

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH “A”: NEW DELHI**

**BEFORE SHRI M. BALAGANESH, ACCOUNTANT MEMBER
AND
SHRI ANUBHAV SHARMA, JUDICIAL MEMBER**

**ITA No. 4841/DEL/2019
Assessment Year: 2014-15**

Ansal Theatres & Clubotels (P) Ltd., 115, Ansal Bhawan, 16, Kasturba Gandhi Marg, New Delhi. PAN: AAACG0509R	<u>Vs</u>	ACIT, Circle-2(2), New Delhi.
Appellant		Respondent
Assessee represented by		Shri R.S. Singhvi, Adv. & Sh. Satyajeet Goel, Adv.
Department represented by		Shri Zafarul Haque Tanweer CIT,DR
Date of hearing		30.10.2023
Date of pronouncement		22 .11.2023

ORDER

PER ANUBHAV SHARMA, JM:

The assessee has come in appeal against the order dated 26.03.2019 passed by the Commissioner of Income Tax (Appeals)-I, New Delhi (hereinafter referred as “learned First Appellate Authority” or in short “FAA”) in Appeal no. 467/16-17, for the assessment year 2014-15, arising out of the assessment order dated 27.12.2016 u/s 143(3) of the Income-tax Act, 1961 (hereinafter referred as the “Act”), passed by the Asstt. Commissioner of Income-tax, Circle 2(2), New Delhi (hereinafter referred in short as “Ld. AO”).

2. The facts in brief are Assessee filed its Return of Income on 29/09/2014 declaring loss of Rs. 10,47,12,787/- for the year under consideration. The case was selected for scrutiny. Subsequently assessment u/s 143(3) of the Act, 1961 was completed vide order dated 27.12.2016 at NIL income after adjusting losses amounting to Rs 15,35,763/-. In the assessment order AO disallowed Rs 10,45,73,650/- on account of legal & professional expenses & compensation u/s 37(1) of the Act and Rs. 16,74,900/- on account of expense towards amounts written off u/s 36(2) of the Act.

3. The assessee company is owner of Uphaar Cinema situated in Green Park Extension Market, New Delhi. However, at the time of assessment, the cinema was not working and no business was conducted during the previous year. Unfortunately, in June 1997, Uphaar Cinema caught fire resulting in considerable damage to the property and loss of life. Thereafter, the premises was sealed by the Investigating agency and not operating since then. During the year under consideration, the assessee company has declared income of Rs. 41,151/- from interest and Rs. 66,960/- on account of Rent, lease & license fee. Against the other income of Rs. 22,66,351/, the assessee has claimed other expenses of Rs. 10,95,52,138/- in its P&L account which includes Rs. 1,64,88,500/- on account of legal & professional charges and Rs. 8,80,85,150/- towards compensation. In this regard, the assessee company was asked to give justification of legal & professional charges and compensation claimed keeping in view of the business activities carried on during the year and why the same should not be disallowed.

3.1 In response, the assessee company vide its letter dated 26 12 2016 submitted to Ld. AO as under-

“On 13.6 1997, a fire at Uphar theatre in Green Park resulted in death of 69 persons besides injuring 103 persons. In the Court cases filed by the

Association of Victims of Uphaar Tragedy, Hon'ble Delhi High Court directed the Appellant to pay compensation of (i) Rs. 18 lakhs to each deceased aged more than 20 years, (ii)Rs. 15 lakhs to each deceased who was less than 20 years of age and (iii)Rs. 1 lakh to each of 103 injured persons.

The compensation was to be paid with 9% interest and the liability to pay compensation was apportioned between the Appellant on one hand and Delhi Vidyut Board, MCD and the Licensing authority on the other hand. Appellant's liability was 55% and the remaining 45% was to be paid by Delhi Vidyut Board, MCD and the Licensing authority in the ratio of 15% each.

Against the judgment of Delhi High Court dated 24.4.2003, appeals were filed by the Appellant, MCD and the Licensing authority. Delhi Vidyut Board did not file any appeal, inasmuch as, it accepted the order of the High Court.

Hon'ble Supreme Court vide judgment dated 13.10.2011, disposing the appeals of MCD, Appellant and the Licensing authority. The Hon'ble Court agreed with the MCD and the Licensing authority that they had no role and that the High Court committed error in requiring them to bear compensation to the extent of 15% each. Having hold that MCD and the Licensing authority were not liable, the Hon'ble Supreme Court held that the liability to pay compensation shall to the extent of 85% be borne by the Appellant and the remaining 15% shall be of Delhi Vidyut Board.

Insofar as, the compensation was concerned, the Apex Court modified the order of the High Court as under (para 38 of the judgment):

"We are of the view that award of Rs 10 lakhs in the case of persons aged above 20 years and Rs.7.5 lakhs in regard to those who were 20 years or below as on the date of the incident, would be appropriate. We do not propose to disturb the award of Rs. 1 lakh each in the case of injured. The amount awarded as compensation will carry interest at the rate of 9% per annum from the date of writ petition as ordered by the High Court, reserve liberty to the victims or the LRS of the victims as the case may be to seek higher remedy wherever they are not satisfied with the compensation. Any increase shall be borne by the Licensee (theatre owner) exclusively."

