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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Oct-29-2004

Reported in : (2006)101ITD85(Mum.)

Judge : M Shrawat, P Kumar

Appellant : intersil India Limited

Respondent : Additional Commissioner of

Judgement :
1. This is an appeal filed by the assessee and it seeks to challenge CIT(A)'s order dated 13^th February 2000, in the matter of assessment under Section 143(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act'), on the three grounds, namely - (a) that the CIT(A) erred in confirming the disallowance of 'study and training expenses of Rs. 11,50,438; (b) that the CIT(A) erred in confirming the disallowance of vehicle expenses of Rs. 76,316; and (c) that the CIT(A) erred in confirming the disallowance of Rs. 22,800 in respect of 'entertainment expense'. We will take up these three grievances one by one.

2. As far as disallowance of disallowance of 'study and training expenses' of Rs. 11,50,438 are concerned, the material facts are like this. During the course of scrutiny assessment proceedings, the Assessing Officer noticed that the assessee has claimed a deduction of Rs. 11,50,438 on account of study and training expenses. It was also noted that the said expense was incurred for sponsoring cost of management education abroad in respect of Shri Rishav Mehra, son of the

Managing director. The Assessing Officer also took note of agreement dated 17^th July 1995 whereby Shri Mehra was under an obligation to serve the company for a minimum period of two years upon completlon of his education abroad. The Judicial precedents cited before the Assessing Officer, i.e. Jhalani Holding Pvt. Ltd. v. ITO 42 TTJ 116 and Hindustan Hosiery Industries v. ITO 5 ITD 349 were considered by the Assessing Officer. As for Jhalani Holdings (supra), the Assessing Officer distinguished the facts of the case by observing that in the said case, son of the Managing Director was already inducted into the assessee company when he left for foreign studies abroad, whereas in the present case Shri Rishav Mehra had not joined the assessee company at the point of time of leaving for education abroad. As for Hindustan Hosiery's case (supra), it was noted that the said Tribunal's decision has been reversed by Their Lordships of Hon'ble Bombay High Court in the case of CIT v. Hindustan Hosiery Industries 209 ITR 383. In the backdrop of these observations, the Assessing Officer came to the conclusion that "assessee's claim of Rs. 11,50,438 in respect of study of the MD's son is held as an expenditure of personal nature and the same is disallowed and added back to the assessee's total income".

Aggrieved by the conclusions so arrived at by the Assessing Officer, assessee carried the matter in appeal before the CIT(A), but without any success. The assessee is not satisfied an is in second appeal before us.

3. We have heard Shri Anil Mehta, learned Counsel for the assessee, and Shri O.P. Sharma, learned Departmental Representative, at considerable length. We have also carefully perused the orders of the authorities below and other material on record, and we have duly considered factual matrix of the case as also the applicable legal position.

4. In the case of Hindustan Hosiery Industries v. ITO 5 ITD 349, a co ordinate bench of this Tribunal was in seisin of a materially identical situation. The assessee firm in that case was engaged in the business of manufacture and sale of hosiery goods. One of the partners of the said concern was sent to USA for further education in business management. The expenditure of Rs. 36,786 incurred on such foreign education of the partner was claimed as a deduction by

the assessee firm, inter alia, on the ground that the said expenditure was for the benefit of the assessee firm inasmuch as application of business management techniques in a competitive atmosphere would give assessee firm a clear edge in successfully carrying out the business. This claim was rejected at the assessment and first appeal stage, but, on the matter being carried in the second appeal before this Tribunal, the claim was allowed for the following reasons: The expenditure under consideration incurred for the training of one of young partners in the techniques of modern business management has been definitely incurred wholly and exclusively for the purposes of business. The mere fact that it has incidentally benefited the partner himself is immaterial.

The knowledge that the partner was adjoining by his studies abroad was such that it would definitely benefit the business carried on by the assessee firm, and, so, the expenditure in acquiring that knowledge had a direct nexus with the business carried on by the firm. This is evident from the increase in sales in the subsequent years. As a matter of fact, the benefit arising out of the acquisition of aforesaid knowledge by the partner ensured to the assessee firm as the partner is still working with the said firm even today.

