M/s. Haji Aziz and Abdul Shakoor Bros.

Vs

The Commissioner of Income-Tax, Bombay City II

Civil Appeal No. 110 of 1957

(J.L. Kapur, M. Hidayatullah, J.C. Shah JJ)

24.11.1960

JUDGMENT

KAPUR, J. -

This is an appeal by special leave against the judgment and order of the High Court of Bombay answering the question submitted to it against the assessee firm who is the appellant before us, the respondent being the Commissioner of Income-tax

The appeal relates to the assessment year 1949-50, the accounting year ended on July 25, 1948. The appellant is a firm doing the business of importing dates from abroad and selling them in India. During the accounting year the appellant imported dates from Iraq. At the relevant time the import of dates by steamers was prohibited by two notifications dated December 12, 1946, and June 4, 1947, but they were permitted to be brought by country craft. Goods which had been ordered by the appellant were received partly by steamer and partly by country craft. Consignments, which were imported by steamer and were valued at Rs. 5 lacs were confiscated by the Customs Authorities under section 167, item 8 of the Sea Customs Act but under section 183 of that Act the appellant was given an option to pay fines aggregating Rs. 1,63,950 which sum on appeal was reduced to Rs. 82,250. This sum was paid and the dates were released. On the sale of the goods certain profits accrued out of which it sought to deduct Rs. 82,250 paid as penalty on ordinary principles of commercial accounting. The Income-tax Officer disallowed this claim which was also disallowed by the Appellate Assistant Commissioner. On appeal to the Income-tax Appellate Tribunal this sum was held to be allowable by a majority of two to one. At the instance of the respondent the Tribunal referred the following question to the High Court for its opinion :

> "Whether on the facts and in the circumstances of the case, the payment of Rs. 82,250 is an allowable expenditure under section 10(2)(xv) of the Indian Income-tax Act ?"

The High Court held that the above amount of Rs. 82,250 could not be said to have been paid for salvaging the goods but was paid as a penalty incurred in consequence of an illegal act on the part of the appellant and was therefore not an allowable item under section 10(2)(xv) of the Income-tax Act. Against this judgment the appellant firm has come in appeal to this Court by special leave.

It was argued on behalf of the appellant firm that it had specifically instructed the shippers in Iraq to send the goods by country craft and we have been referred to certain correspondence but it does not appear that that correspondence in any way helps the appellant firm and the Income-tax authorities and the High Court have rightly proceeded on the basis that the appellant firm imported the goods

contrary to the regulations.

Three questions were raised by counsel for the appellant; (1) that an expenditure does not become inadmissible because it is occasioned by an infraction of the law not involving moral turpitude; (2) in any event the expenditure incurred was as the result of an order in rem against the stock-in-trade of the appellant firm and was therefore allowable as a deduction; (3) on the facts of this case there was no infraction by the appellant firm. The last question was not seriously pressed and it is without substance. The correspondence which has been placed on the record does not support the contention of the appellant firm. It was really the second point which was pressed by counsel although the first point was not given up.

It was argued that the order of confiscation, as a consequence of which the amount was paid to get the goods released, was an order in rem without any liability on the appellant firm or on the person of the partners; that it was not sufficient that there should be mere infraction of the law because the allowability of expense item depended on the nature of the proceedings and on the consequence that followed. The consequences of the breach of the law, it was contended, can be three; (1) confiscation or a fine in lieu of confiscation; (2) personal penalty; (3) prosecution in a criminal court or it may be all three of them. It was submitted that if the purpose of the expenditure is to save or salvage the goods then it is an allowable item of expenditure but if it is for the purpose of saving the person of the assessee then it is not. Therefore as the order passed was against the stock-in-trade and not against the person of the appellant firm it was an item expended for the release of the stock-in-trade of the appellant firm and it would be an allowable expenditure.

The action taken against the appellants was one under section 167, item 8, which is in Chapter XVI dealing with offences and penalties and provides :-

Section 167 - "The offences mentioned in the first column of the following schedule shall be punishable to the extent mentioned in the third column of the same with reference to such offences respectively :

#	Section of this Act to which offence has reference	Offences	Penalties
8.	If any goods, the importation or expo- rtation of which is prohibited or restri- cted by or under Chapter IV of this Act, be imported into or exported from (India) contrary to such prohibition or restriction; or	Such goods shall be liable to confiscat-ion; and any person concerned in any such offence shall be liable to a pena-lty not exceeding three times the value of the goods, or not exceeding one thousand rupees."	for the time being 18 & 19

Option is given in cases governed by this section under section 183 which provides :-

> Section 183 "Whenever confiscation is authorised by this Act, the officer adjudging it shall give the owner of the goods an option to pay in lieu of confiscation such fine as the officer thinks fit."

