

# CTR ENCYCLOPAEDIA ON INDIAN TAX LAWS

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## COMMISSIONER OF INCOME TAX vs. BHARAT TELEVISION PRIVATE LTD.

HIGH COURT OF ANDHRA PRADESH

Syed Shah Mohammed Quadri & G. Bikshapathy, JJ.

Case Refd. No. 48 of 1987

5th July, 1995

(1995) 63 CCH 0375 APHC

(1996) 218 ITR 0173 : (1996) 86 TAXMAN 0056

### Legislation Referred to

Section 37(1)

### Case pertains to

Asst. Year 1979-80

### Decision in favour of:

Revenue

***Business expenditure—Sales-tax penalty—Paid under s. 36(3) of Bombay ST Act—Partly compensatory and partly penal in nature—Tribunal directed to consider the question of apportionment***

### Counsel appeared:

Y. Ratnakar, for the Assessee : S. R. Ashok, for the Revenue

### **SYED SHAH MOHAMMED QUADRI J.**

Under s. 256(1) of the IT Act, 1961, the Tribunal referred the following questions of law as arising out of the order in I. T. A. No. 1050/ (Hyd) of 1983, dt. 25th April, 1984.

"1. Whether, on the facts and in the circumstances of the case, the Tribunal is justified in allowing the sales tax penalty of Rs. 50,151 paid by the assessee under s. 36(3) of the Bombay ST Act as deduction under the IT Act for the asst. yr. 1979-80 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is correct in allowing the sales tax penalty paid by the assessee holding that the payment was made only and exclusively for the purpose of business of the assessee ?"

**2.** The facts giving rise to these questions may be briefly noted here. In the asst. yr. 1978-79, for which the previous year of the assessee ended on 31st Dec., 1978, the question of deductibility of Rs. 50,156 which represented penalty under s. 36(3) of the Bombay ST Act fell for consideration. The ITO disallowed the said amount as permissible deduction and added it back to the returned income, by his order dt. 20th

Sept., 1982. Aggrieved by the same, the assessee went in appeal before the CIT (A.). The appeal was allowed upholding the claim of the assessee for deduction of the said amount. Hence, the Revenue went in appeal before the Tribunal. On an exhaustive consideration of the nature of the amount, paid as penalty, under s. 36(3) of the Bombay ST Act, the Tribunal concluded that the order of the appellate authority was correct and dismissed the appeal of the Revenue. Thus, the above questions came to be referred to this Court.

**3.** Learned counsel, Sri S. R. Ashok, appearing on behalf of the Revenue, has strenuously contended that in CIT vs. Hyderabad Allwyn Metal Works Ltd. (1988) 72 CTR (AP) 2 : (1988) 172 ITR 113, a Division Bench of this Court held on construction of s. 36(3) of the Bombay ST Act that the provisions have to be construed to find out as to whether it is a composite provision comprising partly penalty and partly interest being in the nature of compensation and that the Bombay High Court in CIT vs. Vegetable Vitamin Foods Co. P. Ltd. (1994) 209 ITR 840 held that the penalty imposed under s. 36(3) of the Bombay ST Act is in the nature of penalty and, therefore, not an allowable deduction. Sri Y. Ratnakar, appearing for the assessee, on the other hand, submits that the Andhra Pradesh High Court in Hyderabad Allwyn Metal Works' case (supra) had taken the view that s. 36(3) of the Bombay ST Act is a composite provision and that the view has been upheld by the Supreme Court in Prakash Cotton Mills (P) Ltd. vs. CIT (1993) 111 CTR (SC) 389 : (1993) 201 ITR 684 and as such the contentions raised by the Revenue have to be rejected.

**4.** It is well-settled that under s. 37(1) of the IT Act, if any amount is spent for payment of interest or as compensation, it would amount to an allowable deduction and if it is paid as penalty imposed for infraction of law, it would be impermissible to deduction of the amount thus paid. It is equally well-settled that the nomenclature used in any provisions of law to describe any payment, to be a person, as interest, compensation, penalty, etc., is not conclusive. The authorities will have to construe the provisions as a whole to find out the true nature of the impost sought to be levied ; in certain cases, the impost may be composite comprising an element of compensatory nature as well as penalty nature. Further the authorities dealing with the question of permissible deduction will also have to consider the provisions and determine as to how much of the amount would fall within the category of being compensatory and how much of it is penalty.

