IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'F' NEW DELHI

BEFORE SHRI B. C. MEENA, ACCOUNTANT MEMBER
AND
SHRI C. M. GARG, JUDICIAL MEMBER

I.T.A .No.-3674/Del/2010
(Assessment Year-2007-08)

Mr. Praveen Saxena 301, South Ext. Plaza-II South Extension Part-2, New Delhi. **PAN: AAPPS0648P**	**Vs.**	JCIT, Range-32 New Delhi.
(APPELLANT)		**(RESPONDENT)**

I.T.A. No. 5261/Del/2011
Assessment Year: 2007-08

Asstt. CIT Circle 32 (1), Room No. 376A, C.R. Building, IP Estate, New Delhi.	**Vs.**	Mr. Praveen Saxena 301, South Ext. Plaza-II South Extension Part-2, New Delhi. **PAN: AAPPS0648P**
(APPELLANT)		**(RESPONDENT)**

Assessee by:-Sh. Ajay Wadhwa, Adv.
Revenue by:-Sh. Manoj Chopra, Sr.DR

ORDER

PER C. M. GARG, JM.

The above caption appeals have been preferred by the assessee and the Revenue against the order of CIT (Appeals) ï XXVI, New Delhi, vide

order dated 30.06.2010 in Appeal No.291/09-10 for the Assessment Year 2007-08.

ITA No. 3674/Del/2010

2. The assessee has raised 4 grounds in this appeal but ground no. 1 & 4 are general in nature, remaining two effective grounds read as under:

> *"2. That the Ld. CIT(A) has wrongly upheld the disallowance of Rs.6,45,000/- being fee paid to the lawyers on the ground that the same was incurred for defending the criminal proceedings initiated by the DRI which is personal in nature not allowable under the Income-tax Act, 1961.*
>
> *3. That the fee paid to the lawyers was on account of assess's arrest by the DRI on the allegation of evasion of custom duty on import of palm oil by his proprietary concern M/s Novus International and is an allowable deduction as held by the Supreme Court in the case of CIT vs. Biral Cotton Spinning and Weaving Mills Ltd (1971) 82 ITR 166 (SC) and Dhanrajgiri Raja Nursinghgiri (1973) 91 ITR 564 (SC)."*

3. Apropos above grounds the ld. counsel for the assessee submitted that the ld. CIT(A) has wrongly upheld the disallowance of Rs.6,45,000/- being fee paid to the lawyers on the ground that the same was incurred for defending the criminal proceedings initiated by the Department of Revenue Intelligence (DRI).

3.1 The ld. counsel for the assessee also submitted that the authorities below wrongly held that the fee paid to the lawyers was of personal in nature and not allowable under the provisions of the Income Tax Act, 1961 (for short the Actö). The ld. counsel for the assessee placed his reliance on the decision of Honöble Supreme Court in the case of CIT vs. Birla Brothers Pvt. Ltd., (1971) 82 ITR 166 (SC); and CIT vs. Dhanrajgiri Raja Narsinghgiri (1973) 91 ITR 544 (SC) and contended that the fee paid to the lawyers was on account of assesseeös arrest by the DRI on the allegation on evasion of Custom Duty on import of palm oil as the assessee was in DRI custody / judicial custody subsequent the arrest of the assessee by the DRI in the Custom Duty Evasion case. The ld. counsel for the assessee strenuously contended that the Revenue Authorities below denied the claim of the assessee without any legal and justified reason, therefore, impugned order may be set aside by directing the AO to allow the claim of the assessee pertaining to the payment of legal fees and other expenses.

4. The ld. Departmental Representative (DR) placed reliance on the decision of Honöble Supreme Court in the case of CIT Vs. H. Hirjee (1953) 23 ITR 427 (SC); and decision of Honöble Jurisdictional High Court of Delhi in the case of CIT Vs. Chaman Lal & Brothers (1970) 77 ITR 383 (Del.) and submitted that the impugned claim expenses have been incurred

by the assessee to defend himself in a criminal case in which the assessee was arrested for the change of evasion of Custom Duty which is certainly out of ambit of his business or profession activities and expenditure so incurred cannot be deducted as business expenditure in the computation of business income of the assessee. The ld. DR relying on the decision of Hon'ble Delhi High Court in the case of CIT vs. Chaman Lal (Supra) strongly contended that the expenditure incurred by a firm carrying on export and import business in defending one of its partners for having acquire foreign exchange and not fully utilizing it for import were held not allowable, even when the partner was ultimately acquitted.

