
(1979) 08 MAD CK 0027

In the Madras High Court

Case No : T.C. No's. 614 of 1975 and 26 of 1976

Commissioner of Income Tax

APPELLANT

Vs

Vasantha Mills Ltd.

RESPONDENT

Date of Decision : 07-08-1979

Acts Referred:

Income Tax Act, 1961 — Section 37, 37(1)

Citation : (1979) 120 ITR 321

Hon'ble Judges : Sethuraman, J; Balasubrahmanyam, J

Bench : Division Bench

Advocate : A.N. Rangaswami, J. Jayaraman and Nalini Chidambaram, for the Appellant; S.V. Subramaniam and N.C. Ananthachari, for the Respondent

Judgement

Sethuraman, J.—u/s 256(1) of the I.T. Act, the following question has been referred for the opinion of this court :

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the payment made by the assessee to the Textile Commissioner in pursuance of Clause 21C(1)(b) of the Cotton Textiles (Control) Order, 1948, was laid out or expended wholly and exclusively for the purpose of the business within the meaning of Section 37(1) of the Income Tax Act, 1961 ?"

2. The assessee runs a textile mill at Coimbatore. By a notification dated 2nd August, 1948, the Cotton Textiles (Control) Order, 1948, was promulgated. There were amendments to this order as and when circumstances required. Clause 21A was inserted in this Order by a notification dated 17th August, 1966. The relevant portion of the clause runs as follows:

"(1) Where the Textile Commissioner has specified under paragraph (a) of Sub-clause (1) of Clause 22, the maximum prices at which any class or specification of cloth may be sold...he may, having regard to the matters specified in Sub-clause (2) of Clause 20, by order in writing direct any producer with a spinning

plant or a group of such producers to pack such minimum quantity of such cloth and during such period as may be specified in the direction."

3. Sub-clause (2) of Clause 21A contemplates the Textile Commissioner granting extension of time for complying with the directions. The price applicable to such quantities of cloth so packed is the price in force during the period specified in the direction under Sub-clause (1) or during the extended period, whichever is lower.

4. Clause 21C runs as follows :

"(1) Where the Textile Commissioner has issued directions under sub-clause (1) of Clause 21A to any producer to pack a specified quantity of cloth during the period specified in the directions-

(a) the producer who packs quantities of such cloth during the period in excess of the minimum quantity shall be eligible for receiving cash payment by way of assistance from the Textile Commissioner in respect of such excess quantity packed at such rates and in respect of such maximum quantity as may be specified by the Central Government from time to time;

(b) such producer may, in lieu of packing the whole or part of the minimum quantity of cloth specified in the said direction, make payment to the Textile Commissioner in respect of the deficiency at such rates as may be specified by the Central Government and within such time as may be determined by the Textile Commissioner.

(2) All payments received from producers under paragraph (a) of sub-clause (1) shall, as far as may be, be utilised towards payments, if any, to producers under the said paragraph (a).

Explanation.--In this clause, "producer" includes a group of producers."

5. In pursuance of these powers, the Textile Commissioner directed the assessee to pack a particular quantity of what is popularly known as standard cloth. The assessee did not comply with this, direction. But as contemplated by Clause 21C(1)(b) the assessee paid to the Textile Commissioner a sum of Rs. 30,872. The amount so paid was claimed as deduction u/s 37 of the I.T. Act, 1961. The ITO disallowed it, because, according to him, the payment partook the nature of a fine. The AAC allowed the claim of the assessee holding that the payment did not have the character of a fine, that the scheme gave the assessee an option either to produce a particular quantity of cloth or to make the payment and that the payment made was out of commercial expediency. It was found to be an expenditure laid out wholly and exclusively for the purpose of business. The ITO appealed to the Tribunal and the Tribunal agreed with the AAC. The order of the Tribunal has given rise to the question extracted already.

6. Even before the ITO the assessee contended that the sum was paid as compensation for the non-production of a particular variety of cloth, because it

would have resulted in a bigger loss if the cloth were to be produced and sold in the market. The ITO did not dispute this part of the statement of the assessee, but he took the view that the amount represented a fine for non-fulfilling of certain statutory obligations and, therefore, was not allowable as a deduction. This conclusion of the ITO was not accepted by the appellate authority. The Tribunal in para. 5 of its order has given the reasons for the allowance as follows:

"The assessee is, as stated by the Appellate Assistant Commissioner, given the option either to produce or to make the payment. If the assessee thinks that it is advantageous to make the payment rather than produce the cloth and suffer a loss, there is nothing wrong in it. We cannot find fault with the assessee. It is for the assessee to decide what is the advantageous course.... If the assessee thought that it was advantageous to make the payment rather than to produce the cloth on that account the payment will not cease to be a payment made wholly and exclusively for the purpose of the business."

