

(1991) 09 KAR CK 0033

In the Karnataka High Court

Case No : Income-tax Referred Case No. 146 of 1986

Commissioner of Income Tax

APPELLANT

Vs

Bharat Printers

RESPONDENT

Date of Decision : 06-09-1991

Acts Referred:

Central Sales Tax Act, 1956 — Section 10 A, 8 (3) (b)
Income Tax Act, 1961 — Section 256 (2)

Citation : (1992) 102 CTR 233 : (1992) 198 ITR 601 : (1992) 61 TAXMAN 125

Hon'ble Judges : N. Venkatachala, J;K. Shivashankar Bhat, J

Bench : Division Bench

Advocate : H. Raghavendra Rao, for the Appellant; S.P. Bhat, for the Respondent

Judgement

K. Shivashankar Bhat, J.—The question referred u/s 256(2) of the Income Tax Act, 1961 ("the Act" for short), reads as follows :

"Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in holding that the amount of Rs. 64,048 representing penalty levied u/s 10A of the Central Sales Tax Act, 1956, has to be allowed as deduction in computing the total income in the assessment for the assessment year 1977-78 ?"

2. The assessee is a dealer registered under the provisions of the Central Sales Tax Act, 1956. It is also engaged in the business of printing for which purpose it purchased paper, printing inks, machine spare parts, machine oil, by issuing "C" forms under the Central Sales Tax Act declaring that the said goods were purchased for the purposes of manufacturing or processing of goods for sale as per section 8(3)(b) of the Central Sale Tax Act. However, the assessee used the said goods in the execution of works contract (i.e., printing binding labels) of the assessee's sister concern called Messrs. Bharath Beedi Works; this diversion of the goods for a different purpose, other than the one declared under "C" forms, contravened the provisions of the Central Sales Tax Act; consequently, penalties were imposed on the assessee u/s 10A of the Central Sales Tax Act for different

years. This penalty was ultimately reduced by the appellate authority under the said Act to an amount equivalent to the sales tax that should have been paid by the assessee. As the law then stood as declared by the High Court (in *S.S. Umadi Vs. The State of Mysore and Others*, this levy was perfectly legal and the assessee paid the same. Thereafter, for the purposes of Income Tax Act, 1961, the assessee claimed this sum paid, as a deduction. According to the assessee, the levy of penalty under the Central Sales Tax Act was illegal in the light of a subsequent decision of the Supreme Court, and, therefore, the order levying penalty should not be considered as imposing a penalty. It was further contended that the payment of the sum levied as a penalty was compensatory in nature, to recoup the State, of the loss of tax caused by the assessee's action, and hence should be treated as on par with the sales tax. The Income Tax Officer rejected the claim of the assessee for deduction; this order was affirmed by the first appellate authority. However, the Tribunal has accepted the assessee's contention that the purported levy of penalty u/s 10A of the Central Sales Tax Act was not sustainable in law in view of a decision of the Supreme Court in the case of *Assessing Authority-cum-excise and Taxation Officer, Gurgaon and Another Vs. East India Cotton Mfg. Co. Ltd., Faridabad*, and hence the payment of the said sum by the assessee should not be considered as the payment of a penalty, since there was no contravention of section 8(3)(b) of the Central Sales Tax Act by the assessee.

3. The Revenue has obtained this reference, being aggrieved by the decision of the Tribunal.

4. Learned counsel for the Revenue contended that the assessee, having accepted the order imposing penalty on it u/s 10A of the Central Sales Tax Act, cannot now question the legality of the said order under the Central Sales Tax Act was illegal, it had to be challenged appropriately before the forum created for the said purpose under the sales tax legislations; the present challenge to the said order is a collateral attack which cannot be taken note of at all. Further, even if the measure of penalty was the tax not paid, its character as a penalty is not lost.

5. Sri S. P. Bhat, learned counsel for the assessee, however, contended that, if section 8(3)(b) of the Central Sales Tax Act was not contravened invocation of section 10A of the said Act and levy of penalty thereunder would be without jurisdiction and, therefore, the character of the levy as a penalty would stand erased altogether. Alternatively, learned counsel urged that the levy u/s 10A was compensatory in nature payment of which by the assessee was an expenditure deductible u/s 37 of the Income Tax Act.

6. The first question to be considered is whether the authorities under the Income Tax Act are competent to treat an order made by another statutory authority (acting under the Central Sales Tax Act) as void altogether and, thus, whether the authorities under the Income Tax Act could ignore the real or purported nature of such an order.

