

CTR ENCYCLOPAEDIA ON INDIAN TAX LAWS

NAHAR SPINNING MILLS LTD. vs. COMMISSIONER OF INCOME TAX

HIGH COURT OF PUNJAB & HARYANA

AJAY KUMAR MITTAL & JASPAL SINGH, JJ

ITA No. 69 of 2008

28th July, 2014

(2014) 89 CCH 0309 PHHC

(2014) 226 TAXMAN 0364 (P&H)

Legislation Referred to

Section 260A, 37, 80G, 80IA, 143(1), 143(2), 143(3), 37(1)

Case pertains to

Asst. Year 1989-90

Cases referred:

[Liberty India vs. CIT \(2007\) 293 ITR 520 \(P&H\)](#)

[Liberty India vs. CIT \(2009\) 317 ITR 218](#)

[CIT vs. Loke Nath and Company \(Construction\), \(1984\) 147 ITR 624 \(Del\)](#)

Usha Micro Process Controls Limited vs. CIT (2013) 37 Taxman 324 (Del)

[CIT vs. Parthasarathy \(NM\) \(1995\) 212 ITR 105 \(Mad\)](#)

[Jaswant Trading Company vs. CIT \(1995\) 212 ITR 293 \(Raj\)](#)

[Jamna Auto Industries vs. CIT \(2008\) 299 ITR 92](#)

[CIT vs. Mamta Enterprises, \(2004\) 266 ITR 356](#)

[Sri Venkata Sathyanarayanan Rice Mill Contractor Co. vs. CIT, \(1997\) 223 ITR 101 \(SC\)](#)

[Sassoon J. David and Co. \(P.\) Ltd. vs. CIT \(1979\) 118 ITR 261\(SC\)](#)

ACIT vs. Rajasthan Spinning and Weaving Mills Limited, (2005) 274 ITR 465 (Raj)

Counsel appeared:

Sanjay Bansal, Sr. Adv., Rajni Pal, Adv., for the Appellant: Rajesh Katoch, Adv., for the Respondent.

AJAY KUMAR MITTAL, J:-

1. This appeal has been preferred by the assessee under Section 260A of the Income Tax Act, 1961 (in short, "the Act") against the order dated 14.9.2007, Annexure P.1 passed by Income Tax Appellate Tribunal, Bench, 'A' Chandigarh (in short, "the Tribunal"), claiming following substantial questions of law:-

"i) Whether on the facts and in the circumstances of the case, the Tribunal was legally correct in holding that the amount of Rs. 3,95,425/- paid to the Municipal Corporation, Ludhiana for legalizing the construction of its building was not an allowable business expenditure under section 37 of the Income Tax Act, 1961?

ii) Whether on the facts and circumstances of the case, the Tribunal without adverting to and reversing the findings recorded by CIT(A) was legally correct in negating the claim of the appellant under section 80-G of the Act in respect of donation made by it towards Prime Ministers Relief Fund for Gujarat Earth Quake Relief Fund at the call given by Government authorities?

iii) Whether on the facts and in the circumstances of the case, the appellate Tribunal was justified in law in holding that the sum of Rs. 24,89,000/- being the value of goods sent to the Prime Ministers Relief Fund for Gujarat Earth quake relief was eligible for deduction under section 37 of the Income Tax Act, 1961?

iv) Whether on a correct interpretation of the provisions of Section 80IA of the Income Tax Act, 1961, was the Tribunal legally correct in upholding the order passed by the Assessing officer whereby the latter had held that the receipt from license income to the tune of Rs. 8,33,885/- and export incentives on DEPB of Rs. 1,08,62,906/- could not be treated to be the profits and gains derived by the assessee from its business for the purposes of computing the relief of deduction under the said provision?

