Indian Aluminium Co. Ltd. Vs. Commissioner of Income-tax, West Bengal.

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Court : Kolkata

Decided On : Apr-27-1966

Reported in : [1967]64ITR330(Cal)

Appeal No. : Income-tax Reference No. 90 of 1962

Appellant : Indian Aluminium Co. Ltd.

Respondent : Commissioner of Income-tax, West Bengal.

Judgement :

SEN J. - This is a reference under section 66(1) of the Indian Income-tax Act, 1922, hereinafter called the Act. In this reference the following question arises for out opinion :

'Whether, on the facts and in the circumstances of the case, the sum of Rs. 1,24,199 was deductible from the business income of the assessee either under section 10(1) or section 10(2) (xi) or section 10(2) (xv) of the Income-tax Act ?'

The Indian Aluminium Co. Ltd. is the assessee. It is a public limited company and has its registered office at Calcutta. The relevant previous year ended on December 31, 1954. The principal business of the assessee is manufacture of aluminium ingots, sheets and such other products from aluminium. Under an agreement dated January 31, 1947, between the assessee and one Messrs. Aluminium Laboratories Ltd., Montreal (Canada), the latter agreed to provide the assessee from time to time with technical information, engineering service and advice regarding development for an annual retainer fee. The Montreal Co. provided the assessee-company with technical information and advice on specific problems of production and manufacture of aluminium. In view of the agreement the assessee paid a total sum of Rs. 2,50,808 to the said laboratory between the accounting years ended on September 30, 1944, and on September 30, 1950.

In the year 1951, the Income-tax Officer treated the assessee-company as being in default under section 18(7) of the Act in respect of the amount of taxes which the assessee was liable to deduct from the payments made to the said Montreal company under the provisions of section 18(3A), 18(3B) and 18(3C) of the Act. The amount assessed was Rs. 1,24,199. The assessee entered into correspondence with Messrs. Aluminium Laboratories Ltd., Montreal, asking them for reimbursement of the aforesaid sum of Rs. 1,24,199. The latter refused to accept the assessees claim for reimbursement and their repudiation was communicated to the assessee by their letter date August 3, 1954. On obtaining such letter of repudiation, the assessee wrote off the amount during the relevant accounting year and claimed it as a bad debt deductible under section 10(2) (xi) of the Act. The Income-tax Officer, however,

disallowed the claim of the assessee and such disallowance gate rise to an appeal to the Appellate Assistant Commissioner. The Appellate Assistant Commissioner upheld the contention of the assessee that the amount paid was an allowable deduction in view of the Bombay High Court decision in Commissioner of Income-tax v. Abdullabhai Abdulkadar. Against this order of the Appellate Assistant Commissioner, the department preferred an appeal to the Tribunal. It so happened that at the time of the decision by the Tribunal, the aforesaid decision was reversed by the Supreme Court as reported in 41 I. T. R. 545. It was urged before the Tribunal by the assessee that, although under the agreement dated 31st January, 1947, the assessee was not bound to suffer the tax on the payment of the retainer fee to the said Messrs. Aluminium Laboratories Ltd., Montreal, since the assessee had taken the aid in the shape of technical advice for the proper carrying on of the business, the payment of tax was an expense incidental to the business and was allowable either under section 10(1) or section 10(2) (xv) or as a bad debt under section 10(2) (xi) of the Income-tax Act. This contention of the assessee was repelled by the Tribunal mainly relying upon the decision of the Supreme Court in the case of Commissioner of Income-tax v. Abdullabhai Abdulkadar. The Tribunal held that the expenditure was neither incidental to the business, much less wholly and exclusively laid out for the purpose, nor was it claimable as a bad debt in view of the fact that it was not a trade debt in the course of the fact that it was not a trade debt in the course of the business.

This being the decision, a reference was asked for by the assessee to this court under section 66(1) of the Act which was allowed by the Tribunal.