**5.** In the instant case, the assessee paid certain amounts as penalty under s. 36(3) of the Bombay ST Act. Is the assessee entitled to deduct these amounts under the IT Act ?

**6.** Before this question of deductibility of the amounts paid under that provision could be considered, it is necessary to deal with the nature of the impost levied under s. 36 (3) of the Bombay ST Act. Inasmuch as that issue has already been determined by a Division Bench of this Court, we do not consider it necessary to examine the said question in any detail here. In Hyderabad Allwyn's case (supra), one of the questions which arose for consideration, was "whether interest paid on account of delay in payment of sales tax under s. 36(3) of the Bombay ST Act was an allowable deduction". Having considered the said provision the Bench concluded thus (at page 121) :

"These indicate that the imposition, though called a penalty, is a composite one comprising both a penalty and a compensation for delayed payment. The Tribunal, therefore, was not right in treating the entire payment as merely interest for delayed payment. As already indicated while discussing question No. (1), the nomenclature of the levy as interest, damages or penalty may not be conclusive."

**7.** In Prakash Cotton Mills' case (supra), among other questions, the Supreme Court considered the question of permissibility of deduction of penalty paid under s. 36(3) of the Bombay ST Act. The judgment of this Court in Hyderabad Allwyn's case (supra)

was quoted and approved by the Supreme Court thus (at page 690) :

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

**8.** Further, in Vegetable Vitamin Foods' case (supra), a similar question of permissibility of deduction on payments made under s. 36(3) of the Bombay ST Act fell for the consideration of the Bombay High Court. After referring to the judgment of this Court in Hyderabad Allwyn's case (supra) and the judgment of the Supreme Court in Prakash Cotton Mills' case (supra), the Bombay High Court distinguished the said judgments observing that the Supreme Court in its judgment had throughout referred to the payment made under s. 36(3) of the Bombay ST Act as interest and in view of the decision of the Andhra Pradesh High Court in Hyderabad Allwyn's case (supra), remitted the question to the Tribunal for deciding whether the amount contained any element of compensation or penalty and give deduction accordingly. But the Bombay High Court after examination of the scheme of the provisions of the Act held that the penalty which was levied under s. 36(3) was penal in character and contains no element of interest and hence, declined to accept the prayer of the assessee to remand the case to the Tribunal for consideration.

**9.** We may, with advantage, refer to the latest decision of the Supreme Court of three judges in Standard Batteries Ltd. vs. CIT (1994) 119 CTR (SC) 353 : (1995) 211 ITR 444 which approved the judgment of the two judges of the Supreme Court in Prakash Cotton Mills' case (supra). The Supreme Court in the abovereferred latest decision referred to the question which deals with the nature of the levy under s. 36(3) of the Bombay ST Act and observed that if the exaction partakes of the character of a penalty, its deductibility as an allowable business or revenue expenditure gets contested. If, on the other hand, it is compensatory in character, the claim admits of being considered as an allowable deduction subject to the other provisions of the Act, and held as follows (at page 445) :

"The point raised seems to be covered by the pronouncement of this Court in Prakash Cotton Mills (P) Ltd. vs. CIT (supra). This Court approved the view taken of the matter by the Andhra Pradesh High Court in CIT vs. Hyderabad Allwyn Metal Works Ltd. (supra), that the levy authorised by s. 36(3) of the Bombay ST Act is composite in nature being partly compensatory and partly penal in character and that the proportion between the two requires to be determined and apportioned."

**10.** In view of the above pronouncements of the Supreme Court, it is futile for the Revenue to contend, relying on the judgment of the Bombay High Court in Vegetable Vitamin Foods' case (supra) that the levy under s. 36(3) of the Bombay ST Act is not compensatory in nature, but is penalty.

**11.** For the reasons stated above, we are unable to hold that the view taken by the Tribunal that the nature of the impost or levy under s. 36(3) of the Bombay ST Act is

compensatory and is, therefore, an allowable deduction is correct. In the circumstances, the Tribunal is directed to consider the question of apportionment of levy as to how much of the amount is compensatory in nature and how much of it constitutes penalty and also consider the question of permissibility of deduction.

**12.** The reference is answered accordingly.

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