

ANDHRA PRADESH HIGH COURT

Commissioner of Income-Tax

Vs

Hyderabad Allwyn Metal Works Ltd

(B J Reddy, CJ. Upendralal Waghray, J.)

11.11.1987

JUDGMENT

B.J. Reddy, Upendralal Waghray, J.

1. This is a reference at the instance of the Revenue under section 256(1) of the Income-tax Act, 1961, in which the following two questions are referred for the opinion of this court :

"(1) Whether, on the facts and in the circumstances of the case, the interest paid under section 14B of the Employees' Provident Funds Act, 1952, is an allowable deduction under the Income-tax Act, 1961 ?

(2) Whether, on the facts and in the circumstances of the case, interest paid on account of delayed payment of sales tax is an allowable deduction under the Income-tax Act, 1961 ?"

2. The assessee is a public limited company and the relevant assessment year is 1973-74. Question No. (1) refers to the interest paid under section 14B of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (hereinafter called "The Act"), but what is payable under that provision is damages. It is useful to extract section 14B of the Act :

"14B. Power to recover damages. - Where an employer makes default in the payment of any contribution to the Fund, the Family Fund or the Insurance Fund or in the transfer of accumulations required to be transferred by him under sub-section (2) of section 15 or sub-section (5) of section 17 or in the payment of any charges payable under any other provision of this Act or of any Scheme or Insurance Scheme or under any of the conditions specified under section 17, the Central Provident Fund Commissioner or such other officer as may be authorised by the Central Government, by notification in the Official Gazette, in this behalf may recover from the employer such damages, not exceeding the amount of arrears, as it may think fit to impose :

Provided that before levying and recovering such damages, the employer shall be given a reasonable opportunity of being heard."

3. The question is, therefore, reframed to read as "damages" in the place of "interest".

4. The Income-tax Officer had disallowed the claim of the assessee for deduction of the amount paid by it as damages under section 14B of the Act, as it stood then. According to the assessee, it collected a sum of Rs. 9,31,000 from the employees towards their contributions to the Employees' Provident Fund, but delayed the remittance to the authority under the Act. For this default, a sum of Rs. 22,964 was imposed as damages by the authority under the Act. The assessee claimed the amount paid as damages as a business expenditure on the ground that the delay in the remittance was because the amount was used in its business activity which, otherwise, would have had to be borrowed on interest.

5. The Income-tax Officer has disallowed the deduction on the ground that the levy was penal in nature. The first appellate authority confirmed the order of the Income-tax Officer. On further appeal, the Tribunal has held that the levy was compensatory and akin to interest for delayed payment and allowed the deduction. It applied the ratio of the Supreme Court decision in *Mahalakshmi Sugar Mills Co. v. CIT* and held that the earlier decision of the Allahabad High Court in *Saraya Sugar Mills (P) Ltd. v. CIT [FB]*, relied upon by the first appellate authority, was no longer good law in view of the said Supreme Court decision.

6. Counsel for the Revenue has reiterated the stand taken before the Tribunal and has relied upon the decision in *Saraya Sugar Mills (P) Ltd. v. CIT [FB]* and the decisions of some other High Courts holding that the levy of damages under the provisions of this Act was penal in nature. Counsel for the assessee has supported the order of the Tribunal and placed reliance on the same decision of the Supreme Court as well as on subsequent decisions of the Allahabad High Court in *Triveni Engineering Works Ltd. v. CIT [FB]* and of the Kerala High Court in *RPF Commissioner v. Bharat Plywood & Timber Products*¹

7. The Supreme Court in its decision relied upon by the Tribunal, viz., *Mahalakshmi Sugar Mills Co. v. CIT*, was considering the controversy about the payment of interest under sub-section (3) of section 3 of the Uttar Pradesh Sugarcane Cess Act, 1956. It is useful to extract section 3 in its entirety (at p. 432 of 123 ITR) :

"3. Imposition of cess. - (1) The State Government may by notification in the Official Gazette impose a cess not exceeding four annas per maund on the entry of the cane into the premises of a factory for use, consumption or sale therein..

(2) The cess imposed under sub-section (1) shall be payable by the owner of the factory and shall be paid on such date and at such place as may be prescribed.

(3) Any arrear of cess not paid on the date prescribed under subsection (2) shall carry interest at 6 per cent. per annum from such date to date of payment.

(4) The State Government may, for the purpose of assessment and collection of the cess, appoint

officers and authorities and may also prescribe the manner in which the cess shall be assessed and collected.

(5) Where any person is in default in making the payment of the cess, the officer or authority empowered to collect the cess may direct that in addition to the amount of the arrears and interest, a sum not exceeding 10 per cent. thereof shall by way of penalty be recovered from the person liable to pay the cess.

