Karnataka High Court The Commissioner Of Income Tax vs Smt. Amarjeet Kaur And Ors. on 31 January, 2006 Equivalent citations: (2006) 201 CTR Kar 134, ILR 2006 KAR 1060, 2006 283 ITR 71 KAR, 2006 283 ITR 71 Karn Author: H Dattu Bench: H Dattu, A Bopanna JUDGMENT H.L. Dattu, J. 1. In all these reference cases, the question of law and the facts referred by the Income Tax Appellate Tribunal, Bangalore Bench, Bangalore, for our consideration and decision is common and similar, and therefore, all these cases are taken up together, heard and disposed of by this common order. 2. The facts in ITRC No. 48/1999 is noticed in this judgment for disposal of these reference cases. The assessee has her own proprietary business "M/s Manjog Home" and also gets share income from firms. For the assessment year 1985-86, the assessee is assessed in the status of "individual". M/s Manjog Home was dealing in home appliances like refrigerators, television sets, electric and electronic goods, etc. The assessee as a proprietrix of M/s Manjog Home had launched a sales promotion scheme known as "Deposit Linked Incentive Scheme" for the purpose of raising additional funds to extend her business. Under the Scheme, as noticed by the first appellate authority, the public are invited to become members by making deposits with the assessee and on the making of such deposits, goods dealt by the assessee of the value of about 75% of the deposit would be given free to the members as incentive/gift. The deposit so made by the members were returnable to the members without interest after the expiry of 5 to 10 years depending on the nature of the goods involved. Based on this Scheme, deposits were accepted from the members and goods and articles of the members choice was given to them as gift or incentive. The price of the article was credited as and when the issues were made in the Scheme and a like amount was debited as incentive in the profit and loss account. 3. The assessee debited the value of the goods supplied to the customers in a sum of Rs. 27,27,191/- for the relevant assessment year in her profit and loss account and claimed the same as expenses towards "Deposit Linked Incentive Schemes" and the same amount was also credited by the assessee to the sales account increasing the amount of sales thereby. By this modus operandi, the assessee was able to mobilise deposit to the extent of Rs. 41,92,920/- during the accounting period relevant to the assessment year under this Scheme. In the return of income filed for the relevant assessment year, the assessee bad claimed allowance of the above mentioned amount as revenue expenditure for the purpose of income chargeable to tax. The same was disallowed by the assessing authority on various grounds. In sum and substance, the view of the assessing authority appears to be, that the expenses towards mobilising deposit cannot be allowed under Section 37 of the Income Tax Act, 1961 ('Act' for short), as revenue expenditure. 4. In the appeal filed by the assessee, the first appellate authority has allowed the appeal in part and while doing so, has observed in his order: 8. With regard to the first issue, I have no difficulty in holding that the expenditures incurred are wholly and exclusively for business. The Learned Income Tax Officer's observation that there was no trading with reference to the articles given as incentive is incorrect; The only articles given as incentives are articles dealt with by the appellant as a trader. The other observation of the I.T.O. that the collection of deposits was not a

business activity is again incorrect. The appellant needed money for expanding the turnover; the appellant had several methods of obtaining this finance eg. From borrowals etc. The appellant however chose to obtain deposits and to lure these deposits, offered the articles free to the gullible public on condition that by taking away of these articles worth 75% of the deposit, the depositor has been sufficiently recompensed for making the deposit free of interest. I would observe that by setting out Rs. 27 lakhs of incentives, the appellant was able to mobilise deposits of Rs. 42 lakhs. I would also observe that these incentives of Rs. 27 lakhs are but a small fraction of the total turnover in this case of Rs. 143 lakhs. 9. Had the deposits been taken for interest, the appellant would have been had to pay interest every year on the deposits. On the other hand, instead of making this annual payment of interest, the appellant has incurred a one time expenditure of Rs. 27 lakhs. Can this setting out of expenditure of Rs. 27 lakhs, be then said to be not for the purposes of business I think not. The expenditure has clearly been set out wholly and exclusively for the purposes of business. 5. Feeling aggrieved by the aforesaid order passed by the first appellate authority, the assessee as well as the revenue had filed separate appeals before the Income Tax Appellate Tribunal. The Tribunal by its common order dated 5-3-1996 has allowed the assessee's appeal and has rejected the revenue's appeal, holding that the entire expenditure claimed by the assessee is in the nature of business expenditure and requires to be allowed in computing the income chargeable under the head "profits and gains of business or profession". 