Supreme Court of India
M/S Sri Venkata Satyanaraynarice ... vs The Commissioner Of ... on 25 October, 1996
Author: Kirpal
Bench: J.S.Verma, B.N. Kirpal

PETITIONER:
M/S SRI VENKATA SATYANARAYNARICE MILL CONTRACTORS CO.

Vs.

RESPONDENT:
THE COMMISSIONER OF INCOME-TAX,ANDHRA PRADESH II

DATE OF JUDGMENT: 25/10/1996

BENCH:
J.S.VERMA, B.N. KIRPAL

ACT:

HEADNOTE:

JUDGMENT:

W I T H CIVIL APPEAL NOS. 5625, 5626-27, 5628-29, 5630,56-31, 5633, 5635, 5636, 5637 and 5637A OF 1983 J U D G M E N T KIRPAL, J.

In respect of the assessment years 1971-72 and 1972-73 the appellant filed its return of income and claimed deduction for the amounts paid by it to the Andhra Pradesh Welfare Fund, West Godavari (Branch Eluru) as a business expenditure under Section 37 (1) of the Income-tax Act, 1961 (for short 'the Act').

The case of the appellant was that it was carrying on the business of exporting rice from the State of Andhra Pradesh. This rice could not be exported without the appellant's obtaining a permit from the District Collector. The permits were given only if payment was made to a welfare fund which had been established. The Income-Tax Officer, however, disallowed the deduction by holding that the said payment was neither mandatory, nor statutory but was only discretionary. He further observed that the welfare fund had not been approved by the Commissioner of Income-tax under Section 80-G of the Act and, therefore, contribution to it could not be deducted.

The appeals filed by the appellant before the Appellate Assistant Commissioner met with no success. Thereupon, second appeals were filed before the Income-tax Tribunal. The appeals were heard by a

Full Bench of the Tribunal which, while allowing the appeals, came to the conclusion that thought there was no compulsion on the appellant to make a contribution to a welfare fund still the contributions made in pursuance of a scheme which was evolved by the Rice Millers Association in consultation with the District Collector would show that an advantage would ensue on the payment of the contribution and, therefore, the deduction was allowable under Section 37 (1) of the Act. The Tribunal further held that such contributions could not be held to be opposed to public policy. Against the order of the Tribunal disposing of the appeals the department filed four applications under Section 256 (1) of the Act whereupon the following question of law was referred:

> "Whether on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified to hold that the contribution made to the welfare fund was not opposed to public policy and that the same was motivated purely by commercial consideration, and that the deduction was allowable under Section 37 (1)?"

At the instance of the assessee the following question of law was referred:

> "Whether on the facts and in the circumstances of the case, the Appellate Tribunal was justified in law in holding that the sum of Rs.9,164/- paid by the assessee towards contribution to the District Welfare Fund for getting permits from the Government of Andhra Pradesh for export of rice, did not constitute business expenditure within 'he meaning of Section 37 of the Income-tax Act, 1961?"

The High Court answered the question of law in favour of the respondent. It referred to the establishment of the welfare fund and the payment of money which used to be made and came to the conclusion that the contribution to the welfare fund was a pre condition for the grant of export permits and, therefore, the appellant was right in contending that the contribution was a compulsory payment extracted from it as a price for granting export permits. High Court, however, disallowed the deduction by coming to the conclusion that the payment of this amount was opposed to public policy.

It is contended by Sh. A. Subb Rao, learned counsel for the appellant that on the facts as found by the Tribunal the appellant was entitled to deduction under Section 37 (1) of the Act. He further submitted that the High Court erred in coming to the conclusion that the contribution which was made by the millers like the appellant to the welfare fund could be equated with the giving of a bribe and, therefore, opposed to public policy, as was sought to be suggested by the High Court while holding that the said contribution was contrary to public policy.

The district welfare fund had been established pursuant to a scheme which had been evolved by the rice millers association with the District Collector. According to this each member of the association was to deposit an amount of fifty paise per quintal of rice if he proposed to export the same from Andhra Pradesh. This deposit was to be made in the Andhra Bank. The application for the export permit was required too be made in a form wherein the applicant had to state the amount of contribution deposited by him, giving` the particulars of the bank, the challan number and the date. The High Court referred to the Letter written to the Appellate Assistant Collector by the Collector in

which it was stated as follows:

"With reference to the representation of the Secretary the West Godavari District Rice Millers Association, Tadepallingudem, I am to inform you that Welfare Fund at Rs.0.50 paise per quintal is being collected in respect of all rice and broken rice permits issued on trade to trade accounts."

A similar letter had also been written to the Income-tax Officer at the time of assessment. From the aforesaid facts the High Court came to the conclusion that the contribution was a compulsory one and was being collected from all the exporters of rice from the state of Andhra but the contribution so made, which was linked with the obtaining of permits, was opposed to public policy and, on this ground, could not be allowed as a deduction under Section 37 (1) of the Act.

