IN THE HIGH COURT OF JUDICATURE AT BOMBAY
O.O.C.J.

INCOME TAX APPEAL NO. 51 OF 2016

WITH
NOTICE OF MOTION NO. 797 OF 2018
IN
NOTICE OF MOTION NO. 1975 OF 2016
IN
INCOME TAX APPEAL NO. 51 OF 2016

The Principal Commissioner of Income Tax -17, Mumbai.	.. Appellant
Versus	
Sushil Gupta Legal Representative of Late Shri. Mahabir Prasad Gupta A.Y. 1988-99 PAN : AALPG1065E	.. Respondent

.....

- Mr. Prakash Chandra Chhotaray for the Appellant
- Mr. Vikram Nankani, Senior Counsel with Mr. S.L. Shah i/by M/s. Shah Legal for the Respondent

.....

CORAM : AKIL KURESHI &
B.P. COLABAWALLA, JJ.

RESERVED ON : FEBRUARY 13, 2019.
PRONOUNCED ON : FEBRUARY 22, 2019 at 2.45 P.M. IN CHAMBER

ORAL JUDGMENT (Per Akil Kureshi, J.)

1. This appeal was admitted for consideration of following substantial question of law:-

" Whether on the facts and in the circumstances of the case

and in law, the Tribunal was justified in holding that the redemption fine of Rs. 75,00,000/- is allowable as business expenditure under Section 37 of the Income Tax Act?"

2. The appeal arises in following background:-

2.1 Respondent assessee is an individual. For the assessment year 1988-89, the assessee had filed return of income declaring total income of Rs. 1,47,020/-. The return was accepted without scrutiny. Subsequently, information was received by the Assessing Officer that the assessee had made payment of Rs. 75 lacs in two separate installments towards penalty for import of almonds which import was not permissible. On the basis of such information, the Assessing Officer reopened the assessment for the said assessment year 1988-89 by issuing the notice under Section 148 of the Income Tax Act, 1961 ("the Act" for short).

2.2 During the course of such assessment proceedings, the assessee was called upon to provide various details by the Assessing Officer. The representative of the assessee remained present before the Assessing Officer and conveyed that the assessee was using import license of M/s. Rajnikant Bros. which is an export house. For using the license, the

assessee would pay service charges equivalent to 25% of CIF value of the goods. It was further pointed that the consignment of almond was imported by M/s. Rajnikant Bros. The assessee had merely acted as an agent in the transaction. It was pointed out that upon confiscation of the goods, redemption fine and penalty were imposed by the Collector of Customs, Madras on M/s. Rajnikant Bros. Tribunal in the appeal reduced the redemption fine to Rs. 75 Lacs and deleted personal penalty. It was contended that in any case, the imports were made by M/s. Rajnikant Bros. and the order was passed against M/s. Rajnikant Bros. and not against the assessee. It was also contended that the penalty was paid by M/s. Rajnikant Bros. and not by the assessee. The assessee, however, could not produce the books of accounts to establish this averment. The Assessing Officer, therefore, issued summons to M/s. Rajnikant Bros. asking for a copy of the agreement dated 14.10.1985 entered between the assessee and M/s. Rajnikant Bros. for the use of import licence and other details. In response to the summons, the accountant of M/s. Rajnikant Bros. appeared before the Assessing Officer. A copy of the said agreement dated

14.10.1985 was produced. The procedure attached to the agreement was also produced. The statement of the accountant of M/s. Rajnikant Bros. was recorded. Relevant portion of which reads as under:-

"Q. No. 4 : What is the modus operandi of the transaction made by Shri. M.P. Gupta regarding the use of licence?

Ans. : Mr. M.P. Gupta has imported almonds in Madras Port on 20.12.195 by using the above said licence. The said material imported in the name of M/s. Rajnikant Bros. Total consideration of import material along with duty, fine, foreign payment and clearing charges etc. are as under:-

	Purchases	**Rs.**
i.	Foreign payment	55,65,487.23
ii.	Duty	56,00,000.00
iii.	Redemption Fine (Penalty) (As per Madras Customs Order dt. 27.10.86)	75,00,000.00
iv.	Clearing Charges & Expenses	15,72,487.10
v.	Service Charges of M/s. Rajnikant Bros. (As per Agreement dt. 14.10.85)	12,50,000.00
	Total	Rs. 2,14,87,974.33

Q. No. 5 : As stated by you redemption fine of Rs. 75,00,000/- paid to Madras Customs House. Please state who has paid the sum:

Answer : Rs. 75,00,000/- paid as custom fine by Mr. M.P.

Gupta through Rajnikant Bros. from Banoue Indosuez P. Box 685 A/c No. 11124 201 5301. All transactions were made by Shri. M.P. Gupta hence, he is responsible for the above fine. As per agreement, we are only related for our service charges."

2.3 The Assessing Officer confronted the assessee with the factum of payment of penalty of Rs. 75 Lacs. The assessee in a written response dated 28.2.1997 contended that he had only made advances to M/s. Rajnikant Bros from time to time as per the requirements but had not paid penalty of Rs. 75 Lacs.