2. A few facts relevant for the decision of the controversy involved as narrated in the appeal may be noticed. The assessee company is a manufacturer and exporter of cotton yarn, woollen and cotton hosiery goods and garments. Return of income declaring total income of Rs. 14,68,78,870/- was filed on 31.10.2001 which was processed under section 143(1) of the Act on 26.3.2002. Notice dated 29.5.2002 under section 143 (2) of the Act was served on the assessee on 30.5.2002. In the assessment finalized by the Assessing officer vide order dated 9.5.2003, Annexure P.3 under section 143(3) of the Act, the income determined was Rs. 18,95,14,560/-. Aggrieved by the order, the assessee filed appeal before the Commissioner of Income Tax (Appeals) [CIT(A)]. Vide order dated 22.2.2005, Annexure P.2, the CIT(A) partly allowed the appeal. The Revenue filed appeal whereas the assessee filed cross objections before the Tribunal. Vide order dated 14.9.2007, Annexure P.1, the Tribunal partly allowed both the appeal and the cross objections. Hence the instant appeal by the assessee.

3. Addressing arguments on Question No.(i), learned counsel for the assessee relying upon decisions of Delhi, Madras and Rajasthan High Courts in **CIT vs. Loke Nath and Company (Construction)**, (1984) 147 ITR 624 (Del.), **Usha Micro Process Controls Limited vs. Commissioner of Income Tax**, (2013) 37 Taxman.com 324 (Del.) **CIT vs. Parthasarathy (NM)** (1995) 212 ITR 105 (Mad.) and **Jaswant Trading Company vs. CIT** (1995) 212 ITR 293 (Raj.) respectively submitted that it is not penalty for infraction of law. Any amount paid to municipality as compensation for condoning deviations from original sanction and accepting revised plan of construction is deductible as business expenditure.

4. On the other hand, learned counsel for the revenue supported the impugned order and relied upon judgment of Full Bench of this Court in **Jamna Auto Industries vs. Commissioner of Income Tax**, (2008) 299 ITR 92 and judgment of Karnataka High Court in **CIT vs. Mamta Enterprises**, (2004) 266 ITR 356.

5. After hearing learned counsel for the parties, we do not find any merit in the submissions of learned counsel for the assessee.

6. The Full bench of this Court in **Jamna Auto Industries's** case (supra) had held that any payment made by an assessee on account of infraction of law would not be admissible deduction under Section 37 of the Act. However, any damages paid by the assessee for breach of contract on its part were deductible. In the present case, the assessee had paid the compounding fee as compensation for condoning deviations from original sanctioned plan. In substance, the payment was in the nature of the amount paid on account of infraction of law as there was violation in the building plan of the assessee.

7. Further, Finance (No.2) Act, 1998 had incorporated Explanation to Section 37(1) of the Act which was made retrospectively with effect from 1.4.1962. The Explanation reads thus:-

"Explanation - 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."

According to the explanation, expenditure incurred for any purpose which is an offence or which is prohibited by law, is not entitled for deduction. Thus, the amount paid on account of compounding fee as compensation for condoning deviations from original sanctioned plan in view of the Explanation to Section 37(1) of the Act would not be admissible. The Karnataka High Court in **Mamta Enterprises's** case (supra) distinguished the judgment of the Delhi High Court in **Loke Nath and Company (Construction)'s** case (supra) in the following terms:-

"8. In our view the above observation made by Delhi High Court cannot be of any assistance to the learned counsel for the respondent to support his case as the said decision was rendered prior to amendment to section 37 of the Act by incorporating the explanation referred to above by means of Finance Act 2/998 which is made retrospective effect with effect from 1-4-1962. When the section itself declares the 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, it is not possible to take the view that the expenditure incurred for compounding of the offence should be allowed. When the section is clear and unambiguous, it is not permissible for the Courts to stretch the meaning attached to the provision of law to extend the benefit to a person who violates the law or the Regulations/Rules made by the Corporation or the Municipal Authorities with impunity. Under these circumstances, the expenditure incurred to pay the penalty cannot be treated as loss in business to get the benefit. In our view, the penalty paid has enured to the benefit of the assessee to save the additional construction put up in violation of the provisions of the Act and the By-laws framed thereunder and also the consequences of penal provision provided under the Corporation or the Municipal Law. The view we have taken above is fully supported by the decision of the Honble Supreme Court in the case of Haji Aziz & Abdul Shakoor Bros. (supra), wherein the Supreme Court has observed as follows:

". . . 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 provisions, 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.