As far as, punitive damages of Rs.2,50,00,000/- directed to be paid by the High Court is concerned, the Hon'ble Supreme Court taking into consideration, the profit / income derived from additional seats reduced the same to Rs.25,00,000/- The following observations in para 43 of the judgment may be noted here:

"Therefore the Licensee is not only liable to pay compensation for the death and injuries, but should, in the least be denied the profits/benefits out of their

illegal acts. In that sense it is not really punitive, but a kind of negative restitution. We therefore uphold in principle the liability of the Licensee to return and reimburse the profits from the illegally installed seats, but reduce it from Rs.2.5 crores to Rs.25 lakhs for the reasons stated in the earlier para. The award of the said sum, as additional punitive damages, covers two aspects. The first is because the wrongdoing is outrageous in utter disregard of the safety of the patrons of the theatre. The second is the gravity of the breach requiring a deterrent to prevent similar further breaches."

That based on the judgment of the Supreme Court dated 13.10.2011, the Appellant worked out its liability to pay compensation at Rs. 10,31,55, 150/-. Taking into Consideration the amount already charged to profit & loss account i.e. Rs.1,50,70,000/- net compensation of Rs.8,80,85,150/- was debited under the head 'other expenses'".

That linked to the claim of compensation of Rs.8,80,85,150/- is the claim of Rs.1,64,88,500/- being legal and professional charges in connection with Court cases relating to Uphaar tragedy. The details of 'legal & professional expenses' and 'legal & professional (others)' are at pages 83 to 88 of the paper book. Ledger accounts at pages 83 to 88 provide complete details of the names of the professional (Advocates), bill No, cheque No. and tax deducted at source.

In the audited accounts for the year ended 31.3.2014, following notes having bearing on the disputed issues were given:

1. The liability of company in case of 'Association of Victims of Uphaar Tragedy v. Union of India & others of Rs. 10,31,55, 150 as per the final verdict of Hon'ble Supreme Court has been fully discharged by the company. As company is not taking up the verdict with any authority for its revision or otherwise, therefore, the aforesaid amount of compensation, net of Rs.1,50,70,000/- already charged to profit & loss A/c, being amount directly distributable to claimants, now, is being charged to profit & loss a/c.

2. In June 1997 Uphaar Cinema caught fire resulting in considerable damage to the property and loss of life. The Cinema is not operating since then and has been sealed by the Investigating Authorities. The extent of damage to assets situated at the Cinema could not be ascertained consequent to fire, due to inaccessibility to the premises which has been sealed by the Investigating Agencies. The adjustment in the books of account of loss due to fire, therefore, has not been made. Normal depreciation on the fixed assets relating to the Cinema has, however, been provided in the accounts."

4. Ld. AO was however not satisfied and held in para 3.2 to 3.4 as follows;

“3.2 The reply of the assessee company has been considered and found general in nature. On perusal of details filed by the assessee in respect of legal & professional charges, it is noticed that the same were incurred towards various court cases made by the assessee company. However, the assessee company has not furnished the reasons/justifications. It is also noticed that the above judicial/quasi judicial proceedings related with closed business activities of the assessee company. During the course of assessment proceedings, the assessee has apparently admitted that it has closed down its main business activities of operating cinema since long years back. Thus, it is clear that the legal & professional expenses claimed in P&L account are in respect of the closed down business activities, which have no relation with the income of the assessee. I am afraid that mere making payment through bank will entitle the assessee for claiming expenditure U/s 37(1) of the Income-tax Act, 1961. It is the first and foremost liability of assessee to prove that the expenditure incurred by him qualifies the necessary test of section 37(1) of the Income-tax Act, 1961. I find support in my view from the case of CIT v. Calcutta Agency Ltd. [1951] 19 ITR 191 (SC), wherein the Hon'ble Supreme Court has held that the onus of providing necessary facts in order to avail the deduction under section 37(1) is on the assessee. If, therefore, the assessee fails to establish the facts necessary to support his claim for deduction under section 37(1), the claim for deduction of expenditure is not admissible. The assessee did not furnish or produce any evidence as to what was the expenditure and why it was incurred. The assessee has thus failed to qualify the first test of section 37(1) of the Income- tax Act, 1961. Mere claiming that the expenses were incurred through bank and evidence of payment is available with bank did not itself make the expenditure allowable in the case of assessee as something more is required to allow the deduction U/s 37(1) of the Income-tax Act, 1961. In view of this, the expenses claimed by assessee under the head legal & professional expenses are not allowable as such as claimed by assessee.

3.3 Further, the assessee has also claimed an amount of Rs.8,80,85,150/- towards Compensation in its P&L account. During the course of assessment proceedings, the assessee was asked to furnish the details of these expenses and furnish the justification along with proof of payment. However, no details whatsoever have been furnished by the assessee company. The assessee has neither furnished details of parties nor furnished any proof of payment during the course of scrutiny. It is also relevant to mention here that the compensation so claimed has not been paid by assessee during the previous year and was capitalized by the

assessee under the head 'Advances for Compensation'. Thus, the assessee itself capitalized the above expenses during preceding years; however, the assessee has claimed the above expenses as revenue expenditure during the year under consideration without any justification or basis. Thus, it is held that the compensation paid by the assessee is in the nature of capital expenses and not allowable u/s 30 to 37(1) of I.T. Act.

