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Court : Chennai

Decided On : Apr-27-1955

Reported in : AIR1956Mad47; [1955]28ITR235(Mad)

Appellant : M.

Respondent : G. Baluswamy Iyer V. Commissioner of Income-tax, Madras.

Judgement :

RAJAGOPALA AYYANGAR, J. - This is a reference under section 66(1) of the Income-tax Act. The question referred for our decision is :

'Whether the loss of Rs. 9,720 is an admissible deduction in computing the total income of the assessee for 1948-49 assessment year ?'

It is necessary to set out a few facts to understand the question at issue. The assessee is a firm carrying on business in the manufacture and sale of handloom cloth, and the present assessment proceedings relate to the assessment year 1948-49, the account year being 1st which ended on 31st March, 1948. On 14th March, 1946, the Government of Madras Promulgated the Madras Cotton Cloth and Apparel Export Control Order, 1946, under rule 81(2) of the Defence of India Rules. Clause (4) of this Order provided :

'No person shall on or after 19th February, 1946, transport or cause to be transported cloth or apparel from any place within the limits of the Province of Madras to any place in India outside the said limits except under and in

accordance with the terms and conditions of a permit issued by the Commissioner under this order.'

Rule 7 provided that the holder of the permit issued under the order above-mentioned should be bound by the provisions of the order and the conditions specified in the permit. Under rule 81(4) of the Defence of India Rules any person contravening any order made under that rule was liable to imprisonment for a term which might extend to three years or with fine or with both and 'if the order so provides any Court trying such contravention may direct that any property in respect of which the Court is satisfied that the order has been contravened shall be forfeited to His Majesty.' Rule 10 of this order made provision for this forfeiture and confiscation in these terms :

'Any cloth or apparel in respect of which any of the provisions of this order has been contravened shall be liable to be forfeited to his Majesty and such forfeiture may be adjudged by a Collector on a claim under sub-rule 3(d) or by a court under sub-rule (4) of rule 81 of the Defence of Indian Rules.'

For the year ending 31st March, 1947, the assessee obtained a permit to export 200 yards of cloth, but without regard to the limit of this permit he sold to a party in Amritsar 9762 yards of cloth at a sale price of Rs. 16,807. When the assessee attempted to export this quantity in contravention of his permit, this was detected by the textile authorities and the goods were seized. The assessee was prosecuted in the Court of the Chief Presidency Magistrate, Egmore. The Magistrate found the partners guilty of the offence with they were charged and convicted them. In awarding the sentence the Magistrate took into account the fact that some of the partners of the firm had not taken any prominent part in the commission of the offence and therefore sentenced them to varying amounts of fine. In addition he passed an order in regard to the 9762 yards seized by the textile authorities in these terms :

'The cloth 9762 yards will be confiscated and placed at the disposal of the Provincial Textile Commissioner who will dispose of it in the manner he considers most appropriate and after deducting ten per cent of the sale price which will go to the Government the balance of the sale proceeds will be returned to the accuseds

company.'

In pursuance of this order of the Magistrate the Textile Commissioner utilised the services of the assessee to dispose of 99 pieces and himself effected a sale of the balance of 828 pieces. The total of the sums realised by the two sales thus effected was Rs. 7,962-10-9. The Government deducted therefrom 10 per cent of the sale proceeds and costs and expenses of the sale amounting in all to Rs. 875-12-9 and paid the assessee the balance of Rs. 7,086-14-0. The assessee who kept his accounts on the mercantile basis had calculated the profits of the previous year in which the sale to Amritsar merchant had been effected, by taking credit for a sum of Rs. 16,806-12-0 as representing the price of goods sold. In the year of account with which this reference is concerned what the assessee did was this. He credited himself with the moneys received from the Government and claimed the difference between Rs. 16,806-12-0 and what was paid to him namely Rs. 7,086-14-0 as the loss incurred by him in the accounting year.

The Income-tax Officer held that the sales which resulted in the loss claimed were not sales in the usual course of business and that, as they were necessitated by reason of the illegal act of the assessee, the loss was inadmissible on the broad proposition, that it was the result of the illegal action of the assessee and so it could not be allowed. This was confirmed by the Appellate Assistant Commissioner on appeal. The Tribunal confirmed this disallowance on further appeal to them, for the reason that the loss though connected with the trade was not incidental to it and that it was inseparable from the penalty which was imposed upon the assessee. They considered that the present case was concluded against the assessee by the decision of this Court in *Mask and Co. v. Commissioner of Income-tax, Madras*. The question for our consideration is whether this disallowance is correct.