Before dealing with the arguments as advanced by Mr. S. R. Banerjee, appearing for the assessee, it is necessary to refer to certain salient facts which are admitted by both parties. The assessee entered into an agreement on the 31st day of January, 1947, with the Aluminium Laboratories Ltd., Montreal. The terms, inter alia, were that the yearly retainer fee shall be payable to Aluminium Laboratories Ltd. at Montreal, P. Q., Canada, on the first day of January, April, July and October of each year, in four equal installments, each of one quarter of the total amount of the retainer fee mutually agreed upon for that year or, at the discretion of the Indian Aluminium Company, the annual retainer fee for any year may be paid as a single lump sum on the first day of January that year, provided that, in the event that the assessee is unable to make payments on the specified date, due to exchange control regulations or to any other cause beyond its control, the said payment shall be made on the earliest possible date thereafter. The terms of the contract do not show that any provision for payment of income-tax was made by either by the assessee or the Aluminium Laboratories Ltd., Montreal. It is quiet clear that, by reason of the agreement, the assessee credited a total fee of Rs. 2,50,808 in favour of the said Montreal company in a period of 7 years, that is, between the accounting year ended on 30th September, 1945, and on 30th September, 1950, and it may be presumed that, under the statutory provisions of the Income-tax Act, this amount was deducted from the profits and gains of the business of the assessee-company. What followed next was that the assessee was dealt with under section 18(3A), 18(3B) and 18(3C) of the Act and it was also proceeded against under section 18 (7) of the Act for a total sum of Rs. 1,24,199 and this amount was duly credited of the Income-tax Officer. Thereafter, the assessee-company wrote several letters to the Aluminium Laboratories Ltd. asking them for reimbursement of the aforesaid sum of Rs. 1,24,199. After a series of correspondence, ultimately on the 3rd of August, 1954, the Aluminium Laboratories Ltd., Montreal, finally refused to accept the assessee-companys request for reimbursement. The assessee, thereafter, wrote off the

aforesaid sum during the relevant accounting year and claimed it is a bad debt deductible under section 10(2) (xi) of the Income-tax Act.

Mr. Banerjee has argued that, although the company might have been proceeded against under section 18(3B) and 18(7) of the Act., that matter need not be taken into consideration at this stage as this court is called upon only to decide whether the sum of Rs. 1,24,199 paid as tax liability for the Montreal company should be treated as an expenditure wholly and exclusively laid out for the purpose and that the amount should be treated as a bad debt and liable to be excluded from the profits and gains of the business. This argument we cannot accept in view of the fact that the nature of the payment has to be enquired into and if it is really found that it was made as incidental to the business, in that event only the assessee can claim deduction. For this purpose we are in the first instance called upon to decide as to what should be the scope of section 18 of the Act, especially sub-section (3B) and sub-section (7). The genesis of the liability arose under sub-section (3B). It runs as follows :

'Any person responsible for a paying to a person not resident in the territories any interest not being interest on securities or any other sum chargeable under the provisions of this Act shall, at the time of payment, unless he is himself liable to pay any income-tax and super-tax thereon as an agent, deduct income-tax at the maximum rate and super-tax at the rate applicable to a company or in accordance with the provisions of sub-clause (b) of sub-section (1) of section 17, as the case may be :

Provided that where the person not resident is not a company, the proviso to sub-section (2B) shall apply to the deduction of income-tax and super-tax under this sub-section as it applies to the deduction of income-tax and super-tax under sub-section (2B).'

The other proviso need not be quoted here for the decision of this reference. Now, on an analysis of this section it will appear that (a) the payee should be non-resident in the taxable territories, (b) the amount payable should be interest not being interest on securities or any other sum chargeable under the provisions of this Act, and (c) the person responsible for making the payment should not himself be liable to pay income-tax and super-tax thereon as an agent.

On a perusal of the entire section 18, it appears to us that it imposes an obligation upon every person responsible for paying any amount coming under the head 'salary', interest on securities or dividends or any other sums to a non-resident company, to deduct taxes at the time of making the payment and to pay only the balance to the assessee. It is, therefore, clear that in the instance case, irrespective of the contract between the parties, the assessee was under an obligation to deduct the taxes on the sum payable to the Montreal company at the source and if he does not do so, the provisions of sub-section (7) of section 18 would come into operation. It is clear, therefore, that the assessee at the initial stage was not at all liable to pay the tax due from the non-resident company from its own pocket but was under an obligation to deduct the tax liabilities from the sum payable to the non-resident company.

In the next place let us turn to the provisions of sub-section (7), which was applied to the assessee by the tax authorities in due course. Sub-section (7) provides that if any person does not deduct or after deducting fails to pay the tax as required by or under this section, he, and, in the cases specified in sub-section (3D), the company of which

he is the principle officer shall, without prejudice to any other consequences which he or it may incur, be deemed to be an assessee in default in respect of the tax; provided that the Income-tax Officer shall not make a direction under sub-section (1) of section 46 for the recovery of any penalty from such person unless satisfied that such person has wilfully failed to deduct and pay the tax.

