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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Date of decision: 20th November, 2012

\+ ITA 1006/2011

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr. N. P. Sahni, Sr. Standing Counsel.

versus

ENCHANTE JEWELLERY LTD. .....Respondent
Through: Mr. P. Roy Chaudhary, Advocate.

CORAM:
MR. JUSTICE S. RAVINDRA BHAT
MR. JUSTICE R.V. EASWAR

S. RAVINDRA BHAT, J: (OPEN COURT)

The Revenue in this appeal, challenges the order of Income Tax Appellate Tribunal ('ITAT', for short) dated 25.11.2010 in ITA No.2642/Del/2005, urges that the following questions of law arise for consideration: -

> "*1. Whether the ITAT fell into error in not sustaining the disallowance of Rs.1,04,00,000/- since the same was of a penal nature?*
>
> *2. Whether the Tribunal fell into error in deleting the disallowance of Rs.12,37,200/- made by the Assessing Officer under Section 43B(e) in the facts and circumstances of the case?*"

2. The facts are that the assessee used to manufacture and trade in gold jewellery. Its return for the assessment year 2001-02 was selected for scrutiny and notice under Section 143(2) was issued and served upon the assessee. During the assessment proceedings the Assessing Officer disallowed ₹1,04,000/- paid by the assessee as interest on customs duty demand. The assessee contended that he used to import

jewellery manufacturing machinery under Export Promotion Capital Goods Scheme (EPCG Scheme) at a concessional rate with an export obligation which it could not fulfill and was required to pay interest @ 24% per annum to DGFT. The Assessing Officer after considering the contentions of the assessee held that the interest paid by the assessee cannot be allowed as deduction as it was penal in nature and, therefore, fell within the mischief of Explanation below Section 37(1) of the Act. The assessee appealed to the Commissioner (A) who ruled in favour of the assessee in the following terms: -

> "*3.2 During the course of appellate proceedings it has been submitted by the appellant counsel the interest is on late payment of custom duty and is not a penalty. The penalty was to surrender the special import licenses equivalent to thrice the value of import license. Therefore, the A.O. has wrongly disallowed the amount. It was further submitted if any interest is paid for purchase of capital asset after commencement of the business the same is allowable as a business expenditure.*
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> *3.3 On going through the letter placed on record by the appellant counsel it is observed in the letter it is clearly mentioned that the entire duty saved alongwith interest @ 24% is to be deposited. It is also mentioned that SIL equivalent to thrice the value of import license is also required to be surrendered as penalty. Therefore, from this letter it is clear that the interest paid is not in the nature of penalty. It is also a fact that, the business of the appellant has already commenced and even the interest paid on purchase of machinery is an allowable business expenditure. Therefore, the addition made by the A.O. is deleted.*"

3. The Revenue's appeal before the Tribunal was that the disallowance directed to be set-aside by the CIT (A) was not justified since the amount paid was penal in nature. The Tribunal considered the submissions and held that there was no infirmity in the order of the CIT (A) and the amount paid was not penal in nature as much as it was as per the declared policy of the government and occasioned by the failure of the

assessee to meet its obligations. The amount being interest was compensatory and not penal according to the Tribunal.

4. The counsel for the Revenue attacked the reasoning of the Tribunal contending that since the assessee availed the facility without having fulfilled the obligations, there was a violation of the terms of the scheme, doing something that is prohibited by law.

5. The Revenue, in the opinion of the Court, has been unable to establish that the assessee's conduct was an offence or that it did anything that was prohibited by law. The Assessing Officer has not pointed out which provision of law was violated by the assessee. Even if in any adjudicatory proceedings under Customs Act the word "penalty" is used, that cannot be determinative of the nature of the payment, nor can the Assessing Officer conclude that the assessee did something that was an offence or was prohibited by law. There is nothing brought on record by the Revenue to show that the payment was hit by the Explanation below Section 37(1) of the Act.

6. On the second question the facts are that the assessee had debited a sum of ₹12,37,206/- on account of interest provided in respect of payments made by SBI to M/s. Effibanca SPA Italy under orders of the Debt Recovery Tribunal (DRT). In fact, the assessee was given a loan by M/s. Effibanca SPA Italy for purchase of a plant and machinery the terms of which incorporated a guarantee by SBI under Export Promotion Capital Goods (EPCG) Scheme. Due to assessee's default the decretal amount was paid by the SBI to the Italian Bank. Apparently, the SBI included this amount along with other amounts claimed by it in terms of the assessee's independent contractual liabilities and approached the DRT which made a composite order. The Assessing Officer held that the provisions of Section 43B(e) were attracted and the deduction of ₹12,37,206/- could not be granted. The Assessing Officer also noted that a similar disallowance had been made in earlier year.

7. The CIT (Appeals) deleted the disallowance which resulted in the Revenue's appeal to the ITAT. The ITAT held as follows: -

> "*5.1 Apropos ground no.2 also we see no infirmity in the order of CIT (A) inasmuch the amount claimed as expenditure was not in respect of any interest payable to schedule bank on loan but undisputedly it was in respect of guarantee fee payable by assessee to SBI, therefore, provisions of section 43B are not applicable. This ground of the revenue is also dismissed.*"

8. On the facts of the this case this Court is of the opinion that as to whether the amount of ₹12,37,206/- constituted only interest paid on the directions of the DRT, towards the composite liability of the assessee or in respect of the bank guarantee liability is not clear from the record. The order of the DRT dated 22.06.1999 which was produced during the hearing is for the entirety of the SBI's claim which amounts to more than ₹14,00,00,000/-. Of this, bank guarantee claim is roughly to the extent of ₹1.65 crores. The decretal amount was to be satisfied by the assessee in 35 installments; in these circumstances this Court is of the opinion that the Assessing Officer's order should have been more specific, after taking into consideration the question whether the sum of ₹12,37,206/- or any part of it was to be paid towards guarantee fee or interest. It is only the guarantee fee which would not attract Section 43B of the Act; if it is interest, then it would fall within its mischief. Consequently the matter is remitted to the Assessing Officer for a fresh determination in terms of the previous directions towards segregating the amount and ascertain the true nature and character of the sum of ₹12,37,206/-.

9. In view of the above discussion the first question of law framed in the appeal is answered in favour of the assessee. The second question is answered in the above terms in favour of the Revenue.

The appeal is partly allowed in the above terms.

S. RAVINDRA BHAT, J

R.V.EASWAR, J

NOVEMBER 20, 2012
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