3.4 In view of the facts discussed above, the Legal & professional expenses and Compensation claimed by the assessee to the tune of Rs. 10,45,73,650/- has no relation with the business activities/income earned by the assessee. I, therefore, disallow the above expenses of Rs.10,45,73,650/- and added back the same into the total income of the assessee. Penalty proceedings u/s 271(1)(c) of the Income Tax Act, 1961 for concealment of income as aforesaid and furnishing inaccurate particulars within the meaning of explanation 1 to the sub-section (1) of the section 271(1)(c) of the Income Tax Act, 1961 are initiated.”

5. In appeal Ld. CIT(A) sustained the order of Ld. AO with following findings in para 9.1.5:-

“9.1.5 I have carefully considered the facts of the case. Despite repeated opportunities, the appellant company did not furnish the details of compensations paid by it. I have also perused the ledger account of legal & professional expenses. As per the ledger accounts, payments have been made to different renowned lawyers such Mr. Ram Jethmalani, Mr. Aditya Kumar, Mr Sushil Kumar, Mr Sanjay Jain, Mr Bansuri Swaraj. Hon’ble Supreme Court had already passed the final judgement on October 13, 2011. There is no reason as to why such legal & professional expenses should be debited in the accounts of the appellant company in F.Y 2013-14. Ld. AR did not furnish reasons as to why payments made to lawyers should be allowed as business expend in the hand of the appellant company. In the Judgment in the case of MCD vs. Association of Victims of Uphaar Tragedy & Ors. with CA 7116/2003 & CA 6748/2004, Hon’ble Supreme Court has held as under: "The deaths were on account of the negligence and greed on the part of the licensee in regard to installation of additional seats, in regard to closing of an exit door, parking of cars in front of transformer room by increasing parking from 15 to 35 and other acts.” Considering the above findings of Hon’ble Supreme Court, I am of the view that liability to pay the compensation arising out of Uphaar Tragedy cannot be treated as business expenditure allowable u/s 37(1). The appellant company could not prove that legal & professional expenses have been incurred wholly and exclusively for

the purpose of the business of the appellant company. The AO has disallowed the compensation of Rs.8,80,85,150/- and legal & professional expenses of Rs.1,64,88,500/- on the ground that these two expenses are not allowable u/s 37(1). Considering the facts of the case, I agree with the findings of the AO that these two expenses have not been incurred wholly and exclusively for the purpose of the business of the appellant company and hence, are not allowable u/s 37(1). Accordingly, the disallowance of Rs.10,45,73,650/- is confirmed. These grounds of appeal are ruled against the appellant company.”

6. Assessee is in appeal raising following grounds;

“1. That on the facts and circumstances of the case and in law, the Commissioner of Income tax (Appeals)-I, New Delhi [briefly "the CIT(A)"] has erred in upholding disallowance of Rs.10,45,73,650/- comprising compensation of Rs.8,80,85,150/- and legal & professional charges of Rs.1,64,88,500/-.

1.1 That on the facts and circumstances of the case and in law, the CIT(A) has erred in holding that since liability towards compensation of Rs.8,80,85,150/- was on account of negligence and greed of the Appellant, therefore, the same cannot be allowed deduction under section 37(1) of Income tax Act, 1961 ('the Act').

1.2 That on the facts and circumstances of the case and in law, the CIT(A) in upholding disallowance of compensation of Rs.8,80,85,150/- did not appreciate that compensation liability was not punitive and hence was allowable deduction.

1.3 That on the facts and circumstances of the case and in law, the CIT(A) did not appreciate that compensation of Rs.8,80,85,150/- was fully discharged during the year as has been certified by the Auditors.

1.4 That on the facts and circumstances of the case and in law, the CIT(A) has erred in holding that legal & professional expenses were in relation to Uphaar Cinema but this business activity was closed down and had no relation with the income of the Appellant for the relevant year, therefore, expenditure of Rs.1,64,88,500/- was not incurred wholly and exclusively for the purpose of business.

1.5 That on the facts and circumstances of the case and in law, the CTT(A) has erred in disallowing legal & professional expenses of Rs.1,64,88,500/- allegedly for the reason that since judgment in Uphaar tragedy was passed

by Hon'ble Supreme Court in October 2011, therefore, legal & professional expense was not expense for the financial year 2013-14.

2. That on the facts and circumstances of the case and in law, the CIT(A) has erred in upholding disallowance of Rs.16,74,900/- on account of amounts written off in the profit & loss account.

2.1 That on the facts and circumstances of the case and in law, disallowance of Rs.9,39,150/- out of Rs.16,74,900/- was made simply for want of documents. In so upholding the disallowance, the CIT(A) did not appreciate that documents were lost in the fire that occurred in 1997, which fact is beyond doubt.