The stand so taken by the Tribunal was, however, not approved by Their Lordships of Hon'ble Bombay High Court, who, in the judgment reported in 209 ITR at page 383, observed as follows: We have carefully gone through the order of the Tribunal. It is not possible to accept the submission of the learned Counsel for the assessee that the expenditure in question was incurred in relation to the business of the assessee firm. We have no hesitation in recording our conclusion that to the fact that the expenditure incurred by the assessee has no nexus with the business of the assessee. We agree with the conclusion arrived at by the ITO and the CIT(A).

It is thus clear that Hon'ble Bombay High Court has rejected the school of thought that merely because the assessee would also benefit from the foreign education being received by the partner would be a reason good enough to hold that the expenditure so incurred on the foreign education as a business expenditure. Their Lordships have also rejected the contention that the expenditure in acquiring that knowledge had a direct nexus With the business carried on by the firm which could be evident from the results in the subsequent years and the fact that person so receiving the education actually worked with the assessee in subsequent years. The facts of the case before Their Lordships were much better inasmuch as the person, whose education costs were met, was a partner, whereas, in the present case he is son of the Managing Director and without any formal status in the assessee company.

5. In the case of Sakal Papers Private Limited v. CIT 114 ITR 256, Hon'ble Bombay High Court was in seisin of a case where a company in which husband and wife were the shareholders and directors and this company sent daughter of the two directors, namely Miss Parulekar (P.in short), for further education in the USA. P had worked in the company for five years, in editorial department of the paper and starting as an apprentice, and she received education in Graduate School of Journalism at Columbia University. On her return from USA, she joined the editorial board of the paper and continued to work there till the material point of time. The Tribunal, however, rejected assessee's claim of such education expenses being in the nature of business expenditure, on the ground that merely because there was no commitment or contract taken from the trainee, the expenditure, which was otherwise proper, should be disallowed to the company. On these facts, Hon'ble High Court reversed the order of the Tribunal by observing as follows: On the facts found by the Tribunal, which have been indicated and summarized above, it appears to us that the reasons given by the Tribunal for the disallowance in the facts and circumstances of this case, and particularly bearing in mind the close relationship of the two directors and the trainee, is clearly unsustainable; and if that be the only reason which has weighed with the Tribunal, we must answer the question referred to us in favour of the assessee since the view we have taken is that the t reason given by the Tribunal is not a good reason.

Hon'ble High Court thus held that merely because there is no agreement between the person, whose education costs are met by the assessee company, and the assessee company, this fact per se cannot render an expense, which is other wise allowable as deduction, into disallowable deduction. Their Lordships were adjudicating on this limited question 6. It is also noteworthy, as taken note of in the

High Court judgment itself, that in this case, Tribunal's unchallenged findings in that case, inter alia, were that the P was not selected for further studies because of the reason of her relationship with the two directors, that the selection could not be attributed to any extra commercial considerations, and that there were no doubts about her qualifications, as also in her abilities, to serve the paper. The ground which appealed to the Tribunal, however, was that the company had not taken any commitment about the service from the trainee, and, according to the Tribunal, it had not behaved in a sensible and businesslike manner.

According to the Tribunal, therefore, the spending of such a large amount on her training without obliging her to undertake service of the company clearly smacked of the extra commercial consideration. The question about allowability per se, of the foreign education of director's children, was not before Their Lordships. This judgment, therefore, cannot be construed as an authority for allowability of foreign education expenses incurred on managing director's children even if education received by the children is relevant to the assessee company and even though, after receiving such education, those children work in the assessee company. This is besides the fact that in the Sakal Paper's case, P worked for five years in the assessee company before being sent abroad for higher education and the fact that P's selection could not be attributed to extra commercial considerations.

There is not even a whisper about such factual position in the case before us. The assessee thus derives no assistance by Hon'ble Bombay High Court's judgment in the case of Sakal Papers.