2.4 The Assessing Officer did not accept the said explanation particularly in view of the failure of the assessee to produce books of accounts. He was also of the opinion that the stand of the assessee was in conflict with the agreement dated 14.10.1985. He did not accept the assessee/s version of mere advances being made to M/s. Rajnikant Bros. He, therefore, held as under:-

" All the above facts clearly established that the assessee viz. Shri. M.P. Gupta, user of the licence standing in the name of M/s. Rajnikant Bros., has made the custom penalty of Rs. 75,00,000/-. I, therefore, treat that this expenditure is covered u/S. 69C of the Act and has been incurred by the assessee from unexplained source of which the assessee has no explanation about the source nor the

assessee offered any satisfactory explanation. The penalty proceedings u/S. 271(1)(c) is being initiated separately."

2.5 The assessee carried the matter in appeal and reiterated his stand. In the context of the addition under Section 69C of the Act, the Commissioner rejected the assessee's plea by making following observations:-

" As regards addition u/S. 69C, the appellant has claimed that payment was made through funds arranged by the assessee through M/s. Mangla Bros and debited to M/s. Rajnikant & Bros accounts. The copy of the confirmation filed by M/s. Mangla Bros. as a Certificate dated 24.11.1997 it states that payments have been made to Collector of Customs, M.P. Gupta account, M/s. Rajnikant & Bros. which gives DD No., date, amount and name of the party to whom payment was arranged. The Certificate does not carry any PAN/GIR No. of M/s. Mangla Bros. and thus, itself of limited validity. In the absence of books of account and a valid confirmation the source of expenditure is not satisfactorily explained and the payment is liable to be treated as unexplained expenditure u/s 69C of the Act."

2.6 The assessee had raised additional contention that when the expenditure was attributed to the assessee, the same should be considered as business expenditure. In this context, the question of such expenditure incurred for any purpose which is an offence or which is prohibited by law came up for consideration. The assessee had raised additional contention, though grounds of appeal were

confined to questioning the additions made by the Assessing Officer under Section 69C of the Act. The Commissioner of Income Tax (Appeals) ["the CIT(A) for short], therefore, considered whether the expenditure was in the nature of compensatory expenditure or towards fine in contravention of law. The CIT(A) while rejecting this contention, observed as under:-

> " The appellant's plea is that the expense is allowable as a cost u/S. 37 in accordance with case laws cited. It is found that after considering the judgments of the Bombay High Court in (a) CIT Vs. Pannalal Narottamdas & Co (supra) which laid down that redemption fine is additional cost for the goods purchased and (b) the judgment in Rohit Pulp & Paper Mills Vs. CIT (1995) 215 ITR 919/79 Taxman 168 (Bom), where also there was confiscation of goods u/s. 111(d) of the Customs Act and a fine was paid u/s. 125 of the Customs Act, and the High Court held that payment was in the nature of penalty, the ITAT, Mumbai in Dimexon's case (supra) has held that where the penalty / fine has to be incurred because of the fault of the assessee himself, i.e, carrying on of business in an unlawful manner or in contravention of certain rules and regulations, the penalty / fine paid cannot be regarded as wholly laid out for the purpose of business. Thus, in the face of the specific findings of the Custom Tribunal and Madras High Court, the appellant's contention is without force."

2.7 The assessee carried the matter in further appeal before the Tribunal. In such appeal, the assessee raised both the contentions. In addition to questioning the very addition of Rs. 75 Lacs under Section 69C of the Act, he also

challenged the decision of the CIT(A) not accepting the contention that in any case, the expenditure was made wholly and exclusively for the the purpose of business and therefore, allowable as business expenditure.

2.8 The Tribunal, in the impugned judgment, referred to the documents under which the import of almond was held to be unlawful. The Tribunal noted that the Collector of Customs, Madras had confiscated the goods, imposed redemption fine 1.20 crore and penalty of Rs. 20 lacs on M/s. Rajnikant Bros. Ms/. Rajnikant Bros. had filed appeal before the Customs Tribunal, Madras which had reduced redemption fine to Rs. 75 Lacs and deleted the penalty. The Tribunal, while allowing the appeal of the assessee and recognizing the expenditure as business expenditure came to following conclusions:-

(i). The assessee and the Export House were under bonafide belief that the almond in shell was one of the items allowed for import against additional licence granted;

(ii). That the Customs Tribunal had held that there was no malafide on the part of the assessee as there was certain amount of vagueness in the import policy and therefore, redemption fine was reduced and penalty was deleted;

(iii). The Tribunal noted the decision of the Supreme Court in the

> case of CIT V/s. Ahmedabad Cotton Mfg. Co Ltd.[1] and was of the opinion that the facts of the present case were similar. The Tribunal noted that in the said case, it was found that the fault or defect in the REP licence was not attributable to the assessee. The assessee was not to be blamed,had not indulged in any offence or incurred any expenditure for the purpose which is prohibited by law and the assessee had to pay redemption fine in order to save and protect themselves."

