
(2016) 07 CAL CK 0027
In the Calcutta High Court
Case No : ITA No. 850 of 2008

M/s. Shyam Sel Ltd

APPELLANT

Vs

Deputy CIT

RESPONDENT

Date of Decision : 19-07-2016

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (2016) 386 ITR 492

Hon'ble Judges : Girish Chandra Gupta and Arindam Sinha, JJ.

Bench : Division Bench

Advocate : Mr. R.K. Chowdhury, Advocate, for the Appellant; Mr. Mrinal Kanti Lodh, Advocate, for the Respondent

Final Decision : Allowed

Judgement

1. The subject matter of challenge is a judgment and order dated 31st July 2008 passed by the learned Income Tax Appellate Tribunal "A" Bench, Kolkata in ITA No. 1699/KOL/2007 pertaining to the assessment year 2003-04 by which the learned Tribunal allowed an appeal preferred by the revenue.

2. The aggrieved assessee has come up in appeal. The questions of law formulated at the time of admission of the appeal on 12th January, 2009 are as follows:-

"(a) Whether in the present case the Income Tax Appellate Tribunal has erred in law in disallowing the expenditure of Rs. 12,50,000/- incurred by the petitioner on account of payment of penalty and in not upholding the order of the Commissioner of Income Tax (Appeals)?

(b) Whether on the facts and circumstances of the case, the Income Tax Appellate Tribunal has erred in law in not construing the provision of section 37 of the Income Tax Act, 1961 in passing the impugned order?"

3. At the hearing of the appeal after the learned advocates were heard, we were

inclined to think that the question which falls for determination is as follows:-

"Whether the expenditure of a sum of Rs. 12,50,000/- incurred by the assessee consequent to invocation of the bank guarantee furnished in favour of the West Bengal Pollution Control Board is an allowable expenditure ?

4. The assessing officer disallowed the expenditure for the following reasons :-

"In the course of assessment proceedings the assessee was asked to explain the nature of penalty charges debited in the Profit & Loss account. The amount of Rs. 12,50,000/- was on account of penalty charges paid to Pollution Control Board for non installation of pollution control equipment at the factory premises. The assessee claimed that this amount was deducted by Pollution Control Authorities on account of failure of the assessee for installation of pollution control equipment.

The submission of the assessee is pursued and a sum of Rs. 12,50,000/- on account of penalty charges claimed in the Profit & Loss account for non performance of statutory obligation of Pollution Control Board is being disallowed as the same is inadmissible in nature is being disallowed. The said amount has already been disallowed in earlier assessment. Year also."

5. The CIT(A), however, reversed the order of the assessing officer for the following reasons:-

"On a perusal of the relevant records it is seen that the payment for installation of pollution control equipment has been made in response to the direction of the Senior Law Officer of W. B. Pollution Control Board failing which the Board had decided to issue a Closure Order with disconnection of electricity without any further reference. In view of such facts, it is apparent that the payment was not exactly made in way of penalty but in response to the order of the government."

6. The learned tribunal, however, reversed the order of the CIT(A) for the following reasons:-

"It is very clear that the amount of Rs. 12,50,000/- was levied as penalty by the West Bengal Pollution Control Board because the assessee had failed to comply with the order of the Pollution Control Board to fulfil its statutory obligation of installing the pollution control equipment before the prescribed time limit. The submission of the assessee that it could not fulfil its statutory obligation because of lack of funds and there was no intention to violate the statutory provisions or that the pollution control equipment was finally installed, are of no relevance to the issue because the State Govt. had levied the penalty after considering all the relevant facts and circumstances of the case and what is relevant for us is to decide whether the payment was in the nature of statutory penalty " imposed by way of punishment for breach or infraction of the law" or compensation in exercise of an option, as held by the Hon'ble Supreme Court in the case of Ahmedabad Cotton Mfg. Co. Ltd. (supra). Since in this case neither any option was given to the assessee nor there was any commercial expediency involved

and the penalty was levied for violation of the statute, the amount of Rs. 12,50,000/- had been rightly disallowed as inadmissible expenditure and added back to the income of assessee by the A.O. We, 5 therefore, reverse the order of the learned. CIT(A) on this issue and restore the order of the learned. Assessing Officer This ground of appeal of the revenue is allowed."

