HIGH COURT OF PUNJAB AND HARYANA

Commissioner of Income-tax-II, Chandigarh

v.

Bazaar Decor (India) (P.) Ltd.*

AJAY KUMAR MITTAL AND JASPAL SINGH, JJ.
IT APPEAL NO. 343 OF 2009 (O&M)†
SEPTEMBER 19, 2013

Ms. Urvashi Dhugga *for the Appellant.* **Ms. Radhika Suri** *for the Respondent.*

ORDER

Ajay Kumar Mittal, J. - This appeal has been preferred by the revenue under Section 260A of the Income-tax Act, 1961 (in short, "the Act") against the order dated 31.12.2008, Annexure A.3, passed by the Income Tax Appellate Tribunal, Chandigarh (in short, "the Tribunal") in ITA No.667/Chandi/2007, for the assessment year 2004-05, claiming following substantial question of law:—

> "Whether on the facts and circumstances of the case and in law the order of the Hon'ble Tribunal is perverse in allowing deduction representing sample distribution expenses in terms of Section 37(1) of the Act; in the absence of any sale and documentary evidences, evidencing sending of free samples and also ignoring the fact that distribution of samples also included Shahtoosh Shawls which is a prohibited item as per the Indian Wild Life Act and is thus hit by Explanation to section 37(1) of the Act?"

2. Briefly, the facts necessary for adjudication of the controversy involved, as narrated in the appeal, may be noticed. The assessee-company is an export trading house and is 100% subsidiary of a foreign company 'Bazaar Décor SARAL'. It claimed expenditure of Rs. 15,45,170/- on account of sample distribution. In the absence of evidence of sample distribution on account of foreign shipment or air cargo charges or any other expenditure evidencing sending of free sample to the potential customers, the said amount of Rs. 15,45,170/- was disallowed by the Assessing Officer vide order dated 16.11.2006, Annexure A.1. Aggrieved by the order, the assessee filed appeal before the Commissioner of Income Tax (Appeals) [CIT(A)]. Vide order dated 18.4.2007, Annexure A.2, the CIT(A) allowed the appeal. Not satisfied with the order, the revenue filed appeal before the Tribunal. Vide order dated 31.12.2008, Annexure A.3, impugned herein, the appeal was dismissed holding that section 37(1) of the Act did not require that the expenditure falling therein must necessarily result in earning of an income. The Tribunal also relied upon decision of the Apex Court in *CIT* v. *Malayalam Plantations Ltd.* [1964] 53 ITR 140. Aggrieved by the order passed by the Tribunal, the revenue is before this court through the present appeal.

3. Case of the revenue is that the assessee-company had purchased the stock during the financial years 2001-02 and 2003-04 and did not make any sale out of these items. The claim of deduction on account of export towards free samples was unreasonable and not for the purpose of business. The free distribution of samples also included Shahtoosh shawls which is a prohibited item as per the Indian Wildlife (Protection) Act, 1972 (in short, "the 1972 Act") and thus hit by Explanation to Section 37 of the Act which was inserted by Finance (No.2) Act, 1998 with effect from 1.4.1962.

4. Learned counsel for the appellant-revenue submitted that the distribution of free samples consisting of antique old carpets, special kani shawls, shahtoosh shawls, pashmina shawls and silk carpets would not fall within the domain of Section 37(1) of the Act and therefore, the CIT(A) and the Tribunal were in error in allowing the deduction of Rs. 15,45,170/- representing sample distribution expenses in terms of Section

37(1) of the Act. It was urged that the free sample distribution expenses could be allowed as business expenditure provided the same were sales promotion expenses and there was sale. It was contended that there was no sale and therefore, expenses on account of purchase of the items during the financial years 2001-02 and 2002-03 could not have been allowed for deduction towards free samples distribution.

5. On the other hand, learned counsel for the assessee besides supporting the orders passed by the CIT(A) and the Tribunal, submitted that both the authorities were justified in allowing the deduction.

6. After hearing learned counsel for the parties, we find no merit in the appeal.

7. Firstly, it may be noticed that the question as formulated shows that the revenue is claiming disallowance of expenses incurred by the assessee for distribution of free samples particularly when it included Shahtoosh shawls which was a prohibited item under the 1972 Act and its admissibility was hit by Explanation to Section 37(1) of the Act incorporated retrospectively from 1.4.1962. The argument at the first blush appears to be attractive but when the orders of the Assessing Officer, CIT(A) and the Tribunal are minutely scanned, one is at a loss to find that in the absence of any reference to the Explanation to section 37(1) of the Act on the factual matrix involved in the case, how any such argument arises in this appeal. The substantial question in that regard thus would not arise for our consideration. However, the primary question that arises for consideration would be whether free sample distribution expenses without there being any effective sale during the year under consideration were admissible expenses under section 37(1) of the Act.

8. It would be expedient to refer to section 37(1) of the Act and the Explanation which read 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 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".
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> *Explanation* — For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.'

9. Following are the essential requirements for allowing deduction under Section 37(1) of the Act:—

"(*a*) expenditure should not be of the nature described in sections 30 to 36.

(*b*) It should have been incurred in the accounting year.

(*c*) It should be in respect of business carried on by the assessee and the profits of which are to be computed and assessed.

(*d*) It should not be personal expenditure.

(*e*) It should have been laid out or expended wholly and exclusively for the purpose of such business.

(*f*) It should not be in the nature of capital expenditure."

10. The Gujarat High Court examining the scope of section 37(1) of the Act in *Khimji Visram & Sons (Gujarat) Private Limited* v.*CIT* [1994] 209 ITR 993/[1995] 79 Taxman 112 had observed as under:—

> "From the aforesaid two sections, it is apparent that under section 37, only revenue expenditure, which is expended wholly and exclusively for the purpose of business or profession, can be allowed to be deducted in computing the income while under sections 30 to 36,it could be either revenue expenditure or capital expenditure. Further, section 37 as such is a general provision which provides

for deduction of expenditure while computing the income chargeable under the head 'Profits and gains of business or profession' of the assessee, if the expenditure is of revenue nature and not personal expenses of the assessee and if the said expenditure is laid out or expended wholly and exclusively for the purpose of business or profession. Hence, if the expenses are not covered by the specific provisions of sections 30 to 36 and yet the said expenses are laid out or expended wholly and exclusively for the purposes of the business or profession and they are not in the nature of capital expenditure or personal expenses of the assessee, then deduction is required to be given for the said expenses. It is quite possible that with regard to some expenses there may be overlapping between sections 30 to 36 and section 37. In that set of circumstances, if the expenses are deductible under sections 30 to 36, then section 37 is not to be resorted to. But if the said expenses are not deductible under sections 30 to 36 and the conditions prescribed under section 37 are satisfied, then the said expenses are required to be deducted while computing the income unless there is a specific prohibition."

11. Further, the expression 'for the purpose of the business' occurring in section 10(2) (xv) of the Indian Income-tax Act, 1922 which is pari materia with Section 37 of the Act, was dealt with by the Hon'ble Supreme Court in *Malayalam Plantations Ltd.'s* case (*supra*) wherein it was observed as under:—

"The aforesaid discussion leads to the following result: The expression "for the purpose of the business" is wider in scope than the expression "for the purpose of earning profits". Its range is wide: it may take in not only the day-to-day running of a business but also the rationalization of its administration and modernization of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business. However wide the meaning of the expression may be, its limits are implicit in it. The purpose shall be for the purpose of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business. It cannot include sums spent by the assessee as agent of a third party, whether the origin of the agency is voluntary or statutory; in that event, he pays the amount on behalf of another and for a purpose unconnected with the business..."

12. From the above, it emerges that wherever an expenditure is incurred by an assessee and it does not fall under any of the category which is not admissible, the expenditure would be allowed as a deduction while computing the income under the head 'Income from business or profession'. The aforesaid section nowhere provides that unless actual sales take place, the deduction would not be admissible. It is intended to explore future sale of such commodities. Further, the provision nowhere envisages that the expenditure would be admissible only where such expenditure results in earning of income.

13. The CIT(A) and the Tribunal had recorded a finding that the assessee-company was an export trading house and had distributed carpets and shawls as samples during the year. It was further noticed that these items were exported by the assessee in the subsequent assessment years 2005-06 and 2006-07. The samples distributed were not extraneous to the business of the assessee. Furthermore, the samples were given to the foreign agents in person during their business exploratory visit in India and the same would fall under the expenditure laid out or expended wholly and exclusively for the purpose of such business.

14. The Tribunal while upholding the admissibility of expenditure on account of sample distribution by the assessee to its customers affirmed the findings recorded by the CIT(A) as under:—

