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Court : Income Tax Appellate Tribunal ITAT Hyderabad

Decided On : Sep-30-1983

Reported in : (1984)7ITD324(Hyd.)

Judge : S Rajaratnam, K Thanikkachalam, J Member

Appellant : Mopeds India Ltd.

Respondent : inspecting Assistant

Judgement :

1. This is an appeal filed by Mopeds India Ltd. of Tirupathi, objecting to the order of the Commissioner (Appeals) for the assessment year 1979-80.

2. The assessee is a company engaged in manufacture of mopeds and spare parts for mopeds. The first objection relates to addition of Rs. 3,85,000 made by the IAC towards revaluation of closing stock. The assessee, admittedly, was taking into consideration the proportionate overheads for 'administrative expenses, selling expenses and interest' in stock valuation till the end of the immediately preceding year. This method is described as 'total cost' method and the opening stock has, therefore, been valued by such method. The method to which the assessee changed is known as 'works cost' method where the administrative overhead was not reckoned. It is the assessee's case that it is a bona fide change inasmuch as it is considered preferable to write off the administrative overheads incurred in the same year instead of attributing a part of it to closing stock. The first appellate authority also recognised the assessee's claim on merits. In fact, the

assessee has shown that international accounting standards also recommend such a method. The first appellate authority had only remitted the question back to the ITO for verification as to whether the assessee had included direct labour, factory overheads, etc. It is the assessee's case that it had included these items as works overheads. If so, we cannot have any complaint with the direction of the first appellate authority that the assessee's claim should be accepted after verification. However, the first appellate authority went further and found that the opening stock also should be similarly revalued. It is the assessee's case that it is not necessary to do so.

There has been no suggestion that the assessee has changed its method with a view to manipulate its profits. In fact, the facts clearly show that the assessee has shifted to better and approved method of closing stock valuation. It is the assessee's claim that the change is made on a permanent basis and then the assessee would continue to value the closing stock hereafter by the new method. As pointed out by the first appellate authority, there is some distortion of profits for this year because of the change in method. But, his solution to revalue the opening stock would necessitate modifying the earlier assessment so that closing stock of immediately preceding year is made to conform to such revised valuation distorting the income of that earlier year or further modifying the opening stock of that year as well and so on.

This will mean more revisions indefinitely in order to ensure uniformity. The opening and closing stocks of earlier years had been valued in the same manner and, hence, disturbance of any earlier year is unnecessary. If the earlier year's closing stock is allowed to remain as it is, while disturbing the opening stock of this year alone, it would be unfair and inconsistent. Under such circumstances, it is considered permissible not to disturb the opening stock. We have the authority of the decision of the Calcutta High Court in the case of British Paints India Ltd. v. CIT [1978] 111 ITR 53, where it was observed that the Tribunal was not justified in rejecting the method of valuation of the goods-in-process and the finished products on the basis of the cost of raw material adopted by the assessee, since the method followed by the assessee was a recognised method, The assessee in this case had been following not merely the valuation of closing stock with

reference to raw material consumed, but also attributing direct labour and works overheads. If the assessee's departure from the method of accounting hitherto followed was a casual one, or was not bonafide, or the shift to the new system was not for a better or more scientific one, or was made merely with a view to escaping liability to tax, or for any such other consideration, the ITO would be justified in rejecting the change in method altogether. In this case, the first appellate authority upheld the change, but has asked that the opening stock should be revalued in the same manner-Sarupchand v. CIT [1936] 4 ITR 420 (Bom.), Indo-Commercial Bank Ltd. v. CIT [1962] 44 ITR 22 (Mad.), Forest Industries Travancore Ltd. v. CIT [1964] 51 ITR 329 (Ker.), CIT v. Eastern Bengal Jute Trading Co. Ltd. [1978] 112 ITR 575 (Cal.), CIT v. Rajasthan Investment Co. (P.) Ltd. [1978] 113 ITR 294 (Cal.) and Reform Flour Mills (P.) Ltd. v. CIT [1978] 114 ITR 227 (Cal.) are all decisions rendered by different High Courts taking the uniform view that it is open to the assessee to make a change in the accounting method provided he satisfies the revenue on proper evidence that he has in fact changed the regular basis of accounting bonafide and not casually. No doubt, in Sarupchand's case (supra), it was pointed out by Beaumont, Chief Justice that too frequent a change may disentitle the assessee from changing his method. Even granting that it is open to the ITO to impose conditions before permitting such a change, the direction of the first appellate authority, which has the effect of reducing the opening stock which was accepted as closing stock of the preceding year, could hardly be taken as a reasonable condition, unless, of course, he had also directed and the revenue had accepted a consequential relief by revaluation to the same extent of the closing stock of the earlier year as well. After considering the decisions, we do not find any justification for the further direction of the first appellate authority to revalue the opening stock as well.

His first direction alone for not changing the assessee's valuation of closing stock subject to verification of the assessee's claim that it has valued the closing stock in the manner claimed by it should stand.

