

(1997) 04 SHI CK 0033

In the High Court Of Himachal Pradesh

Case No : Income-tax Reference No. 1 of 1988

Khushal Singh Subhash Chander

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 01-04-1997

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1997) 228 ITR 608

Hon'ble Judges : M. Srinivasan, C.J.; A.L. Vaidya, J

Bench : Division Bench

Advocate : Ramakant Sharma, for the Appellant; Inder Singh, General, for the Respondent

Judgement

M. Srinivasan, C.J.—The question referred to this court by the Tribunal reads as follows :

" Whether, on the facts and in the circumstances of the case, the Tribunal erred in law in disallowing the payment of additional royalty/ penalty on blazes cut on trees which were not allotted to the assessee ?"

2. The relevant facts are that the assessee had entered into a contract for cutting blazes in the trees for the purpose of collecting resin. He had to pay penalty on two counts, one for cutting bigger sizes of blazes than permitted and second for putting blazes on trees which were not allotted to him. The total penalty levied was with reference to three assessment years, i.e., 1978-79, 1979-80 and 1980-81. In the course of assessment proceedings, the Income Tax Officer held that the payment of those sums had to be made because the assessee had acted in contravention of law and disallowed the claim of the assessee that it should be treated as business expenditure. When the matter came before the Tribunal it was held by the Tribunal that a distinction should be made with regard to the penalty or additional royalty levied for cutting bigger blazes on allotted trees and the penalty or additional royalty paid for cutting blazes unauthorisedly on unallotted trees. The Tribunal took the view that payment made with regard to

the cutting of blazes bigger in size than permitted could be treated as business expenditure and the other payments of additional royalty or penalties on blazes cut on trees which were never allotted to the assessee could not be treated as business expenditure. In order to ascertain the relevant facts under the two different counts, the Tribunal remanded the matter to the Income Tax Officer for redoing the assessment in the light of the observations made by the Tribunal.

3. However, at the instance of the assessee, this court had directed the reference of the question set out earlier by its order dated August 18, 1986. Pursuant to the said order of this court, the question has been referred to us.

4. In so far as the principle is concerned, there is no difficulty whatever, as it has been settled by the Supreme Court as early as in 1960 in *Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II*, . In that case, the assessee was carrying on the business of importing dates from abroad and selling them in India. He imported dates from Iraq partly by steamer and partly by country craft, at a time when import of dates by steamer was prohibited. As he had contravened the provisions of the Sea Customs Act, the customs authorities confiscated the dates imported by him and he was given an option u/s 183 of that Act to pay a fine for getting the dates released. Thus, he paid the fine but claimed the same as allowable expenditure u/s 10(2)(xv) of the Indian Income Tax Act, 1922. It was held that the expenditure incurred by him was by way of penalty for a breach of law, even though it might involve no personal liability and it cannot be said for the purpose of Section 10(2)(xv) of the Income Tax Act as expenditure incurred wholly and exclusively for the business of the assessee. Thus, the claim of the assessee was disallowed. The principle was laid down by the Supreme Court in the following passage (page 359) :

" A review of these cases shows that expenses which are permitted as deductions are such as are made for the purpose of carrying on the business, i.e., to enable a person to carry on and earn profit in that business. It is not enough that the disbursements are made in the course of or arise out of or are concerned with or made out of the profits of the business but they must also be for the purpose of earning the profits of the business. As was pointed out in *Alexander von Glehn's* case [1920] 2 KB 553 an expenditure is not deductible unless it is a commercial loss in trade and a penalty imposed for breach of law during the course of trade cannot be described as such. 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 contemplable 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 a 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."

5. This principle has been reiterated by the Supreme Court in Commissioner of Income Tax, Gujarat-I, Ahmedabad Vs. Ahmedabad Cotton Mfg. Co. Ltd. and Others, though on the facts of the case a distinction was made with regard to the claim made by the assessee in that case; the assessee in that case paid certain sums of money by exercising an option available under clause 21C(1)(b) of the Cotton Textiles (Control) Order, 1948. The question was whether the payment of the said amount would amount to a business expenditure. Upholding the judgment of the High Court of Gujarat, the Supreme Court held that it was not a case of a breach of law and breach of infraction of law as such and it could be treated as a business expenditure though it bore the label "penalty". The Supreme Court referring to the earlier judgment of the court in Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II, said (page 174 of 205 ITR) :

" It is true that an assessee doing business in the accounting year is not entitled to claim deduction u/s 37 of the Income Tax Act, 1961, of an amount paid by such assessee during the year as an amount of penalty or an amount akin to penalty for any breach or infraction of law or any public policy which is sought to be achieved by such law, as is also held by this court in Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II, . But if such payment is made by the assessee during the relevant accounting year without any breach or infraction of any law or any public policy sought to be achieved by it and in fact in obedience to provisions of such law as a measure of business expediency, there could be no valid reason not to allow such payment as deductible expenditure of the assessee u/s 37 of the Income Tax Act.

Therefore, what needs to be done by an assessing authority under the Income Tax Act, 1961, in examining the claim of an assessee that the payment made by such assessee was a deductible expenditure u/s 37 of the Income Tax Act although called a penalty is to see whether the law or scheme under which the amount was paid required such payment to be made, as penalty or as something akin to penalty, that is imposed by way of punishment for breach or infraction of the law or the statutory scheme. If the amount so paid is found to be not a penalty or something akin to penalty due to the fact that the amount paid by the assessee was in exercise of the option conferred upon him under the very law or scheme concerned, then one has to regard such payment as business expenditure of the assessee, allowable u/s 37 of the Income Tax Act, as an incident of business laid out and expended wholly and exclusively for the purposes of the business. However, such payment of the assessee is one which is made in exercise of the option given to such assessee by the law or the statutory

scheme and there arises no need for the assessing authority to go into the question whether the payment could be regarded as one made as a measure of business expediency, for it cannot ignore the fact that the law or the statutory scheme enables incurring of such expenditure in the course of the assessee's business."

6. In view of the aforesaid judgments of the Supreme Court, it is not necessary for us to refer in detail to the decisions cited by counsel on both sides which include COMMISSIONER OF Income Tax Vs. HIMALAYA ROSIN-TURPENTINE MANUFACTURING COMPANY., and Commissioner of Income Tax Vs. C. Baljee and Sons, . The later case is relied on by learned counsel for the assessee. But it is seen from the facts thereof that the ruling will not in any way apply in the present case. In that case the assessee had incurred a liability by way of damages for use and occupation of the premises where he was carrying on the business of running a hotel. The Estate Officer of the Government of India had determined the damages and recovered the amount. The court held that the amount which was paid by the assessee could certainly be treated as a business expenditure and was, therefore, a permissible deduction.

7. We have no doubt in this case that the view expressed by the Tribunal making a distinction between the two counts of payments is correct and in accordance with the law settled by the Supreme Court.

8. In the circumstances, the reference is answered in favour of the Revenue that the Tribunal was right in disallowing the payment of additional royalty/penalty on blazes cut on trees which were not allotted to the assessee.