The principles for determining whether such a payment can be regarded as being allowable as a business expense are, in our opinion, well settled, As long ago as in the case of Atherton Vs. British Insulated & Helsby Cables Ltd. (10 TC 155 191 (HL) it was observed that "A sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of trade." The aforesaid observation was quoted with approval by this Court in Eastern Investments Ltd. Vs. Commissioner of Income Tax, West Bengal ([1951] SCR 594). Again in the case of The Commissioner of Income-tax, Bombay Vs. Chandulal Keshavlal and Co., Petlad (1960 [3] SCR 38) a similar question arose for consideration. The assessee who was managing agent was entitled to commission. It, however relinquished part of the commission which was receivable from the managing company, inter alia, for the reason that the financial condition of the managing company was unsatisfactory. The question arose whether the amount relinquished was deductable as an expenditure or not. While upholding the claim for reduction this Court observed at page 50 that "Thus in cases like the present one in order to justify deduction the same must be given up for reasons of commercial expediency; it may be voluntary, but so long as it is incurred for the assessee's benefit the deduction would be claimable." What, therefore, is to be seen is not whether it was compulsory for the assessee to make the payment or not but the correct test is that of commercial expediency. As long as the payment which is made is for the purpose of the business, and the payment made is not by way of penalty for infraction of any law, the same would be allowable as a deduction.

The Court in the case of Commissioner of Income-tax, Gujarat Vs. S.C. Kothari ([1971] 82 ITR 794) was considering a case where the assessee had suffered loss in an illegal transaction and the question arose whether the same could be set off under Section 24 of the Income-tax Act, 1922 against the profits and gains of speculative transaction. While allowing the set off it was observed that if a business is illegal, neither the profits earned nor the losses incurred would be enforceable in law but that does not take the profits out of the taxing statute. Similarly the taint of illegality of the business cannot detract from the losses being taken into account for computation of the amounts which can be subjected to tax under Section 10 (1) of the 1922 Act. The tax collector, it was observed, cannot be heard to say that he will bring the gross receipts to tax without deducting losses and the legitimate expenses of the business.

Again in the case of Commissioner of Income tax Vs. Piara Singh ([1980] 124 ITR 40) a question arose with regard to the loss sustained by an assessee in the carrying on of an illegal business. The respondent therein carried on smuggling activities and was apprehended by the Indian police while crossing the border into Pakistan and Rs.65,000/- in currency notes were recovered from him. This money was being taken to Pakistan for the purposes of purchasing gold which was to be smuggled into India. This amount was confiscated. Thereupon the income-tax authorities came to the conclusion that the assessee, who was carrying on the business of smuggling, was liable to income tax and he was accordingly assessed to tax. The assessed claimed deduction under Section 10 of the 1922 Act of the loss of Rs. 65,000/- which had been confiscated by the customs authorities. While allowing this deduction it was held that the carriage of the currency notes across the border was an essential part of the smuggling operation and detection by the customs authorities and consequent confiscation was a necessary incident of the said business and constituted a normal feature of such an operation. The confiscation of the currency notes was a loss which sprang directly from the carrying on of the business and was allowable as a deduction under Section 10 of the 1922 Act.

Even though this Court has in the cases of Piara Singh and S.C. Kothari (supra) held that loss suffered while carrying on illegal business is allowable as a deduction, in the present case we find that the contribution which was made by the appellant could under no circumstances be regarded as illegal payments or payments which were opposed to public policy. This is not a case where the assessee was paying any bribe to any person nor is this a case where money was being contributed to any private fund or for the benefit of an individual which could be regarded as a form on illegal gratification. By a voluntary scheme, with which the District Collector was associated, the district welfare found had been established for the benefit of the general public. The payment to such a found which was openly made by all the millers and which fund was being used for public benefit cannot be regarded as being opposed to public policy. Requiring payment to be made for a just cause which would entitle a businessman to obtain a licence or permit cannot be regarded as being against the public policy.

A case similar to the present one came up for consideration before the Madhya Pradesh High Court in the case of Additional Commissioner of Income tax vs. Kuber Singh Bhagwandas ([1979] 118 ITR 379). In this case the Government of Madhya Pradesh had under the Essential Commodities Act, 1955 passed an order which, inter alia, prohibited any person from exporting gram from Madhya Pradesh except under and in accordance with the permit issued by the State Government. The Madhya Pradesh Anaj Vyapari Maha Sangh, the association of food grain merchants of the state, addressed a representation to the Food Minister to the effect that the stock of gulabi chana and other pulses was steadily deteriorating in quality because of want of market. The Chief Minister of Madhya Pradesh thereupon informed the President of the Maha Sangh that the Government had decided to allow liberally permits for the export of gulabi chana and pulses outside the State., In the same letter the Chief Minister brought to the notice of the trading community that the kisans and labourers were undergoing untold hardship on account of drought conditions resulting from the failure of the monsoon and, as the merchants were bound to earn rich profits, he appealed to the trading community that they should contribute a portion of such profits to the Chief Minister's Drought Relief Fund. This was followed by a letter written by the Joint Secretary to the Maha Sangh asking the merchants to deposit Rs. 30/- per quintal for the export of gulabi chana and Rs. 5/- per