Enforcement of the payment of penalty is provided in section 193 the second clause of which is relevant to the case and is as follows :-

> Section 193 cl. (2) "When an officer of Customs who has adjudged a penalty or increased rate or duty against any person under this Act is unable to realize the unpaid amount thereof from such goods, such officer may notify in writing to any

> Magistrate within the local limits of whose jurisdiction such person or any goods belonging to him may be, the name and residence of the said person and the amount of penalty or increased rate of duty unrecovered; and such Magistrate shall thereupon proceed to enforce payment of the said amount in like manner as if such penalty or increased rate had been a fine inflicted by himself."

These sections show the punishments provided for the breach of the prohibitions in regard to importation or exportation of goods under sections 18 and 19; the power of the Customs authorities to given an option to pay in lieu of confiscation and how the penalties are to be imposed. Therefore when the appellants incurred the liability they did so as a penalty for an infraction of the law; but it cannot be said that the money which they had to pay was not paid as a penalty and in fact under section 167(8) it was a penalty.

In support of his argument counsel for the appellant firm referred to Maqbool Hussain v. State of Bombay etc. ([1953] S.C.R. 730.) and to the following passage at p. 742 where Bhagwati, J., said:-

> "Confiscation is no doubt one of the penalties which the Customs Authorities can impose but that is more in the nature of proceedings in rem than proceedings in personam, the object being to confiscate the offending goods which have been dealt with contrary to the provisions of the law and in respect of the confiscation also an option is given to the owner of the goods to pay in lieu of confiscation such fine as the officer thinks fit. All this is for the enforcement of the levy of and safeguarding the recovery of the sea customs duties."

Similar observations were made by S. K. Das, J., in Shewpujanrai Indrasanrai Ltd. v. Collector of Customs & Ors. ([1959] S.C.R. 821, 836.) where it was said that a distinction must be drawn between an action in rem and proceeding in personam and that confiscation of the goods is a proceeding in rem and the penalties are enforced against the goods whether the offender is known or not. The view taken by this Court in the other two cases cited by counsel for the appellants, i.e., Leo Roy Frey v. Superintendent, District Jail, Amritsar ([1958] S.C.R. 730.) and Thomas Dana v. The State of Punjab ([1959] Supp. 1 S.C.R. 274, 298.) is the same. In Dana case ([1959] Supp. 1 S.C.R. 274, 298.) Subba Rao, J., said at p. 298 :-

> "If the authority concerned makes an order of confiscation it is only a proceeding in rem and the penalty is enforced against the goods. On the other hand, if it imposes a penalty against the person concerned, it is a proceeding against the person and he is punished for committing the offence. It follows that in the case of confiscation there is no prosecution against the person or imposition of a penalty on him."

In Maqbool Hussain's case ([1953] S.C.R. 730.) the question for decision was whether after proceedings had been taken under the Sea Customs Act an accused person could be prosecuted and could or could not rely upon the plea of double jeopardy, it was held that he could not. In Shewpujanrai's case ([1959] S.C.R. 821, 836.) the contention raised was that after proceedings had been taken under the Foreign Exchange Regulation Act it was not open to the Customs Authorities to take any action under the Sea Customs Act. The other two cases were similar to Maqbool Hussain's case ([1953] S.C.R. 730). The contention now raised before us is quite different. What is to be decided in the present case is whether the penalty which was paid by the appellant firm was an allowable deduction within section 10(2)(XV) of the Income-tax Act which provides :

> Section 10(2)(xv) "any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

The words "for the purpose of such business" have been construed in Inland Revenue Commissioners v. Anglo Brewing Co. Ltd. ((1925) 12 T.C. 803, 813.) to mean "for the purpose of keeping the trade going and of making it pay". The essential condition of allowance is that the expenditure should have been laid out or expended wholly and exclusively for the purpose of such business.