2.9 Against this judgment, the Revenue has filed this appeal.

3. Mr. Chhotaray, learned counsel appearing for the Revenue submitted that the amount of Rs. 75 Lacs paid by the assessee was towards redemption fine. In terms of Explanation 1 to Section 37(1) of the Act, such expenditure was not an allowable deduction. The Tribunal, therefore, committed serious error in allowing the assessee's appeal. He took us extensively through the orders and statements on record and submitted that the Assessing Officer and CIT(A) came to the specific conclusion that it was the assessee who had made the imports and had, therefore, paid the redemption fine. The Tribunal without any basis came to the conclusion that the assessee was not connected with the import of almond which led to imposition of redemption fine.

1 [1994] 205 ITR 163 (SC)

He submitted that the judgment of the Supreme Court in case of Ahmedabad Cotton Mfg. Co. Ltd. (supra) was therefore, wrongly applied by the Tribunal. Learned counsel heavily relied on the decision of the Supreme Court in the case of **Haji Aziz & Abdul Shakoor Bros. Vs. CIT[2].** Learned counsel for the Revenue has also relied on certain decisions reference to which would be made at proper stage.

4. On the other hand, Mr. Nankani opposed the appeal contending that the assessee was not an importer. The imports were made by M/s. Rajnikant Bros. The assessee had merely entered into an agreement with M/s. Rajnikant Bros. for purchase of imported almond which in turn would be sold by the assessee to local consumers / manufacturers for commission. The sum of Rs. 75 Lacs was thus paid to prevent the imported consignment being forfeited. The expenditure was thus made on business considerations. Sum of Rs. 75 Lacs thus, was an additional cost of purchase in the hands of the assessee. In the hands of the assessee, it would not partake the character of penalty. He placed reliance on the decision of this Court in the case of **CIT,**

2 41 ITR 350 (SC)

Bombay Vs. Pannalal Narottamdas & Co[3]. He also referred to several other judgments reference to which would be made at proper stage.

5. Before dealing with the rival contentions, we may record the genesis of the present dispute. M/s. Rajnikant Bros. and another who were diamond exporters had applied for grant of Export House Certificates under the Import Policy 1978-79 which was denied to them on the ground that they had not diversified their exports. They had, therefore, filed writ petition before the Bombay High Court claiming that they were entitled to Export House Certificates. Such declaration was granted by the Bombay High Court. Special Leave Petition filed by the Union of India against the judgment of the Bombay High Court was dismissed directing the Government of India to issue necessary Export House Certificates for the year 1978-79 and further providing that : "Save and except items which are specifically banned under the prevalent Import Policy at the time of import, the respondents shall be entitled to import all other items whether canalized or otherwise in accordance with the

3 (1968) 67 ITR 667 (Bom)

relevant rules". Pursuant to such directions, M/s. Rajnikant Bros. were granted additional licence. It started importing goods. At that stage, Indo Afghan Chambers of Commerce who was the association of dealers engaged in the business of selling dry fruits in North India filed a petition before the Supreme Court under Article 32 of the Constitution contending that the goods sought to be imported on the additional licences included those which were prohibited by the prevalent import policy. The Supreme Court held that under the import policy of 1985-88 when the dry fruits were sought to be imported, they were no longer open to import under the Open General Licence. Relevant observations of the Supreme Court read thus:-

> "7. We may assume for the purpose of this case that a diamond exporter is legitimately entitled to obtain an Additional Licence under the Import Policy 1978-79 for an item which is different from the item he may have intended to import had the Additional Licences been rightly granted to him originally. In that event, the diamond exporter can succeed only if the item could have been imported under the Import Policy 1978-79 and also under the Import Policy 1985-88 in accordance with the terms of the order of this Court dated April 18, 1985 as construed by this Court by its judgment dated March 5, 1986.
>
> 12. In our opinion the respondents diamond exporters are not entitled to import dry fruits under the Import Policy 1985-88 under the

Additional Licences possessed by them. They are also not entitled to the benefit extended by the judgment of this Court dated March 5, 1986 to those diamond exporters who had imported items under irrevocable Letters of Credit opened and established before October 18, 1985. It appears from the record before us that the respondents diamond exporters opened and established the irrevocable Letters of Credit after that date.

14. The writ petition is allowed and the respondents Nos. 10 and 11, M/s. Rajnikant Brothers and M/s. Everest Gems are restrained from importing dry fruits during the period 1985-88 under the Additional Licences granted to them under the Import Policy 1978-79. In the circumstances there is no order as to costs."

With this background, we may refer to the facts on hand. As noted, the Assessing Officer in the order of assessment after giving ample opportunities to the assessee came to the conclusion that the assessee M.P. Gupta was the user of the licence in the name of M/s. Rajnikant Bros. and all transactions including the payment of penalty had been carried out by him. He did not accept the version of the assessee that the assessee had merely advanced the money to M/s. Rajnikant Bros. in time of its need. It was held that the assessee had paid the customs fine of Rs. 75 Lacs. Since, it could not shown the legitimate source of this amount, the Assessing Officer treated the same as

assessee's unexplained expenditure. Before the CIT(A) also, the assessee failed to persuade the Appellate Authority that the addition under Section 69C of the Act was wrongly made by the Assessing Officer. At which time, the petitioner raised additional contention claiming deduction of the same amount by way of business expenditure. In response to this, the CIT(A) held that the penalty or fine had to be incurred because of the fault of the assessee himself of carrying on business in unlawful manner or in contravention of the rules and regulations.

