

**CUSTOMS, EXCISE AND SERVICE TAX APPELLATE
TRIBUNAL, CHENNAI**

REGIONAL BENCH – COURT NO. III

**Service Tax Appeal Nos.40343 to 40346 of 2020, 40349 of 2020
and 40355 to 40357 of 2020-DB**

[arising out of Order-in-Appeal No.320/2019, dated 14.11.2019 passed by the Commissioner of GST & CE (Appeals), Coimbatore]

M/s.V.V. Minerals [100% EOU]

: Appellant

No.4/160, D-25, Harbour Construction Road,
Muthiapuram,
Tuticorin 628 005.

VERSUS

Commissioner of GST & CE,
O/o Commissioner of GST & CE,
No.4, Lal Bahadur Shastri Marg,
C.R. Buildings, Madurai – 2.

: Respondent

APPEARANCE:

Shri A.K. Jayaraj, Advocate for the Appellant

Shri Arul C. Durairaj , Authorized Representative for the Respondent

CORAM:

HON'BLE SMT. SULEKHA BEEVI C.S, MEMBER (JUDICIAL)
Hon'BLE SHRI P. VENKATA SUBBA RAO, MEMBER (TECHNICAL)

41597,
FINAL ORDER NOS. 41585 to 41591/2021

DATE OF HEARING: 16.04.2021

DATE OF PRONOUNCEMENT: 04.06.2021

Per Smt. Sulekha Beevi C.S:

Brief facts are that the appellant is a 100% EOU and is engaged in the manufacture and export of 'Garnet' and 'Super Garnet'. They

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filed refund claims in terms of Notification No.41/2012-ST, dated 29.06.2012 claiming refund of service tax paid on input services used for export of goods. The refund claims were filed for the period from May, 2016 to December, 2016. Meanwhile, it came to the knowledge of the department from the District Level Committee of Tirunelveli District constituted by the State Government to verify the allegation of illicit mining of Beach Sands after the ban imposed by the Government of Tamil Nadu that the appellant group company have unlawfully transported a total quantum of 57,71, 688 MTs of mineral extracted from the total quantum of 98,80,600 MTs of Raw Sands during the period from 2000-01 to 2015-16 and they themselves had accepted that a total quantum of 9,65,948.8 MTs of minerals were transported by them during the period from 2014-15 and 2015-16 after the mining operation was banned and issuance of transport permits halted. It was also learnt from the Committee that the entire quantum of 9,65,948.8 MTs of minerals transported without transport permit during the period from 2014-15 and 2015-16 was an illegal transport. The respondent was thus of the view that appellants were not eligible for the refunds claimed, inasmuch as, the minerals had been exported by illicit mining and transportation. Hence, eight show-cause notices were issued upon the appellant proposing to deny the eight refund claims for the period from May, 2016 to December, 2016 on the above grounds. After due process of law, the Assistant Commissioner of CGST & Central Excise, Tuticorin Division, who was the Refund Sanctioning Authority (RSA) denied the eight refund claims. Appeal was preferred by the appellant against such rejection of refund claims. The Commissioner (Appeals), vide Order impugned herein, upheld the rejection of refund claims. Hence these appeals.

2. The issue involved in all these appeals being the same, they were heard and are disposed off by this common order.

3. On behalf of the appellant, the learned counsel Shri A.K. Jayaraj appeared and argued the matter. His submissions can be summarised as under:-



(i) The appellant is registered as 100% EOU and are exporting Garnet/Super Garnet. The refund claims were filed for refund of service tax paid by them on input services used by them for the export of goods. The input services availed are in the nature of Clearing and Forwarding Agent Services, Port Services and Customs House Agents Service. The refund claims were made under Notification No.41/2012-ST, dated 29.06.2012 [as amended]. As per the notification after the goods are exported appellant is eligible to claim refund of the service tax paid on input services used for export of goods.

(ii) The department does not raise any allegation that the appellant has not fulfilled the conditions of the notification. So also, there is no allegation that the goods have not been exported or that the appellant has not paid service tax for the input services. When the goods have been exported and all the conditions as per the notification have been fulfilled, the department cannot reject the refund claims for extraneous reasons.