7. This conclusion of the Tribunal is correct on facts and supported by authorities.

8. The Gujarat High Court in *Additional Commissioner of Income Tax, Gujarat Vs. Rustam Jehangir Vakil Mills Ltd.*, considered an identical question. In that case also there were directions to pack the particular variety of cloth as mentioned in the directive of the Textile Controller. The assessee instead of packing the minimum of the particular variety of the cloth, chose to make the payment. The Gujarat High Court at page 309 pointed out :

"On the contrary, the scheme is that the law itself gives an option to the producer concerned to adopt one of the three courses and, if he complies with the law by choosing one of the three options offered to him, he cannot be said to commit any infraction of law. Hence, there is no question of any amount paid as penalty or any amount paid being akin to penalty as was the case before the Madras High Court in the *M. S. P. Senthikumara Nadar and Sons Vs. Commissioner of Income Tax, Madras*, ."

9. In the same judgment, again at p. 309, the learned judges observed:

"We may also point out that under the scheme it is contemplated that the manufacturer who produces the minimum quantity of the type of cloth specified in the direction issued by the Textile Commissioner may have to incur some loss on that particular item of production and he may be allowed to make it up by charging appropriate prices in the rest of the items of production. If a particular manufacturer exceeds the minimum quantity specified in the direction issued by the Textile Commissioner to him, he is entitled under Clause 21C(1)(a) to be reimbursed by way of some assistance in cash. If a manufacturer does not incur any particular item of extra expenditure by producing the minimum quantity of cloth specified in the direction issued by the Textile Commissioner, then in order to see that he does not make any undue profit by refraining from production of such minimum quantity, this particular piece of legislation provides in Clause 21C(1)(b) for making a payment in cash to the Textile Commissioner in lieu of

the production of the whole or part of the minimum quantity. Hence, what is being done at the time of making the payment is an incident of the production of cloth by the manufacturer depending upon the exercise of option which he will do in view of the technical or technological reasons of his own production machinery. Under these circumstances, it is obvious that the payments made under Clause 21C(1)(b) can never be said to be by way of a payment extracted or required for an infraction of the law....." (underlining ours)

10. At p. 310, the following observations were made by the learned judges :

"In the instant case, the amount was spent by the manufacturer concerned for the purpose of carrying on its business and it was laid out and expended wholly and exclusively for the purposes of the business so that from the commercial point of view, he would carry on the business of manufacturing cotton cloth under the scheme set out in Clauses 21A and 21C of the Cotton Textiles (Control) Order. Hence, the amount spent by the manufacturer would fall fairly and squarely within Section 37(1) of the Income Tax Act, 1961....."

11. We are in complete agreement with the above passages. We do not find it necessary to add anything further in support of the same view.

12. The learned counsel for the Commissioner drew our attention to certain other decisions, some of which have also been considered by the Gujarat High Court. However, in deference to the argument, we would briefly refer to the cases cited. In *M. S. P. Senthikumara Nadar and Sons Vs. Commissioner of Income Tax, Madras*, , the assessee carried on business in coffee. It entered into contracts with the India Coffee Board and purchased coffee at a rate far below the price of coffee to be sold within India, with an obligation to export the whole of the coffee so purchased to places outside India. The assessee, however, exported only part of the coffee so purchased and sold the balance within India in contravention of its obligations. When the Coffee Board came to know of the sales within India and called upon the assessee to explain, the assessee admitted that it had failed to export part of the coffee purchased, and agreed to pay liquidated damages in accordance with one of the three alternatives provided in the contract. The Coffee Board accepted the damages, and the assessee claimed the amount so paid as deduction u/s 10(2)(xv) of the Indian I.T. Act, 1922. This court pointed out that though what the assessee paid to the Coffee Board was called liquidated damages, the payment was really akin to a penalty for committing an act opposed to public policy, a policy that underlay the Coffee Market Expansion Act, 1942, and which the Act left to the Coffee Board to enforce. The breach of its contractual obligations with the Board was not in the course of the normal trading activities of the assessee and the money was held not to have been expended or paid out for the purpose of the assessee's business. It was held that the payment was not even incidental to the business itself. The claim for deduction was, therefore, rejected on the ground that Section 10(2)(xv) did not apply. The main aspect to be noticed about this decision is that the assessee contravened an obligation on the basis of which it was allotted coffee at a

concessional price. The breach of such obligation was considered to be against public policy, and not also incidental to the business, and, therefore, the court rejected the assessee's claim for deduction. The business could have been carried on without committing this breach. The crux of the decision appears at p. 159 and the relevant passage runs as follows :

"The breach of its contractual obligation to the Board was not in the normal course of business, and the liability the assessee had to discharge for such a breach was not incidental to the trade itself that it carried on."