6. In our opinion, the Tribunal without adverting to the relevant facts and materials on record granted benefit to the assessee on the lines followed by this Court in the case of Pannalal (supra). The Tribunal without discussing the relevant materials compared the case of the assessee with the facts arising in the judgment of the Supreme Court in the case of Ahmedabad Cotton Mfg Co Ltd (supra) in which it was recorded that the fault or defect in the REP licence was not attributable to the assessee and therefore, the assessee was not to be blamed for indulging in any offence or having

incurred any expenditure for the purpose which was prohibited by the law. In the present case, the Assessing Officer had held that it was the assessee who had imported the goods. The CIT(A) also largely concurred with this finding. The Tribunal did not advert to the materials on record to give a different conclusion. The Tribunal totally ignored the statement of the representative of M/s. Rajnikant Bros., relevant portion of which is reproduced earlier in which he attributed the entire transaction of import and payment or fine to the assessee. The Tribunal merely referred to the terms of the agreement overlooking the ground realities. The entire consideration of the Tribunal, therefore, has been vitiated on account of this vital error. Even otherwise, the facts on record would suggest that it was the assessee who had imported the goods by utilizing the advance licence of said M/s. Rajnikant Bros. M/s. Rajnikant Bros. merely received payment computed in terms of percentage of CIF value of the imports. For the purpose of making declarations and filing bill of entries, M/s. Rajnikant Bros. may be the correct entity and therefore, the Customs Authorities might have offered redemption fine and imposed penalty on M/s.

Rajnikant Bros and the Tribunal in the appeal may have reduced the redemption fine and deleted the penalty in the hands of M/s. Rajnikant Bros, but in the context of income tax liability, we cannot ignore the hard facts that the imports were made by the assessee himself. M/s. Rajnikant Bros. had merely allowed the licence to be used for such purpose. In essence,therefore, whatever the fault, defect or error of law in such import, would attach to the assessee. In the context of considering whether the expenditure incurred in the process of importing the goods could be claimed by way of expenditure regard being had to the first explanation to sub-section (1) of Section 37, would therefore have to be decided on the anvil of this conclusion.

7. Once this much is clear, everything else would fall in line. There is a clear line of distinction between two lines of authorities, one led by the judgment of the Supreme Court in the case of Hazi Aziz (supra) and the other adopted by this Court in the case of Pannalal (supra) as pointed out by learned counsel for the assessee.

8. In case of Hazi Aziz (supra), the facts were that the assessee was a firm doing the business of importing dates from abroad and selling them in India. During the accounting year under consideration, the assessee had imported dates from Iraq. At the relevant time, import of dates by steamer was prohibited but permitted to be brought by country craft. The goods ordered by the assessee were received partly by steamer and partly by country craft. Consignments imported by steamer were confiscated by the Customs Authorities and the assessee was given an option to pay fine for redemption of goods, upon payment of which the dates were released. The assessee claimed the redemption fine amount by way of deduction while computing profit arising out of sale of the goods. In this background, the issue reached the Supreme Court. The Supreme Court held that the expenditure was in the nature of penalty for infraction of law and therefore, not a deductible expenditure. It was observed as under:-

> " 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 Von

Glehn's case [1920] 2 K.B. 553 an expenditure is not deductible unless it is a commercial loss in trade and a penalty imposed for breach of the 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.

It was argued that unless the penalty is of a nature which is personal to the assessee and if it is merely ordered against the goods imported it is an allowable deduction. That, in our opinion, is an erroneous distinction because disbursement is deductible only if it falls within 10(2)(iv) of the Income-tax Act and no such deduction can be made unless it falls within the test laid down in the cases discussed above and it can be said to be expenditure wholly and exclusively laid for the purpose of the business. Can it be said that a penalty paid for an infraction of the law, even though it may involve no personal liability in the sense of a fine imposed for an offence committed, is wholly and exclusively laid for the business in the sense as those words are used in the cases that have been discussed above. In our opinion, no expense which is paid by way of

penalty for a breach of the law can be said to be an amount wholly and exclusively laid for the purpose of the business. The distinction sought to be drawn between a personal liability and a liability of the kind now before us is not sustainable because anything done which is an infraction of the law and is visited with a penalty cannot on grounds of public policy be said to be a commercial expense for the purpose of a business or a disbursement made for the purposes of earning the profits of such business.

In our opinion the High Court rightly held that the amount claimed was not deductible and we therefore dismiss this appeal with costs."