(iii) The allegation in the show-cause notices is that the Government of Tamil Nadu vide its order GO (MS) No.156, dated 08.08.2013 and GO (MWS) No.173, dated 17.09.2013 had banned the mining of Beach Sands and minerals and also formed District Level Committee to verify the allegations. The District Level Committee of the Tirunelveli District under the Chairmanship of District Collector, Tirunelveli in its Minutes reference dated 09.11.2016 has recorded that M/s. V.V. Minerals have unlawfully mined the raw sand and other



minerals and transported in excess of the permitted quantity of mining during the period from 2008-09 to 2012-13. In the Minutes, it is also recorded that on the basis of export details obtained from the Assistant Commissioner of Customs (Tuticorin), the appellant have exported a total quantity of 16,21,400 MTs of minerals by illicit transportation during the period from 2012-13 to 2016-17. The department has taken the view that the quantity of 16,21,400 MTs of minerals included the minerals exported during May, 2016 to December, 2016 for which the refund claims have been filed. Assuming as illicit mining on the basis of Minutes of the Committee, the refund claims have been wrongly rejected.

(iv) The learned counsel submitted that the allegation of illegal mining is against M/s. V.V. Minerals [Mines], whereas, the export is made by M/s. V.V. Minerals [100% EOU], which is a different entity. The EOU has procured minerals from another entity M/s. V.V. Minerals (Mines) and exported the goods after processing. In fact, M/s. V.V. Minerals, the appellant herein which is an 100% EOU has no mining lease. They procured minerals from other licence holders and undertook further processing of the raw materials. The recommendation by the District Level Committee is only against the mining licensees. Since the appellant does not have any mining lease, such recommendations made by District Level Committee is not applicable to them. The orders passed by the authorities below merely basing of the Minutes of the District Level Committee are not tenable in law.



(v) As per section 21 of Mining and Minerals [Development and Regulation] Act, 1957 (hereinafter called as "MMDR Act") punishments are provided for contravening the provisions laid in the said Act. So far, no action under above provisions of MMDR Act has been initiated against the appellant or licence holders [suppliers] by the State Government except for the Minutes recorded. A reply No.M/1/49/2018, dated 29.10.2018 was received from the Mines Department, State Government of Tamil Nadu under RTI Act stating that no action has so far been taken against the appellant or the licence holders for violation provisions of of MMDR Act/Rules. Merely on the basis of Minutes of the District Level Committee it cannot be concluded that the minerals are illegally mined and exported. Further, export of minerals does not come within the purview of MMDR Act, 1957. It is also submitted by the learned counsel that the District Level Committee has no legal backing or power for the reason that the Government order so published in the Official Gazette is not placed before the legislative assembly.

(vi) The main allegation raised in show-cause notice is that goods are exported in violation of the MMDR Act/Rules and hence illegal export as per section 11H of the Customs Act, 1962. There is nothing mentioned in the MMDR Act regarding export and import of minerals. In the absence of restriction regarding export and import in the said Act, it could not be said that the goods are exported in violation of MMDR Act. There is no evidence to show that there is illegal export on the side of the appellant. Without substantiating with evidence, that



the quantity of minerals exported are illegally mined, by mere assumption, the department has denied the refund claims.

(vii) He placed reliance on the decision of the Tribunal in the case of *M/s. Transworld Garnet India Pvt. Ltd.*, vide Final Order No.40031/2020, dated 02.01.2020.

4. The learned Authorised Representative Shri Arul C. Durairaj appeared for the department. He reiterated the findings in the impugned order. He adverted to section 11H(a) of the Customs Act, 1962 to argue that illegal export is defined as under:-

Illegal export means "*the export of any goods in contravention of the provisions of this Act or **any other law for the time being in force***". Since the minerals have been excavated/mined more than the permitted quantity, the appellant has violated the provisions of MMDR Act/Rules. Such goods then fall falls under the category of illegal exports. The authorities below have rightly denied the refund claims, as the claims which arise out of illegal exports. He prayed that the appeals may be dismissed.

5. Heard both sides.

6. The issue is the rejection of refund claims filed under Notification No.41/2012-ST, dated 29.06.2012. Undisputedly, the department does not have a case that the appellant has not exported goods or that they have not paid service tax on the input services used for export of goods. So also, there is no allegation that the conditions



of the above notification are not fulfilled. The reason for rejecting the refund claims for the period from May, 2016 to December, 2016 is that the department gathered information from the District Level Committee of Tirunelveli that appellant has committed illicit mining of Beach Sands and unlawfully transported the same. The export of goods procured by violation of MMDR Act/Rules and, therefore are illegal exports as per section 11H of Customs Act, 1962. TO understand the allegations raised in the show-cause notice, it would be worthwhile to reproduce the relevant provisions of MMDR Act/Rules, which reads as under:-

4(1A) No person shall transport or store or cause to be transported or stored any mineral otherwise than in accordance with the provisions of this Act and the rules made there under.

As per section 21 of Mines and Minerals [Development and Regulation] Act, 1957 [herein after called the MMDR Act] the following actions could be initiated against the appellant for violation of section 4(1A) of the Act.

1(1) Whoever contravenes the provision of sub-section (1) or sub-section (1A) of section 4 shall be punishable with imprisonment for a term which may extend to five years and with fine which may extent to five lakh rupees per hectare of the area

(2) Any rule made under any provision of this Act may provide that any contravention thereof shall be punishable with imprisonment for a term which may extend to two years or with fine which may extend to five lakh rupees, or with both, and in the case of a continuing contravention, with additional fine which may extend to fifty thousand rupees for every day during which such contravention continues after conviction for the first such contravention.

(3) Where any person trespasses into any land in contravention of the provisions of sub-section (1) of section 4, such trespasser may be served with an order of eviction by the State Government or any authority authorised in this behalf by that Government and the State Government or such authorised authority may, if necessary, obtain the help of the police to evict the trespasser from the land.

2(4) Whenever any person raises, transports or causes to be raised or transported, without any lawful authority, any mineral from any land, and, for that purpose, uses any tool, equipment, vehicle or any other thing, such mineral tool,

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equipment, vehicle or any other thing shall be liable to be seized by an officer or authority specially empowered in this behalf.

(4A) Any minerals, tool, equipment, vehicle or any other thing seized under sub-section (4), shall be liable to be confiscated by an order of the court competent to take cognizance of the offence under sub-section (1) and shall be disposed of in accordance with the directions of such court.

(5) Wherever any person raises, without any lawful authority, any mineral from any land, the State Government may recover from such person the mineral so raised, or, where such mineral has already been disposed of, the price thereof, and may also recover from such person rent, royalty or tax, as the case may be, for the period during which the land was occupied by such person without any lawful authority.

7. From the above, it can be seen that the MMDR Act itself provides for punishments for contraventions of provisions of the Act. Sub-clause (a) of section 11H defines illegal exports. Though, the department contends that the goods fall within the definition of "Illegal export", apart from the Minutes of the District Level Committee, there is nothing to establish violation of MMDR Act/Rules by the appellant. For that matter, it is also contended by the appellant that M/s. V.V. Minerals [Mines] is a different entity, which is the licence holder for mining of Beach Sands. The appellant herein is a registered 100% EOU and does not possess any mining lease. Both these are different entities in the eyes of law. Merely because the supplier of goods has committed violation of local law, the exporter, who has procured the goods cannot be put into adverse situations. Even if it is proved that the supplier had contravened the provisions of MMDR Act, to hold that the exports are illegal exports, it has to be established that the exporter had acted consciously or abetted for such illegal mining.

8. Be that as it may, it needs to be stated that there is no show-cause notice issued under the Customs Act, 1962 against the



appellant alleging illegal export. By depriving the refund the department has sought to impose a punishment or penalty on the appellant for the alleged illegal export. The intention of Notification No.41/2012 is to refund the service tax paid by the exporter on the goods exported. This is to give effect to the policy of the Government that "taxes are not to be exported". To deny refund would be directing the appellant to suffer the burden of taxes on the goods exported. Thus, it would be imposing penalty/punishment on the appellant without due process of law. If the department has reasons to believe that appellant has contravened any provision of the Customs Act, 1962, then the appellant has to be put to notice by issuing a show-cause notice. He should then be heard and adjudicated. Without such due process of law, the appellant cannot be punished indirectly by denying the refund claim. Needless to say, that the goods were inspected and LEO [Let Export Order] issued by the Customs authorities before export of the goods. Till date, there is no action taken on the side of the department alleging that these goods are illegally exported. The Refund Sanctioning Authority has to look into the conditions of the notification to decide the eligibility of the claims. Anomalous or unintended consequences are to be avoided while processing the refund claims.