4.1 The ld. DR pointed out that the assessee was arrested by the DRI in the Custom Duty Evasion case and the assessee was in judicial custody and the payment of legal fees and other expenses were incurred by the assessee for hiring lawyers to represent his criminal case in the Lower Courts, therefore, these legal expenses are not allowable under the provisions of the Act.

5. On careful consideration of above rival submissions and vigilant perusal of the decisions relied upon by both the parties. At the outset we observe that, admittedly, the assessee incurred expenditure of Rs.6,45,000/- for hiring lawyers and other support services to get the bail for him, as the

assessee was in judicial custody due to his arrest by DRI in the Custom Duty Evasion criminal case.

6. The authorities below have not disputed the quantum of expenses and have not raised any doubt about the expenses incurred by the assessee. But the issue remains that whether expenditure incurred by the assessee on payment of legal fees to defend himself in a criminal case is allowable under the provisions of the Act. The authorities below has relied and followed the ratio of the decision of Hon'ble Supreme Court in the case of CIT vs. H. Hirjee (Supra) wherein it was held that the sum/amount spend in defending the criminal proceeding was not an expenditure laid down or expanded wholly and exclusively for the purpose of business and therefore, it was not an allowable deduction u/s 10(2)(XV) of the IT Act, 1922. The AO has also followed the decision of Hon'ble Delhi High Court in the case of CIT Vs. Chaman Lal & Brothers (Supra) wherein it was held that the amount expenditure incurred by the assessee firm on the defence of its partner in the criminal case for alleged contravention of the provisions of the Foreign Exchange Regulation Act, 1947 (FERA) was not deductible u/s 10(2)(XV) of the IT Act, 1922. In this case their lord ship also made it clear that the fact of the acquittal of the partner was important for the reputation of the assessee-firm did not detract from this legal position.

7. The relevant operative para (at page 391) reads thus:

> *"In our opinion, the assessee cannot derive much help from the above authority because the defence expenditure in that case was with a view to establish that the goods manufactured by the assessee-company were not of sub-standard quality. The expenditure was thus held to be wholly and exclusively for the purpose of the business of the company. The same cannot, however, be said of the expenditure for defending a partner of the assessee-firm who is being prosecuted for alleged contravention of the foreign Exchange Regulation Act. An accused charged with an offence under section 4(3), read with section 23 of the foreign Exchange Regulation Act, can be sentenced to undergo imprisonment which may extend to two years. The nature of charge in the criminal case against Chaman Lal was of a contravention alleged to have been personally committed by him and the object of spending money on his defence in that case was to save him from being sent to jail. It, cannot consequently, be said that the expenditure of Rs.6,000 was wholly and exclusively for the purpose of the business of the assessee –firm. The fact that the acquittal of Chaman Lal was important for the reputation of the assessee-firm would not detract from the above conclusion. We, therefore, are of the view that the expenditure of Rs.6,000 is not a permissible allowance under section 10(2)(xv) of the Act."*

8. The ld. counsel for the assessee has placed reliance on the decision of Hon'ble Apex Court in the case of CIT vs. Birla Brothers Pvt. Ltd., (Supra) wherein it was held that the expenditure which was incurred by the assessee in opposing the coercive government action with the object of saving taxation and safeguarding business was justified by commercial expediency and therefore, the same was allowable u/s 10(2) (XV) of the IT Act, 1922.

9. The ld. counsel for the assessee has also placed reliance on the decision of Hon'ble Supreme Court in the case of CIT vs. Dhanrajgiri Raja Narsinghgiri, (Supra) and submitted that it was not open to the department to prescribe what expenditure and assessee should incur and in what circumstances he or it should incur expenditure. The ld. Counsel further contended that it is not correct to say that expenditure incurred in connection with a criminal case cannot be deducted as business expenditure u/s 37(1) of the Act as the provision does not make any distinction between civil litigation and criminal litigation. The ld. DR replied that prosecution by the assessee to protect tax and other liability is different from a case wherein the assessee is charged with criminal mala fide act in a criminal prosecution against the assessee.