9. In case of **Maddi Venkataraman & Co P Ltd Vs. CIT**[4] , the facts were that the assessee company had remitted to a party in Singapore certain amounts in violation of law. The proceedings were undertaken against the assessee for infringement of the relevant provisions of Foreign Exchange Regulation Act which ultimately resulted into penalty being imposed against the assessee. The Supreme Court held and observed as under:-

"20. The case of Haji Aziz Abdul Shakoor Bros. (supra) is important for another reason. It was categorically held in this case that no distinction can be made in this regard between a personal liability and a liability of any other kind. So long as the payment has to made for infraction of law, it cannot be said that it was made in course of carrying out of the trade.

4 (1998) 2 SCC 95

23. In the instant case, the assessee had indulged in transactions in violation of the provision of Foreign Exchange (Regulation) Act. The assessee's plea is that unless it entered into such a transaction, it would have been unable to dispose of the unsold stock of inferior quality of tobacco. Another words, the assessee would have incurred a loss. Spur of loss cannot be a justification for contravention of law. The assessee was engaged in tobacco business. The assessee was expected to carry on the business in accordance with law. If the assessee contravenes the provision of FERA to cut down its losses or to make larger profits while carrying on the business, it was only to be expected that proceedings will be taken against the assessee for violation of the Act. The expenditure incurred for evading the provisions of the Act and also the penalty levied for such evasion cannot be allowed as deduction. As was laid down by Lord Sterndale in the case of Alexander Von Glehn (supra) that it was not enough that the disbursement was made in the course of trade. It must be for the purpose of the trade. The purpose must be a lawful purpose.

24. Moreover, it will be against public policy to allow the benefit of deduction under one statute of any expenditure incurred in violation of the provisions another stature or any penalty imposed under another statute. In the instant case, if the deductions claimed are allowed, the penal provisions of FERA will become meaningless. It has also to be borne in mind that evasion of law cannot be a trade pursuit. The expenditure in this case cannot, in any way, be allowed as wholly in this case cannot, in any, way be allowed as wholly and exclusively laid out for the purpose of assessee's business."

10. In case of **Rohit Pulp and Paper Mills Ltd Vs. C.I.T.[5],** the assessee had imported goods which were found by Customs Authorities not covered by a valid licence. The

5 [1995] 215 ITR 919 (Bom)

Deputy Collector of Customs ordered confiscation of the goods and offered redemption on payment of fine. This amount was claimed by the assessee as a deduction. Rejecting such a claim, the High Court observed as under:-

> " We do not find that the above amount paid by the assessee is anything else than a penalty. It is, therefore, not allowable as a deduction under the Income Tax Act. The Income Tax Officer and other authorities were justified in not allowing any deduction under Section 37 of the Income Tax Act on account of the same. The third question is, therefore, answered in the negative and in favour of the Revenue."

11. In case of **M.S.P. Senthikumara Nadar & Sons Vs C.I.T. Madras[6],** Division Bench of Madras High Court considered a case where the assessee firm which was carrying on the business in coffee had entered into contract with India Coffee Board and purchased coffee at a rate far below the price of coffee to be sold within India with the contractual obligation to export the whole of the coffee so purchased to the places outside India. The assessee, however, exported part of it and sold the rest within India. The Coffee Board, in terms of the agreement levied damages from the assessee for breach of the contract. This amount

6 [1957] 32 ITR 138 (Madras)

was paid by the assessee and and claimed by way of expenditure. The High Court referred to various judgments on the issue and observed as under:-

> "From what we have said above it should be clear that it was not a case of a payment of damages for a mere breach of contract with nothing more. It was not of course a case of penalty paid under the terms of a statute for contravention of any specific statutory provision. In the circumstances of this case, the liquidated damages claimed and paid was, however, more akin to a penalty than the damages suffered for breach of contract in the course of normal trading activities, whether or not that breach of a contract was also dishonest. That is why we said that it may not be necessary to rest our decision in this case on the rule laid down in Masks case [1943] 11 ITR 454. In our opinion it is the principle laid down in Von Glehns case [1920] 12 Tas Cas. 232 that should be extended and applied to negative the claim of the assessee in this case. To adopt the words of Sterndale, M. R., in Von Glehns case (supra) the assessee's business could perfectly well be carried on without any infraction of the obligations laid on the assessee by the India Coffee Board, entrusted with the statutory duty of controlling and regulating sales of coffee. A penalty was imposed because of an infraction of these obligations and the money was not expended or laid out for purposes of the trade which the assessee carried on. Or in the words of Scrutton, L.J :
>
> "Were these fines made or paid for the purpose of earning the profit ? The answer seems to me obvious, that they were not, they were unfortunate incidents which followed after the profits had been earned."

12. In case of **Agra Leatheries Ltd Vs. CIT[7],** the Division Bench of Allahabad High Court considered the case where the assessee had obtained licence for import under which the assessee had imported plastic sponges. The Customs Authorities held that under the licence, the assessee could have imported only natural sponges and not plastic sponges and the import of plastic sponges was thus illegal. The assessee claimed penalty for infraction of law by way of expenditure. The Allahabad High Court relied on the decision of the Supreme Court in the case of Hazi Aziz (supra), ruled against the assessee by making following observations:-

> " The question whether penalty levied for infraction of law is a permissible deduction is not res integra. In Haji Aziz and Abdul Shakoor Bros. v. CIT [1961] 41 ITR 350, the Supreme Court held that in a case where the penalty has to be incurred because of the fault of the assessee himself, as for instance for the reason of his having carried on his business in an unlawful manner or in contravention of certain rules and regulations, the penalty paid by the assessee for such conduct could not be regarded as wholly laid out for the purpose of the business, because the incurring of the said expenses has not been necessitated by the business but by the conduct of the assessee in trying to carry on the business in unlawful manner. We, therefore, do not see any legal infirmity in the view taken by the Tribunal."