Learned counsel for the assessee did not contest the correctness of the ruling of this Court in *Masks* case nor the reasoning upon which that decision was tested. The deduction, that was claimed in *Masks* case and which was disallowed by this Court consisted of damage paid by the assessee for breach of contract by reason of their selling goods at lower rates than they were bound to sell. The damages

payable were assessed by the Court at Rs. 5,000 and this with costs incurred by the assesseees came to Rs. 6,203. In negating the right of the assesseees to deduct this under section 10(2) (xv) of the Act this Court adopted the test laid down by Rowlatt, J., in *Inland Revenue Commissioners v. Warnes & Co.*, that a loss connected with or arising out of a trade should amount to 'a loss which is contemplable and in the nature of a commercial loss.' In the case before Rowlatt, J., the assesseees who were oil exporters were sued for a penalty under the Customs Consolidation Act, 1876, and that action was compounded on the assesseees agreeing to pay a sum of pounds 2000 and costs, and the question debated was whether this sum comprising the penalty and costs was a loss connected with or arising out of a trade or business. The learned Judge negated the assesseees claim for deduction. This view of Rowlatt, J., was upheld by the Court of Appeal in *Inland Revenue Commissioners v. Von Glehn* where also the deduction claimed was a penalty imposed upon the assesseees for breach of orders and of a proclamation issued under statutory provisions. But the question still remains whether the entirety of the loss claimed by the assessee in the present case could be disallowed on the principle of *Masks* case. The problem that arises for our consideration is whether the principle that penalties imposed for breaches of the law are not 'contemplable' losses and so not deductible could be extended to losses representing not the confiscation effected or the penalty or fine imposed but arising incidentally by the manner in which the confiscation was directed to be enforced.

The loss of Rs. 9,720 claimed, it would be seen, is computed on the basis of the difference between Rs. 16,807, the sale price credited in the account in the previous year, and Rs. 7,087, the amount paid to the assessee by the Government. Even accepting the contention of the assessee, he would not be entitled to claim the entirety of this sum since it includes the diminution in value caused by the confiscation ordered. The sum representing the value of 1/10 confiscated and the costs incurred in effecting the sales came to Rs. 875-12-9 and the assessee would not be entitled to claim this as a loss. Learned counsel for the assessee did not dispute this position, that he would not in any event be entitled to claim more than Rs. 8,844-0-0 as loss.

The question is whether this loss of Rs. 8,844, which arose by reason of the sale of the 9/10th of the goods not ordered to be confiscated was a 'contemplable' loss 'in the course of trade.'

It is clear that neither the decision in Masks case nor that of Rowlatt, J., and of the Court of Appeal which were followed in Masks case touch the point arising in relation to the loss on the goods not confiscated, and this was not disputed by Mr. Rama Rao Saheb, learned counsel for the Commissioner, and the matter has therefore to be determined on principle.

The first point urged by learned counsel for the Commissioner was that this loss resulted from a sale effected in invictum which could not be considered as a commercial transaction. In our opinion this is neither correct nor determinative of the question. In the first place what was the character in which the sales were effected; was it or was it not on behalf of the assessee The 9/10th of the goods remained the property of the assessee, for the forfeiture or the confiscation did not extend to them, and we have the further fact that a portion of these sales in respect of 99 pieces were effected by the assessee himself. This would point to the other sales also being on his account, but we do not propose to rest our decision on this basis.

Even conceding that the sales were affected by government in their own right in pursuance of the orders of the Magistrate, it does not necessarily follow that the sales might not result in a commercial loss. The more important aspect is to examine whether the money paid over to the assessee by the Government was or was not a business receipt or a receipt in the course of business. The assessee has so treated it and has computed his loss on that basis. If the argument advanced on behalf of the Commissioner were accepted, this receipt from the Provincial Textile Commissioner ought to be eliminated from the credit side in the assessee's books, and learned counsel for the Commissioner frankly stated that this would be the logical result of the acceptance of his argument. We are however of the opinion that the receipt in question was a business receipt and was properly entered as such by the assessee. The nature result of the sale. Nor in the circumstances of this case is it affected by the fact that the sale effected was

controlled by the Provincial Commissioner. If for instance prices had risen and the sale of 9/10th of the goods had resulted in a profit, the sale proceeds would have constituted a business receipt. The profit could not have been treated as a windfall resulting from the order of confiscation of 1/10th of the goods. That the assessee sustained a loss would not alter the nature of the receipt of the sale proceeds.

It would follow that there was a trading loss satisfying the tests formulated by learned counsel for the Commissioner. To the extent to which the Magistrate directed the confiscation to proceed, the loss was not contemplable and so not a commercial loss in the course of trade. The order of confiscation might have taken the form of a return to the assessee of 9/10th of his goods and a confiscation of the other 1/10th. In such a case there would be no room for controversy that any loss incurred by the assessee in the sale of the 9/10 returned to him would be a trading loss. The form of the order of the Magistrate, viz., a confiscation of a portion of the sale proceeds, cannot make a difference in principle from a confiscation of a 1/10th of the goods in specie.

Mr. Rama Rao Saheb faintly suggested that the loss incurred by the assessee in the present case arose incidentally out of the enforcement of the penalty imposed by the Magistrate and should therefore be deemed part of the penalty. In other words, the suggestion was that the Magistrate must be deemed to have inflicted a further punishment by his direction as regards the manner in which the confiscation should be enforced in addition to the confiscation ordered. We are unable to consider this as any reasonable deduction from, or construction of, the order of the Magistrate.

In our opinion the loss sustained by the assessee to the extent of Rs. 8,844 is a trading loss which is deductible in computing the income of the assessee for the assessment year. The reference is therefore answered in favour of the assessee to the extent stated above. The assessee is in favour of the assessee to the extent stated above. The assessee is entitled to his costs. Counsels fee Rs. 250.

Reference answered accordingly.