10. In the present case the ld. CIT(A) upheld the disallowance with the following observation and conclusion:

"5.5 The next ground of appeal relates to the disallowance of Rs.6,45,000/- being fee paid to the lawyers. The Ld. Counsel has submitted that the legal fee paid to the lawyers is in respect of appellant's case before lower court and High Court in connection with the search conducted by the DRI on 21.11.2006. The appellant was arrested by the DRI on the alleged charge of evading duty on import of palm oil. The business of import of palm oil is being carried on as proprietary concern by the name Nova International. The appellant was arrested on preemptive basis without there being any established charge of duty evasion by his proprietary concern. The appellant was acting not in his individual capacity but as sole business head of the proprietary concern. The continued arrest of the appellant would not only have spelt financial ruin of the business but would have also irreparably damaged its name and reputation. Therefore in order to continue the business in a normal manner it was very important to defend the palpably wrong detention of the assessee.

5.5.1 According to the appellant, the Hon'ble Supreme Court in the case of CIT v. Birla Cotton Spinning and Weaving Mills Ltd (1971) 82 ITR 166 (SC) and CIT vs. Dhanrajgiri Raja Narsinghgiri (1973) 91 ITR 544 (SC) had held that section 37(1) does not make any distinction between expenditure incurred in civil litigation and that incurred in criminal litigation. All that the Court has to be see is whether the legal expenses were incurred by the assessee in his character as a trader, in other words, whether the expenditure was bonafide

incurred wholly and exclusively for the purpose of the business. The appellant states that these principles laid down by the Apex Court are fully satisfied by the assessee's case and as such, the legal fee paid to the lawyers is an allowable deduction u/s 37(1) of the Act. The appellant had incurred expenditure on fighting the case involving interalia allegations on evasion of Custom Duty by the Department of Revenue Intelligence. The legal expenditure was necessary for defending the case when the very continuation of the appellant's business depended on it.

5.5.2 The Assessing Officer on the hand, has relied upon the judgment in the case of H. Hirjee 23 ITR 427 (SC), CIT Vs. Gasper & Co. 8TR 100 (Rang), wherein it has been held that the sum spent in defending the criminal proceedings was not an expenditure laid out or expended wholly and exclusively for the purpose of business. In the case of CIT Vs. Chaman Lal and Bros 77 ITR 383 the Rajasthan High Court held that the amount spent by the assessee from on the defence of its partners in the criminal case for the alleged contravention of the provisions of the Foregin Exchange Regulation Act 1947 was not deductible.

5.5.3 I have considered the submissions made by the appellant and the contentions of the Assessing Officer on the said issue. The expenditure incurred on counsels for defending the criminal proceedings initiated by the Department of Revenue Intelligence is an expenditure which is personal in nature and cannot be said to be allowable under any provision of the Act. The disallowance of expenditure of Rs.6,45,000/- on

lawyers/legal professionals during the year is therefore upheld. Ground no. 3 is held against the appellant."

11. In view of above observations and conclusion of the CIT (A) we note that the ld. CIT (A) uphold the disallowance by holding that the expenditure incurred on counsels for defending the criminal proceedings initiated by the Department of Revenue Intelligence (DRI) is an expenditure which is of personal in nature and cannot be said to be allowable under any provisions of the Act.

12. At the same time, we also note that the legal expenses were incurred by the assessee to defend and to secure bail for him, as the assessee was arrested by the DRI in the Custom Duty Evasion case.

13. On careful consideration of the decisions relied by the assessee, we respectfully hold that the benefit of ratio of the decision of Hon'ble Apex Court in the case of CIT vs. Birla Brothers Pvt. Ltd. (Supra) is not available for the assessee as in this case the law charges so incurred in connection with the proceedings before the Investigation Commission were incurred for the preservation and protection of the assessee's business from any process or proceedings which might have resulted in the reduction or lowering its income and profits. In this case, their lord ship also held that the expenditure was incidental to the business and was necessitated or justified by commercial expediency. The facts of the present case are distinguishable as

in the present case the assessee incurred towards legal fees and other incidental expenses in criminal case which was registered against him by the DRI with an allegation of custom duty evasion but in the case of Birla Brothers Pvt. Ltd., (Supra) the law charges were incurred for the preservation and protection of assesseeô business from taxation proceedings which might have resulted in the adverse effect on the profitability of the assessee company.