Analysing, the sub-section, it appears that if the payer, namely, the assessee-company, does not deduct the tax in accordance with provisions of section 18, the terms whereof we have described before, he would be deemed to be an assessee in default in respect of the tax and would also be personally liable to pay the same; further, he may also be subjected to a penalty under section 46(1) of the Act if it is a case of wilful failure to deduct and pay the tax. It is also clear that, in the absence of any reasonable cause or excuse, non-compliance with the provisions of the section would also be an offence punishable with fine under section 51. We have got to consider, in view of the argument advanced by the learned counsel of both the parties, as to whether this sub-section envisages any penal provision for non-compliance with the provisions of sub-section (3B). Before dealing with this aspect of the case, let us now turn to the contentions as raised by Mr. Banerjee.

Mr. Banerjee has mainly contended, as he did before the Tribunal, that the payment under section 18 (3B) was made a liability of the assessee and was also incidental to his business because although under an agreement between the assessee-company and the Aluminium Laboratories there was no agreement for the assessee to suffer the tax on the payment of the retainer fee, but all the same the assessee had to bear the burden which it would not have borne but for the fact that the assessee-company had taken aid from that company which was a technical aid and was an aid necessary for the proper acceleration of the assessees business. In support of his contention he has referred us to a number of decisions and has argued that the case comes clearly within the ambit of section 10(1) or 10(2) (xi) or 10(2) (xv). Both the learned counsel appearing for the parties have relied on the observations in Commissioner of Income-tax v. Abdullabhai Abdulkadar. In this case, the facts were that the respondent carried on business as commission agent and supplied goods from India to a non-resident principal who, on his part, sent cotton to the respondent and others for sale in India. The tax authorities treated the respondent as an agent of the non-resident principal, under section 43 of the Act, and assessed it in respect of the tax payable by the non-resident principal. The respondent in all paid Rs. 3,78,491 which after adjustment against the amounts payable to the non-resident principal, left a debit balance of Rs. 3,20,162. In the year of account the respondent wrote off the amount and claimed it as a bad debt or a trading loss.

On these facts it was held by the Supreme Court that in order that a loss might be deductible, it must be a loss in the business of the assessee and not a payment relating to the business of somebody else which under the provisions of the Act was deemed to be and became the liability of the assessee. Loss is only allowable if it springs directly from was incidental to the business of the assessee. It was not sufficient that it fell on the trader in some other capacity or was merely connected with his business. The loss which was occasioned was not incurred in its own business of the appellant but arose because of the business of another person and, therefore, not a permissible deduction under section 10(1) of the Act. Under clause (xi) of section 10(2) the debt was only allowable when it was a debt and arose out of and as an incident to the trade. Except in money-lending trade, debts could only be so described if they were due from customers for goods supplied or loans to constituents

or transactions of similar kind. Therefore, in every case, the test is whether the debt due was incidental to the business. If it was not of the character, it would be a capital loss.

Undoubtedly we agree that this transaction of payment formed a nexus to the business of the assessee inasmuch as such payment had an indirect bearing upon the technical aid which the assessee-company had obtained from the Montreal company but we are of opinion on a consideration of another decision of the Supreme Court reported as Badridas Daga v. Commissioner of Income-tax that, even if it has some connection with the business, it cannot be said to be incidental to it, inasmuch as we have already discussed that such a liability could be avoided by the assessee if it had deducted at the source the required income-tax from the money which was payment to the Montreal company. In Badridas Dagas case, it was decided by the Supreme Court that when a claim is made for deduction for which there is no specific provision under section 10(2), whether it is admissible or not will depend on whether, having regard to the accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and be incidental to it. The loss from which a deduction is claimed must be one that springs directly from the carrying on of the business and is incidental to it and not any loss sustained by the assessee even if it has some connection with his business. If that is established, then the deduction must be allowed provided that there is no provision against it express or implied in the Act.

Keeping these two decisions in our view, we have to consider whether this amount paid as income-tax by the assessee can be said to have sprung out of the business activities of the assessee and if it was found irrecoverable from the Montreal company whether it should be treated as bad debt within the meaning of section 10(2) (xi). Before dealing with this aspect of the argument advanced by Mr. Banerjee, we would like to refer to the contentions as raised by Mr. Pal, learned counsel appearing for the revenue. He has advanced this argument that, although the assessee-company cannot in terms of section 18(3B) be treated as an agent, his position under section 18(3B) is in pari materia with the concept of agency. We do not think that we can accept this part of his argument as the liability of the agent for a non-resident trader has been provided for in sections 42 and 43 of the Act. Section 42(1) provides that the income mentioned therein could be charged either in the name of the non-resident or in the name of the agent and in the latter case such agent was deemed to be an assessee in respect of such income. Section 43, after enumerating the categories of persons liable to be appointed as agents, enacted that such one amongst the various persons mentioned therein, upon whom the Income-tax Officer has caused a notice to be served of his intention of treating him as an agent, shall be deemed to be an agent for the purpose of the charge. It is clear from this section that the imposition of the charge was made on a person under section 43 statutorily deemed to be an agent. We have already said that the concept of agency could not be imported to the provisions of section 18(3B) of the Act inasmuch as it has been clearly provided therein 'that the person responsible for making the payment should not himself be liable to pay income-tax and super-tax thereon as an agent.' This being the position we are of the opinion that all the decisions cited before us on sections 40, 42 and 43 are not relevant for the purpose of the decision in this reference.

After considering the true scope of section 18(3B) it appears clear to us that sub-section (7) of section 18 provides that if the person concerned, viz., the assessee in

the instance case, does not deduct the tax payable by the non-resident company, he shall be deemed to be in default in respect of the tax. When an assessee is deemed to be in default in making the payment of the tax he shall also be liable to pay penalty under section 46(1), if the Income-tax Officer is satisfied that the person concerned has wilfully failed to deduct the tax. It is obvious that in the instance case the Income-tax Officer did not take recourse to section 46(1), as presumably he found that there was no wilful default. We have already said that there is a clear provision in this sub-section to the effect that in case of default, the assessee would be personally liable to pay tax which he was not required to pay on his own account, had he deducted the requisite tax from the dues of the Montreal company at the source under sub-section (3B). Now we have got to see what this personal liability should cannot. It cannot but contemplate that the payment is in the nature of punishment as otherwise the assessee-company could not have been saddled with a personal liability. Such personal liability is the direct result of non-compliance with the provision of section 18(3B) of the Act and for all intents and purposes, this may be construed as a penalty. The expression 'penalty' has not been defined in the Act, but Mr. Banerjee contends that as the relevant clause of sub-section (7) of section 18 does not come within the ambit of section 28, it cannot be treated as penalty and if it cannot be characterised as such, it necessarily follows that the payment made should be treated as incidental to the assessees business. We have already said that it may have connection with the assessees business but since it has sprung from non-compliance with the mandatory statutory provision for deduction at source, it cannot be any show of reason be treated as incidental to the assessees business. There is no charm in the word 'penalty' and it cannot be said that because such expression has not been used in section 18(7), the language used therein does not connote that the personal liability imposed is not penal in nature. Accordingly, we do not consider, as argued by Mr. Banerjee, that penal provisions are circumscribed only by section 28 of the Act. In this connection Mr. Pal has referred us to a decision of the Supreme Court in Haji Aziz and Abdul Shakoor Bros. v. Commissioner of Income-tax for a proposition that any infraction of any statutory obligation may result in a penalty and if such penalty is imposed that can never deducted from the profits and gains of the business. This case has been reported in 41 I. T. R. as page 350 (Haji Aziz and Abdul Shakoor Bros. v. Commissioner of Income-tax). The facts of this case were that the assessee, which carried on the business of importing dates from the abroad and selling them in India, imported dates from Iraq partly by steamer and partly by country craft, at a time when import of dates by steamer was prohibited. The dates which were imported by steamer were confiscated by the customs authorities under section 167 of the Sea Customs Act, and the assessee, being given an option under section 183 of that Act to pay a fine, paid the fine and had the dates released. In computing its profits the assessee sought to deduct the amount paid as fine as an allowable expenditure under section 10(2) (xv) of the Act. On these facts it was decided 'that no expense which was paid by way of penalty for a breach of the law, even though it might involve no personal liability, could be said to be an amount wholly and exclusively laid out for the purpose of the business of the assessee within the meaning of section an allowable deduction under that section. 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 the profits of the business but they must also be for the purpose of earning profits of the business. They cannot be deducted if they fall on the assessee in some character other than that of a trader. An 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 for an infraction of the law, it cannot be claimed as deductible expense, as it cannot be called a commercial loss incurred in carrying on his business. Infraction of the law is not a normal incident of business.' This decision was made by their Lordships on the question whether a penalty imposed under the Sea Customs Act should be considered as an allowable expense. Their Lordships negatived the contention of the assessee on the ground that since the penalty followed the infraction of the law such a deduction was not allowable. This decision, however, does not refer to any infraction of the provisions of the Income-tax Act, but refers to infraction of the statutory provisions in other fields of law. Be that as it may, we are of the view that even if an assessee disobeys the statutory provision as envisaged in the Income-tax Act and as a sequel thereof any liability is imposed upon the assessee, that cannot also in our opinion be construed as a part of the business expense within the meaning of section 10(2) (xv) of the act, nor can it be said that such expense was wholly and exclusively laid out for the purpose of the business.