Hence, the assessee's ground in this regard will be treated as allowed.

3. to 5. [These paras are not reproduced here as they involve minor issues.] 6. The next dispute relates to the disallownce of provision for minimum wages to the extent of Rs. 97,991 out of a total provision of Rs. 2,13,000. On the basis that the assessee-company was doing business falling under the category of automobile industry, the assessee made a provision to the extent of Rs. 2,13,000. For the view that the assessee was engaged in an automobile industry, the assessee had the authority of the view of the Labour Commissioner by his memorandum dated 26-6-1978. In fact, he was the person who was one of the authorities for enforcing the payment of minimum wages fixed by the notification dated 20-5-1976. There is no doubt that this notification applied to the assessee. All the same, the assessee was subsequently able to negotiate with the workers under an agreement that the assessee's business was not an automobile industry and was able to satisfy the workers that the additional minimum wages payable were only to the extent of Rs. 97,991. The difference was also credited back to the profit and loss account for the year ending 30-6-1980. It was the assessee's case that at the time of making the provision it was anticipated that the assessee would be liable to pay Rs. 2,13,000.

Subsequent events, it was claimed, cannot justify any part of the disallowance. The authorities did not accept this claim. After all, they felt that the actual subsequent payment represents a better evidence for the amount payable than the provision made on the basis of the Labour Commissioner's letter. According to the first appellate authority, the opinion of the Labour Commissioner cannot be treated as a judicial order so as to justify the treatment of this provision as a liability.

7. We have carefully considered the arguments of both sides. We are of the view that the assessee's claim that it anticipated this amount of Rs. 2,13,000 as a liability for additional minimum wages payable under the notification as interpreted by the Labour Commissioner stands uncon-tradicted. The fact that the assessee was able to salvage part of the liability does not mean that the assessee could be credited with hindsight at the time of closing of the accounts. The opinion of the Labour Department could not, in our opinion, be brushed aside in the manner done by the first appellate authority. Under the circumstances, the assessee succeeds on this claim. This amount of Rs. 97,991 will be allowed as a deduction.

It is needless to point out that the amount written back to the accounts when the actual liability fell short of the provision has to be taxed in the year in which the negotiation was completed, We empower and authorise the ITO to bring it back to taxation in case he had not done so consistent with the view taken by him in the assessment.

8. The next contention relates to the disallowance of 15 per cent of Rs. 1,80,055 being part of the amount paid as overriding amount to distributors. Though the assessee seems to contest the entire disallowance under Section 37(3 A) of the Income-tax Act, 1961 ('the Act') on the grounds, it is clear that it has now confined its objection to the disallowance of 15 per cent of Rs. 1,80,055 only. The total amount paid was Rs. 10,01,382. Section 37(3A) authorises the disallowance of 15 per cent of the adjusted expenditure where such aggregate expenditure exceeds half per cent of the turnover or gross receipts of the business or profession, such adjusted expenditure being the aggregate expenditure incurred by the assessee on advertisements, publicity and sales promotion in India as reduced by any disallowance or any part thereof under Section 37(3A) vide provision introduced by the Taxation Laws (Amendment) Act, 1978. with effect from 1-4-1979.

Hence, this provision is in force for this year. The assessee paid an amount of Rs. 1,80,055 as incentive bonus under 'Multi-stage Incentive Scheme' formulated by it. A minimum target is fixed depending upon the potential of the area and Rs. 10 per vehicle is given as an incentive to the dealer. If the offtake is more than the prescribed minimum, there is an enhanced rate. This incentive bonus was in addition to dealer's commission. While the ITO considered this and some other items as part of sales promotion expenses, the first appellate authority considered that this amount of Rs. 1,80,055 alone should be considered as sales promotion expenses. In this view, he reduced the disallowance made by the ITO to 15 per cent of Rs. 1,80,055. The assessee is not satisfied with this relief.

9. We have considered the question as to what constitutes expenditure on 'advertisement, publicity and sales promotion' in IT Appeal Nos.

1027 and 1029 (Hyd.) of 1982 dated 29-4-1983 to which both of us were parties. We have observed as under in that order : 'Advertisement' according to Concise

Oxford Dictionary is 'public announcement; (esp. in newspapers, or posters, by television, etc.); advertising... 'Advertise' has been similarly defined to mean 'generally or publicly known; (esp.) describe (goods), publicity with a view to increasing sales; notify;...'. Meaning assigned in other dictionaries are not different. Though dictionaries need not always be the sole or a reliable guide on such matters, we find that the meaning assigned by the dictionaries is the one assigned in commercial and popular parlance. The word 'advertisement' has not been defined in the statute and, hence, we will be justified in assigning it. the same sense as is given in the commercial world. Advertisement is publicity to the world at large with a view to attract political customers. It is mainly addressed to future customers though it may also be intended to retain present customers in a general sense. There is no quid pro quo between the outlay and the result.