14. We further observe that the benefit of the ratio of the decision of Honôble Supreme Court in the case of CIT vs. Dhanrajgiri Raja Narsinghgiri, (Supra) is also not available for the assessee. As in this case the legal expenditure was incurred to initiate criminal prosecution by the assessee against the transferee of Managing Agency and prosecution was instrumental terms in the settlement between the assessee and the transferee, therefore, it was held that the legal expenditure so incurred was for the purpose of the business of the assessee and the expenditure incurred by the assessee to initiate criminal prosecution was held as allowable as bona fide expenditure incurred wholly and exclusively for the purpose of business which is clearly distinguishable from the present case.

15. Turning to the factual matrix of the present case, we are of the considered opinion that the ratio of the Supreme Court in the case of CIT Vs.

H. Hirjee and decision of Hon'ble Jurisdictional High Court of Delhi in the case of CIT Vs. Chaman Lal & Brothers (Supra) was rightly followed by the authorities below. The factual matrix of the present case is that there was a criminal case against the assessee with an allegation of custom duty evasion and he incurred impugned expenditure of legal fees for hiring lawyers to represent his criminal case before the Hon'ble High Court and Lower Courts to get the bail order. As the assessee was arrested and sent in judicial custody by the DRI in the Custom Duty Evasion case which cannot be said to be incurred bona fidely wholly and exclusively for the purpose of business of the assessee. It is also pertinent to mention that it is not the case of the assessee, that the assessee initiated any proceedings or prosecution to defend his business and the claimed expenditure was incurred wholly and exclusively for the purpose of business of the assessee.

16. The ratio of the above decisions can be summarized as follows. In the cases where assessee is able to demonstrate positively that the claimed expenditure on legal fees and proceedings is in extricably or proximately related to caring on the business of the assessee more effectively then the same shall be allowable. However, in the cases where the given or claimed expenditure on legal fees and proceedings is remotely connected or unconnected to caring on of business of the assessee, then the same may not

be allowable u/s 37 of the Act. Applying this to the facts in extant case, it can be safely inferred that expenditure to defend in custom duty evasion criminal case, having no connection with caring on of business, is held to rightly disallowed by the AO and same disallowance was upheld by the CIT(A) on cogent and reasonable basis. Ergo the assesseeôs contentions are jettisoned.

17. Per contra, we clearly observed that the assessee was arrested in Custom Duty Evasion criminal case by the DRI and the payment of legal expenses and fees to the lawyers was made to defend and to secure bail for the assessee in that case. In this situation respectfully following the decision of Honôble Supreme Court in the case of CIT Vs. H. Hirjee (Supra), we reach to the logical conclusion that the authorities below were right in holding that the payment of legal fees and expenses towards defending in a criminal prosecution not allowable as business expenditure because the same was not expended wholly and exclusively for the purpose of business. Accordingly, ground nos. 2 & 3 of the assessee are dismissed.

ITA No. 5261/Del/2011

18. In this appeal, the Revenue has raised the following grounds:

"1. In the facts and circumstances of the case, the Ld. CIT(A) has erred in deleting addition of Rs.70 lacs made by the AO

disallowing the payment which was considered as penalty not allowable under Income tax Law.

2. *In the facts and circumstances of the case the Ld. CIT(A) has erred in allowing expenses of Rs.70 lacs which as per explanation to section 37 of the IT Act, 1961 is prohibited as it was incurred for other than business purpose."*

19. Apropos above grounds, we have heard argument of both the sides and carefully perused the material placed on record inter alia paper book filed by the assessee spread over 89 pages and relevant decisions of Hon'ble High Court and the Tribunal.