7. In the case of CIT v. Kohinoor Paper Products 226 ITR 220, Hon'ble M P High Court rejected She reference applications under Section 256(2) on the question whether the Tribunal was right in holding that the expenses of Rs. 42,974 spent on the education of a partner in USA was in the nature of business expenditure. Their Lordships observed that "the conclusion is based on appreciation of facts and, as such, it does not give rise to the questions as proposed". This rejection of reference application can hardly be construed as an authority for the proposition that foreign education expenses of the partner are to be allowed as a business deduction. In any event, in the case of M.Subramaniam Bros v. CIT 250 ITR 769,

Their Lordships of Hon'ble Madras High Court has dissented from the view taken by Hon'ble M P High Court in the case of Kohinoor Paper Products (supra) and observed that "the fact that one of the sons Vishwanathan was sent abroad for further education cannot be regarded as deputation made by the firm of one of its partners in connection with business" and that "it was only a step taken by a father, who is naturally interested in giving the best possible education to his son, and sent him abroad to get a higher degree. The agreement that was drawn up was merely the one which was intended to give a colour of commercial expediency and was rightly not relied upon by the Tribunal". Their Lordships then referred to, with concurrence, the views of Hon'ble jurisdictional High Court in the case of Hindustan Hosiery Industries (supra). We may also add that we are anyway bound by the esteemed views of Hon'ble jurisdictional High Court. The assessee thus derives no assistance from this Kohinoor Paper Product's judgment either.

8. A reference is also made to the SMC order of this Tribunal in the case of Trikaya Grey Advertising India Limited v. DCIT ITA No 941/Bom/93; order dated 7^th April 1999. In the said order, SMC has followed the Tribunal's division bench decision in the case of Hindustan Hosiery Industries, which has since been reversed by the Hon'ble Bombay High Court. The SMC order has also followed the judgment in the case of Sakal Papers (supra), which, as discussed earlier, is not relevant on the facts of this case. We, therefore, regret our inability to follow the SMC decision in the case of Trikaya Grey Advertising India Limited (supra), which, in any event, is not a binding precedent for a division bench of the Tribunal.

9. In the case of KB Mehta v. DCIT 86 ITD TM 256 Pune, this issue was subject matter of dissenting views between the members constituting the division bench, and this issue was then referred to a Third Member in accordance with the provisions of Section 255(4) of the Act. In this case also, thee was no employer employee relationship at the point of time when the agreement was entered into. In paragraph 3 of the Third Member's order, due note of this fact was taken. The judicial precedents referred to by the assessee, i.e. Sakal Papers and Kohinoor Paper Products, were also taken note of It was also In the Third Member decision, which was the majority view, the Tribunal, inter alia, concluded as follows: The true test of an expenditure laid out wholly and exclusively for the purpose of trade or

business is that it is incurred by the assessee as incidental to his trade for the purpose of keeping the Trade going and of making it pay not in any other capacity than a trader. It is to be seen whether the expenditure was incurred with the object of further the trade or business interest of the assessee, unalloyed or unmixed with any other consideration. If the expense is found to bear an element other than the trade or business interests of the assessee, the expenditure is not allowable one.

When we examine the case of the assessee on the principles so laid down by the Third Member decision, the conclusion is irresistible that the expenditure could not be "said to be entirely without extra commercial considerations. Shri Rishav Mehra was not an employee of the company at the material point of time, and there is no material before us, unlike the case of Sakal Papers for example, that the selection of Shri Rishav Mehra was on pure commercial considerations. It is useful to remember that in Sakal Papers case, there was a categorical conclusion by the Tribunal that the person sent abroad was not selected for further studies because of the reason of her relationship with the two directors, that the selection could not be attributed to any extra commercial considerations, and that there were no doubts about her qualifications, as also in her abilities, to serve the paper. In assessee's submissions before us, it was stated that 'though not an employee' Shri Rishav Mehra was rendering services to the assessee company in the USA. However, there is no material to support, or even indicate, that Shri Rishav Mehra rendered any services from the USA. We have also noted that the assessee has categorically accepted that Shri Rishav Mehra was not an employee of the assessee company.