2.1 That on the facts and circumstances of the case and in law, the CIT(A) in sustaining disallowance of Rs.7.35,750/- out of Rs.16,74,900/- has erred in holding that the amount written off in the profit & loss account did not relate to the business of the Appellant.

That the appellant craves leave to add, alter, amend or vary any of the ground either at or before the hearing of the appeal.”

7. Heard and perused the record. At the time of final arguments, learned Counsel stated at the Bar that on instructions of the appellant he is not pressing ground no.2 with its sub-grounds.

8. As regards ground no. 1, with its sub-grounds, learned Counsel at the outset relied on the judgment of the Third Member, Calcutta Bench of the Tribunal, in the case of **Eveready Industries India Ltd. v. DCIT [2001] 78 ITD 175 (Cal.)(TM)**, to submit, that was a case similar to the present assessee and that related to the compensation given as a consequence to Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985. It was submitted that damages are paid by an assessee to compensate injuries suffered by victims and loss of lives

and the property. It was an allowable expenditure incidental to and incurred for the purpose of carrying out business of assessee.

9. Learned DR, however, rebutted the same by submitting that these principles are applicable where otherwise there is no violation of any law and submitted that in the case of assessee there are explicit findings of the Hon'ble Supreme Court that there were violation of Municipal Laws with regard to providing exit gates and installation of fire extinguishers etc.

10. The learned AR pointed out that assessee had earlier paid compensation and the present year compensation is only part of it, culminating the whole. It was submitted that even otherwise the assessee was running in loss which has been accepted and the disallowance of compensation is part, as such does not affect the Revenue.

11. In regard to the legal and professional expenses, learned AR drew attention of the Bench towards ledger account, copy available at page nos. 112-117, containing details of legal and professional expenses. It was submitted that the expenses were only part of the major expenses which had already been paid in the earlier years. He drew attention to the fact that legal and professional charges are paid for defending the assessee company of its prospective liability and there is no dispute with regard to the genuineness of the payments as the same are

made to top lawyers of the country by banking channels.

12. Learned DR, however, relied on the orders of learned tax authorities below to submit that they are not related to the present year and are in respect of the business which was closed down long back.

13. Giving thoughtful consideration to the matter on record and the submissions we proceed to decide the grounds, as raised, on following two issues –

- (i) Whether, the compensation of Rs. 10,45,73,650/- was not punitive, therefore, allowable deduction?
- (ii) Whether, legal and professional charges amounting to Rs. 1,64,88,500/- were in relation to the business activity of the assessee for the current financial year?

14. In relation to the first issue, we are of the considered view that the judgment of the Hon'ble Supreme Court in the case of **Civil Appeal No. 7114-15 of 2003, titled Municipal Corporation of Delhi Vs. Association of Victims of Uphaar Tragedy & Ors. Dated 13.10.2011** is of vital consequence to understand as to what was the nature of compensation directed to be paid to the victims of Uphaar Tragedy. In this context as the Bench goes through the judgment of Hon'ble Supreme Court, It comes up that Hon'ble Apex Court, extensively examining the concept of sovereign immunity, statutory and absolute

liability under the law of Torts awarded compensation. In para 38 of judgment,

Hon'ble Court has observed as under:

“38. Therefore what can be awarded as compensation by way of public law remedy need not only be a nominal palliative amount, but something more. It can be by way of making monetary amounts for the wrong done or by way of exemplary damages, exclusive of any amount recoverable in a civil action based on tortious liability. But in such a case it is improper to assume admittedly without any basis, that every person who visits a cinema theatre and purchases a balcony ticket should be of a high income group person. In the year 1997, Rs.15,000 per month was rather a high income. The movie was a new movie with patriotic undertones. It is known that zealous movie goers, even from low income groups, would not mind purchasing a balcony ticket to enjoy the film on the first day itself. To make a sweeping assumption that every person who purchased a balcony class ticket in 1997 should have had a monthly income of Rs. 15,000 and on that basis apply high multiplier of 15 to determine the compensation at a uniform rate of Rs.18 lakhs in the case of persons above the age of 20 years and Rs.15 lakhs for persons below that age, as a public law remedy, may not be proper. While awarding compensation to a large group of persons, by way of public law remedy, it will be unsafe to use a high income as the determinative factor. The reliance upon Neelabati Behera in this behalf is of no assistance as that case related to a single individual and there was specific evidence available in regard to the income. Therefore the proper course would be to award a uniform amount keeping in view the principles relating to award of compensation in public law remedy cases reserving liberty to the legal heirs of deceased victims to claim additional amount wherever they were not satisfied with the amount awarded. Taking note of the facts and circumstances, the amount of compensation awarded in public law remedy cases, and the need to provide a deterrent, we are of the view that award of Rs.10 lakhs in the case of persons aged above 20 years and Rs.7.5 lakhs in regard to those who were 20 years or below as on the date of the incident would be appropriate. We do not propose to disturb the award of Rs. 1 lakh each in the case of injured. The amount awarded as compensation will carry interest at the rate of 9% per annum from the date of writ petition as ordered by the High Court, reserve liberty to the victims or the LRS. of the victims as the case may be to seek higher remedy wherever they are not satisfied with the compensation. Any increase shall be borne by the Licensee (theatre owner) exclusively.”