"... 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." (p. 359) Further, a similar view is taken by the Honble Supreme Court in the case of *Maddi Venkataraman & Co. (P) Ltd.* (supra). The Honble Supreme Court has observed thus:

"In the instant case, the assessee had indulged in transactions in violation of the provisions of the 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. In other 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 provisions of the 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 & Co. Ltd.* (1920) 12 TC 232 (CA), 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."

8. Further, the judgments of Madras and Rajasthan High Courts in **Parthasarathy (NM)** and **Jaswant Trading Company's** cases (supra) relied upon by the learned counsel for the assessee were prior to the insertion of the Explanation to Section 37(1) of the Act and would, therefore, not help the assessee in any manner. Still further, with regard to judgment in **Usha Micro Process Controls Limited's** case (supra) on which reliance has also been placed by the learned counsel for the assessee, therein, on facts, it was recorded that the assessee importer had paid redemption fine in lieu of confiscation of re-exported goods which was compensatory in nature and not penal and was, therefore, an allowable deduction under Section 37(1) of the Act. The case being different on facts, the assessee cannot take any advantage from the same. In view of binding judgment of Full Bench of this Court in **Jamna Auto Industries's** case (supra) and also Explanation to Section 37(1) inserted retrospectively w.e.f 1.4.1962, question No.(i) is answered against the assessee.

9. As regards question No.(ii), the assessee had made donation by way of clothes. The deduction under Section 80G of the Act was declined by the Tribunal. Learned counsel for the assessee was unable to show in the SINGH light of Explanation 5 to section 80G which was inserted by Finance Act 1976 effective from 1.4.1976 that the deduction was admissible. It would be apt to reproduce Explanation 5 to section 80G of the Act:-

“Explanation 5.—For the removal of doubts, it is hereby declared that no deduction shall be allowed under this section in respect of any donation unless such donation is of a sum of money.”

In view of the above, the assessee could not claim deduction under Section 80G of the Act in respect of donations by way of clothes sent to Prime Minister Relief Fund for Gujarat Earthquake relief the same being in kind and not in cash, cheque or draft. The Tribunal was right in declining the benefit under Section 80G of the Act.

10. With regard to Question No.(iii), learned counsel placed reliance on judgments in **Sri Venkata Satyanarayana Rice Mill Contractor Co. vs. CIT**, (1997) 223 ITR 101 (SC), **Sassoon J. David and Co. (P.) Ltd. vs. Commissioner of Income-Tax**, (1979) 118 ITR 261(SC) and **ACIT vs. Rajasthan Spinning and Weaving Mills Limited**, (2005) 274 ITR 465 (Raj.) to submit that the donations being voluntary payments would qualify for deduction as the same fell within the scope of “wholly and exclusively” for the purpose of business which was in contra distinction to “wholly and necessarily”, so that even what is not necessary to be incurred may well be allowable on the ground of commercial expediency and in the larger interest of the business and State, though not having immediate nexus with current profits.

11. Learned counsel for the revenue supported the order passed by the Tribunal that there was no commercial expediency.

12. After hearing learned counsel for the parties, we do not find any merit in the submissions of learned counsel for the assessee. The Tribunal had observed that the contribution which was made by the assessee in kind to the Prime Minister's Relief Fund for Gujarat Earthquake relief was not on account of any business compulsion which could be termed to be falling within the expression “wholly and exclusively”. It was also noticed that the expenditure incurred in the form of relief for earthquake victims although was for public good but would not have any impact on the business of the assessee. It was concluded that there being no commercial expediency in incurring such expenditure, it was not deductible under Section 37 of the Act. The Tribunal in para 19 had recorded as under:-

