expenditure.

31.2 This amendment takes effect retrospectively from 1 April, 1976, and will, accordingly, apply in relation to the assessment year 1976-77 and subsequent years.

31.3 Under the existing provisions of section 37(2A) of the Income-tax Act, deduction in respect of expenditure on entertainment is subject to certain limits calculated with reference to the quantum of profits as under:-

(at page 2255) In the Income-tax Act, 1961, Chapter IV contains provisions relating to computation of total income wherein Section D containing Sections 28 to 44D pertains to profits and gains of business or profession. Section. 28 specifies the income which is chargeable to income tax under the head "profits and gains of business or profession". Section 29 says that the income referred to in Section 28 shall be computed in accordance with the provisions contained in Sections 30 to 43D. Sections 30 to 36 provide for deduction of certain expenditures incurred for the purposes of business or profession. Then comes Section 37 which contains the general provision permitting deduction of "any expenditure ..... laid out or expended wholly and exclusively for the purposes of the business or profession ..... in computing the income chargeable under the head "profits and gains of business or profession", by sub- section (1), sub-section (2) therein begins with a non-obstante clause to exclude from the ambit of sub-section (1) the entertainment expenditure by saying that "no expenditure in the nature of entertainment expenditure shall be allowed" in the case of a company which exceeds the specified amount. Similar provision is made in sub-section (2A) for any assessee. In other words, the general provision in Section 37 is that any expenditure laid out or expended wholly or exclusively for the purposes of the business or profession shall be allowed but no expenditure in the nature of entertainment shall be allowed as stated in sub-sections (2) and (2A) in excess of the amount specified. For claiming deduction of the business expenditure according to the

general rule, the test of commercial expediency is applied but exclusion is made of any expenditure which is in the nature of "entertainment expenditure". Without anything more, it means that an expenditure incurred for commercial expediency or usage of the trade is a permissible deduction unless it partakes the character of an entertainment expenditure, in which case the permissible limit is specified. The controversy in the present case relates to the meaning of "entertainment expenditure" in sub-section (2A) of Section 37 before insertion of Explanation 2 therein.

The question involved in these matters relates to deduction of expenditure incurred in providing ordinary meals and refreshments to the outstation customers according to the customary hospitality and trade usage satisfying the general test of commercial expediency.

Generally, "entertainment expenditure" is an expression of wide import. However, in the context of disallowance of "entertainment expenditure" as a business expenditure by virtue of sub-section (2A) of Section 37, the word "entertainment" must be construed strictly and not expansively. Ordinarily, "entertainment" connotes something which may be beneficial for the mental or physical well being but is not essential or indispensable for human existence. A bare necessity, like ordinary meal, is essential or indispensable and, therefore is not "entertainment. If such a bare necessity is offered by another, it is hospitality but not entertainment. Unless the definition of "entertainment" includes hospitality, the ordinary meaning of "entertainment" cannot include hospitality. For this reason, the expenditure incurred in extending customary hospitality by offering ordinary meals as a bare necessity, is not "entertainment expenditure" without the aid of the enlarged meaning given to the words by Explanation 2 inserted w.e.f.1.4.1976. The definition in Explanation 2 is not the ordinary meaning of the words "entertainment expenditure", but the enlarged meaning given for the purpose of the Act w.e.f.1.4.1976.

The object of sub-section (2A) is to disallow any lavish expenditure in the form of business expenditure. This is obvious from the several amendments made in the provision from time to time. It is so understood even in the circular issued by the Board. The object of the provision clearly is to allow deduction of the essential business expenditure incurred due to commercial expediency and according to the trade usage excluding the lavish expenditure. The dispute in the present cases relates only to the amount which has been held to be essential business expenditure of this kind incurred in providing ordinary meals as bare necessity. In the view taken by us, such expense did not come within the meaning of "entertainment expenditure" prior to 1.4.1976 when Explanation 2 was brought in by a retrospective amendment made in 1983 of sub-section (2A) of Section 37. The finding of fact in all cases, therefore, satisfies this test to allow deduction of the expenditure incurred by each assessee and claimed under this head for the period prior to 1.4.1976.

Sub-section (2A) was inserted w.e.f. 1st October, 1967 by the Taxation Laws (Amendment) Act, 1967 and Explanation 2 inserted therein by Finance Act, 1983 retrospectively w.e.f. 1.4.1976 while sub-section (2B) was inserted w.e.f. 1st April, 1970 by the Finance Act, 1970. As earlier stated, these cases relate to the period prior to 1.4.1976 from which date Explanation 2 to sub-section (2A) was inserted retrospectively. We have, therefore, to construe sub-section (2A) as it existed without the Explanation 2. The meaning of Explanation 2 is quite clear and it has enlarged the meaning to widen the tax net.

Learned counsel for the revenue contended that Explanation 2 is clarificatory and, therefore, even without Explanation 2 the provision must be understood and construed in the same manner. It appears to us that insertion of Explanation 2 made retrospectively but restricted in its application only w.e.f.1.4.1976 is itself an indication that its application prior to 1.4.1976 is excluded. If Explanation 2 was merely clarificatory of the ordinary meaning, as contended by learned counsel for the revenue, it was unnecessary to restrict its restrospective application in this manner only from 1.4.1976. The construction we have made of sub-section (2A) of Section 37 as it existed during the relevant assessment period cannot, therefore, be affected by Explanation 2 to sub-section (2A) which was inapplicable during the relevant period.

In our opinion, the construction we have made of the provision as it existed during the relevant period flows not merely from the language of the provision but also matches with the object thereof. It means that the expenditure incurred by the assessees in providing ordinary meals to the outstation customers according to the established business practice, was a permissible deduction inspite of sub-section (2A) of Section 37, to which the assessees were entitled in the computation of their total income for the purpose of payment of tax under the Income-tax Act, 1961 during the relevant period prior to 1.4.1976.