15. Thereafter the Hon'ble Supreme Court decided the compensation granted on the basis of dependency arrived by the multiplier as laid down in the case of

Sarla Verma v. Delhi Transport Corporation (2009) 6 SCC 121. It will be appropriate to reproduce para 39 & 40 in that regard:

“39. Normally we would have let the matter rest there. But having regard to the special facts and circumstances of the case we propose to proceed a step further to do complete justice. The calamity resulted in the death of 59 persons and injury to 103 persons. The matter related to a ghastly fire incident of 1997. The victims association has been fighting the cause of victims for more than 14 years. If at this stage, we require the victims to individually approach the civil court and claim compensation, it will cause hardship, apart from involving huge delay, as the matter will be fought in a hierarchy of courts. The incident is not disputed. The names and identity of the 59 persons who died and 103 persons who were injured are available and is not disputed. Insofar as death cases are concerned the principle of determining compensation is streamlined by several decisions of this court. (See for example Sarla Verma v. Delhi Transport Corporation (2009) 6 SCC 121. If three factors are available the compensation can be determined. The first is the age of the deceased, the second is the income of the deceased and the third is number of dependants (to determine the percentage of deduction for personal expenses). For convenience the third factor can also be excluded by adopting a standard deduction of one third towards personal expenses. Therefore just two factors are required to be ascertained to determine the compensation in 59 individual cases. First is the annual income of the deceased, two third of which becomes the annual loss of dependency the age of the deceased which will furnish the multiplier in terms of Sarla Verma. The annual loss of dependency multiplied by the multiplier will give the compensation.

40. As this is a comparatively simple exercise, we direct the Registrar General of Delhi High Court to receive applications in regard to death cases, from the claimants (legal heirs of the deceased) who want a compensation in excess of what has been awarded that is Rs.10 lakhs/Rs.7.5 lakhs. Such applications should be filed within three months from today. He shall hold a summary inquiry and determine the compensation. Any amount awarded in excess of what is hereby awarded as compensation shall be borne exclusively by the theatre owner. To expedite the process the concerned claimants and the Licensee with their respective counsel shall appear before the Registrar without further notice. For this purpose the claimants and the theatre owner may appear before the Registrar on 10.1.2012 and take further orders in the matter. The hearing and determination of compensation may be assigned to any Registrar or other Senior Judge nominated by the Learned Chief

Justice/Acting Chief Justice of the Delhi High Court. As far as the injured are concerned if they are not satisfied with the sum of Rs.1 lakh which has been awarded it is open to them to approach the civil court for claiming higher compensation and if they do so within 3 months from today, the same shall be entertained and disposed of in accordance with law. It is not possible to refer the injury cases for summary determination like death cases, as the principles are different and determination may require a more detailed enquiry.”

16. It further comes up that thereafter the Hon’ble Supreme Court examined the question of damages beyond the tortious liability for granting punitive damages wherein the Hon’ble Supreme Court took into cognizance the illegal profits derived by the theatre owner by selling tickets in regard to extra seats unauthorizedly and illegally sanctioned by the Authorities and installed by the licensee. Taking into consideration the judgment of Hon’ble Supreme Court in **M.C. Mehta Vs. Union of India (1997) 1 STC 395**, the Hon’ble Supreme Court held as follows in relevant para 43:

*“43. What has been awarded is not exactly punitive damages with reference to the magnitude or capacity of the enterprise. All that the High Court pointed out was that the Licensee has installed additional seats illegally. That illegality contributed to the cause for the death and injuries, as they slowed down the exiting of the occupant's balcony. If people could have got out faster (which they could have if the gangway was wider as before, and if there had been two exits as before, instead of only one) many would not have died of asphyxiation. Therefore the Licensee is not only liable to pay compensation for the death and injuries, but should, in the **least be denied the profits/benefits out of their illegal acts**. In that sense it is not really punitive, but a kind of negative restitution. We therefore uphold in principle the liability of the Licensee to return and reimburse the profit from the illegally installed seats, but reduce it from Rs.2.5 crores to Rs.25 lakhs for the reasons stated in the earlier para. The award of the said sum, a additional punitive damages, covers two aspects. The first is because the wrongdoing is outrageous in utter disregard of the safety of the patrons o the*

theatre. The second is the gravity of the breach requiring a deterrent to prevent similar further breaches.”

17. Further, Hon’ble Justice K.S. Radhakrishnan, had further elaborated on the concept of Constitutional Tort and Compensatory Jurisprudence and made following relevant observations in paras 17 & 18 as follows:

“17. Legal liability in damages exist solely as a remedy out of private law action in tort which is generally time consuming and expensive and hence when fundamental rights are violated claimants prefer to approach constitutional courts for speedy remedy. Constitutional courts, of course, shall invoke its jurisdiction only in extraordinary circumstances when serious injury has been caused due to violation of fundamental rights especially under Article 21 of the Constitution of India. In such circumstances the Court can invoke its own methods depending upon the facts and circumstances of each case.

Constitutional Torts and Punitive Damages

*18. Constitutional Courts' actions not only strive to compensate the victims and vindicate the constitutional rights, but also to deter future constitutional misconduct without proper excuse or with some collateral or improper motive. Constitutional courts can in appropriate cases of serious violation of life and liberty of the individuals award punitive damages. However, the same generally requires the presence of malicious intent on the side of the wrong doer, i.e. an intentional doing of some wrongful act. Compensatory damages are intended to provide the claimant with a monetary amount necessary to recoup/replace what was lost, since damages in tort are generally awarded to place the claimants in the position he would have been in, had the tort not taken place which are generally quantified under the heads of general damages and special damages. Punitive damages are intended to reform or to deter the wrong doer from indulging in conduct similar to that which formed the basis for the claim. Punitive damages are not intended to compensate the claimant which he can claim in an ordinary private law claim in tort. Punitive damages are awarded by the constitutional court when the wrong doer's conduct was egregiously deceitful. Lord Patrick Devlin in leading case on the point *Rookes v. Barnard* [1964] All E.R. 367 delineated certain circumstances which satisfy the test for awarding punitive damages such as the conduct must have been oppressive, arbitrary, or unconstitutional, the conduct was calculated to make profit for the wrong doer and that the statute expressly authorizes awarding of punitive damages.*

Above principles are, however, not uniformly followed by English Courts though the House of Lords in a decision in Attorney-General Vs. Blake [2001] 1 AC 268, awarded punitive damages when it was found the defendant had profited from publishing a book and was asked to give an account of his profits gained from writing the book. In this case where the wrong doer was made to give up the profits made, through restitution for wrongs, certainly the claimant gained damages. In United States, in a few States, punitive damages are determined based on statutes. But often criticisms are raised because of the high imposition of punitive damages by courts. The Supreme Court of United States has rendered several decisions limiting the awards of punitive damages through the due process of law clauses of the Fifth and Fourteenth Amendments. In BMW of North America Inc. v. Gore 517 U.S. 559 (1996) the Court ruled that the punitive damages must be reasonable, as determined based on the degree of reprehensibility of the conduct, the ratio of punitive damages to compensatory damages and any criminal or civil penalties applicable to the conduct. In Philip Morris USA v. Williams 549 U.S. 346 (2007), the Court ruled that the award of punitive damages cannot be imposed for the direct harm that the misconduct caused to others, but may consider harm to others as a function of determining how reprehensible it was. There is no hard and fast rule to measure the punitive damages to determine such a claim. In United States in number of cases the Court has indicated that the ratio 10:1 or higher between punitive and compensatory damages is held to be unconstitutional. Several factors may gauge on constitutional court in determining the punitive damages such as contumacious conduct of the wrong doer, the nature of the statute, gravity of the fault committed, the circumstances etc. Punitive damages can be awarded when the wrongdoers' conduct 'shocks the conscience' or is 'outrageous' or there is a willful and "wanton disregard" for safety requirements. Normally, there must be a direct connection between the wrongdoer's conduct and the victim's injury.”

18. Now, as we take into consideration the aforesaid observations of Hon'ble Supreme Court of India and the manner in which Hon'ble Supreme Court proceeded to determine the compensation, there is no doubt in the mind of this Bench that the compensation as granted by the hon'ble Supreme court and as paid by the assessee was by way of restitution as well as punitive, in terms of the

rights of the victim under the Private Law. The remedy that was availed was by way of writ jurisdiction of Hon'ble Delhi High Court, as determined finally by Hon'ble Supreme Court. The damages were ordered against the theatre owner, Delhi Vidyut Boart, Municipal Corporation of Delhi, Fire Force and the Licensing Authority for their alleged callous disregard to their statutory obligations and to the fundamental inducible rights guaranteed under Article 21 of the Constitution of India, of the theatre coming public in failing to provide safe premises free from reasonably forcible hazards.

19. There is no doubt that the compensation so granted by way of restitution was out of civil consequences only and had nothing to do with any criminal liability, which any of these parties may have incurred. However, punitive damages granted by Hon'ble Delhi High Court of Rs. 2.5 Crore was reduced by Hon'ble Supreme Court to Rs. 25 Lacs. Learned AR has relied the case of **Eveready Industries India Ltd. (supra)**, submitting the same was in similar facts and circumstances. Certainly in that order, it was held specifically that the happening or mis-happening, incident or accident, if arises in the course of operation of business, it cannot be treated to be criminal liability or an liability for criminal negligence, disentitling the assessee for claim of the expenditure. However, it was also held that provided such compensation paid is not in the form of any fine or penalty **or punitive damages**.

20. Thus with regard to the **punitive damages** component in the disallowance the Bench intends to further examine the issue and see if '**Punitive Damages**' fall in the category which Explanation 1 to Section 37(1) of the Act, as expressly disallowed being any expenditure incurred by an assessee for any purpose which is an offence or is prohibited by law, which may be claimed as an expenditure incurred for the purpose of business/profession.