(6) The officer or authority empowered to collect the cess may forward to the Collector a certificate under his signature specifying the amount of arrears including interest due from any person, and on receipt of such certificate, the Collector shall proceed to recover the amount specified from such person as if it were an arrear of land revenue.

(7) Any sum imposed by way of penalty under sub-section (5) shall be recoverable in the manner provided in sub-section (6) for the recovery of the arrear of cess."

8. The Supreme Court held that the payment required by sub-section (3) of section 3 for interest at 6 per cent. per annum, could not be treated as penalty and it was, in essence, compensation paid to the Government for the delay in payment of cess. The nature of payment under section 14B of the Act was not considered in the said decision. The Tribunal has applied the same principle to the levy under section 14B of the Act. The nature of this impost was considered by the Supreme Court in the case of *Orango Chemical Industries v. Union of India*, AIR 1979 SC 1803; [1979] 55 FJR 283 (SC), where the two judges who constituted a Bench have given separate, but concurring judgments. It was not a case under the Income-tax Act, but the following passage from the judgment of A. P. Sen J., in paragraph 47, is relevant for ascertaining the nature of the levy (at p. 304 of 55 FJR) :

"47. The expression 'damages' occurring in section 14B is, in substance, a penalty imposed on the employer for the breach of the statutory obligation. The object of imposition of penalty under s. 14B is not merely 'to provide compensation for the employees'. We are clearly of the opinion that the imposition of damages under section 14B serves both the purposes. It is meant to penalise defaulting employers as also to provide reparation for the amount of loss suffered by the employees. It is not only a warning to employers in general not to commit a breach of the statutory requirements of section 6, at the same time it is meant to provide compensation or redress to the beneficiaries, i.e., to recompense the employees for the loss sustained by them. There is nothing in the section to show that the damages must bear relationship to the loss which is caused to the beneficiaries under the Scheme. The words 'damages' in section 14B is related to the word 'default'. The word used in section 14B are 'default in the payment of contribution' and, therefore, the word 'default' must be construed in the light of para. 38 of the Scheme which provides that the payment of contribution has got to be made by the 15th of the following month and, therefore, the word 'default' in section 14B must mean 'failure in performance' or 'failure to act'. At the same time, the imposition of damages under section 14B is to provide reparation for the amount of loss suffered by the

employees."

9. Earlier, in the same judgment, the learned judge has noticed the conflict of views in the various High Courts on the question whether the damages awarded under this section was penal in character or compensatory. In view of this decision of the Supreme Court, it cannot be said that the amount payable under section 14B is wholly compensatory and, therefore, it cannot be equated to the interest payable under section 3(3) of the U. P. Sugarcane cess Act. It is not disputed that any penal levy (i.e., other than compensatory levy) cannot be claimed as a deduction for ascertaining the income from business under the Income-tax Act. The aforesaid decision of the Supreme Court does not appear to have been considered in the decisions cited by the Revenue or the assessee. In fact, the conflict of decisions in the various High Courts is referred to by the Supreme Court. The Tribunal, therefore, was not right in treating the payment as purely compensatory. The question whether any such impost is in essence compensatory or is by way of penalty will have to be decided having regard to the relevant provisions of the law under which it is imposed and the circumstances under which it has been imposed. The mere nomenclature as interest, penalty or damages in the Act may not be conclusive for the purpose of allowing it as a deduction under the Income-tax Act. Similarly, the circumstance that a fixed rate of interest has to be paid also may not be conclusive. Section 14B of the Act provides for levy of damages for delayed payment as a percentage of the amount due up to a prescribed maximum. Such a determination is to be done by the appropriate authority after giving an opportunity to the employer. Thus, the levy will be by a speaking order of the authority fixing quantum of damages. As held by the Supreme Court, the said amount comprises both an element of penal levy as well as compensatory payment. It will be for the authority under the Income-tax Act to decide with reference to the provisions of the Employees' Provident Funds Act and the reasons given in the order imposing and quantifying the damages to determine what proportion should be treated as penal and what proportion as compensatory. The entire sum can neither be considered as mere penalty nor as mere interest. In view of what has been stated above, our answer to question No. (1) is that only a portion (which is held to be compensation) out of the amount paid as damages under section 14B of the Employees' Provident Funds Act is an allowable deduction under the Income-tax Act. We direct the Tribunal to determine the appropriate portion after hearing the parties and then pass consequential orders.