We shall now refer briefly to the conflicting decisions of the several High Courts on the point. Amongst the decisions in favour of the revenue is Brij Raman Dass & Sons vs. Commissioner of Income-tax. Lucknow. [1976] 104 I.T.R. 541 of the Allahabad High Court which has been referred and followed in subsequent decisions of other High Courts taking the view in favour of the revenue. In this line of cases are the decisions of the High Courts of Punjab & Haryana, Patna and Kerala. The other line of cases wherein the view taken is in favour of the assessee are the decisions of the HIgh Courts of Gujarat, Andhra Pradesh, Madhya Pradesh, Rajasthan and Karnataka. The main decision of the Gujarat High Court is Commissioner of Income-tax, Gujarat II vs. patel Brothers & Co. Ltd., [1977] 106 I.T.R. 424 which has been referred and followed in the later decisions in that line.

We would first deal with the decision of the Allahabad High Court reported in [1976] 104 I.T.R. 541 which is under appeal in Civil Appeal No. 1850 of 1975 and the decision of the Gujarat High Court reported in [1977] 106 I.T.R. 424 which is under appeal in Civil Appeal Nos. 1455-57 of 1976. In Brij Raman Dass & Sons (supra), it was held that sub- section (2A) of Section 37 is not an independent provision but is a proviso to sub-section (1) of section 37 since the expenditure falling under sub-section (2A) must necessarily come within sub-section (1). Thereafter, while considering the meaning of "entertainment" in this context, it was held as under :-

> " ..... What we have to see is as to what is the meaning of the word "entertainment" for purposes of section 37(2A) of the Act. In the Income-tax Act, this word has not been defined and we will have to give it its general meaning. An "entertainment expenditure" would, in our opinion, include all expenditures incurred in connection with business on the entertainment of customer and constituents. The entertainment may consist of providing refreshments as in this case or it may consist of providing some other sort of entertainment.

> In Bentleys, Stokes & Lowless v. Beeson (H.M.Inspector of Taxes), [1952] 33 TC 491 (CA), a firm of solicitors incurred expenses in entertaining clients. The entertainment consisted of providing lunch to the clients. It was held that expenditure was incurred wholly and exclusively for purposes of business and was an allowable deduction. The same is the position in the instant case. The petitioner has been providing to its customers refreshments and this constitutes an expenditure in the nature of entertainment expenditure". the entire expenditure would have been allowed but for the amendment introduced by section 37 (2A) which restricts the allowance of such an expenditure to a maximum limit of Rs. 5,000/-"
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> (at page 544) There is no more discussion on the point in this decision.

On the other hand, the Gujarat High Court in Patel Brothers & Co. Ltd. (supra) took a different view. In this decision, certain broad tests or guidelines have also been indicated to determine the nature of expenses allowed as entertainment expenses. In our opinion, that exercise is unnecessary since the broad test indicated by us is the only thing which can safely be indicated and the determination of the question in each case is one of fact. The conclusion on the basis of the finding of fact recorded therein was stated thus :

> "..... The Tribunal has agreed with the Appellate Assistant Commissioner who has found that it was customary for the assessee due to very long-established tradition that farmers who came to deliver the goods, i.e., cotton, groundnuts, rice, pulses, were given meals from the kitchen run by the assessee and if the assessee failed to give this normal courtesy, it apprehended that the farmers might offer their produce to other competitors in the field of the assessee and the assessee would lose the goods. The Appellate Assistant Commissioner has also found that the expenditure was for serving ordinary meals to the employees as well as to the farmer customers and they were not such which entertained or amused the guests since the assessee provided served meals as a bare necessity of the business. In that view of the matter, therefore, these references must be rejected and we answer the questions referred to us in the negative and against the Commissioner,....."
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> (at page 442) This conclusion of the Gujarat High Court on the finding of fact recorded by the Tribunal is consistent with the view we have taken and, therefore, we uphold the same for the reasons given by us which are sufficient to sustain the ultimate view. We may observe that the wide observations and the elaborate guidelines given in the Gujarat decision which are in excess of the broad test indicated by us and not necessary to support the conclusion, are unnecessary for the decision and, therefore, affirmance of the conclusion reached in the Gujarat decision should not be constured as an affirmance of the wide observation therein.

We may now refer to the decision of the Delhi High Court in Commissioner of Income-tax vs. Rajasthan Mercantile Co. Ltd. etc. etc., [1995] 211 ITR 400. The true effect of Explanation 2 added in sub-section (2A) of Section 37 of the Act has been correctly understood therein as under.

> "The declaration and the clarification involved in Explanation 2, are only for the purposes of assessments with effect from April 1,1976. This provision widens the concept of "entertainment expenditure" by including in its scope such of the expenditures which are otherwise traditionally understood as routine business expenditures incurred in connection with "business-hospitality". Therefore, the widened meaning cannot be extended to past periods when the amended Explanation 2 was not in operation."
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> (at page 416) We approve the above view which accords with the construction made by us of the provision.

In the view we have taken, the contrary view of the Allahabad High Court in Brij Raman Dass & Sons, [1976] 104 I.T.R. 541, cannot be accepted to be correct and so also the decisions of the different High Courts which have taken the same view. Accordingly, the decision of the Allahabad High Court and the other decisions of different High Courts taking that view are to be treated as overruled.

Consequently, all these matters are decided in favour of the assessees and against the revenue with the result that the appeals of the assessees are allowed while the appeals, SLPs and Tax References by the revenue are dismissed. No costs.