6. Though the revenue in its application filed under Section 256(1) of the Act had requested the Tribunal to state the case and refer four questions of law, the Tribunal has thought it fit to refer only one question of law said to be arising out of the orders passed by the Tribunal in ITA No. 1654/1989 dated 5-3-1996 for the assessment year 1985-1986 for our consideration and decision, The same is as under: Whether on the facts and in the circumstances of the case, the ITAT is right in law in holding that the expenditure being the cost of goods given to the depositors at the time of accepting deposits received under DLIP Scheme, being deferred revenue expenditure (claimed by the assessee also as such) as revenue expenditure relating to the previous year assessable for the assessment year 1985-86? 7. At the time of hearing of these reference cases, Sri Seshachala, Learned Counsel for the revenue would contend, that in view of insertion of Explanation to Section 37 of the Act by Finance (No. 2) Act, 1998 with effect from 1-4-1962, the expenditure claimed by the assessee as allowable expenditure, is an expenditure incurred in a Scheme which is prohibited by law and therefore, the expenditure claimed cannot be deemed to have been incurred for the purpose of business or profession and therefore, no deduction or allowance can be made in respect of such expenditure. It is further contended by the Learned Counsel that this prea could not be raised by the revenue before the Tribunal when the appeal filed by the assessee was disposed of on 5-3-1996, since the Explanation to Section 37 of the Act was inserted by Finance (No. 2) Act, 1998, with effect from 1-4-1962. Proceeding further, the Learned Counsel would contend, that the matter need not be remanded by this Court to the Income Tax Appellate Tribunal, since the legal issue referred for consideration and decisions by the Tribunal can be de-

cided by this Court with reference to the amended provision, namely, insertion of Explanation to Section 37 of the Act with retrospective effect i.e. with effect from 1-4-1962. In aid of this submission, the Learned Counsel for the revenue relies on the observations made by this Court in the case of Sterling Foods v. Commissioner of Income Tax wherein this Court by relying on the observations made by the Apex Court in the case of CST v. Bijli Cotton Mills has concluded that "when the law has been amended with retrospective operation, it should be the duty of the High Court to apply the law so amended if it applies". In our view, the law declared by the Apex Court in Bijli Cotton Mill's Case (SUPRA) and the law declared by this Court in Sterling Food's Case (SUPRA) following the view expressed by the Apex Court in the aforesaid decision requires to be noticed. Therefore, they are extracted and they are as under: In Bijli Cotton Mill's Case (Supra), the Apex Court has stated as under: Mr. Desai, Learned Counsel for the respondent, objects to this Order being relied on by Mr. Sastri on various grounds. He further says that on a true interpretation of the Order, it does not apply to the case of the assessee. The question then arises whether we are entitled to take into consideration the 1962 Order. Learned Counsel has cited various cases and has argued that this being an appeal by special leave from a reference, we should not take the order into consideration. It is unnecessary to refer to the cases because the point is concluded by a judgment of this Court in CST v. Bijli (Supra) as follows (pp. 664,665); 'Undoubtedly the Tribunal called upon to decide a taxing dispute must apply the relevant law applicable to a particular transaction to which the problem relates, and that law normally is the law applicable as on the date on which the transaction in dispute has taken place. If the law which the Tribunal seeks to apply to the dispute is amended, so as to make the law applicable to the transaction in dispute, it would be bound to decide the question in the light of the law so amended. Similarly, when the question has been referred to the High Court and in the meanwhile, the law has been amended with retrospective operation, it would be the duty of the High Court to apply the law so amended if it applies. By taking notice of the law which has been substituted for the original provision, the High Court is giving effect to legislative intent and does no more than what must be deemed to be necessarily implicit in the question referred by the Tribunal, provided the question is couched in terms of sufficient amplitude to cover an enquiry into the question in the light of the amended law, and the enquiry does not necessitate investigation of fresh facts. If the question is not so couched as to invite the High Court to decide the question in the light of the law as amended or if it necessitates investigation of facts which have not been investigated, the High Court may refuse to answer the question. Application of the relevant law to a problem raised by the reference before the High Court is not normally excluded merely because at the date when the Tribunal decided the question the relevant law was not or could not be brought to its notice'. Therefore, following this judgment, we must hold that Mr. Sastri is entitled to rely on the 1962 Order and it is our duty to answer the reference in accordance with the amendment made by the Order, unless the question referred is not couched in terms of sufficient amplitude to cover an enquiry into the question