20. The ld. DR submitted that the ld. CIT(A) has erred in deleting the addition of Rs.70 lac made by the AO, disallowing the payment which was considered as penalty and was not allowable under the provisions of the Act. The ld. DR further contended that the ld. CIT(A) has erred in allowing expenses of Rs.70 lac which was not allowable as per Explanation to section 37 of the Act, as the same was incurred for other than the business purpose.

21. The ld. DR drawn our attention towards bail order of Hon'ble High Court of Delhi, dated 01.02.2007 (Paper Book Page Nos. 82 to 85) and submitted that the assessee deposited impugned amount as per order of the Hon'ble High Court which was obviously a penalty for evasion of Custom Duty, therefore, the ld. CIT(A) was not justified in allowing these payments

as business expenditure of the assessee. The ld. DR finally submitted that the impugned order may be set aside on this issue by restoring that of the AO.

22. Replying to the above, the ld. counsel for the assessee supported the impugned order and submitted that the AO made impugned disallowance of Rs.70 lac by wrongly holding that the amount paid by the assessee is being treated as penal in nature and was liable to be disallowed.

23. The ld. counsel for the assessee drawn our attention towards relevant portion of the impugned order and submitted that the AO was wrong in disallowing the payment towards Custom Duty by treating the same as penal in nature by invoking the provisions of Explanation to section 37(1) of the Act because the payment was made by the assessee on the direction of the Hon'ble High Court which was given while granting bail to the assessee and the payment of Rs.70 lacs was incurred towards advance payment of extra / additional Custom Duty that may have arisen subsequently.

24. The ld. counsel for the assessee vehemently contended that the ld. CIT(A) was right in holding that the amount of Rs.70 lacs paid by the assessee was nothing but an advance towards payment of additional Customs Duty which cannot be said to be a payment of penal nature or penalty. The ld. counsel for the assessee placed his reliance on the decision of Hon'ble Supreme Court in the case of Malwa Vanaspati & Chemical Co.

225 ITR 383 (SC) and submitted that until and unless the amount of the tax payable, interest thereon and penalty out of total liability is not ascertained then the interim payment cannot be held as penalty or penal in nature and in the situation of impugned consolidated payment, paid on the directions of the High Court in the bail order then the same is to be bifurcated in tax and penalty. The ld. counsel for the assessee also contended that the assessee made payment of Rs.70 lacs to the Custom Department on direction of the Hon'ble High Court and that time payment was not made towards penalty or penal in nature but the same was certainly a payment of advance custom duty tax as the amount of penalty can only be ascertained after completion of custom assessment proceedings which were yet to be completed and the custom duty assessment proceedings were pending when the payment of Rs.70 lacs was made.

25. The ld. counsel for the assessee also pressed and supported an alternative argument placed before ld. CIT(A) that without prejudice to above arguments the additional custom duty of Rs.70 lacs was an allowable expenditure u/s 43B of the Income Tax Act as per the decision of Special Bench of ITAT Chandigarh in the case of DCIT Vs. Glaxo Smithkline Consumer Healthcare Ltd (2007) 110 TTJ (Chd.), wherein it was held that section 43B of the Act allows deduction of tax and duty actually paid

irrespective of the previous year in which the liability to pay a sum was incurred by the assessee.

26. The ld. counsel for the assessee further drawn our attention and submitted that there was no requirement on the part of the assessee to prove the incurring of the liability prior to payment to be entitled to deduction in the financial year of the actual payment.

27. On careful consideration, and above submissions and thoughtfully perusal of the impugned order, we observed that the ld. CIT (A) granted relief for the assessee in this issue with following observations and findings:

> *"5. I have carefully gone through the facts available on record and the submissions made by the Ld. Counsel. I have also considered the details of proceedings under the Customs Act, 1962. On careful perusal of the various details, I find that after the Search operation carried out by the DRI, no adjudication in case of the appellant has taken place by the DRI authorities. This fact has been got independently verified by me with the DRI authorities. Therefore, till the time the adjudication takes place, the ascertainment of duty and penalty, if any, cannot be determined. As and when such a determination takes place, the amount deposited by the appellant shall first be appropriated towards the payment of Duty and the balance shall go towards interest, if any. The balance if any, shall be thereafter appropriated towards Penalty, if levied, in the case of the appellant.*