13. In the present case, as the extract from the Control Order would show, the assessee was given an option either to produce the controlled cloth or to pay in lieu thereof certain amounts to be fixed by the Textile Commissioner. The assessee complied with one of the alternatives given to him and paid the amount. In such a case, it cannot be stated that there is any infraction of law or any breach of public policy or even any breach of a contractual obligation. The aim and object of the Control Order was only to encourage production of a particular type of cloth and the mills were given the option of either producing the type of cloth or making a payment which could be absorbed for giving the cash incentive to the other mills which complied with the regulation of producing the particular type of cloth. The entire transaction is thus completely bound up with what the assessee is carrying on as a business. The option available to the assessee was only a business option and the exercise of such an option cannot be equated with what happened in *M. S. P. Senthikumara Nadar and Sons Vs. Commissioner of Income Tax, Madras*, .

14. In *Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II*, the case of *M. S. P. Senthikumara Nadar and Sons Vs. Commissioner of Income Tax, Madras*, was noticed at page 358 and it was understood as a case involving payment of penalty for an infraction of the law which fell outside the scope of permissible deductions u/s 10(2)(xv). It was also pointed out that the assessee in that case was paid liquidated damages which was akin to penalty incurred for an act opposed to public policy, a policy underlying the Coffee Market Expansion Act, 1942, which was left to the Coffee Board to enforce. As indicated earlier, the assessee here by exercising the option available to it under the Control Order was not violating any public policy and did not also indulge in infraction of law or pay any penalty, but it actually complied with the law. The case in *Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II*, was cited only for the purpose of showing that the decision of this court in *M. S. P. Senthikumara Nadar and Sons Vs. Commissioner of Income Tax, Madras*, was approved. The Supreme Court had to consider in *Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II*, , a case where the assessee had imported goods contrary to law and the goods were liable to be confiscated. In order to get a release of the goods, he paid certain amounts as fine. The question was whether the amount paid as fine was deductible and the Supreme Court held that

infraction of law was not a normal incident of business and that the claim could not be allowed as deduction. As will be clear from what we have discussed about the case on hand, there is no question of any infraction of law here.

15. Two other decisions were brought to our notice. In *Cineramas Vs. Commissioner of Income Tax*, the assessee who carried on business in exhibition of films was a member of the East Punjab Motion Pictures Association. It failed to carry out the directive of the association, and for such failure, the assessee could be suspended from membership of the association, subject to being reinstated on payment of a specific sum of penalty and other charges. During the relevant year, the assessee paid Rs. 4,300 by way of "penalty" to the association and claimed it as business expenditure. The expenditure was disallowed by the ITO and the Tribunal. The Punjab and Haryana High Court held that the amount paid by way of "penalty" was not allowable as revenue expenditure. That was not really a case of "penalty" in the sense of money paid for breach of law or rules. It is more a contractual payment. We are concerned here with a statutory payment which has no element of any breach of law or rules about it. The principle of that decision has no scope for application here.

16. A Full Bench of the Allahabad High Court in *Saraya Sugar Mills (P.) Ltd. v. CIT* [1919] 116 ITR 387 considered the allowability of interest paid for the delay in payment of purchase tax. Purchase tax payable by the assessee on sugarcane u/s 3 of the U.P. Sugarcane Purchase Tax Act, 1961, had not been paid in time. The assessee had, therefore, to pay interest and the Allahabad High Court considered it to be a liability which accrued on infraction of the law, namely, failure to pay within the prescribed time and was not incurred by the assessee in his character as a trader. For our present purpose, it is unnecessary to go further into the decision as in the present case the facts are wholly different. As pointed out earlier, this is a case in which the assessee had an option to carry on business under two alternatives and he exercised one of the options available to him under the Control Order and when in exercise of such an option it paid a particular sum, that sum cannot be treated as penalty or non-business expenditure.

17. The result is that the question referred to us is answered in the affirmative and in favour of the assessee. The assessee will be entitled to its costs. Counsel's fee Rs. 250.

T.C. No. 26 of 1976

18. The question referred to us runs as follows:

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the payment made by the assessee to the Textile Commissioner in pursuance of Clause 21C(1)(b) of the Textiles (Control) Order, 1948, is a business expenditure admissible u/s 37 of the Income Tax Act, 1961?"

19. The facts are identical with those considered by us in T.C. No. 614 of 1975 and the provisions are the same. There is no other feature to be considered by us in this case. The question is accordingly answered in the affirmative and in favour of the assessee. The assessee will be entitled to its costs. Counsel's fee Rs. 250.