"We have considered the rival submissions carefully. Ostensibly, the case of the assessee for allowability of expenditure of free sample distribution is liable to be examined in terms of the provisions of Section 37(1) of the Act. Shorn of other details, the said Section permits deduction of an

expenditure which is let out or expended wholly and exclusively for the purpose of business or profession in computing the income chargeable under the head 'profits and gains of business or profession'. The crucial expression in the said section 'for the purpose of the business' provides the answer to the controversy before us. The moot point is as to whether the expenditure on free sample distribution can be said to have been expended wholly and exclusively by the assessee for the purpose of its business. The revenue has urged that such expenditure does not fall under section 37(1) for no sales of the items distributed free has been made by the assessee. In this context, it would be of relevance to refer to the judgment of the Hon'ble Supreme Court in the case of *CIT* v. *Malayalam Plantations Ltd*. 53 ITR 140 wherein the meaning of expression 'for the purpose of business' has been explained. The Hon'ble Supreme Court was dealing with the said expression as appearing in Section 10(2) (xv) of the Indian Income-tax Act, 1922, which is pari materia to section 37(1) of the Act. According to the parity of reasoning laid down by the Hon'ble Supreme Court the expression 'for the purpose of business' cannot be equated to the expression "for the purpose of earning profits". It is laid down that the range of the former expression is much wider and comprehends expenditure beyond the day-to-day running of business and in fact includes many other acts which may be incidental to the carrying on of the business. The only limitation which is required to be read is that the expenditure should be for the purpose of the business, in other words, the expenditure incurred shall be for the carrying on of the business and the assessee ought to have incurred it in his capacity as person carrying on business.

9. Applying the aforesaid parity of reasoning to the facts of the instant case, in our view, the impugned expenditure fits into the scheme of Section 37(1) of the At. Firstly, factually it is not in dispute that the assessee is a company which is an export trading house, meaning thereby that it is essentially undertaking export of commodities. Secondly, the items distributed as samples during the year are carpets and shawls. In the report of the Assessing officer dated 25.5.2008 submitted by the learned DR, it is apparent that such goods and other items have been exported by the assessee in the subsequent assessment years of 2005-06 and 2006-07. Apparently, a variety of items have been exported. Therefore, it is not a case where the samples distributed were extraneous to the business of the assessee. May be, the sale of the same commodities has not been undertaken but by the very nature, distribution of samples to the potential customers is an expenditure intended to explore future sale of such commodities. Therefore, in this light, we are in agreement with the stand of the assessee that the expenditure is incurred wholly and exclusively for the purpose of business. At this stage, it would be also appropriate to observe that Section 37(1) does not require that the expenditure falling therein must necessarily result in earning of an income. This is so because there is no such requirement in section 37(1). Therefore, the plea of the Assessing officer that no sales of carpets and shawls have been carried out by the assessee during the year, is not a ground to deny the claim for deduction under section 37(1) of the Act with regard to the expenditure in question. Thus, on this aspect, we affirm the stand of the CIT(A).

10. The only other objection of the Assessing officer was that the assessee did not furnish the evidence of sample distribution. The Assessing officer has said that so far the assessee had not incurred many expenditure on foreign shipment or air cargo charges or any other expenditure for sending free samples to the potential customers. In this regard, we have carefully considered the discussion made by the CIT(A). The CIT(A) has examined the case of the assessee on the basis of the material before him namely, copies of challans, invoices, gate passes, details of persons to whom gifts were given etc. as illustrated in his order. We also find that such material was forwarded to the Assessing Officer during the appellate proceedings for comments. The CIT(A) has also culled out in his order the comments of the Assessing Officer in this regard. According to the CIT(A), objections of the Assessing Officer were mere suspicious. The assessee had contended before the CIT(A) that the samples were distributed to the potential customers who had visited it in India. The assessee

provided the names and passport numbers also of the persons to whom the free samples have been distributed. The relevant invoices and the challans of the products have also been relied upon. The assessee also found support from the gate passes which carried the signatures of the recipients to demonstrate that the samples in question were physically carried out from its premises by the potential customers. With respect to the aforesaid evidence, the only plea of the revenue before us is that such evidence was not before the Assessing Officer but was produced only before the CIT(A). On the contrary, the stand of the respondent is that there was no such occasion for it to produce such materials before the Assessing Officer during the assessment proceedings as the same was not specifically called for. Instead, it has been stated that the Assessing Officer in para 1 clearly observes that the assessee had filed the details from time to time. In this connection, it is also submitted that the CIT(A) has noted that the assessee had produced the complete records before the Assessing Officer.

11. On this aspect, in our considered opinion, from the conspectus of facts emerging from the respective orders of the lower authorities, one aspect which emerges is that the CIT(A) has based his decision on the basis of material which was very much in the knowledge of the Assessing Officer, may not be during assessment proceedings but certainly during the remand proceedings during the appellate stage. The CIT(A) has called for the comments of the Assessing Officer which have duly been noted and thereafter the claim of the assessee has been adjudicated upon. Therefore, we are inclined to affirm the decision of the CIT(A) on this point also."

15. In view of the above, the CIT (A) and the Tribunal were right in allowing deduction on account of expenditure on free sample distribution by the assessee. The substantial question of law is answered against the revenue and in favour of the assessee. Accordingly, finding no merit in the appeal, the same is dismissed.