

(1969) 01 OHC CK 0005

In the Orissa High Court

Case No : Special Jurisdiction Case No. 31 of 1961

Commissioner of Income Tax

APPELLANT

Vs

Prafulla Kumar Mallik

RESPONDENT

Date of Decision : 23-01-1969

Acts Referred:

Income Tax Act, 1922 — Section 10(1), 66(1)
Sales of Goods Act, 1930 — Section 59

Citation : AIR 1969 Ori 187 : (1969) 73 ITR 119

Hon'ble Judges : S. Barman, C.J;B.K. Patra, J

Bench : Division Bench

Advocate : D. Mohanty, for the Appellant; S.C. Roy and S.C. Sahu, for the Respondent

Judgement

Barman, C.J.—This matter arises out of a question referred by the Income Tax Appellate Tribunal to this court u/s 66(1) of the Indian Income Tax Act, 1922, for decision. The question referred is:

"Whether on the facts and circumstances of the case, the amount of Rs. 25,700 paid by the assessee by way of penalty to the Government of Orissa was an admissible deduction u/s 10 (1) of the Income Tax Act, 1922."

This Court by its judgment dated January 22, 1963 while dealing with this question, considered the provisions of Section 10 (2) of the Income Tax Act and held that the deduction claimed by the assessee was not admissible as it amounted to a penalty imposed on the assessee for his dishonest action in supplying sub-standard quality goods and, as such, it could not be said to be in expenditure incurred wholly and exclusively for the purpose of his business.

2. The facts and circumstances in which the question was referred to the High Court are these. During the calendar year 1954, which was the year previous to the assessment year 1955-56, the opposite party (hereinafter referred to as the assessee) worked as the Paddy Procuring Agent under the Government of Orissa

on the basis of an agreement entered into by him with the Government of Orissa. Under that agreement the assessee was required to supply paddy and rice of certain standard quality known as Fair Average quality. The criterion for this Fair Average quality was defined. There was a clause in the agreement that the quality of the foodgrains supplied must conform to the Fair Average quality standard and that the Collector may, subject to the approval of the Government of Orissa, levy such penalty as he may deem fit, for supply of food-grains not conforming to the Fair Average Quality and as such penalty shall be deducted from the amount or amounts due to the Agent on pending or future bills submitted in accordance with Clause 13 of the agreement. In exercise of this power, during the course of the accounting year in question, penalties amounting to Rupees 25,700/- were imposed on the assessee and were realised by deduction from the bills.

The assessee claimed deduction of this amount on the assessable income u/s 10 (1) of the Indian Income Tax Act. His claim was negated by the Income Tax Officer and the Appellate Assistant Commissioner, but was accepted by the Income Tax Appellate Tribunal. The Tribunal held that this amount of Rupees 25,700/- deducted by the Government of Orissa from the bills of the assessee could not be taxed in view of Section 10 (1) of the Income Tax Act. Thereupon, the Commissioner of Income Tax asked for a reference to the High Court and the Tribunal, u/s 66 (1) of the Act referred the aforesaid question for opinion to the High Court who answered the same in the negative and against the assessee, that is to say that the said sum of Rs. 25,700/- paid by way of penalty by the assessee to the Government of Orissa was not an admissible deduction.

3. There was an appeal from the said decision to the Supreme Court on a certificate granted by the High Court. The Supreme Court, by their judgment dated September 15, 1966, allowed the appeal and the case was sent back to this Court for answering the question referred to in the appeal on the aspect as explained in that judgment. That is how this reference has come back to this Court for hearing. The scope of the question which was referred to the High Court for decision has been explained by the Supreme Court. The material portion of the judgment explaining the aspect in which the High Court is called upon to answer the question is this:

"The High Court was actually required to answer the question whether this sum of Rs. 25,700/- which was paid by the assessee by way of penalty to the Government of Orissa was an admissible deduction u/s 10 (1) of the Income Tax Act. The question was no doubt framed in rather unfortunate language, because Section 10 (1) of the Income Tax Act does not refer to any deduction. Section 10 (1) lays down that the tax shall be payable by an assessee under the head "profits and gains of business, profession or vocation" in respect of the profits or gains of any business, profession or vocation carried on by him. In these circumstances, what the appellant had claimed was that, in computation of profits and gains of the Act, this amount should be deducted, which was intended

to mean that this amount should not be included in the computation of the profits and gains of the business. The word "deduction" appears to have been used by the appellant as well as by the Tribunal only because the dispute related to a sum which had been deducted by the Government of Orissa as a penalty from the amount due to the appellant for the supplies made by him in pursuance of the agreement. The High Court, therefore, in answering the question referred to it, should not have gone into the question of the applicability of Section 10 (2) (xv) of the Act at all, and should have confined itself to deciding whether this amount deducted from the claims of the assessee by the Government of Orissa was liable to be excluded when computing the income u/s 10 (1) of the Act."

4. After remand by the Supreme Court, the High Court is to now consider the question in the aspect as explained in the Supreme Court judgment, confined to the provisions of Section 10 (1) of the Income Tax Act, which reads as follows:

"10(1). The tax shall be payable by an assessee under the head "profits and gains of business, profession or vocation in respect of the profits or gains of any business, profession or vocation carried on by him."

The question is: How the said sum of Rs. 25,700/- paid by the assessee to the Government of Orissa by way of penalty is to be considered for the purpose of computation of the "profits and gains of business" in the year in question in the business carried on by the assessee.