In the assessee's case, the payment is nothing more than an additional compensation of the same nature as selling commission which has been allowed and has not been treated as sales promotion expenses. A selling agent's commission, in our opinion, can never be treated as an outlay on advertisement, publicity or sales promotion. This is part of selling cost. If it is allowed directly as a discount to the buyer, it is an abatement in the price. Even if the goods are routed through a distributor, or a selling agent, the commission (and bonus) is an expenditure in the nature of sale commission which, in our opinion, is totally distinct from expenditure on advertisement, publicity or sales promotion. The expenditure contemplated under Sec-section (3A) of Section 37 is an expenditure on appeal to the potential customers at large and not a remuneration for service rendered to the assessee. In an advertisement outlay, there is no quid pro quo. A person who sees the advertisement may or may not buy the product advertised. Our interpretation is also buttressed by the fact that the various items which are exempted under Sec-section (3B) such as advertisement in a small newspaper, expenditure for maintaining an office for the purposes of advertisement, payment of salary to advertisement staff, expenditure on participation in press conference, sales conference, trade convention, trade fair or exhibition, expenditure on publication of pamphlets, etc., indicate the type of expenditure that is contemplated.

Selling expenses by way of remuneration to agents and distributors, in our opinion, could have never been in contemplation of the disallowance which was introduced in the statute with a view to curbing ostentatious and excessive advertisement outlay at the expense of the exchequer. We, therefore, find no justification for invoking Section 37(3A) in the assessee's case with reference to the item of Rs. 1,80,055 as confirmed by the first appellate authority. The assessee's appeal succeeds on this point.

10 and 11. [These paras are not reproduced here as they involve minor issues.] 12. The last ground relates to claim for provision of gratuity to the extent of Rs. 2,18,672. The assessee had made a total provision of Rs. 2,24,540 and had paid Rs. 5,868 as gratuity to two employees who had retired during the year. It appears that an amount of Rs. 1,50,000 was a transfer from Mopeds India Gratuity Fund during the year while the further amount of Rs. 68,672 was debited to profit and loss account.

The entire amount was considered to be not admissible on the simple ground that Section 40A(7) of the Act barred any such allowance as the gratuity fund was approved by the Commissioner only on 24-10-1978 though the application was dated 16-10-1978. He had also given some other ground as to why the entire amount could not be allowed. The assessee had claimed that it was a provision on the basis of actuarial valuation and that for the year under consideration there was a gratuity fund in existence. The ITO noticed that the gratuity fund has not yet been accorded recognition by the Commissioner and that he would allow the expenditure under Section 155(13) of the Act, on recognition.

By the time the appeal came up, recognition was available but it was found that the assessee itself had applied for recognition on 16-10-1978. The fund itself, it is claimed, was created on 30-3-1978.

It was pointed out on behalf of the revenue that the assessee had not applied for recognition during the year and that the recognition clearly stated that it was with effect from 24-10-1978 which is after the end of the accounting year. The ITO seems to have gone by the impression that if the fund was in existence during the accounting year, subsequent recognition is good enough especially in view of

Section 155(13) which enables the ITO to allow the provision on such recognition. We are not able to say that his view was incorrect in view of the fact that the Madras Bench of this Tribunal, in the case of Palani Andavar Mills [IT Appeal No. 479 of 1980], accepted this view and this was followed in another case in Deccan Sugar & Bakari Co. Ltd. [IT Appeal No. 1426 of 1982] by 'B' Bench at Hyderabad by order dated 17-5-1983. Even creation of the fund subsequent to the year was considered permissible for the assessment year 1976-77 by this Tribunal in IT Appeal No. 773 (Mad.) of 1981 dated 9-1-1982. Orient Pharma (P.) Ltd. v. ITO [1983] 16 TTJ (Mad.) 423. Section 40A(7) bars a provision when there is no recognised fund. If there was a provident fund in existence as at the end of the year, we do not see how a later recognition could debar the assessee's right. It necessarily takes some time for the authorities to examine the claim. Similarly, the assessee also may take some time to file a formal application after the fund has been constituted. As long as the fund as constituted has been recognised, we are of the view that both the spirit and the letter of the law under Section 40A(7) should be taken as having been satisfied.

The assessee, it would appear, would prima facie be eligible for the allowance even on the basis of what the ITO has stated in the order if the assessee's claim was correct, viz., that there was a gratuity fund in existence as at the end of the accounting year. The first appellate authority has also raised some doubt that the entire amount is not a provision since the amount of Rs. 1,50,000 would appear to be an amount which has not been charged to the profit and loss account during the year but only a transfer. If this amount had not been allowed as a deduction in any earlier year, it would appear that even this amount would be entitled to deduction. At any rate, since the ITO himself had promised consideration after recognition, we think the ends of justice will be met if the entire claim is remitted back to the ITO to decide the issue afresh in the view that if the fund had been constituted prior to the end of the accounting year, it makes no difference to the assessee's claim merely because such fund has been recognised only subsequently. The appeal on this point will be treated as allowed.

13. In the result, the appeal is partly allowed in the manner indicated in the earlier paragraphs.