10. Keeping all these factors in mind, as also entirety of the case, we approve the conclusions arrived at by the CIT(A) and decline to interfere in the matter. The expenses incurred on the foreign education of Shri Rishav Mehra, whose only connection with the assessee company at the relevant point of time was that he was son of the Managing Director of the company, cannot be allowed as deduction in computing business income of the assessee company. We see no infirmity in CIT(A)'s sustaining the said disallowance.

12. In ground No. 2, the assessee is aggrieved that the CIT(A) erred in sustaining the disallowance of 'vehicle expenses' of Rs. 76,316. So far as this ground of appeal is concerned, it is sufficient to take note of the fact that the disallowance of 25% of vehicle expenses is made for want of log book of the vehicles and as non business expenditure. In appeal, CIT(A) confirmed the said action on the basis of his order for the preceding years, wherein, dealing with similar disallowance, the CIT(A) had observed as follows: I have considered the facts. The appellant company is located at SEEPZ Andheri. Considering the location of the factory, the expenses claimed is not excessive. The appellant admits that 5% of the total vehicle expenses may be attributable to personal use. Taking into account all these factors, the Assessing Officer is directed to disallow 10% of the vehicle expenses.

The CIT(A) thus confirmed the disallowance of 25% of vehicle expenses.

The assessee is not satisfied and is in second appeal before us.

14. The disallowance has been confirmed by the CIT(A) treating the expenses as personal expenses. But then, a company is an artificial juridical person, and, therefore there can not be any personal expenses in the case of the company. This is so held in the judgment of Hon'ble Gujarat High Court in the case of Sayaji Iron & Engg. Co. Ltd v. CIT 253 ITR 749 which has also been followed by a number of benches of the Tribunal, including by the Ahemdeabad bench in the reported case of DCIT v. Mira Industries 87 ITD 475. In view of these discussions, we direct the Assessing officer to delete the impugned disallowance of Rs. 76,316. The assessee will get the relief to that extent.

16. In ground No. 3, the assessee is aggrieved that the CIT(A) erred in confirming the disallowance of Rs. 22,800 on account of entertainment expenses.

17. During the course of scrutiny proceedings, the Assessing Officer observed that the staff welfare expenses, inter alia, include Rs. 5,987 in respect of food for manager and staff, Rs. 4,507 in respect of payments to the Diner's Club and that these two expenses have not been included as disallowable under Section 37(2). It was also noted that the staff welfare expenses included Rs. 1,82,268 to the

canteen contractor as for refreshments to staff members, Rs. 10,000 paid to the canteen contractor as reimbursement of expenses, and that an amount of Rs. 22,246 was debited as miscellaneous staff refreshment - reimbursement to staff members of the company. It was in this backdrop that 20% of total expenses were treated as for entertainment expenses.

The amount so worked out to Rs. 45,601. After taking into account the amount suo motu offered by the assessee for disallowance, the disallowance made by the Assessing Officer was Rs. 22,800. Aggrieved, assessee carried the matter in appeal before the CIT(A) but without any success. The assessee is not satisfied and is in further appeal before us.

18. We have heard the rival contentions, we have perused the material before us, and we have duly considered factual matrix of the case as also the applicable legal position.

19. We find that it is an undisputed position that the canteen expenses were incurred for the purpose of staff members and managers of the company but the objection is taken by the revenue that the outsiders being provided the tea and snacks from the same canteen cannot be ruled out. The revenue has failed to discharge the onus of demonstrating that the suo motu disallowance offered by the assessee is lesser than what is required. In the earlier years also, no such additional disallowance was made by the Assessing Officer. The CIT(A) has also confirmed the disallowance in a somewhat mechanical manner and without marshalling out the relevant facts. Keeping in view all the factors, as also entirety of the case, we direct the Assessing Officer to delete the additional disallowance of Rs. 22,800. The assessee will get relief on this issue also.