5.2 In my considered opinion, the Assessing Officer has wrongly disallowed the amount of Rs.70 lacs by treating the same as penal in nature, by invoking the provisions under Explanation to section 37(1) of the Income-tax Act, 1961 in this regard, even though, as discussed above, the nature of payment that was made by the appellant on the directions of the High Court given while granting bail to the appellant, was advance towards payment of Customs Duty, that may have arisen subsequently. I therefore, hold that the amount of Rs.70 lacs paid by the appellant was nothing but an advance towards payment of additional customs duty which is not a penal payment. It is a settled law that additional tax payment would be compensatory in nature and only the penalty amount levied on account of infraction of law would be disallowed.

5.3 XXXX

XXXX

5.4 As an alternate argument and without prejudice to the above, the Ld. Counsel further submitted that additional customs duty of Rs.70 lacs paid is an allowable expenditure u/s 43B of the Income-tax Act, 1961. My attention was drawn to the decision of the Special Bench of the ITAT in the case of DCIT v. Glaxo Smithkline Consumer Healthcare Ltd (2007) 110 TTJ 183 (Chd), wherein it was held that section 43B allows deduction of tax and duty actually paid irrespective of the previous year in which, the liability to pay such sum was incurred by the assessee. Hence, there is no requirement on the part of the

assessee to prove the incurring of the liability prior to payment to be entitled to deduction in the year of payment.

On careful consideration, I hold that the interpretation of the appellant is in accordance with the provisions of Section 43B, and hence, even if the advance payment towards duty is made, it would be allowed u/s 43B of the Act. This interpretation flows directly from the section itself which states that the deduction is to be allowed irrespective of the previous year in which the liability to pay such sum was incurred. Hence, even on this count, the amount paid by the assessee is allowed.

In view of the above discussion, the Assessing Officer is directed to allow the payment of Rs.70 lacs to the Customs Department as allowable expenditure u/s 37 (1) of the Income-tax Act, 1961. Ground of appeal No. 2 is thus allowed."

28. In view of above, at the outset, we note that undisputedly the assessee made payment of Rs.70 lacs as per direction of Hon'ble High Court of Delhi given in the bail order dated 01.02.2007 which enlarged the assessee on bail in a criminal case of Custom Duty Evasion. At the time of payment the custom duty assessment was pending and yet to be completed in future. Obviously, when it is found that the assessee has evasioned custom duty then the penalty is obvious and leviable as per the relevant provisions of the Act but until and unless assessment is not completed the amount of custom duty/additional custom duty, interest thereon and penalty cannot be

ascertained and in this situation impugned payment made by the assessee cannot be held as penalty or penal in nature at any stretch of imagination.

29. Under above facts and circumstances the ld. CIT(A) rightly hold that till the time the adjudication takes place ascertained of duty and penalty, if any, cannot be determined. The ld. CIT(A) further went to hold that as such situation takes place the amount deposited by the assessee shall first be appropriated towards the custom duty and balance shall go towards interest, if any, and the balance amount so paid, if any, shall be thereafter appropriated towards penalty, if levied, in the case of assessee. We are also in agreement with the findings of the ld. CIT(A) wherein he accepted the alternate argument of the assessee that the additional custom duty of Rs.70 lacs paid by the assessee is an allowable expenditure u/s 43B of the Act. Respectfully following the decision of Special Bench of the ITAT, Chandigarh in the case of DCIT Vs. Glaxo Smithkline Consumer Healthcare Ltd. (Supra) we hold that section 43B allow deduction of impugned payment as additional custom duty irrespective of the previous year in which the liability to pay such sum was raised against the assessee. Accordingly, we are unable to see any perversity, ambiguity or any other valid reason to interfere with the impugned order and we uphold the same.

30. On the basis of foregoing discussion, we hold that both the grounds of the Revenue being devoid of merits deserve to be dismissed and we dismiss the same.

31. In the result, appeal of the Revenue as well as of the assessee are dismissed.

Order pronounced in the open Court on31/10/2014.

Sd/- **Sd/-**

(B. C. MEENA) **(C. M. GARG)**
ACCOUNTANT MEMBER **JUDICIAL MEMBER**

Dated: 31/10/2014
AK VERMA
Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR