(1978) 02 CAL CK 0006

Calcutta High Court

Case No: Income-tax Reference No. 493 of 1974

Apeejay (Private) Limited		APPELLANT
	Vs	
Commissioner of Income Tax (Central)		RESPONDENT

Date of Decision: Feb. 1, 1978

Acts Referred:

- Income Tax Act, 1961 - Section 28, 37(1), 43(5)

Citation: (1978) 114 ITR 544

Hon'ble Judges: Sudhindra Mohan Guha, J; Sabyasachi Mukharji, J

Bench: Division Bench

Advocate: Debi Pal and A. Roy Chowdhury, for the Appellant; Ajit Sengupta and Probir Mazumdar, for the Respondent

Judgement

Sabyasachi Mukharji, J.
The following question has been referred to this court u/s 256(1) of the Income Tax Act, 1961 :

" Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the amounts of Rs. 26,574 relating to rights and other expenses and Rs. 7,492 relating to bank commission and bank guarantee with regard to re-export of goods could not be allowed as deductible revenue expenses ? "

2. The assessment year under reference is 1967-68, for which the relevant accounting year was the year ending 31st July, 1966. The assessee carried on the business of manufacture of iron and steel rounds, bars, etc., and was one of the importers of sheets having head office in Calcutta and branches at Kumhari and Raipur, In the profit and loss account, the assessee claimed a sure of Rs. 26,574 with reference to freight and other expenses and expenses of Rs. 7,492 relating to bank commission and bank guarantee with regard to re-export of goods. The Income Tax Officer added these amounts to the total income of the assessee. The Income Tax

Officer in his order stated as follows :.

" In the P/L a/c this amour it has been claimed as deduction for re-exporting some sheets which were imported in the past. Examination of the case revealed that in the past the assessee imported some steel sheets from foreign country without any valid licence. On its arrival the materials were not allowed to be taken away by the assessee on the ground that the import was made illegally. After protracted correspondence and in order to avoid demurrage the company approached the Iron and Steel Controller who refused to oblige the company but issued a customs clearance permit to enable the company to take possession of the materials from the customs to avoid demurrage, etc., with a clear direction that the materials must have to be re-exported. The company agreed to do so. During this year, the materials were re-exported and a total amount of Rs. 26,574 was incurred by way of freight and other expenses. The assessee was asked to show cause as to why the expenditure should not be disallowed on the ground that it related to illegal transaction which did not give to the assessee any profit. This aspect of the case was also the subject-matter of enquiry by the Public Accounts Committee in the 50th report as well as by the Sarkar Commission. In their petition dated 11th November, 1971, the company argued that as soon as the clearance permit was granted to clear the goods the transaction, viz., import of the materials was regularised and, accordingly, any loss arising out of business transaction legally done must be allowed to the assessee. It seems that the company has not duly considered the proper impact of the whole transaction vis-a-vis its Income Tax assets. If the assessee''s contention is accepted then the question of disallowing the expenses may not have any valid force. In this regard, the company drew inspiration from the observation of the report of the Committee of Enquiry (Steel Transaction) by the Sarkar Committee. It appears that the assessee had not gone through properly the findings of the Sarkar Committee. At para 9.15 vide page 128 the Committee has categorically stated asunder;
'' We therefore come to the conclusion that in respect of the orders of re-export of the goods which M/s. Aminchand Payarelal and M/s. Apeejay (P.) Ltd. had imported without valid licence and in respect of which the Steel Controller issued the customs clearance permit on condition of reexport..... ''

3. It would be, therefore, quite clear that the goods were imported without any valid licence which was not regularised by the issue of customs clearance permit. The permit was issued with a clear direction to re-export the goods. This was nothing but a punishment to the company for importing goods illegally. Accordingly, I cannot accept the contention of the assessee that the re-export expenses arose out of a valid business transaction. Accordingly, the claim of Rs. 26,574 would be disallowed.

4. In this connection the company had to give letter of guarantee from a bank to the Government of India to ensure re-export of the goods. The assessee paid guarantee

commission to the bank of Rs. 7,378. The company also had to pay a sum of Rs. 114 as insurance for personal bond in this connection. These two sums totalling Rs. 7,492 were directly connected with the re-export of the goods. They would also be disallowed." The Income Tax Officer has referred to the report of the Sarkar Committee, as mentioned hereinbefore.'' In the report of the Sarkar Committee it was, inter alia, observed as follows:

" The question that arises for this Committee on these facts is whether the imports by Messrs. Amin Chand Payare Lal and Messrs. Apeejay (Private) Limited were irregular and without a licence. Not much difficulty arises on the question, because it would be apparent from what we have stated earlier that the Steel Controller''s organi''sation did not treat them as regular or proper imports, and that organisation directed the re-export. But a further question arises as to whether the Steel Controller had power to direct such re-export. We should mention here that the Solicitor to the Central Government in Calcutta, Shri S. N. Sen, had expressed the opinion that there was no such power. But the Steel Controller, Shri Banerjee, disagreed with that view and directed re-export. We find: that the licensing authority has powers under Clause 5(1)(i) of the Import (Control) Order, 1955, to issue a licence directing disposal of goods covered by a licence in a certain manner and under Clause 5(1)(iii) of the same Order to take a bond from the applicant for fulfilment of such directions of the licence. This clause would tend to show that customs clearance permit, being in essence a licence, the Steel Controller could issue it subject to the condition that the goods covered by it would be re-exported. Assuming this view is incorrect it has to be remembered that it is a question of law in which a mistake could occur. The Committee also sees no justification for the view that there was improper or dishonest motive in issuing a permit subject to the condition to re-export. Shri Banerji stated that he thought this order of his would involve a heavier punishment on the guilty parties than if he were to leave it to the Customs authorities to confiscate the goods. In his view, in such cases the parties would have the right to clear the goods from the customs on payment of the fine imposed. That no doubt was the earlier law. At the time, however, when Shri Banerji passed his order, the law was that the Customs authorities had the discretion to give the party the option to have the goods released on payment of fine or to refuse them such an option. Mr. Banerji stated that his attention had not been drawn to the change in law. However that may be, Mr. Banerji''s point would not still completely lose its ground, because, if the Customs, in its discretion allowed the party to obtain release of the goods, the harm which Shri Banerji had in his mind would not have been eliminated. Shri Banerji wanted to stop the entry of goods into the country in any event, for he thought that then it would be easy for the importers to sell them at a much higher rate which would cover up the fine and yet leave them a large profit. He further said that the re-export order passed by him involved not only the payment of demurrage during the time that the goods lay in port and rent for the warehouse where the goods were stored pending export but also that the

party would be saddled with the extra freight involved in the re-export. A further consideration which led him to issue the order of re-export was that it would save the country from spending the foreign exchange for the import, which it would have to if the party were to obtain a release of the goods from the Customs on payment of the fine. We are unable to say that these reasons which operated on the mind of Shri Banerji are without substance. It also seems to us that, in view of the events that actually happened at the end, viz., the order of the Steel Ministry setting aside Shri Banerji''s decision and treating the goods as legal imports, it is unnecessary now to go into the question of the propriety of Shri Banerji''s order. As we have no reason to think that there was any dishonest motive it would at the worst only mean that Shri Banerji had misinterpreted his statutory powers.

5. We, therefore, come to the conclusion that, in respect of the orders of re-export of the goods which Messrs. Arnin Chand Payare Lal and Messrs, Apeejay (Private) Limited had imported without valid licences and in respect of which the Steel Controller issued the Customs clearance permits on condition of re-export, it would not be justifiable to find fault with the action of the Steel Controller, Shri Banerji. " From the order of the Income Tax Officer, the assessee preferred an appeal before the Appellate Assistant Commissioner and contended that the expenses were of revenue nature and were incurred wholly and exclusively for the purpose of the business. The Appellate Assistant Commissioner, inter alia, observed as follows :

" I have carefully considered all the facts and circumstances of the case as also the decisions relied upon by the learned advocate. It has to be admitted that, legal or otherwise, if an assessee makes profits from a business, the same is automatically brought to tax. For similar reasons, any loss claimed to have been incurred, though in the course of illegal transactions, has to be allowed. It cannot be denied that, in case the assessee had not come into trouble with the Customs authorities and the Iron and Steel Controller, any profits arising would have been brought to tax. It has also to be noted that the whole matter had been regularised, by the company agreeing to re-export the goods. As a result, any stigma of a penalty as such disappeared. The expenditure claimed was definitely incurred in the course of the business, and, if it is of a revenue nature, the same has to be allowed.

The next ground is closely linked with the earlier ground just discussed. The company was required to give a letter of guarantee from a bank to the Government of India in order to ensure re-export of the goods. For this purpose, guarantee commission of Rs. 7,378 and personal bond insurance amount of Rs. 114 had to be disbursed. The Income Tax Officer disallowed the total of Rs. 7,492. For the reasons discussed earlier it has to be admitted that the payment was made in the interest of the business, and to avoid demurrage. This amount is also clearly allowable. "

6. Being aggrieved with the said decision of the Appellate Assistant Commissioner, the revenue went up in appeal before the Tribunal. The Tribunal referred to the relevant facts of this case and thereafter stated in its order as follows :

" In the instant case there were no sale proceeds of goods that had been brought from foreign countries. Profit on these sales proceeds had not been taxed. It follows that expenditure was not with reference to profit as there had been no purchases and no sales of goods. In the present case, the Government with a view to higher punishment and with a view that the assessee cannot take advantage of even increase in prices of imported goods and take advantage of the situation, ordered the re-export of goods imported without licence. It is in this light the report of the Sarkar Committee is to be considered.

8. Both the assessee arid the department are silent as to whether the claim is allowable u/s 37(1) or Section 28(1) of the Act of 1961. But the case could be viewed from both the angles. Action taken against the property which is imported illegally can by no process of reasoning be said to be trading or commercial loss or commercial expenses connected with or incidental to the assessee''s business. In this view of the matter alone the claim of the assessee can be rightly rejected. But as already stated in the beginning the problem is not of any easy solution because of the number of case laws cited. " Thereafter, the Tribunal referred to Section 2 as well as Section 23 of the Indian Contract Act and observed further as follows :

" It is in this light, Anson, in the Principles of the English Law of Contract, 22nd edition, stated the agreements which tend to abuse the legal process and which tend to encourage litigation, which is not bona fide and speculative in nature. The Supreme Court in the case of Commissioner of Wealth-tax, Gujarat Vs. S.C. Kothari, has reversed the decision of the Gujarat High Court Commissioner of Income Tax Vs. S.C. Kothari, in part. The Supreme Court has stated that a contract has to be an enforceable contract and not an unenforceable one by reason of any taint of illegality resulting in its invalidity. The Supreme Court has stated that if a business is of illegal and speculative nature, set-off of loss cannot be given under any head, though in respect of particular illegal business, expenses could be allowed in terms of Section 28(1) of the Act.

According to Anson''s Principles of the English Law. of Contract, the adventure of the assessee is speculative in nature and hence any expenses not with reference to the actual purchase of goods, cannot be set off against income, profits or gains under any head in that year. Thus having regard to this principle, the assessee''s claim cannot be entertained. "

7. In the result, the Tribunal allowed the appeal of the revenue. In the background of these facts, the aforesaid question has been referred to this court.

8. The Tribunal has disallowed the expenses on the ground that the transaction in question was speculative in nature and hence the expenses were not allowable. We are of the opinion that the view of the Tribunal cannot be sustained. For Income Tax purposes the definition of " speculative transaction" can be found in Sub-section (5) of Section 43 of the Income Tax Act, 1961. Sub-section (5) of Section 43 of the

Income Tax Act, 1961, is in similar language to the Explanation to Section 24 of the Indian Income Tax Act, 1922. The said Explanation to Sub-setion (5) of Section 43, without the proviso, which is not material for our present purpose, read as follows:

"43. (5) '' speculative transaction'' means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. "

9. The Supreme Court in the case of Davenport and Co. Pvt. Ltd. Vs. Commissioner of Income Tax, West Bengal-II, , observed as follows:

" Section 6 of the Indian Income Tax Act, 1922, enumerates the heads of income chargeable to Income Tax. Section 24(1) of the Act provides that where an assessee sustains a loss under any of these heads in any year, he shall be entitled to have the loss set off against his income, profits or gains under any other head in that year. This general provision is qualified by the first proviso which permits the set-off of a loss in speculative business against the assessee''s profits and gains, if any, in a similar business o,nly. Explanation 1 says that where the speculative transactions are of such a nature as to constitute a business, the business shall be deemed to be distinct and separate from any other business. Explanation 2 defines a speculative transaction as a transaction in which a contract for purchase and sale of any commodity is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity. The words * actual delivery'' in Explanation 2 mean real as opposed to notional delivery. For Income Tax purposes speculative transaction means what the definition of that expression in Explanation 2 says, (underlined* by us). Whether a transaction is speculative in the general sense or under the Contract Act is not relevant for the purpose of this Explanation. The definition of '' delivery '' in Section 2(2) of the Sale of Goods Act which has been held to include both actual and constructive or symbolical delivery has no bearing on the definition of speculative transaction in the Explanation. A transaction which is otherwise speculative would not be a speculative transaction within the meaning of Explanation 2 if actual delivery of the commodity or the scrips has taken place ; on the other hand, a transaction which is not otherwise speculative in nature may yet be speculative according to Explanation 2 if there is no actual delivery of the commodity or the scrips. The Explanation does not invalidate speculative transac tions which are otherwise legal but gives a special meaning to that expression jor Purposes of Income Tax only." (underlined* by us) In the light of the aforesaid observations of the Supreme Court, we have to consider whether the transaction in respect of which the expenses have been claimed by the assessee, in the instant case,, can be considered to be speculative transaction within the meaning of Sub-section (5) of Section 43. This transaction cannot certainly be considered to be a contract for the purchase or sale of any commodity including stocks or shares which . was settled otherwise than by the actual delivery or transfer of the commodity. In

this case, actual delivery of goods had taken place by re-exporting of the goods. Therefore, the transaction in question cannot be described to be a speculative transaction in terms of Sub-section (5) of Section 43 of the income tax Act, 1961. Even if the transaction, in respect of which the expenses in question were incurred, is considered from the point of general law or on the basis of the principles enunciated by Anson as noted above, the same in our opinion cannot be considered to be speculative. The expenses were in connection with re-export of the goods. There is no evidence that the re-export of the goods had been made by the assessee as a result of any agreement which was not bona fide or tended to encourage litigation.

10. The next question is, whether the expense incurred by the assessee can be allowed as business expenses. This question has to be considered in terms of Section 37(1) of the Income Tax Act, 1961, or Section 28 of the Act. Therefore, we have to examine whether the expenses in question were expended wholly and exclusively for the purpose of the business. The assessee had to re-export the goods pursuant to the direction given by the appropriate authorities to re-export the goods because the assessee had imported the goods without a valid licence. Therefore, it is clear that the assessee originally had imported the goods in infraction of the law. But the assessee was allowed to re-export the goods without suffering the confiscation of the goods. The expenses that the assessee had incurred were in connection with the said re-exportation of the goods. There is no dispute that such expenses were incurred by the assessee in the capacity as a trader. The cause for such re-exportation of the goods was the importation of the goods by the assessee in infraction of the law. In those circumstances, the question that falls for consideration is whether such expenses can be allowed. It is clear that the amounts were not the amounts which had been imposed upon the assessee as any penalty or any fine for the infraction of law.

11. In the case of Commissioner of Wealth-tax, Gujarat Vs. S.C. Kothari, , the Supreme Court observed that if the business was illegal neither the profits earned nor the losses incurred would be enforceable in law. But that did not take the profits out of the taxing statute. Similarly, the taint of illegality in the business could not detract from the losses being taken into account for computation of the amount which would be subject to tax as profits u/s 10(1) of the Act of 1922. The tax collector could not be heard to say that he would bring the gross receipts to tax. He could only tax profits of a trade "or business. That could not be done without deducting the losses and the legitimate expenses of the business. The Supreme Court held that "for the purpose of Section 10(1) of the Indian Income Tax Act, 1922, the losses which actually had been incurred in carrying on a particular illegal business must be deducted before a true figure relating to profits which had to be brought to tax could be computed or determined. So, in the instant case., before us, the expenses that were incurred by the trader, qua-trader, in connection with his trade would be allowable even though additional expenses might have been necessitated because

of the fact that the assessee had not complied with the law and the expenses could be described to be the expenses which were the liability incurred because of carrying on the business not in accordance with the laws.

12. Our attention was drawn to the decision of the Supreme Court in the case of Haji Aziz and Abdul Shakoor Bros. Vs. The Commissioner of Income Tax, Bombay City II, . There, fine paid related to goods imported illegally and was held not to be allowable expenses u/s 10(2)(xv) of the Indian Income Tax Act, 1922. There the Supreme Court observed that the expenses. which were permitted as deductions were such as were made for the purpose of carrying on business, that is to say, to enable a person to carry on and earn profit in that business. It was not enough that the disbursements would be made in course of or arise out of or were 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. In this connection, it was urged that these expenses were incurred for carrying on the business that the assessee was carrying on but any sum paid for infraction of law was not to be deducted because the infraction of law was not the normal incident of business.

13. In the case of COMMISSIONER OF Income Tax, U. P. Vs. MATHURA PRASAD HARDWAR PRASAD DEORIA. COMMISSIONER OF Income Tax, U. P. v. RAGHUNATH PRASAD JAGDISH PRASAD DEORIA., , the Division Bench of the Allahabad High Court did not allow the penalty of Rs. 3,000 imposed upon the assessee for illegal importation into Pakistan of certain goods which were prohibited. Similarly, in the case of penalty imposed for infraction of law under the Sea Customs Act, the assessee claimed deduction as business expenditure which was disallowed by the Patna High Court in the case of Lakshmi Narayan Gouri Shankar Vs. Commissioner of Income Tax, .

14. In the case of Parshva Properties Ltd. Vs. Commissioner of Income Tax, Central, , this court was concerned with two kinds of expenses, viz., fine imposed for infraction of law as well as the expenses incurred in defending the employees of the company in criminal proceedings. So far as the fine imposed was concerned, it was held that such amount could not be deducted but, so far as the expenses incurred for defending the employees were concerned, it was held that such expenses were incurred in the capacity of a trader, and, as such, were allowable. The principle which governed this case is to determine the nature and the purpose of the expenditure incurred and also to determine in what capacity the expenditure was incurred. In this case, because of the manner in which the assessee had carried on the business, viz., the illegal importation of the goods in question, the assessee might have incurred the expenditure but the purpose of the expenditure was for carrying on of the business and the expenditure was incurred in the capacity of a trader. The expenditure was not a liability imposed for violation of law. The liability might have arisen for carrying on the business in a manner not in accordance with law. But that does not detract from the fact that the expenditure was incurred in the

capacity of a trader for carrying on the business. If that is the position, then, in our opinion, the amounts in question were allowable as deduction as revenue expenses.

15. In the aforesaid view of the matter, the question referred to us is answered in the negative and in favour of the assessee. Each party will pay and bear their own costs.

Guha, J.

16. I agree.