BOMBAY HIGH COURT

Commissioner of Income Tax

Vs.

Haji Aziz and Abdul Sakoor Bros

Income-tax Ref. No. 57 of 1954

(Chagla, C.J. and Tendolkar, J.)

25.02.1955

JUDGMENT

Chagla, C.J.

The following question of law was referred to the High Court-

> "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?"

Chagla, C.J.

2. In our opinion the question submitted to us by the Tribunal is capable only of one answer, although Mr. Palkhivala with considerable force has argued that it is only capable of the contrary answer.

3. The facts are very brief. The assessee is an importer of dates from Iraq. At the relevant time there was a notification issued under the Imports and Exports Control Act prohibiting the import of dates by steamers. Import of dates was only permissible by country crafts. In breach of this notification the assessee imported large quantity of dates by steamers. The Customs authorities under Section 167(8) of the Sea Customs Act confiscated the dates which had been imported by steamers and they gave him the option under Section 183 of paying a fine of Rs. 82,250 in lieu of confiscation. The assessee paid the fine and released the goods from the Customs authorities. In the relevant assessment year he claimed Rs. 82,250 as a permissible deduction under Section 10(2)(xv).

4. Now, under Section 10(2)(xv) what is a permissible deduction is an expenditure laid out or expended wholly and exclusively for the purpose of the assessee's business, profession or

vocation. Although the Legislature has not so stated it in express terms, we must read into Section 10(2)(xv) by necessary intendment that the expenditure contemplated by this sub-section is an expenditure which is laid out or expended for the purpose of carrying out the business of the assessee lawfully. In our opinion it is impossible to suggest that if an assessee spends money in order to carry the business unlawfully, he would be entitled to deduction under Section 10(2)(xv). If certain expenses become necessary not because the assessee wants to carry out his business lawfully, but they become necessary because he has committed an unlawful act or has carried out the business in a manner prohibited by law, then those expenses cannot fall within the ambit of Section 10(2)(xv). This is not a principle of income-tax law; it is a principle underlying all laws that no person can benefit by an unlawful act and no person can be permitted in support of his claim to put forward an act which is an unlawful act. In effect and in substance what the assessee is contending is that he committed an unlawful act, he did what was prohibited by law, by doing that he had to incur an expenditure and that expenditure should be permitted by us as falling within the ambit of Section 10 (2) (xv).

5. It is urged by Mr. Palkhivala that this expenditure was necessary for salvaging the goods. He says that if he had not paid the fine and obtained the goods, he could not have traded with these goods, he could not have made profits on these goods, and the Income-tax Department could have obtained no tax at all, and in that sense according to him this expenditure was laid out wholly and exclusively for the purpose of his business. Now, it is erroneous to suggest that this fine was paid by the assessee in order to salvage the goods. Any amount spent for safeguarding or saving the stock-in-trade of a business would undoubtedly fall under Section 10(2)(xv), but Mr. Palkhivala puts the case of his client very euphemistically when he suggests that he paid this fine in order to save or safeguard his goods. This fine was paid as a consequence of the illegal act of the assessee, and it is a very far cry from paying a penalty for committing an offence to a case where a businessman spends money to salvage or safeguard his goods. A very fine distinction was sought to be drawn by Mr. Palkhivala between what he calls a penalty 'in rem' and a penalty 'in personam'. He points out that under the Sea Customs Act it was open to the Customs authorities to impose a penalty upon the assessee. It was also open to the customs authorities to confiscate the goods. He says that a case of a penalty may be different, but as far as confiscation is concerned it has nothing to do with the assessee personally; it has only to do with the goods; and therefore when he paid the fine in lieu of confiscation, he was trying to get over the effect of an order which, as it were, was directed against the goods. Now, we find it rather difficult to appreciate this very fine distinction. If the penalty was imposed upon the assessee, undoubtedly he would have had to pay from his pocket or the necessary coercive measures would have been taken against him. But why is it not equally a penalty upon the assessee when his goods are confiscated? The goods which can be confiscated are only the goods of the owner, and whether the penalty takes the shape of cash being paid by the assessee or takes the shape of the assessee losing his goods, it is difficult to understand what distinction exists between penalty of one kind and penalty of a different kind. In our opinion, both are penalties prescribed by the Sea Customs Act and it is left to the discretion of the Customs authorities which penalty in the particular

circumstances of the case to impose upon the assessee.

6. In support of this distinction Mr. Palkhivala has relied on one English decision and two decisions of the Supreme Court. The first is - *Commrs. of Inland Revenue v. Alexander Von Glehn and Co. Ltd*[2]*.',* That case is very similar to the case before us, and in our opinion with respect, Lord Sterndale, Master of the Rolls, has laid down the correct principle. That was the case where the assessee exported goods to Russia during the war contrary to the provisions of law. The assessee was prosecuted and he agreed to pay a

[2] (1920) 12 Tax Cas 232

compromise penalty, and claimed as a permissible deduction both the penalty which he had paid and the legal expenses of defending the action, and Lord Sterndale observes (p.238):

> "During the course of the trading this company (i.e. the assessee) 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, and that does not seem to me to be a loss connected with the business, but it is a fine imposed upon the company personally, as far as a company can be a person, for a breach of the law which they had committed."