7 [1993] 200 ITR 792 (Allahabad)

The decision of this Court in the case of Pannalal (supra) was cited before the Court which was distinguished.

13. This Court in a decision in the case of **T. Khemchand Tejoomal Vs. CIT**[8] considered a case where the assessee was a registered firm doing business mainly in cloth. The assessee had acquired a licence for importing automobile spare parts. The assessee then entered into a contract for import and sale of capacitors to one Bipin Automobiles. The purchaser would bear all expenses including customs duty. Pursuant to the agreement, the assessee placed an order of capacitors and the goods were imported. However, it was found that the goods did not conform to some of the specifications in the licence and the Customs Authorities confiscated the goods and offered the option to pay penalty for clearance of goods. The assessee paid the penalty and claimed it as business expenditure. Before the High Court, it was argued that the assessee was a mere nominal licence holder and the penalty was really levied on Bipin Automobiles to whom the goods have been sold and therefore, the assessee should be allowed to claim the

8 161 ITR 492 (Bom)

expenditure as business expenditure. The Court held and observed as under:

> " The submission of Mrs. Jagtiani, learned counsel for the assessee, is that in this case, on the facts found, the assessee must be regarded as a mere nominal licence-holder and the penalty was really levied on M/s. Bipin Automobiles to whom the goods had been sold as aforesaid. It was argued by her that, in these circumstances, the assessee should be allowed to claim the amount of penalty paid by the assessee as a deduction in the computation of profits under section 28 of the Income Tax Act, 1961. She placed strong reliance on the decision of a Division Bench of this court in CIT v. Pannalal Narottamdas & Co. : [1968] 67 ITR 667(Bom) . We shall deal with this case after setting out our own views. In the present case, the facts found by the Tribunal clearly show that it was the assessee who had got the import licence. It was the assessee who imported the goods in question, and it was the fault of the assessee if the goods in question imported did not conform to the specifications of the licence. In these circumstances, there is no escaping the conclusion that the penalty was levied on the assessee for the default of the assessee itself and not on the ground of any other person's default. Nor is this a case in which the assessee can be regarded in any sense as a nominal licence-holder. It is not as if the assessee gave its licence to M/s. Bipin Automobiles for importing the goods in question and M/s. Bipin Automobiles imported the goods. The licence was utilized by the assesses-firm itself and that fact cannot be altered by the circumstance that they had agreed to sell the goods to be imported by them to M/s. Bipin Automobiles. It is well settled that if an assessee has to pay a penalty to the customs authorities in respect of goods imported by the assessee on account of its own default, the amount of that penalty cannot be deducted in the computation of taxable profits of the assessee.

Coming to the case of Pannalal Narottamdas & Co. (supra) cited by Mrs. Jagtiani, the facts in that case were altogether different. In that case, in the course of its business, the assessee had purchased bills of lading and other shipping documents from certain parties in respect of some consignments of goods imported by them from a foreign country. When the goods arrived in India and were sought to be cleared through the customs by the assessee on the basis of the documents purchased by it, it was found that the imports were unauthorized and the goods were liable to be confiscated and a penalty was liable to be imposed under section 167(8) of the Sea Customs Act, 1878. The assessee paid the penalty for saving the goods from being confiscated. The Tribunal took the view that the assessee was entitled to plead that it had purchased the documents of title in good faith and had paid consideration thereon, and, thereafter, it had to pay the penalties in order not to lose the goods which had become its property and, in these circumstances, the penalty could be legitimately regarded as part of the cost of the goods. It was held by the Division Bench that, on the facts and circumstances, the actual cost of the goods to the assessee was not only what it had paid to the importers but in addition thereto what it had to pay by way of penalty in order to save the goods from being confiscated and lost to it. It is significant that the observations of the Division Bench set out at page 672 of the aforesaid report show that the Division Bench clearly took the view that in cases where penalty had to be incurred because of the fault of the assessee himself, as for instance, by reason of his having carried on his business in an unlawful manner or in contravention of certain rules and regulations, the penalty paid by the assessee for such conduct thereof could not be regarded as wholly laid out for the purpose of the business, and, in support of this conclusion, the decision of the Supreme Court in Haji Aziz & Abdul Shakoor Bros. v. CIT : [1961] 41 ITR 350 was cited. This decision, in our view, does not advance the argument of Mrs. Jagtiani, and, in fact, the aforesaid observations pointed out by us lend considerable support to the view which we have taken."

It can, thus, be seen that consistently various High Courts following the decision of the Supreme Court in the case of Hazi Aziz (supra) have held that fine or penalty for redemption of goods ordered to be confiscated for breach of import conditions is not an allowable deduction. The case of the assessee squarely falls in this category.

14. We may now refer to the decisions cited by Mr. Nankani, the learned counsel for the respondent. The decision in the case of Pannalal (supra) would require close examination. It was the case in which the assessee, a registered firm was dealing inter alia in gum. In the course of its business, the assessee purchased bills of lading and other shipping documents from certain parties in respect of some consignments of gum imported by them from Africa. When the goods arrived in India, the assessee sought to clear them on the basis of the documents purchased by it. It was found that the imports were unauthorized and the goods were liable to be confiscated and penalty liable to be imposed. The assessee paid an amount of Rs. 31,302/- by way of penalty for saving the goods being confiscated. This

amount the assessee claimed by way of allowable deduction. The assessee had argued that the amount must be regarded as a part of purchase price of the gum. It was argued that the assessee had purchased the consignments of gum in good faith and was not aware of any faults committed by the importers in such importation. It was only when the goods arrived in India that the assessee found that the imports were unauthorized. The parties from whom the assessee had purchased the goods declined to pay the penalties. It was further argued that in the circumstances, the penalty amount which the assessee had to bear was in the nature of additional cost of the goods in the hands of the assessee. The Revenue Authorities rejected such contention. The Income Tax Appellate Tribunal, however, had taken a view that the assessee was correct in contending that it had purchased the documents of title in good faith and therefore, it had to pay the additional cost not to loose goods which had become its property. In this context, a reference was made to the High Court on following substantial question of law:-

> "Whether the penalties totaling Rs. 31,302/- paid in breach of the Sea Customs Act in respect of imports of stock-in-trade, but

on bills of lading, purchased in good faith, is a proper deduction under Section 10(1) of the Income Tax Act?"

The Department objected to the framing of the question and insisted that the following question be re-framed by the High Court:-

"Whether, on the facts and in the circumstance of the case, the penalty of Rs. 31,302 paid by the assessee to the customs authorities for infringement of Import Control Regulations constitutes an allowable deduction under Section 10 of the Income-tax Act?"

The High Court first rejected any modification to the question as desired by the Revenue observing that the Tribunal had concluded that what was paid as penalties by the assessee was to be regarded as cost of the goods, which was based on its acceptance of the contention of the assessee. In other words, the conclusion of the Tribunal was based on its acceptance of the assessee's case that its purchase of bills of lading was in good faith. Having thus accepted the Tribunal's conclusion on facts, the Court proceeded to answer the question referred in favour of the assessee by making following observations:-

"7. Coming now to the question as framed, we think that it must be answered in the affirmative and in favour of the assessee. Under section 10(1) of the Indian Income Tax Act, tax is made payable in respect of the profits or gains of business. Profits or gains of

business would be the excess of the sale price over the cost price and in determining the profits or gains, therefore, the cost has to be deducted from the proceeds realized on sale of the goods. On the facts and circumstances of the present case, the actual cost of the goods to the assessee was not only what it had paid to the importers, but in addition thereto what it had to pay by way of penalty, in order to save the goods from being confiscated and lost to it. The penalty paid by it could, therefore, be regarded as part of the cost of the goods to it. It can also be regarded as an amount expended by it wholly and exclusively for the purposes of the business, because unless the said amount was expended, the goods could not have been saved from confiscation. It may be pointed out that, in cases where the penalty has to be incurred be incurred because of the fault of the assessee himself, as for instance, for the reason of his having carried on his business in an unlawful manner or in contravention of certain rules and regulation, the penalty paid by the assessee for such conduct thereof, could not be regarded as wholly laid out for the purpose of the business, because the incurring of the said expenses has not been necessitated by the business,but but by the conduct of the assessee in trying to carry out the business in an unlawful manner (see Haji Aziz and Abdul Shakoor Bros. v. Commissioner of Income-tax [supra]). In the present case, however, on the finding of the Tribunal the penalty has been imposed not for the fault of the assessee but he had to bear the same for the purpose of getting his goods released from the customs authorities. In the present case, therefore, the expenses incurred by the assessee could be regarded as wholly and exclusively incurred for the purpose of his business. In our opinion, therefore, the conclusion arrived at by the Tribunal that the sum of Rs. 31,302 was allowable to the assessee as proper deduction is correct and the deduction is capable of being allowed under section 10(1) of the Income Tax Act as held by the Tribunal or even under section 10(2)(xv) of the Act."

This case, thus, is clearly distinguishable. On facts, the Tribunal had held that the assessee was not responsible for the breach of law, a finding on the basis of which the High Court proceeded. It was in this background that the Court upheld the Tribunal's decision allowing deduction of the amount in question as an expenditure emphasizing that such amount in the hands of the assessee was not penalty but an additional cost for purchase of goods.

15. In case of **CIT, Gujarat V/s. Ahmedabad Cotton Mfg. Co Ltd & Ors.**[9], the assessee company had to pay to the Textile Commissioner an amount in view of the non production and non packing of the minimum quantity of specified types of cloth. It was, in this background, that the payment was held to be allowable expenditure. The Court held that the decision in the case of Hazi Aziz (supra) would not apply.

16. The Supreme Court in the case of **Prakash Cotton Mills Pvt Ltd. Vs. CIT**[10] had emphasized on the nature of

9 (1994) 1 SCC 632
10 (1993) 201 ITR 684

statutory imposts paid by the assessee, be it in the nature of damages or penalty or interest in the context of assessee's claim of expenditure under Section 37(1) of the Act. The test laid down was whether such payment was compensatory or penal in nature.

17. In the case of **CIT Vs. N.M. Parthasarathy**[11] , the Madras High Court considered the case where the assessee, an individual running a small scale industry was granted a licence for importing permissible spare parts for construction machinery and spare of machine tools. On the basis of such licence, the assessee imported 400 drums of sodium cyanide from Hungary. When the goods arrived, the Customs Authorities noticed that there was no valid licence covering the consignment and that the provisions of Customs Act, 1962 were violated. This resulted into confiscation of the goods and imposition of redemption fine in lieu of confiscation. The assessee claimed the amount of redemption fine of Rs. 1,84,000/- by way of business expenditure which was disallowed by the Revenue Authorities. The High Court noticed the decision of the

11 (1995) 212 ITR 105 (Mad)

Supreme Court in the case of Hazi Aziz (supra) and the ratio laid down therein but observed that in view of later decisions in the case of Prakash Cottom Mills (supra) and Ahmedabad Cotton Mfg Co Ltd (supra), the ratio laid down in the case of Hazi Aziz (supra) cannot be stated to have laid down an inflexible rule of law to be followed in all eventualities and situations.

18. In our opinion, the ratio laid down by the Supreme Court in the case of Hazi Aziz (supra) continues to hold the field even post decisions in the case of Prakah Cotton Mills (supra) and Ahmedabad Cotton Mfg Co Ltd (supra). In neither of these two decisions, the ratio laid down in the decision in case of Hazi Aziz (supra) which was a decision of Bench of three Judges can be seen to have been diluted. In other words, what the facts of the case are materially similar as the facts before the Supreme Court in the case of Hazi Aziz, the ratio laid down therein would squarely apply. The later decision cited by the learned counsel for the assessee emphasizes that not the nomenclature of fine or penalty, but the true character of payment must be taken into

consideration. If the payment is compensatory in nature, it would be allowable deduction. Judgment of this Court in Pannalal (supra) proceeded on the basis that the infraction of law for which penalty was imposed, was by the importer and not the assessee who had purchased the goods, though the fine was borne by the assessee. It was in this background, the Court had held that the payment in question was in the nature of additional cost of the goods for the assessee.

19. Reliance was also placed on the decision of Punjab & Haryana High Court dated 9.12.2008 in the case of **Commissioner of Income Tax Vs. Hero Cycles Ltd.** However, this decision does not lay down any ratio which can be applied in the present case. The observations in the judgment that: "there is no doubt that payments made in the nature of penalty or fine for any wrongful act cannot be allowed as permissible deductions but mere label of the payment is not conclusive. Certain payments may be incidental to the business and have to be allowed on the test of 'commercial expediency', if no violation of law or public policy is involved. Where penalty is not for deliberate

violation of law." can at best be seen as passing remarks, obiter dicta but not ratio.

20. In the present case, the Tribunal, without proper justification or detailed examination of material on record, followed the line of logic adopted by this Court in the case of Pannalal (supra) whereas the facts as we have noticed squarely fall within the parameters of the decision of the Supreme Court in the case of Hazi Aziz (supra). The Assessing Officer had summoned the import licence holder M/s. Rajnikant Brothers whose representative had stated before the Assessing Officer that M.P. Gupta, the present assessee had imported almond by using the licence and that redemption fine of Rs. 75 lacs paid to the Madras Custom House was done by M.P. Gupta. All transactions were made by him and he was responsible for the fine. He stated clearly that as per the agreement, M/s. Rajnikant Brothers were only entitled to the service charges. Thus, there was ample evidence on record suggesting that the assessee had made imports through his direct involvement by using the import licence of M/s. Rajnikant Brothers and that M/s. Rajnikant

Brothers merely received an agreed commission. The assessee cannot disassociate or divest himself from the irregularities or illegalities committed in the process of importing the goods. Thus, the penalty was for the infraction of law committed by the assessee. Under these circumstances, the question is answered in the negative i.e in favour of the Revenue and against the assessee. The impugned judgment of the Tribunal is set aside. Accordingly, the appeal is disposed of.

21. In view of the Revenue's appeal being allowed, the question of releasing a sum of Rs. 1,90,50,000/- in favour of the respondent assessee would not arise. However, the very dispute with respect to the source of this amount is pending in Suit No. 445 of 2002 before the learned Single Judge. It will be open for the Revenue to file appropriate Motion before appropriate forum as may be advised for withdrawal of the amount.

22. In view of disposal of appeal, nothing survives in the Notice of Motion. The same is disposed of accordingly.

[B.P. COLABAWALLA, J.] **[AKIL KURESHI, J]**