21. The expression '**punitive**' implies involving or inflicting punishment. It is matter of common understating that damages awarded by the courts are different from fines, which are prescribed under law for any act or omission giving rise to penal consequences. Damages, liquidated or unliquidated, generally arise out of acts or omission giving rise to civil consequences. They are primarily based on principle of restitution or reasonable and adequate compensation but are not punitive in nature. This distinction can be better understood with the help of the observations of Hon'ble Delhi High Court in **Time Incorporated vs Lokesh Srivastava And Anr 2006 131 CompCas 198 Delhi** wherein it was observed as follows;

"This Court is of the considered view that a distinction has to be drawn between compensatory damages and punitive damages. The award of compensatory damages to a plaintiff is aimed at compensating him for the loss suffered by him whereas punitive damages are aimed at deterring a wrong doer and the like minded from indulging in such unlawful activities. Whenever an action has criminal propensity also the punitive damages are clearly called for so that the tendency to violate the laws and infringe the

rights of others with a view to make money is curbed. The punitive damages are founded on the philosophy of corrective justice ad as such, in appropriate cases these must be awarded to give a signal to the wrong doers that law does not take a breach merely as a matter between rival parties but feels concerned about those also who are not party to the list but suffer on account of the breach.” In this judgment Hon’ble Delhi High Court relied the findings in Mathias v. Accor Economy Lodging, Inc. reported in 347 F.3d 672 (7th Cir. 2003) where in the factors underlying the grant of punitive damages were discussed and it was observed that one function of punitive damages is to relieve the pressure on an overloaded system of criminal justice by providing a civil alternative to criminal prosecution of minor crimes. It was further observed that the award of punitive damages serves the additional purpose of limiting the defendant's ability to profit from its fraud by escaping detection and prosecution. If a tort feason is caught only half the time he commits torts, then when he is caught he should be punished twice as heavily in order to make up for the times he gets away Hon’ble High court observed, “This Court feels that this approach is necessitated further for the reason that it is very difficult for a plaintiff to give proof of actual damages suffered by him as the defendants who indulge in such activities never maintain proper accounts of their transactions since they know that the same are objectionable and unlawful. Thus while defendants in civil cases can’t be punished with imprisonment, punitive damages can be used to punish a defendant who’s acted reprehensibly toward the plaintiff. Further, Punitive damages are also awarded as a form of specific deterrence that is, they’re meant to deter the defendant from engaging in the misconduct again and also as General deterrence to deter other individuals and entities from engaging in the same kind of misconduct the defendant was found guilty of.

22. In **M/s. Haji Aziz And Abdul Shakoor vs The Commissioner Of Income-Tax, 1961 AIR 663**, referring to words "*for the purpose of such business*", Hon’ble Supreme Court relied what has been construed in **Inland Revenue v. Anglo Brewing Co. Ltd. ((1925) 12 T.C. 803, 813)** to mean "*for the purpose of keeping the trade going and of making it pay*". The essential condition of allowance is that the expenditure should have been laid out or expended wholly and exclusively for the purpose of such business. The view of the

Hon'ble Supreme Court in the case of **Haji Aziz & Abdul Shakoor Bros. (Supra)** was that no expense which is paid by way of penalty for breach of the law can be said to be an amount wholly and exclusively laid for the purpose of the business.

23. Similarly Hon'ble Supreme Court in **Badridas v. Commissioner of Income-tax, 1958 AIR 783** considered what would amount to a trading loss and held:

"When a claim is made for a deduction for which there is no specific provision in Section 10(2), whether it is admissible or not will depend on whether, having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and to be incidental to it. If that is established, then the deduction must be allowed, provided of course there is no prohibition against it, express or implied, in the Act. The loss for which a deduction could be made under Section 10(1) must be one that springs directly from the carrying on of the business and is incidental to it, and not any loss sustained by the assessee, even if it has some connection with his business."

24. Further, in the case of **Prakash Cotton Mills Pvt. Ltd. v. Commissioner of Income Tax - [1993] 201 ITR 68**, Hon'ble Supreme Court, relying decision in the case of **Mahalakshmi Sugar Mills Co. reported in [1980] 123 ITR429** and the decision of the Andhra Pradesh High Court in **Hyderabad Allwyn Metal Works Ltd. reported in [1988] 172 ITR 113**, held that whenever any statutory amount is paid by an assessee by way of damages or penalty or interest and same is claimed as an allowable expenditure under Section 37(1) of the Act, the assessing authority is required to examine the scheme of the provisions of the

relevant statute providing for payment of such payment notwithstanding the nomenclature of the impost as given by the statute, to find whether it is compensatory or penal in nature. If the amount so paid be of compensatory nature the assessing authority has to allow deduction under Section 37(1) and, where the impost is found to be of composite nature, the authorities are bound to bifurcate the two components and give relief to the compensatory component of the impost.