in the light of the amended law. In Sterling Food's Case (Supra), this Court has stated as under: When a question has been referred to the High Court and, in the meanwhile, the law has been amended with retrospective operation, it would be the duty of the High Court to apply the law so amended if it applies. Application of the relevant law to a problem raised by reference before the High Court is not normally excluded merely because at the date when the Tribunal decided the question, the relevant law was not or could not be brought to its notice. 8. Sri Parthasarathy, Learned Counsel for the assessee would submit, that the Scheme floated by the assessee was for her business purpose and that by no stretch of imagination, it could be characterised as a Scheme which is prohibited by law and therefore, the expenditure incurred by the assessee is purely for business purpose and therefore, the allowance or deduction claimed in respect of such expenditure requires to be allowed as revenue expenditure inspite of insertion of Explanation to Section 37 of the Act by Finance (No. 2) Act, 1998 with effect from 1-4-1962. 9. In reply, the Learned Counsel for the revenue would submit, that the "Deposit Linked Incentive Scheme", which the assessee had floated for the purpose of her business activities is nothing but "Money Circulation Scheme", which was not only deprecated by the Apex Court in the case of Registrar of Firms, Societies And Chits, Uttar Pradesh v. Secured Investment Co., Lucknow and Anr. , but also had declared that such Schemes are prohibited by law and therefore, the assessee in view of the Explanation inserted by Finance (No. 2) Act, 1998 is not eligible and entitled to claim deduction or allowance of such expenditure as an expenditure for the purpose of business or profession. 10. After hearing the Learned Counsel for the parties to the lis, the question of law referred by the Income Tax Appellate Tribunal requires to be re-framed as under: I. Whether the business carried on by the assessee is prohibited by law and thereby the expenditure incurred by the assessee is deemed not to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure? II. Whether in the facts and circumstances of the case, the matter requires to be remanded to the Tribunal for a fresh disposal in view of insertion of Explanation to Section 37 of the Act by Finance (No. 2) Act, 1998, with effect from 1-4-1962? 11. We will take up the second issue first for our consideration. The Tribunal while disposing of the assessee's appeal for the assessment year 1985-1986, has concluded, that the expenditure incurred by the assessee being the cost of the goods given to the depositors at the time of accepting deposits received under "Deposit Linked Incentive Scheme", is a revenue expenditure relating to the previous year assessable for the assessment year 1985-1986. The question so referred covers the issue, whether the expenditure incurred by the assessee for her business or profession is allowable deduction in computing the income chargeable under the head "profits and gains for business or profession"? This question of law now requires to be decided in view of the Explanation inserted retrospectively by Finance (No. 2) Act, 1998, with effect from 1-4-1962. Whether this can be done by this Court without remanding the matter to the Tribunal is now well settled by the decision of the Apex Court in Bijli Cotton Mill's Case (Supra), which view is adopted by this Court in the case of Sterling

Food's Case (Supra). Therefore, we are of the opinion that these reference cases need not be remanded to the Income Tax Appellate Tribunal for determination of the legal issue canvassed by the Learned Counsel for the revenue. 12. The next question that falls for our consideration is whether the amounts collected by the assessee from depositors under the "Deposit Linked Incentive Scheme" is allowable expenditure in computing the income chargeable under the head "profits and gains of business or profession"? The Learned Counsel for the revenue placing heavy reliance on the observations made by the Apex Court in the case of Secured Investment Co. Lucknow and Anr. (Supra), contends that the Scheme evolved by the assessee is nothing but "Money Circulation Scheme" which is prohibited by law and therefore, in view of the language employed in the Scheme, the expenditure is deemed to have been incurred for a purpose which is prohibited by law and therefore, no deduction or allowance could be made in respect of such expenditure. 13. In our view, the reliance placed by the Learned Counsel for the revenue may not assist him much in the fact situation of the present case, for the reason, in M/S Secured And Investment Co.'S CASE (Supra), the Supreme Court was considering a case of 'Prize Chit' and what are the ingredients, which constitutes a 'Prize Chit' for the purpose of Section 2(e) of the Prize Chits and Money Circulation Scheme (Banning) Act, 1978. 14. In our view, the case law which is nearer to the issue which has fallen for our consideration, is the decision of the Apex Court in the case of State of West Bengal v. Swapan Kumar Guha and Ors. . In this case, the expression "Money Circulation Scheme" on which heavy reliance is placed by the Learned Counsel for the revenue, came up for consideration. While explaining the concept of "Money Circulation Scheme" and the test or tests for determination whether a particular Scheme floated by a business house or promoter would fall within the meaning of the expression "Money Circulation Scheme", which is banned under the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978, etc., the Court has stated: 7. In order to give meaning and content to the definition of the expression 'money circulation scheme' which is contained in Section 2(c) of the Act, one has, therefore, to look perforce to the adjectival clause which qualifies the words "for the making of quick or easy money". What is within the mischief of the Act is not "any scheme, by whatever name called, for the making of quick or easy money" simpliciter, but a scheme for the making of quick or easy money, "on any event or contingency relative or applicable to the enrolment of members into the Scheme", (whether or not such money or thing is derived from the entrance money of the members of such scheme or their periodical subscriptions). Two conditions must, therefore, be satisfied before a person can be held guilty of an offence under Section 4 read with Sections 3 and 2(c) of the Act. In the first place, it must be proved that he is promoting or conducting a scheme for the making of quick or easy money and secondly, the chance or opportunity of making quick or easy money must be shown to depend upon an event or contingency relative or applicable to the enrolment of members into that scheme. The legislative draftsman could have thoughtfully foreseen and avoided all reasonable controversy over the meaning of the expression "money circulation scheme" by shaping its definition in this

form: money circulation scheme' means any scheme, by whatever name called, (i) for the making of quick or easy money, or (ii) for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions; I have reshaped the definition, in order to bring out its meaning clearly, without adding or deleting a single word or comma from the original text of Section 2(c). The substance or the matter is really not in doubt : only the form of the definition is likely to create some doubt as to the meaning of the expression which is defined and, therefore, I have made a formal modification in the definition without doing violence to its language and indeed, without even so much as altering a comma. 8. There is another aspect of the matter which needs to be underscored, with a view to avoiding fruitless litigation in future. Besides the prize chits, what the Act aims at banning is money circulation schemes. It is manifestly necessary and indeed, to say so is to state the obvious, that the activity charged as falling within the mischief of the Act must be shown to be a part of a scheme for making quick or easy money, dependent upon the happening or non-happening of any event or contingency relative or applicable to the enrolment of members into that scheme. A 'scheme', according to the dictionary meaning of that word, is 'a carefully arranged and systematic programme of action', a 'systematic plan for attaining some object', 'a project', 'a system of correlated things'. (See Webster's New World Dictionary, and Shorter Oxford English Dictionary, Vol. II). The systematic programme of action has to be a consensual arrangement between two or more persons under which, the subscriber agrees to advance or lend money on promise of being paid more money on the happening of any event or contingency relative or applicable to the enrolment of members into the programme. Reciprocally, the person who promotes or conducts the programme promises, on receipt of an advance or loan, to pay more money on the happening of such event or contingency.... Proceeding further, the Court has observed: 8. ... In other words, there has to be a community of interest in the happening of such event or contingency. That explains why Section 3 makes it an offence to "participate" in the scheme or to remit any money "in pursuance of such scheme". He who conducts or promotes a money spinning project may have manifold resources from which to pay fanciful interest by luring the unwary customer. But, unless the project envisages a mutual arrangement under which, the happening or non-happening of an event or contingency relative or applicable to the enrolment of members into the arrangement is of the essence, there can be no "money circulation scheme" within the meaning of Section 2(c) of the Act. 15. Now coming to the Scheme floated by the assessee in these proceedings, we had the advantage of seeing the application form issued by the assessee that requires to be filled and filed by any person interested in becoming a member under the Scheme. We are told by Sri Parthasarathy, Learned Counsel, who appears for all the assessees in these reference cases, that similar application forms had been issued by all the assessees while floating the "Deposit Linked Incentive Scheme". The nomenclature that the assessee has

given to her Scheme is "Guru Credit Card Goods Linked Incentive Schemes". According to the promoters of the Scheme, it is a double benefit Scheme and to avail the benefits of a free present item as an incentive, a person must become a regular credit card member by paying the prescribed security deposit amount and once he becomes a member under the Scheme, he can terminate his membership only after five years and the security deposit would be refunded to him without interest after adjusting any dues from the member. The security deposit can also be paid in monthly installments and in such cases, member is required to provide two guarantors preferably by Government/Bank/Public Sector employees. The free present item would be given only after acceptance of membership and the security deposit. If for any reason, the item as per the choice of the member cannot be supplied within a reasonable period, the security amount would be refunded in full less Rs. 10/- as processing charges. 