quintal for the export of pulses into the State Bank of India or the State Bank of Indore to the credit of the Chief Minister's Drought Relief Fund and to obtain duplicate receipt from the bank. It was further directed that the originals of such receipts were to be sent along with the duly filled in application forms for permits to the Maha Sangh at Bhopal. Members were also required to send fifty paise per quintal for meeting the administrative expenses of the said Maha Sangh. On the application being received in accordance with the aforesaid documents the Maha Sangh forwarded the same, including the application of the assessee, to the relevant authorities of the Food Department whereupon permits for export of gulabi chana or pulses, as mentioned in the application, were issued to the merchants. In his income tax return the assessee claimed a deduction on the contribution so made to the Chief Minister's Drought Relief Fund. The contention of the assessee was that permit for exporting gulabi chana could not be obtained without the making of such a contribution and, therefore, making of the said donation should be allowed as a deduction under Section 37 (1) of the Act. The Income-tax Tribunal upheld the contention and at the instance of the Revenue reference was made to the High Court under Section 256 (1) of the Act. An earlier reference, on the same issue, had been decided by a Division Bench of the Madhya Pradesh High Court in the case of Additional Commissioner of Income-tax Vs. Badrinarayan Shrinarayan Akodiya ([1975]) 101 ITR 817 (MP)). As the correctness of the same was challenged, the Division Bench referred Kuber Singh's case to a Full Bench. While holding that the decision in Akodiya's case was not correctly decided the Full Bench held that any normal trader would have realised that there was greater prospect of getting a permit for carrying on the export business in case he made a donation as requested by the Chief Minister. The merchants had made the donations as a matter of commercial expediency to facilitate the obtaining of permits which were necessary for carrying on the export trade. The nature of the expenditure was such that benefit to a third party or charity had resulted but that did not disqualify it from being an expenditure incurred wholly and exclusively for purposes of business. The Full Bench distinguished this Court's decision in Haji Aziz and Abdul Shakoor Bros. Vs. CIT ([1961] 41 ITR 350) by observing that in the case before it the donations which were made by the traders did not contravene any law and nor were the donations made as penalty for infraction of any law. It, therefore, concluded that the Tribunal was right in holding that there was a direct nexus between the assesses business and the donations made to the Chief Minister's Drought Relief Fund and that the donations were allowable under Section 37 (1) of the Act and as expenditure incurred wholly and exclusively for purposes of the assessee's business.

In our opinion the decision in Kuber Singh's case correctly spells out the principle relating to the allowability of such an expense which has been incurred with a view to the promotion of an assessee's business.

Same principle as was followed in Kuber Singh's case had been applied, in somewhat different circumstances, by other High Court and the same has been approved by this Court. In Commissioner of Income-tax, Orissa Vs. Middle East Construction Equipments ([1979] 117 ITR 382) the Orissa High Court had to deal with a case where the assessee carried on the business of supplying machines to Government Departments. The State Government decided to give preferential treatment in the matter of placing of orders for supply of materials to parties holding State Government Loan Bonds. The assessee borrowed money for purchase of Government Loan Bonds and claimed deduction of interest paid on such borrowed money. The Tribunal found that the