7. For the due working and implementation of the various taxing laws, the Legislature or Parliament has to create an appropriate hierarchy of authorities. The particular statute invariably creates appellate or revisional forums to examine the legality or the correctness of such statutory orders. The need to maintain unity amongst various jurisdictions is the essence of such jurisdictions. Finality achieved by an order made by an authority acting under one statute cannot be defeated by the decision of another authority acting under a different law, unless such law clearly confers a power to examine the validity or correctness of the order made by the former authority. Orders of assessment and orders imposing penalty under the taxing statutes are quasi-judicial orders and, apart from the remedy under the statute in question, such orders are to be challenged only by recourse to writ jurisdiction. When an authority created under the provisions of the Income Tax Act has no power of judicial review, to examine the validity of an order made by another officer under the sales tax law, such a power of judicial review cannot be indirectly read into the functions of the authority under the Income Tax Act. Learned counsel for the assessee contended that the Central Sales Tax Act nowhere makes the order made thereunder "final" and, therefore, while considering the real nature or purport of such an order, its legality could be considered by the Income Tax Officer. In other words, according to learned counsel, to find out whether the payment made by the assessee in compliance with an order made u/s 10A of the Central Sales Tax Act, was actually an expenditure falling within section 37 of the Income Tax Act, legality of the former order could be examined by the authority created to consider the nature of the expenditure u/s 37 of the Income Tax Act. This contention, if accepted, would confer a wide jurisdiction on the Income Tax Officer to examine the validity or otherwise of the orders made by the Sales Tax Officer; a power which is not directly conferred cannot be, thus, read into his jurisdiction. The jurisdiction of the authorities under the Income Tax Act cannot extend beyond their declared competence; they have to read the order under which the assessee made the payment in the same manner in which the said order was made and understood by those who made the order.

8. The order imposing penalty was made u/s 10A of the Central Sales Tax Act. This is a provision providing for the imposition of penalty in lieu of prosecution. The section empowers the authority concerned to impose "by way of penalty" a sum not exceeding one and a half times the tax which would have been levied. This is imposed on a person who is guilty of an offence under some of the clauses of section 10. The section is applied against a person who is guilty of an offence; in lieu of prosecution, such a person is made liable to pay a penalty and the minimum penalty shall not exceed one and half times the tax which would have been levied in respect of the transaction involved. Thus, there can be no doubt that section 10A is a penal provision and the sum levied on the assessee is a substitute for the prosecution and is levied as a punishment. The amount of penalty depends upon the discretion of the authority subject to the maximum stated in the section; no minimum is prescribed. Nowhere it stated that the

person ordered to pay the penalty u/s 10A is exonerated from paying the tax which escaped assessment. It may be that, in given case, the discovery of tax evasion may be too late to recover it by recourse to the tax-collecting provisions, but that is an altogether different question. If the levy u/s 10A is compensatory in nature, a corresponding exoneration from tax liability would have been provided for. A ceiling on the penalty livable with the reference to the quantum of tax would not alter the character of the imposition as a compensatory levy; the reason for the action u/s 10A, the nature of the proceedings thereunder and the judicial discretion required to be exercised in quantifying the levy are some of the matters to be considered to arrive at the true nature of the imposition. We have no hesitation to conclude that, irrespective of the quantum of the particular imposition in a given case, every order levying a penalty u/s 10A is a penal levy and it is not a substitute for tax.

9. The above conclusion of ours actually concludes the question referred to us against the assessee. However, it is necessary to refer to a few decisions cited before us by respective learned counsel.

10. Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II, is a decision of the Supreme Court. The assessee therein had to pay a fine to release the confiscated goods which were imported by the assessee contrary to law. This amount of fine was climbed by the assessee by way of deduction as a business expenditure under the earlier section 10(2)(xv) of Indian Income Tax Act, 1922 (similar to the present section 37). The claim of the assessee was negated by the Supreme Court. After referring to the several provisions of the Customs Act (Sea Customs Act), the Supreme Court held that the provisions governing the confiscation of goods, levy of fine, etc., were provided against committing breach of the prohibition in regard to importation or exportation of goods under the said Act. The Supreme Court held at page 354, thus :

"Therefore, when the appellants incurred the liability they did so as a penalty for an infraction of the law; but it cannot be said this the money which they had to pay was not paid as a penalty and in the u/s 167(8) it was a penalty."

11. The Supreme Court, at page 357, quoted the following observations of Lord Sterndale :

"During the course of the trading this company committed a breach of the law. As I say, it has been agreed that they did not intend to do anything worrying in the sense that they were willingly and knowingly sending these goods to an enemy destination; but they committed a breach of the law, and for that breach of the law, they were fined. That, as it seems to me, was not a loss connected with the business, but was a fine imposed upon the company personally, so far as a company can be considered to be person, for a breach of the law which it had committed. It is perhaps a little difficult to put the distinction into very exact language, but there seems to me to be a difference between a commercial loss in

trading and penalty imposed upon a person or a company for a breach of the law which they have committed in that trading. For that reason, I think that both the decision of Rowlatt J., in this case, and his former decision in IRC v. Warnes and Co. [1919] 2 KB 444, which he followed, were right and that this appeal should be dismissed with costs."

12. Again at page 359, it was held by the Supreme Court :

"If a sum is paid by an assessee conducting his business, because in conducting it he has acted in a manner which has rendered him liable to penalty, it cannot be claimed as a deductible expense. It must be a commercial loss and in its nature must be contemptible as such. Such penalties which are incurred by an assessee in proceedings launched against him for an infraction of the law cannot be called commercial losses incurred by an assessee in carrying on his business. Infraction of the law is not a normal incident of business and, therefore, only such disbursements can be deducted as are really incidental to the business itself. They cannot be deducted if they fall on the assessee in some character other than that of a trader. Therefore, where a penalty is incurred for the contravention of any specific statutory provision, it cannot be said to be commercial loss falling on the assessee as a trader, the test being that the expenses which are for the purpose of enabling a person to carry on trade for making profits in the business are permitted but not if they are merely connected with the business."

13. As Lord Sterndale has pointed out, there is a difference between a commercial loss in trading and penalty imposed upon a person for contravening the law which contravention took place in the course of the trading activity.

14. In Simplex Structural Works Vs. Commissioner of Income Tax, , the Madhya Pradesh High Court was concerned with a similar question with reference to an amount paid as a penalty. The penalty was quantified in the said case with reference to the tax that was not paid. The Bench held that this quantification of the penalty, equalising it with the tax payable rendered the imposition compensatory in nature and, therefore, the penalty paid was deductible u/s 37 of the Income Tax Act. At page 785, the Bench observed :

"Properly understood, when the penalty imposed u/s 8(2) of the State Act or u/s 10A of the Central Act is only the difference between the tax payable at the full rate and the tax payable at the concessional rate, the real nature of such a penalty is merely the balance amount of sales tax which ought to have been paid by the assessee at the time of purchase of goods. Although termed as penalty the amount so paid is really sales tax and should be allowed as business expenditure u/s 37."

15. Thereafter, the decision of the Supreme Court in Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II, referred to by us above was cited and was distinguished on the ground that (at page 785) :

"The penalty imposed u/s 8(2) of the State Act and u/s 10A of the Central Act in the cases before us do not require the assessee to pay more than what they should have paid as tax in obedience to the law."

16. With utmost respect, we are unable to agree with the view expressed by the learned judges of the Madhya Pradesh High Court. The nature and quality of the imposition cannot stand altered by referring to the quantum of the actual levy. The quantum of the penalty u/s 10A of the Central Sales Tax Act depends upon the exercise of judicial discretion of the authority empowered to impose the penalty. Only because the quantum of penalty is equalised to the tax that was to be paid it cannot be that the authority empowered to levy the penalty did not levy the penalty but demanded a compensatory amount. In *Commissioner of Income Tax Vs. Rajdev Kirana Stores*, , another Bench of the same High Court followed an earlier decision of the said High Court in *Commissioner of Income Tax Vs. Malwa Vanaspati and Chemical Co. Ltd.*, , and held that the penalty levied under the Sales Tax Act cannot be a deductible expenditure u/s 37 of the Income Tax Act. In the said earlier decision, i.e., *Commissioner of Income Tax Vs. Malwa Vanaspati and Chemical Co. Ltd.*, , the penalty was imposed u/s 8(2) of the Madhya Pradesh General Sales Tax Act. It was observed that the liability to penalty was not automatic and it arises only as a result of an order imposing the penalty on the discovery that the assessee had committed a breach of the provisions of the law. Therefore, the payment of levy cannot be equated to any trading expenditure. We are in respectful agreement with the ratio of this decision. The view taken by the Bombay High Court in *Jairamdas Bhagchand Vs. Commissioner of Income Tax*, also supports the conclusion reached by us. In the said case, the penalty levied under the provisions of the Bombay Sales Tax Act was claimed by the assessee as in the nature of the interest and, therefore, a trading expenditure. This contention was not accepted.

17. In view of the above, the question referred to us has to be answered in the negative and in favour of the Revenue. Reference is answered accordingly.