Mr. Pal has also referred to another decision, Commissioner of Income-tax v. Malayalam Plantations Ltd. At page 150 their Lordships of the Supreme Court have quoted with approval the decisions made in Inland Revenue Commissioner v. Anglo-Brewing Co. Ltd. It runs, inter alia, as follows :

'.... 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 making profits in the business are permitted but not if they are merely connected with the business.'

Their Lordships of the Supreme Court therefore observed as follows : 'No doubt this judgment is really based upon the facts that an expense which is paid by way of penalty for breach of law cannot be said to be an amount wholly and exclusively laid out for the purpose of the business; but the observations in the decision go further and indicate that the expenditure, if incurred by the trader in some character other than that of a trader, is not an allowable deduction.'

At page 150 of the report their Lordships have also held that :

'The purpose shall be for the purpose of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as person carrying on the business. It cannot include sums spent by the assessee as agent of a third party, whether the origin of the agency is voluntary or statutory; in that event, he pays the amount on behalf of another and for a purpose unconnected with the business.'

This principle in our opinion applies aptly to the facts of the instant case because there was dereliction of duty imposed by sub-section (3B) and such dereliction was followed by the punishment as indicated in section 18(7). Accordingly, the expenditure made by the assessee was in its capacity as a person other than that of the trader and the amount paid could not, therefore, be treated as an allowable deduction. It is needless repeat that in Badridas Dagas case, the Supreme Court observed that even if the assessee had some connection with the business the loss could not be sustained. We agree with Mr. Banerjee that the payment had some nexus to the carrying on of the business in so far as technical advice was necessary for

producing aluminium goods, but in view of the payment being characterised as penal in nature this cannot be said to be incidental to the business within the meaning of section 10(1) of the Act.

This being our view we do not think that the decisions referred to by Mr. Banerjee have got any bearing whatsoever in the instant case. They are Motipur Sugar Factory Ltd. v. Commissioner of Income-tax, Commissioner of Income-tax v. Mysore Sugar Co. Ltd., Associated Banking Corporation of India Ltd. v. Commissioner of Income-tax, Commissioner of Income-tax v. Standard Vacuum Oil Co. Ltd., Poona Electric Supply Co. Ltd. v. Commissioner of Income-tax, Narandas Mathurdas & Co. v. Commissioner of Income-tax, Commissioner of Income-tax v. Motiram Nandram, Commissioner of Income-tax v. Smt. Singari Bai, Keshav Mills Ltd. v. Commissioner of Income-tax, A. V. Thomas & Co. Ltd. v. Commissioner of Income-tax, India Cements Ltd. v. Commissioner of Income-tax, and Commissioner of Income-tax v. Nainital Bank Ltd. Mr. Banerjee cited these decisions only to show that they illustrate as to what should constitute as incidental to the business wholly or exclusively of the purpose of the business and what a bad debt should constitute.

In the premises we agree with the conclusion of the Tribunal and our decision is summarised as follows :

(1) The payment of income-tax amounting to Rs. 1,24,999 directly arose on an application of sub-section (7) of section 18 of the Act.

(2) It contemplates that the payment is in the nature of punishment as the assessee was under a statutory obligation to deduct the said amount at the source under sub-section (3B) of section 18.

(3) The liability has arisen out of an infraction of the statutory provisions and accordingly not deductible from the profits and gains of the business either under section 10(1) or under section 10(2) (xv) of the Act. It is neither incidental to the business, much less wholly and exclusively laid out for the business.

(4) It is not also climbable as bad debt in view of the fact that it was not a debt advanced as a trading debt in the course of the business.

In the result, the reference cannot be decided in favour of the assessee and the question posed before us is answered in the negative.

The assessee shall pay the costs to the revenue.

GUPTA J. - I agree.

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