“19. We have carefully considered the rival submissions on this aspect. In so far as the claim of the assessee for deduction under section 80G is concerned, the same has been rightly disallowed by the Assessing officer. The alternative claim of the assessee that the impugned expenditure is deductible under section 37(1) shall be examined by us now. The entire case of the assessee is on the basis of the judgment of the Hon'ble Supreme Court in the case of Sri Venkataya Satyanarayana Rice Mills (supra). We have carefully perused the judgment of the Hon'ble Supreme Court and find that the ratio of the decision is that any contribution made by an assessee towards public welfare which is directly connected or related to the carrying on of the assessee's business or which results in benefit to the assessee's business is to be regarded as an item of deduction under section 37(1) of the Act. According to the Hon'ble Supreme Court such contribution, whether made voluntarily or at the instance of the authorities concerned would not disentitle the assessee from claiming deduction under section 37(1) of the Act. Applying the aforesaid reasoning to the facts of the present case, in our view, the claim of the assessee is not in order. In the instant case there is no material or

evidence to show that the contribution in question was either directly connected or related to the carrying on of assessee's business or that there was any benefit resulting to the assessee's business thereof. The assessee may be correct in saying that the contribution has been made on the appeal by the Government authorities and that the same was for public good but the tests laid down by the Hon'ble Supreme Court, as referred to above, do not appear to have been fulfilled. Thus, the parity of reasoning enunciated by the Hon'ble Supreme Court in the case of Sri Venkataya Satyanarayana Rice Mills (supra) does not help the case of the assessee. Similarly we have perused the decision of the Tribunal in the case of Nahar Spinning Mills Limited (supra) and find that the expenditure was held allowable under section 37(1) only after noticing that it would have an impact on the export business of the assessee. The Tribunal was satisfied, on facts that the reasoning enunciated by the Hon'ble Supreme Court in the case of Sri Venkataya Satyanarayana Mills (supra) was applicable. The assessee was found to have made donation towards an Earthquake Relief fund of USSR. The Tribunal found that the assessee was also a main exporter to USSR and thus there was a possibility of impacting the business interests of the assessee with the USSR Government. Hence the contribution made by the assessee towards the earthquake Relief Fund of USSR was held allowable as a deduction under section 37(1) of the Act. Factually speaking, in the instant case such inference cannot be drawn in the absence of any material or evidence on record. There is nothing to show as to how the impugned expenditure, although incurred for public good, would have an impact on the business of the assessee company. Therefore, the ratio of the decision of the Tribunal in the case of Nahar Spinning Mills (supra) for assessment year 1989-90 does not help the assessee in the present case. In our opinion, the CIT(A) erred in allowing the claim of the assessee on the basis of the decision of the Hon'ble Supreme Court in case of Sri Venkataya Satyanarayana Rice Mills (supra) and of the Tribunal in the case of Nahar Spinning Mills Limited (supra). The decision of the Tribunal in the case of Oswal Woollen Mills Limited (supra) relied upon by the learned counsel for the assessee, also does not help the claim of the assessee as it was rendered on facts identical to that of Nahar Spinning Mills Limited (supra), which we have already held to be inapplicable in the instant case because of distinction on facts. Therefore, in conclusion, we hold the assessee as ineligible for deduction under section 37(1) of the Act in relation to Rs. 24,89,000/- being value of goods contributed to Gujarat Earthquake Relief. We therefore, set aside the order of the CIT(A) on this issue and restore that of the Assessing Officer. The revenue succeeds on this ground."

13. A clear finding had been recorded by the Tribunal that there was no commercial expediency which would encompass the value of the goods sent to Prime Minister Relief Fund for Gujarat Earthquake relief to be admissible as business expenditure under Section 37 of the Act. Further more, the assessee had given the donations in the form of clothes and claimed deduction under section 37(1) by quantifying the same in monetary terms. In such circumstances, it could not be said that it was essential for the assessee to have contributed towards the Prime Minister's Relief Fund for carrying on business activities. No fault is found with the findings recorded by the Tribunal on this issue. The same are affirmed. In the light of the aforesaid findings of fact recorded by the Tribunal, the judgments relied upon by the learned counsel for the assessee does not advance the case of the assessee.

14. In view of the decision of this Court in **Liberty India vs. CIT**, (2007) 293 ITR 520 (P&H), affirmed by the Apex Court in **Liberty India vs. CIT**, (2009) 317 ITR 218, the issue with regard to question No.(iv) is decided against the assessee.

15. Consequently, the appeal is dismissed.

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