16. Now the question is, whether such a Scheme floated by the asessee is a Scheme which is prohibited by law as envisaged under the provisions of The Prize Chits and Money Circulation Schemes (Banning) Act, 1978'? The preamble of the Act makes clear the object of the Act. It is an Act to ban the promotion or conduct of prize chits and money circulation schemes and for matters connected therewith or incidental thereto. Section 2 of the Act is the interpretation clause. Clause (c) of Section 2 of the Act defines "Money Circulation Scheme" to mean any Scheme, by whatever name called for making of quick or easy money, or for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrollment of members into the Scheme, whether or not such money or thing is derived from the entrance money of the member of such Scheme or periodical subscriptions. Section 3 of the Act imposes ban of prize chits and money circulation schemes or enrolment as members or participating therein. Section 4 of the Act provides penalty for contravention of Section 3 of the Act. A reading of these Sections would reveal as observed by the Apex Court in the case of Swapan Kumar Guha and Ors. (SUPRA), that two conditions must be satisfied before a person can be held guilty of an offence under Section 4 read with Sections 3 and 2(c) of the Act. In the first place, it must be proved that promoter of the Scheme is promoting or conducting a Scheme for making of quick or easy money and secondly, the chance or opportunity of making quick or easy money must be shown to depend upon an event or contingency relative or applicable to the enrollment of members into that Scheme. 17. The basic features of the Scheme in the present case is that the assessee collects deposits from its subscribers, gives them free present item of the value of about 75% of the deposit amount and refunds the deposit after five years without interest. For instance, a subscriber, who enrolls himself as a member, makes a deposit of Rs. 525/-, he is given a free present item/gift of the value of Rs. 400/- and thereby a sum of Rs. 125/- of such deposit would be retained by the promoter for a period of five years, but it would not earn any interest to the member and after the expiry of period of five years, the deposit of Rs. 5251- is refunded to the depositor. The assessee as promoter of the Scheme has promoted a Scheme where she can make a quick and easy money. The Scheme so promoted by the assessee would

include a person to invest his/her money by way of deposit to get an incentive or gift worth 75% of the amount deposited. The remaining 25% of the amount is retained by the assessee not for a short term but for a period of five years and sometimes more and after the expiry of the stipulated period, what the member gets is what is deposited by him/her without interest. This Scheme, in our view, answers the requirements of definition of "Money Circulation Scheme", which is banned under the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. Now coming back to the facts of this case, in the previous year relevant to the assessment year, the assessee had received deposit of Rs. 41,92,920/- from its members and as against this, the assessee had distributed articles worth of Rs. 27,27,191/- by way of gift/free present item and under this Scheme, the assessee could retain a sum of Rs. 14,65,729/- for a period of five years, use it the way she wants it, and return thereafter the depositors money without any interest. In our view, this Scheme has all the basic ingredients of money circulation scheme, which is banned under Section 3 of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978, and therefore, the expenditure incurred by the assessee is an expenditure prohibited by law and therefore, in view of Explanation inserted by Finance (No. 2) Act, 1998 to Section 37(1) of the Act, which has come into force with effect from 1-4-1962, the expenditure shall not be deemed to have been incurred for the purpose of business and therefore, no deduction or allowance can be made in respect of such expenditure in computing the income chargeable under the head "profits and gains of business or profession". This amendment is given retrospective effect from 1-4-1962 and will accordingly, apply in relation to assessment year 1962-1963 and subsequent years. It is relevant to note that in the Explanation inserted, the Legislature has specifically employed the deeming provision for the purpose of creating a fiction. The purpose of introduction of a deeming provision is explained by the Supreme Court in the case of Consolidated Coffee Limited v. Coffee Board wherein the Court has stated that "a deeming provision might to be made to include what is obvious or what is uncertain or to impose for the purpose of a statute, an artificial construction of a word or phrase that would not otherwise prevail but in such cases, the motive of the legislature would be relevant". The Speech of the Finance Minister on the floor of the Parliament does not provide any clue for insertion of the Explanation with retrospective effect. To our mind, it appears, it could be to overcome the pronouncement of decisions by various High Courts, wherein it is stated that in considering the allowability of an expenditure under Section 10(2)(xv) of the Income Tax, Act 1922, and the corresponding provision, namely, Section 37 of the Income Tax Act, 1961, one cannot travel outside the provisions of the Income Tax Act and deny the benefit of deduction under that Section on the ground that the payment is unauthorised or has been prohibited by some statute. 18. In view of our above discussions, the question of law, which we have re-framed, requires to be answered in the affirmative i.e. in favour of the revenue and against the assessee. Accordingly, reference proceedings are disposed of No. order as to costs. Ordered accordingly.