25. Lately Hon'ble Supreme court in **The Commissioner Of Income Tax vs Prakash Chand Lunia (D) Thr Lrs decided on 24 April, 2023, CIVIL APPEAL NOS.7689-90 OF 2022**, after taking cognizance of various judicial precedents in regard to nature of penalty imposed and claim of same as deduction by an assessee observed as follows:

“Reference was also made during the course of arguments to Commissioner of Income- tax v. Hirjee [(1953) SCR 714]. In that case the assessee was prosecuted under the Hoarding and Profiteering Ordinance but was finally acquitted and claimed the amount spent in defending himself under s. 10(2)(xv) in his assessment. It was held that the distinction between the legal expenses on a successful and unsuccessful defence was not sound and that the deductibility of such expenses under s. 10(2)(xv) must depend on the nature and purpose of the legal proceedings in relation to the business whose profits are in computation and are unaffected by the final outcome of the proceedings.

A review of these cases shows that expenses which are permitted as deductions are such as are made for the purpose of carrying on the business i.e. to enable a person to carry on and earn profit in that business. It is not enough that the disbursements are made in the course of or arise out of or are concerned with or made out of the profits of the business but they must

also be for the purpose of earning the profits of the business. As was pointed out in Von Glehn's case [(1920) 2 KB 553] an expenditure is not deductible unless it is a commercial loss in trade and a penalty imposed for breach of the law during the course of trade cannot be described as such. If a sum is paid by an assessee conducting his business, because in conducting it he has acted in a manner, which has rendered him liable to penalty it cannot be claimed as a deductible expense. It must be a commercial loss and in its nature must be contemplable as such. Such penalties which are incurred by an assessee in proceedings launched against him for an infraction of the law cannot be called commercial losses incurred by an assessee in carrying on his business. Infraction of the law is not a normal incident of business and therefore only such disbursements can be deducted as are really incidental to the business itself. They cannot be deducted if they fall on the assessee in some character other than that of a trader. Therefore where a penalty is incurred for the contravention of any specific statutory provision, it cannot be said to be a commercial loss falling on the assessee as a trader the test being that the expenses which are for the purpose of enabling a person to carry on trade for making profits in the business are permitted but not if they are merely connected with the business."

26. Now coming back to the case of present assessee, Hon'ble Supreme Court had reasoned that punitive damages could be granted only in very limited circumstances. In the pertinent part of the judgment, Hon'ble Apex court stated: "Punitive damages can be awarded when the wrongdoers' conduct 'shocks the conscience' or is 'outrageous' or there is a willful and 'wanton disregard' for safety requirements. Normally, there must be a direct connection between the wrongdoer's conduct and the victim's injury."

27. This punitive damages of Rs. 25 lacs, paid by the assessee, is one which cannot be said be one which was out of natural course of events of business activity. Rather Hon'ble Supreme Court has said that this punitive damage is

being allowed as negative restitution for the reason what Hon'ble Supreme Court said was by way of "*least be denied the profits/benefits out of their illegal act*".

28. Thus Learned Tax Authorities and especially learned CIT(A) had fallen in error to failing to distinguish the two components of the damages. First being by way of restitution and second being negative restitution. The former is allowable as business expenditure allowable u/s 37(1). As if any assessee is directed to make payment under law or orders of courts by way of compensation arising out of civil consequence the same has to be considered to be allowable business expenditure. However, the Punitive damages as awarded cannot be allowed as expenditure.

29. In regard to second issue, it comes up that Revenue does not dispute the genuineness of payment. Revenue also does not dispute the checkered history of assessee, litigating in various courts to defend the civil and criminal consequences of the tragedy. The bills raised by the lawyers and as shown in the ledger account are not disputed nor alleged to be exorbitant or inflated. The bald assertion of the learned CIT(A) that assessee could not prove that legal and professional expenses have been incurred wholly and exclusively for the purpose of business of the appellant company is not sustainable. The AO had made observation that legal and professional expenses claimed in P&L A/c are in

respect of closed-down business activities which has no relation with the income of the assessee. Thus, first thing is there is apparent diversion of opinion for making the disallowance. Secondly when the assessee company's business was closed due to loss of the theatre due to fire then there could have been no business as such the business was closed due to "*force majeure*" which cannot be attributed to any commercial decision to not work and claim expenses. As pointed above the fact of assessee litigating in courts is not disputed so legal and professional expenditure in absence of any business, needed to be allowed. Tax authorities below have not taken a prudent approach to understand the nature of litigation faced by the assessee that ran over the years and at different forums. Even if the business activities were stopped, the upcoming financial liabilities and even penal consequences required the assessee company to continue defending the cases in the courts and other forums. Thus, legal and professional expenses were erroneously disallowed by the learned tax authorities. Issue is decided in favour of the assessee.

30. As a consequence of above, ground no. 1 with its sub-grounds is decided in favour of the assessee to the extent that except for the punitive damages of Rs.25 lakhs, the remaining disallowances are not sustained. **The appeal of the assessee is allowed partly.**

Order pronounced in open court on 22.11.2023.

Sd/-

**(M. BALAGANESH)
ACCOUNTANT MEMBER**

Sd/-

**(ANUBHAV SHARMA)
JUDICIAL MEMBER**

Dated, 22 November, 2023.

MP

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

**ASSISTANT REGISTRAR
ITAT, NEW DELHI**