In deciding this case, reference to decisions in some English cases will be fruitful. In Commissioners of Inland Revenue v. Warnes & Co. ([1919] 2 K.B. 444.), the assessees who carried on the business of oil exporters were sued for a penalty on an information exhibited by the Attorney-General under the Sea Customs Consolidation Act for breach of orders and proclamations. The matter was settled by consent on the assessee agreeing to pay a mitigated penalty of Pound 2,000. All imputations on the moral culpability of the assessees were withdrawn. The provisions of the Act under which this information was lodged and penalty paid were similar to the provisions of the Indian Sea Customs Act. This amount was held not to be a proper deduction because in order to be within the provision similar to section 10(2)(xv) of the Indian Act the loss had to be something within commercial contemplation and in the nature of a commercial loss. Rowlatt, J., relying on the observation of Lord Loreburn, L.C., in Strong & Co. v. Woodifield ([1906] A.C. 448.) said at p. 452 :-

> "but it seems to me that a penal liability of this kind cannot be regarded as a loss connected with or arising out of a trade. I think that a loss connected with or arising out of a trade must, at any rate, amount to something in the nature of a loss which is contemplable and in the nature of a commercial loss. I do not intend that to be an exhaustive definition, but I do not think it is possible to say that when a fine - which is what the penalty in the present case amounted to - has been inflicted upon a trading body, it can be said that that is a "loss connected with or arising out of" the trade within the meaning of this rule."

This statement of the law was approved in the Commissioners of Inland Revenue v. Alexander Von Glehn & Co. Ltd. ([1920] 2 K.B. 553.) where also in similar circumstances by consent of the assessee penalty of Pound 3,000 was paid and the penalty plus the costs were claimed as deduction in arriving at the profits. The Special Commissioners had found that the penalty and costs were incurred by the assessee in the course of carrying on their trade and so incidental thereto and were admissible deductions. Rowlatt, J., on a reference held it to be a non-deductible item. This judgment was affirmed on appeal by the Court of Appeal. Lord Sterndale, M. R., was of the opinion that it was immaterial whether technically the proceedings were criminal or not. The money that was paid was paid as a penalty and it did not matter if in the information it was called a forfeiture.

It was argued by the assessees in that case that no moral obliquity was attributed to them and that it did not matter whether the expense was incurred in consequence of an infraction of the law or whether it was a penalty for doing an illegal act. At p. 565 Lord Sterndale said :-

> "Now what is the position here ? This business could perfectly well be carried on without any infraction of the law. This penalty was imposed because of an infraction of the law, and that does not seem to me be, any more than the expense which had to

> be paid in Strong & Co. v. Woodifield ((1906) A.C. 448.) appeared to Lord Davey to be, a disbursement or expense which was laid out or expended for the purpose of such trade.....".

Warrington, L. J., said at p. 569 :-

> "It is a sum which the persons conducting the trade have had to pay because in conducting it they have so acted as to render themselves liable to this penalty. It is not a commercial loss, and I think when the Act speaks of a loss connected with or arising out of such trade it means a commercial loss, connected with or arising out of the trade."

In Strong & Co. v. Woodifield ((1906) A.C. 448.) a brewing company owned a licensed house in which they carried on the business of inn-keepers. They incurred a liability to pay damages on account of injuries caused to a visitor, by the falling in of a chimney. This sum was held not to be allowable as a deduction in computing the profits. Lord Loreburn, L. C., in his speech said no sum could be deducted unless it be money wholly and exclusively laid out or expended for the purpose of such trade and that only such losses could be deducted as were connected with it in the sense that they were really incidental to the trade itself and they could not be deducted if they were mainly incidental to some other vocation or fell on the trader in some character other than that of a trader. Lord Davey observed :-

> "I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with the trade or is made out of the profits of the trade. It must be made for the purpose of earning the profits."