bonds had been purchased in order to boost the sales of the assessee and that the Bonds, which were sold within a year, had been held as investment and had allowed the claim of the assessee. On reference being made at the instance of the Revenue the Orissa High Court allowed the said deduction by observing that the loan had been taken for purchasing bonds for the purpose of boosting up of the assessee's business and, therefore, the payment of interest was rightly allowable as a reduction. A similar question once again arose before the Orissa High Court in the case of Commissioner of Income-tax Vs. Industry and Commerce Enterprisers (P) Ltd. The assessee which had purchased Government Loan Bonds had sold the same and had incurred a loss. This loss was claimed as a deduction. The Tribunal held that the assessee had acquired business from the Government by the purchase of the securities and, although the relevant correspondence did not speak of any condition precedent to the grant of the business to the assessee, yet because of the coincidence of the date of purchase of the bonds and the business allotted to the assessee which was of an equal sum, there was a direct nexus between the business acquired by the assessee and the purchase of the securities. The Tribunal accordingly allowed the said deduction. On a reference being made the High Court upheld the decision of the Tribunal which had allowed the said deduction. Before the Madras High Court also a similar question arose where an assessee, carrying on road transport business, subscribed to Government Bonds carrying 4.5 per cent interest. There Bonds were purchased at the instance of the Road Transport Authorities and for this purpose the assessee had borrowed money at the rate of 10 per cent. This was done, according to the assessee, with a view to keep the road transport authority in good humor under the bona fide belief that it was necessary to do so in order to carry on its business. Subsequently, the assessee sold the bonds at a loss of Rs.3127/-and claimed this amount as a business loss. This claim was allowed by the Tribunal who found that the motor vehicle inspector had handed over the necessary forms to the assessee for purchasing Government Bonds, that the assessee was under an obligation to purchase the Bonds for the smooth running of the transport business especially when the mandate for purchase of the Bonds came from the inspector and, therefore, the loss was allowable as deduction. While upholding the decision of the Tribunal the Madras High Court observed "subscribing to Government Loans as in the present case, is not, in our opinion, opposed to public policy, and we are of the opinion that the Tribunal has rightly found that the assessee was obliged to sell the Bonds before they became ripe from payment only to stop incurring further loss as the money with which the subscription for the Government Bonds had been made had been borrowed by the assessee from a bank at 10 per cant interest while the Bonds carried interest only at 4.5 per cant." A minor question again arose for consideration before the Madras High Court in Commissioners of Income-tax Vs. Dhandayuthapani Foundry (Private) Ltd. ([1980] 123 ITR 709). In that case, as a result of the pursuation of the Sales Tax Authorities who were making assessments on the assessee and who also had the control over From No.XX which are delivery notes to be issued by them for the despatch of goods, the assessee was obliged to subscribe to certain government securities. However, instead of directly purchasing these securities and then selling them, the assessee paid certain margin money to the brokers which represented the difference between the issue price and the market price for the securities. The assessee claimed a loss of Rs.1900/-. This claim was upheld by the Appellate Assistant Commissioner and the Tribunal. The High Court following its decision in the case of B.M.S. (P) Ltd. (supra) upheld the decision of the Tribunal to the effect that these securities were purchased and sold in order to retain the goodwill of the Sales-tax Authorities which was necessary and essential for the smooth carrying on of the business by the assessee.

The aforesaid decisions of the Orissa High Court in industry and Commerce Enterprisers (P) Ltd. and of the Madras High Court in B.M.S. (P) Ltd. and Dhandayuthapani Foundry cases (supra) were cited with approval by this Court in M/s Patnaik and Co. Ltd. Vs. Commissioner of Income Tax, Orissa ([1986] 4 SCC 16). In that case the assessee was told that if he subscribed for the Government loan preferential treatment would be grated to it in the placing of orders for motor vehicles required by the various government departments and the assessee would further benefit by an advance from the Government upto fifty per cent of the value of the orders placed. The Tribunal found that the investment in the purchase of Government Bonds was made in order to boost its business and as the investment had been made by way of commercial expediency for the purpose of carrying on its business, the loss suffered by the assessee on the sale of the bonds must be regarded as a Revenue loss. The High Court, however, decided the question in favour of the Revenue. While reversing the judgment of the High Court, and upholding the conclusions arrived at by the Tribunal, this Court held that the investments made by the assessee were not a capital asset and the loss suffered by it was allowable as a reduction. It then observed as follows:

> "It was held by the Orissa High Court in CIT V. Industry and Commerce Enterprisers (P) Ltd., and by the Madras High Court in Addl. CIT Vs. B.M.S. (P) Ltd. and again in CIT V. Dhandayuthapani Foundry (P) Ltd. that where government bonds or securities were purchased by the assessee with a view to increasing his business with the government or with the object of retaining the goodwill of the authorities for the purpose of his business, the loss incurred on the sale of such bonds or securities was allowable as a business loss."

From the aforesaid discussion it follows that any contribution made by an assessee to a public welfare found which is directly connected or related with the carrying on of the assessee's business or which results in the benefit to the assessee's business has to he regarded as an allowable deduction under Section 37 (1) of the Act. Such a donation, whether voluntary or at the instance of the authorities concerned, when made to a Chief Minister's Drought Relief Fund or a District Welfare Fund established by the District Collector or any other Fund for the benefit of the public and with a view to secure benefit to the assessee's business, cannot be regarded as payment opposed to public policy. It is not as if the payment in the present case had been made as in illegal gratification. There is no law which prohibits the making of such a donation. The mere fact that making of a donation for charitable or public cause or in public interest results in the government giving patronage or benefit can be no ground to deny the assessee a deduction of that amount under Section 37 (1) of the Act when such payment had been made for the purpose of assessee's business.

For the aforesaid reasons we hold that the conclusion of the High Court arrived at in the present cases was not correct. The questions of law referred to by the Tribunal are accordingly answered in favour of the appellants who will also be entitled to costs.