Mr. Palkhivala reads into these observations of Lord Sterndale a distinction between a case where a fine is imposed personally and where a fine is directed against the goods. We refuse to see any such distinction. What Lord Sterndale clearly points out is that when an assessee is penalised for breach of the law, the penalty can under no circumstances be looked upon as an expenditure incurred wholly and exclusively for the purpose of the business. It is entirely immaterial in our opinion what the nature of the penalty might be. So long as the deduction that is sought is in respect of a penalty or a fine imposed for a breach of the law, such a deduction can never be a permissible deduction under Section 10(2)(xv).

7. The Supreme Court in - *'Maqbool Hussain v. State of Bombay*[3]*',* was considering the scheme of the Sea Customs Act solely for one purpose whether under Article 20(2) of the Constitution an order of the customs authorities of confiscation or penalty could be considered to be a conviction so as to bar another prosecution, and in connection with this scheme, Bhagwati J. points out (p.330):

> "....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"

Now, this observation was made in order to repel the argument that wide powers were conferred upon the Customs authorities and therefore their order must be looked upon as a conviction, and the learned Judge points out that even the extent of the fine was only Rs. 1,000 and with regard to the goods the action was confined to the goods only. We do not understand how this decision can be of any assistance in deciding the point that has arisen before us.

8. The next decision on which Mr. Palkhivala relies is the decision of the Supreme Court in - *'Commissioner of Income Tax, West Bengal v. H. Hirjee[4],.* In that case the assessee company was prosecuted under the Hoarding and Profiteering Ordinance on a charge of

[3] AIR 1953 SC 325

[4] AIR 1953 SC 324

selling goods at prices higher than were reasonable in contravention of the provisions of Section 6. The prosecution ended in an acquittal and the company claimed the expenses of legal defense as permissible deduction under Section 10(2)(xv). The Calcutta High Court agreeing with the Tribunal allowed the deduction. In appeal the Supreme Court took a contrary view. The view taken by the Calcutta High Court, following a decision of this Court in - *'J. B. Advani and Co. Ltd. v. Commissioner of Income Tax and E.P. Tax[5]',* was that if the primary object of incurring the expenditure was to protect the good name of the business and if the transaction in respect of which the assessee was charged was a transaction which took place in the ordinary course of business, then the expenditure could be considered to be wholly and exclusively for the purpose of the business. With regard to the first test the Supreme Court took the view that the purpose for which the company defended itself was not a single purpose, but a composite purpose. It was not merely defending the good name of the business, but it was also trying to save itself from a conviction which would have resulted in the imprisonment of those responsible for the carrying on of the company, and it was because of this that the Supreme Court came to the conclusion that the expenditure was not a permissible deduction. Mr. Palkhivala relies on the observation of the learned Chief Justice at p.325 where he says:

> ". . The deductibility of such expenses under Section 10(2)(xv) must depend upon the nature and purpose of the legal proceeding in relation to the business whose profits are under computation, and cannot be affected by the final outcome of that proceeding."

The learned Chief Justice is emphasising that the mere fact that the assessee was acquitted should have no bearing upon the question as to whether the expenses of legal defence were justifiable deduction under Section 10(2)(xv) or not, and with respect the learned Chief Justice rightly says that we must look to the nature of the legal proceeding in order to decide what was the purpose for which the legal defence was undertaken. Now, again, we really do not understand how this principle laid down by the Supreme Court can help the assessee in this case. We are not dealing with legal expenditure. We are dealing with a case where the assessee has been penalised for an illegal act, and what he is seeking to deduct is not any legal expense for defending himself, but to claim as a deduction the penalty which he has paid as a result of the breach of the law he

committed.

9. Mr. Palkhivala says that a line must be drawn between an expenditure which is prohibited and an expenditure which is not prohibited but which is permissible, and he concedes and even that with some reluctance that if an assessee paid a bribe in order to get the goods which are the stock-in-trade of his business and which yields profits, it may be that that expenditure being a prohibited expenditure it would not be a permissible deduction under Section 10(2)(xv). But, says Mr. Palkhivala, where as in this case the law permits him to pay a fine in lieu of confiscation, the expenditure should not be looked upon as of the same character or nature as the other expenditure which is itself prohibited. In our opinion no distinction can be drawn between a case where an assessee makes an unlawful expenditure and claims it as a deduction under Section 10(2)(xv) and a case where an assessee commits a breach of the law, incurs an expenditure as a result of that breach of the law, and then claims that expenditure under Section 10(2)(xv). The two cases are identical and no distinction can be drawn between them.

[5] AIR 1950 Bom 297

10. Mr. Palkhivala then suggests that what the Court must look at for the purpose of Section 10(2)(xv) is the expenditure itself. The only relevant factor according to him is the point of time at which the expenditure was incurred. He says that the Court must wipe out the past and must not look at the genesis of the transaction. That again, in our opinion, is a wrong approach to Section 10(2)(xv). In order to be satisfied that the expenditure was wholly and exclusively for the business, the Court must look at the circumstances under which that expenditure was incurred, and if the Court is satisfied that the circumstances were such as to disentitle the assessee to claim the deduction-under Section 10(2)(xv), it must do so. It would be impossible to accept the position that the Court must so detach itself as only to remember that the assessee paid a certain amount and got back the goods, forgetting and overlooking the fact that that action was due to his earlier action in committing a breach of the law.

11. Therefore, in our opinion, on the facts of this case it is clear that the amount claimed by the assessee cannot be a permissible expenditure under Section 10(2)(xv). We, therefore, answer the question submitted to us in the negative. Assessee to pay the costs.

Answer in the negative.