The following passage from Lord Sterndale's judgment at page 566 in Von Glehn's case ([1920] 2 K.B. 553.) from which we have already quoted shows the effect of incurring a penalty as a result of a breach of the law :

> "During the course of the trading this company committed a breach of the law. As I say, it has been agreed that they did not intend to do anything wrong in the sense that they were willingly and knowingly sending these goods to an enemy destination; but they committed a breach of the law, and for that breach of the law, they were fined. That, as it seems to me, was not a loss connected with the business, but was a fine imposed upon the company personally, so far as a company can be considered to a person, for a breach of law which it had committed. It is perhaps a little difficult to put the distinction into very exact language, but there seems to me to be a difference between a commercial loss in trading and a penalty imposed upon a person or a company for a breach of the law which they have committed in that trading. For that reason I think that both the decision of Rowlatt, J., in this case, and his former decision in Inland Revenue Commissioners v. Warnes & Co. ([1919] 2 K.B. 444.) which he followed were right, and that this appeal should be dismissed with costs."

In Spofforth and Prince v. Glider ((1945) 26 T.C. 310.) the assessee was a firm of chartered accountants, who claimed a deduction for certain legal costs paid in connection with a successful defence of one of the partners in a Police Court. The assessee firm also sought legal advice in regard to matters connected with some proceedings. Summons were issued against the assessee firm but

were eventually dismissed. The assessee contended that the whole of the costs incurred in connection with the proceedings were "wholly and exclusively" laid out or expended for the appellant's profession and were therefore allowable deductions. The Special Commissioner had held against the assessee which was upheld by the Court. The test laid down by Lord Davey in Strong & Co. v. Woodifield ([1906] A.C. 448.) was applied and applying that test it was held that except the expenses for obtaining legal advice the other expenses were not admissible.

In Farrie v. Hall ([1947] 28 T.C. 200.) F, a sugar broker was sued in the High Court for libel and the Court held that F had acted maliciously and that the defence of privilege could not prevail and awarded damages against him. F sought to claim the amount of damages as an allowable deduction contending that it was an expenditure laid out wholly and exclusively for the purposes of his trade or was a loss connected with or arising out of the trade. Relying on the cases above-mentioned this amount was disallowed because it fell on the assessee in his character of a calumniator of a rival sugar broker and it was only remotely connected with his trade as a sugar broker. Therefore it was not laid out exclusively and wholly for the purpose of his business. We were also referred to the observations of Danckwerts, J. in Newson v. Robertson ([1952] 33 T.C. 452, 459.) where it was said that if the expenditure is incurred by the taxpayer for more than one purpose including the commercial purposes in the sense that it is incurred for the purposes of earning profits of the trade and also some outside purpose then the expenses cannot be claimed at all as not being wholly and exclusively laid out or expended for the purpose of the trade. In that case expense claimed by a Barrister for travelling between his house and his chambers were disallowed because his object and purpose in travelling was mixed and not wholly and exclusively for the purpose of the profession.

Coming now to Indian cases; In Mask & Co. v. Commissioner of Income-tax, Madras ([1943] 11 I.T.R. 454.) the assessee in breach of his contract sold crackers at a lower rate and a decree was passed against him for damages for breach of contract which he claimed as an allowable deduction. It was held that as the assessee had disregarded the undertaking given and his conduct was palpably dishonest it did not constitute an allowable expenditure. Sir Lionel Leach, C.J., after referring to Warnes' case ([1919] 2 K.B. 444.) and Von Glehn's case ([1920] 2 K.B. 553.) held that the amount did not constitute an expenditure falling within section 10(2)(xii). The Madras High Court in Senthikumara Nadar & Sons v. Commissioner of Income-tax, Madras ([1953] S.C.R. 714.) held that payments of penalty for an infraction of the law fell outside the scope of permissible deductions under section 10(2)(xv). In that case the assessee had to pay liquidated damages which was akin to penalty incurred for an act opposed to public policy a policy underlying the Coffee Market Expansion Act, 1942, and which was left to the Coffee Board to enforce.

Reference was also made during the course of arguments to Commissioner of Income-tax v. Hirjee ([1953] S.C.R. 714.). In that case the assessee was prosecuted under the Hoarding and Profiteering Ordinance but was finally acquitted and claimed the amount spent in defending himself under section 10(2)(xv) in his assessment. It was held that the distinction between the legal expenses on a successful and unsuccessful defence was not sound and that the deductibility of such expenses under section 10(2)(xv) must depend on the nature and purpose of the legal proceedings in relation to the business whose profits are in computation and are unaffected by the final outcome of the proceedings.

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.) and 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 section 10(2)(xv) 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 be 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 or grounds of public policy be said to be a commercial expense for the purpose of a business or a disbursement made for the purpose 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.

Appeal dismissed.

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