7. Mr.Chowdhury, learned advocate appearing for the assessee submitted that payment of a sum of Rs. 12,50,000/- was by way of compensation because the assessee had failed to install the requisite device within the prescribed time, as per the performance guarantee furnished by him, which so far as material for our purpose is as follows:-

"1. We, Oriental Bank of Commerce, Princep Street Branch, 2B, Ganesh Chandra Avenue, Kolkata - 700 013 (hereinafter referred to as Guarantor Bank term include it's successor or assignee) with it's Head Office at Harsha Bhawan, E-Block, Connaught Place, New Delhi - 110 001, hereby agree unequivocally to pay within 1(One) year, on demand in writing from the Member Secretary, West Bengal Pollution Control Board (hereinafter referred as the Board), which term included his successor or assignee or any officer authorised by this Board in this behalf any amount up to and not exceeding Rs. 10,00,000/- (Rupees Ten Lacs only) only to Board on behalf of M/s Shyam SEL Limited, formerly M/s Shayma Cast Limited, Regd. Office at 29, Ganesh Chandra Avenue, Kolkata - 700 013 (hereinafter called the industry, which term shall include it's successor or assignee).

2. Where as the industry has undertaken to complete the erection of Pollution Control System in all respect up to the satisfaction of the State Board and meeting the statutory norms under existing Environmental Acts and Rules. We, Oriental Bank of Commerce, Princep Street Branch, 2B, Ganesh Chandra Avenue, Kolkata - 700 013 (the guarantor bank), do, hereby undertake to pay to the Board an amount not exceeding Rs. 10,00,000/- (Rupees Ten Lacs only) if and when demanded by this Board within 1 (One) year from the date of execution of Bank Guarantee."

8. There is evidence to show that bank guarantees for an aggregate sum of Rs. 25 lakhs were furnished. Because the assessee had failed to install the device in time, the bank guarantees were invoked, consequent thereto the payment of a sum of Rs. 12,50,000/- was made by way of compensation. He drew our attention to a judgment of the Apex Court in the case of M.C. Mehta v. Kamal Nath and Others reported in 2000(6) SCC 213 wherein the subject matter of challenge was a notice issued for imposition of fine for causing pollution. Their Lordships in that case held that :-

"A fine is to be imposed upon the person who is found guilty of having contravened any of the provisions of the Act. He has to be tried for the specific offence and then on being found guilty, he may be punished either by sentencing him to undergo imprisonment for the period contemplated by the Act or with fine

or with both. But recourse cannot be taken to Article 142 to inflict upon him this punishment."

9. Their Lordships held that notice was bad. The notice should have been a notice to show cause, why exemplary damages should not be awarded for having caused pollution. The aforesaid direction is contained in the paragraph 24 of the report which reads as follows:-

"24. Pollution is a civil wrong. By its very nature, it is a Tort committed against the community as a whole. A person, therefore, who is guilty of causing pollution has to pay damages (compensation) for restoration of the environment and ecology. He has also to pay damages to those who have suffered loss on account of the act of the offender. The powers of this Court under Article 32 are not restricted and it can award damages in a PIL or a Writ Petition as has been held in a series of decisions. In addition to damages aforesaid, the person guilty or causing pollution can also be held liable to pay exemplary damages so that it may act as a deterrent for others not to cause pollution in any manner. Unfortunately notice for exemplary damages was not issued to M/s. Span Motel although it ought to, have been issued. The considerations for which "fine" can be imposed upon a person guilty of committing an offence are different from those on the basis of which exemplary damages can be awarded. While withdrawing the notice for payment of pollution fine, we direct a fresh notice be issued to M/s. Span Motel to show cause why in addition to damages, exemplary damages be not awarded for having committed the acts set out and detailed in the main judgment. This notice shall be returnable within six weeks. This question shall be heard at the time of quantification of damages under the main judgment."

10. Mr. Chowdhury submitted that the learned Tribunal held that it was a penalty imposed and, therefore, not deductible. He contended that no proceedings were initiated against the assessee. There is no finding that the assessee committed any offence. There is no order imposing penalty upon him. From the order passed by the CIT (A), it will appear that payment was made pursuant to an order of Senior Law Officer of West Bengal Pollution Control Board. He submitted that the learned Tribunal fell into an error in not realising that the payment was in the nature of compensation and not in the nature of penalty. Therefore, the question of the sum being not deductible could not arise. He also drew our attention to a judgment of the National Green Tribunal in the case of State Pollution Control Board v. M/s. Swastik Ispat Pvt. Ltd. and Ors. He drew our attention to paragraph 33 wherein the practise of insisting upon furnishing a bank guarantee has been discussed, which reads follows :-

"The procedure normally adopted by the Board is to permit the industrial operations for a definite period upon furnishing of Bank Guarantee for compliance and compensation, if required, and during interregnum permitting the industry to comply with the various directions and the conditions stated in the consent order including installation of antipollution devices. This helps the

sustainable development as industrial activity is not straightaway closed or prohibited but is permitted to carry on subject to compliance with the conditions imposed. Thus, it clearly falls in the domain of regulatory regime as opposed to prohibitory or closure regime."

11. In support of his submission that the amount recovered from the assessee was in the nature of compensation and not penalty, Mr. Chowdhury relied upon paragraph 38 of the judgment, which reads as follows:-

"Being punitive is the essence of ?penalty?. It is in clear contradistinction to ?remedial? and/or ?compensatory?. ?Penalty? essentially has to be for result of a default and imposed by way of punishment. On the contrary, ?compensatory? may be resulting from a default for the advantage already taken by that person and is intended to remedy or compensate the consequences of the wrong done. For instance, if a Unit has been granted conditional consent and is in default of compliance, causes pollution by polluting a river or discharging sludge, trade effluent or trade waste into the river or on open land causing pollution, which a Board has to remove essentially to control and prevent the pollution, then the amount spent by the Board, is thus, spent by encashing the bank guarantee or is adjusted threat and this exercise would fall in the realm of compensatory restoration and not a penal consequence. In gathering the meaning of the word ?penalty? in reference to a law, the context in which it is used is significant."

12. Mr.Lodh, learned advocate, appearing for the revenue drew our attention to the judgment of the learned Tribunal and reiterated that the payment made by the assessee was in the nature of a penalty and, therefore, should not be deductible under section 37.

13. We have considered the rival submissions advanced by the learned advocates. It would be fruitful to notice section 37 and Explanation I thereto, which are as follows:-

"37. (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly 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".

[Explanation 1]- 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."

14. Under sub-section I of Section 37 it is provided that the revenue expenditure should have been spent wholly and exclusively for the purposes of business or profession in order to be deductible. Explanation-1 provides for the expenses which are not deductible. An 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. It is an indirect recognition of the fact that there may be an expenditure incurred by the assessee which may be wholly or exclusively for the purposes of business, yet shall not be deductible if the purpose of such payment is an offence or is prohibited by law. For better understanding of the issue, reference may be made to Section 24 of the Contract Act, which provides as follows:-

"24. Agreements void, if considerations and objects unlawful in part.- If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void.

Illustration

A promises to superintend, on behalf of B, a legal manufacture of indigo, and an illegal traffic in other articles. B promises to pay to A a salary of 10,000 rupees a year. The agreement is void, the object of A's promise, and the consideration for B's promise, being in part unlawful"

15. It would appear from the statutory Illustration that the promise to pay a sum of Rs. 10000/- by way of salary is partly for illegal trafficking consequently the agreement is void and not enforceable in law. The Illustration throws light upon the question to be determined by us. The payment of the sum of Rs. 12,50,000/- would not be deductible if the same had been made for the purpose of achieving an illegal object or for an illegal purpose. Such payment is opposed to public policy which presumably is the reason why the same is not deductible.

16. The payment in this case was for the purpose of compensating the damage to the environment and this compensation has been recovered on the "polluter pays principle" adopted by the Organisation for Economic Cooperation and Development which has been recognised both in the judgment of M.C. Mehta (para 11) and in the judgment of Green Tribunal referred to above by us.

17. It is nobody's case that the business pursued by the assessee was illegal. The compensation was paid because the assessee had failed to install the pollution control device within the time prescribed. Therefore, payment of the sum of Rs. 12,50,000/- is not hit by explanation-1 to Section 37 of the Income Tax Act. The payment is undoubtedly for the purpose of business or is in consequence of business carried on by the assessee and is thus covered by section 37.

18. For the aforesaid reasons, the order passed by the learned Tribunal is set aside.

19. The question formulated by us is answered in the affirmative and against the revenue. The questions originally formulated need not be answered.

20. The appeal is, thus, allowed.