10. Question No. (2) :

The assessee claimed deduction of Rs. 74,363 being the interest paid on account of delay in payment of sales tax levied under the Bombay Sales Tax Act, 1959, in respect of its sales which attracted that levy. The assessee has not contested the validity or quantum of the tax payable under the said Act. According to it, the tax payable was withheld and used in the business of the company, otherwise it would have had to borrow money on interest. It contended that this payment was compensatory in nature and ought to have been allowed as deduction. The Income-tax Officer and the first appellate authority negatived the claim on the ground that the payment

was in the nature of a penalty. The Tribunal has, however, held, following its earlier decision, that the payment was only compensatory and not penal.

11. For determining the controversy whether the payment is penal or compensatory, it is necessary to examine the provisions of the Bombay Sales Tax Act, 1959. The aforesaid payment is said to have been made under section 36(3) of the said Act. Section 38 of that Act provides for the payment of, and deferred payment of, tax, etc. According to sub-section (2) of the said section, the tax has to be paid by the registered dealer into the Government Treasury along with the return to be filed by him under section 32 of the said Act. Section 33 provides for the assessment of tax. Sub-section (7) of section 33 reads as follows :

"33. (7) Any assessment made under this section shall be without prejudice to any penalty, or prosecution for an offence, under this Act."

12. Sections 36 and 37 provide for imposition of penalties by the authorities in certain cases and for contravening certain provisions of the Act. Section 36 contains several sub-sections providing for penalties in various situations. Similarly, section 37 also provides for imposition of penalty for contravening certain provisions of the Act. Both sections 36 and 37 contain an identical provision in sub-section (5) of section 36 and sub-section (4) of section 37, which read as follows :

"No prosecution for an offence under this Act shall be instituted in respect of the same facts on which a penalty has been imposed under this section."

13. Section 63 of the Act provides for offences and penalties to be imposed by a criminal court. Sub-section (14) of the said section also provides that where a penalty has been imposed by the Commissioner under any of the provisions of the Act, he shall not be prosecuted under section 63. Sub-section (3) of section 36 under which the amount is said to have been paid in this case reads as follows :

"36. (3) If a dealer does not, without reasonable cause, pay tax within the time he is required by or under the provisions of this Act to pay it, the Commissioner may, after giving the dealer an opportunity of being heard, by an order in writing, impose upon the dealer by way of penalty, in addition to the amount of tax, a sum equal to :

(a) one and one-half per cent. of the amount of tax for each month for the first three months, after the last date by which the dealer should have paid that tax; and

(b) two per cent. of the amount of tax for each month thereafter during the time the dealer continues to make default in the payment of tax :

Provided that the Commissioner, or any appellate or revisional authority, may remit the whole or any part of the penalty payable in respect of any period :

Provided further that, no penalty under this section shall be payable by a dealer to whom an

eligibility certificate has been granted by the State Industrial and Investment Corporation of Maharashtra Limited (SICOM) or by a Regional Development Corporation, and for whom due date of payment has been extended, moratorium has been granted or instalments have been granted under the second proviso to sub-section (4) of section 38 and the payments have been made accordingly."

14. From a reading of the aforesaid provision and in the background of the various sections mentioned above, it cannot be said that the levy under section 36(3), though called a penalty, is merely compensatory or in the shape of interest for delayed payment or penal in character. The Act does not provide for automatic payment of interest due to delay in payment. The levy under sub-section (3) of section 36 is to be made after giving notice to the dealer and after recording reasons for it where the tax has not been paid within the time contemplated for payment by the Act. The Commissioner has also the power to remit the whole or any part of the interest calculated in the manner mentioned in it which can be only on relevant grounds. Sub-section (5) of section 36, which is extracted above, indicates that after the levy of this amount under sub-section (3), immunity is granted from prosecution on the same facts. These indicate that the imposition, though called a penalty, is a composite one comprising both a penalty and a compensation for delayed payment. The Tribunal, therefore, was not right in treating the entire payment as merely interest for delayed payment. As already indicated while discussing question No. (1), the nomenclature of the levy as interest, damages or penalty may not be conclusive.

15. In view of the provisions of the Act mentioned above, we are of the opinion that this levy is also of a composite nature. The order of the Commissioner imposing the levy is not available on record. Therefore, it will be for the authority under the Act to decide with reference to the provisions of the Act and the reasons given in the order imposing the penalty to apportion appropriate portions towards penalty and compensatory payment. To the extent of compensatory payment so determined, a deduction is to be allowed under the Income-tax Act. Our answer to question No. (2) is that a portion of the interest paid on account of delayed payment of sales tax under section 36(3) of the Bombay Sales Tax Act is allowable deduction under the Income-tax Act. We direct the Tribunal to determine the appropriate portion after hearing the parties and then pass consequential orders.

Cases Referred.

1[1980] Lab IC 446