5. The learned Standing Counsel for the Income Tax Department submitted that when this is a case of penalty, it is not a business loss; it does not arise out of business, nor is it incidental to business, that is to say it was not a commercial loss. On the other hand, it was contended on behalf of the assessee that payment of penalty by way of damages to the Government of Orissa in the circumstances, was incidental to the assessee's business of paddy procurement and therefore it was a commercial loss. It was further submitted that an assessee cannot be taxed on a mere notional income; he can be taxed on what he actually received and not on what he might have received.

6. For the determination of this question, the High Court is to consider it in the light of facts found by the Tribunal. The jurisdiction of the High Court in the matter of Income Tax references made by the Appellate Tribunal under the Income Tax Act is an advisory jurisdiction, and under the Act the decision of the Tribunal on facts is final unless it could be successfully assailed on the ground that there was no evidence for the conclusion on facts recorded by the Tribunal. It is, therefore, the duty of the High Court to start by looking at the facts found by the Tribunal and answer the question of law on that footing. Any departure from this rule of law will convert the High Court into a fact-finding authority which it is not under the advisory jurisdiction Commissioner of Income Tax, West Bengal Vs. Calcutta Agency Ltd.,

7. The relevant findings of the Tribunal in their order dated July 20, 1960 purporting to indicate the real nature of the transaction in which the assessee

had to pay penalty are in Paragraph 3 of the said order, which reads as follows:

"We find that Government had accepted the deliveries although, according to them, the supply did not conform to the F. A. Q. (Fair Average Quality) standard. Having not chosen to refuse the deliveries and having paid the assessee at the contractual rates, it is evident that the Government treated the same as a breach of warranty resulting in a claim of damage. The damages were measured in terms of costs. Therefore, the real effect of levy of penalty was to reduce the price of rice and paddy paid or to be paid to the assessee. There is no evidence that the assessee either mixed foreign materials or passed off the inferior quality of paddy and rice to the Government as F. A. Q. The assessee might have bona fide believed that the supply he made to Government was in conformity with the F. A. Q. standard. The dishonest or criminal intent have not been proved."

This finding of the Tribunal on the real nature of the transaction as a breach of warranty resulting in a claim of damage is conclusive on facts. The Tribunal found that there was no dishonest or criminal intention on the part of the assessee.

8. In determining the question whether payment of penalty by way of damages was incidental to the business itself, one has to consider the degree of connection between the trade or business carried on and the cause of liability for damages. As Lord Loreburn L.C. held in *Strong and Co. v. Woodfield* 1900 AC 448 only such losses can be deducted as are connected with it in the sense that they are really incidental to the trade itself. The nature of the trade is to be considered. In the present case it is an inevitable consequence of the assessee's business as a paddy-procuring agent that as a result of the goods delivered not being of contract quality, breach of warranty, with the risk of liability to pay damage, should at times be committed and payment of such damages as a result of breach of warranty in the course of or as a consequence of earning profits and gains of business is incidental to the carrying out of the assessee's business as a paddy procuring agent; it was an unavoidable loss arising as one of the consequences of carrying on such business.

9. It is clear from Section 59 of the Sale of Goods Act, 1930, that the remedy for such breach of warranty is that the buyer is not by reason only of such breach of warranty entitled to reject the goods but he may set up against the seller the breach of warranty in diminution or extinction of the price, as has been done in the present case by the Government by deducting from the bills resulting in diminution of the price paid to the assessee. If the goods do not conform to the description there is no performance of the contract at all. If the goods are not of marketable quality, the thing for which the buyer bargained was not given. In either case the default of the seller goes to the root of the transaction and therefore the occasion would arise for the buyer to reject the goods and sue for the price if he paid the price. It is also open to the buyer to accept the goods and sue on the basis of a warranty. u/s 59 of the Sale of Goods Act the remedy for the buyer where he accepts the goods is only to sue for damages. In the present case the effect of Government deducting from the bills--the total amount of such

deductions being Rs. 25,700/- -- is that the said amount was by way of deduction from the bills realised as damages for breach of warranty. The payment by the assessee of such penalty by way of damages for breach of warranty is thus incidental to the assessee's business as a paddy procuring agent for the Government of Orissa. The assessee had no dishonest or criminal intent as found by the Tribunal.

10. Moreover, it is an elementary principle of Income Tax law that a man is taxed only on the profits he actually receives and not on the profits he might have, but has not received. In the present case the real effect of deductions from the bills of the assessee was to reduce the price of paddy and rice paid or payable to the assessee under the contract. The Tribunal found that there was no evidence that the assessee either mixed foreign materials or passed off inferior quality of rice to the Government as the F. A. Q.; indeed he might have bona fide believed that the supply he made to Government was in conformity with the contract standard. The tribunal also did not find that there was any misbehaviour on the part of the assessee regarding the quality factors in the matter of rice and paddy. The finding of the Tribunal on facts is final and it is the duty of the High Court to start by looking at the facts found by the Tribunal and answer the question of law on that footing only.

11. In this view of the matter as considered from the aspect discussed above, we are of opinion that on the facts and circumstances of the case, the amount of Rs. 25,700/- paid by the assessee by way of penalty to the Government of Orissa was an admissible deduction u/s 10 (1). We accordingly answer the question referred to us in the affirmative and in favour of the assessee. The assessee is entitled to the costs of this reference. Hearing fee Rs. 250-00 (Rupees two hundred and fifty only).

Patra, J.

12. I agree.