9. In a similar matter, where one of us was sitting single, in the case of *M/s. Transworld Garnet India Pvt. Ltd.* Vide Final Order No.40031/2020, dated 02.01.2020, the Tribunal had considered the very same issue and held that the rejection of refund claim cannot sustain. The relevant paragraph is reproduced as under:-



"5. On perusal of the impugned order as well as after hearing the submissions of both sides, I find that the ground for rejection is on an allegation that the appellant has done unlawful mining of raw sand and other minerals in excess of the permission granted to them. This aspect has to be looked into by the Government of Tamil Nadu as well as the Committee formed for this purpose. The provision of Mines and Minerals Act of the State has to look into the legal consequences of unlawful mining. When the appellant has exported the goods paying service tax on the services availed for exporting the goods, the department cannot deny the refund stating reasons beyond the Customs Act as well as Finance Act. Notification No41/2012 emanates from the Finance Act and, therefore, only if there is violation under the said Act as well as the notification, refund can be rejected. Since the department does not have a case that the appellants have violated provisions of the Finance Act or the notification, I am of the opinion that the rejection of refund claim cannot sustain."

10. We do not find any ground to differ from the view taken in the above case. From the foregoing, we hold that the rejection of refund claim is unjustified. The impugned orders are set aside, the appeals are allowed with consequential reliefs, if any.

(Pronounced in open court on)



**(SULEKHA BEEVI C.S.)
MEMBER (JUDICIAL)**

 Separate order by Member Technical.

**(P. VENKATA SUBBA RAO)
MEMBER (TECHNICAL)**

Per P. Venkata Subba Rao

11. I agree with the conclusion of my sister Member (Judicial) but for slightly different reasons. The questions which need to be answered in this case are (a) whether tax laws apply even to cases of illegal activities if they are otherwise covered by the tax law? (b) Consequently, will tax be leviable even on illegal activities? and (c) Conversely, whether any tax benefit or relief is available to illegal activities also?

12. The goods exported in this case are allegedly made out of illegally mined sand according to the State Government which regulates the mining of sand. As per notification No. 41/2012-ST dated 29.6.2012, exporters are eligible for refund of the service tax paid on transport of the exported goods. The appellant in this case is a 100% EOU and hence no taxes are paid. However, the export goods had to be transported from the factory to the port and service tax was paid on such transportation charges and they sought refund of the same as per the notification. It is undisputed that the conditions of the notification no. 41/2012 -ST have been fulfilled. However, the exported goods were made out of illicitly mined beach sand.

13. It would be appropriate to consider the laws allegedly violated. Sand, a minor mineral, like any other mineral, is a scarce material resource of the country and has to be used to so as to subserve the common good of people. Article 39 (b) of the Constitution of India reads as follows:

39. Certain principles of policy to be followed by the State: The State shall, in particular, direct its policy towards securing



(a);

(b) that the ownership and control of the material resources of the community are so distributed as best to subserve the common good;

....."

14. Therefore, scarce material resources are regulated by law. Entry 54 of List I (Union List) and entry 23 of List II (State List) of the Seventh Schedule of the Constitution which deal with the regulation of mines and minerals. These are as follows:

List I (Union List)

Entry 54 Regulation of mines and mineral development to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.

List II (State List)

Entry 23 Regulation of mines and mineral development subject to the provisions of List I with respect to regulation and development under the control of the Union.

15. Thus, mines and minerals can be regulated by Parliament by declaring it to be expedient in public interest to do so. Subject to this power of the parliament, states can also regulate the mines and minerals. Parliament has passed the Mines and Minerals (Development and Regulation) Act, 1957. Section 2 of this Act contains the declaration by the parliament that it is expedient in public interest to regulate mines and minerals (as required under entry 54 of the List I of the Seventh Schedule of the Constitution). It reads as follows:

2. Declaration as to expediency of Union Control.—It is hereby declared that it is expedient in the public interest that the Union should take under its control the regulation of mines and the development of minerals to the extent hereinafter provided.

16. This Act classifies some minerals as 'minor minerals' including sand which can be regulated by the State Governments while the other minerals are regulated by the Central Government. Relevant sections are as follows:

Section 2 (e): "**minor minerals**" means building stones, gravel, ordinary clay, **ordinary sand other than sand used for prescribed purposes**, and any other mineral which the Central Government may, by notification in the Official Gazette, declare to be a minor mineral;

Section 15. Power of State Governments to make rules in respect of minor minerals.—(1) The State Government may, by notification in the Official Gazette, make rules for, regulating the grant of quarry leases, mining leases or other mineral concessions in respect of minor minerals and for purposes connected therewith....."

17. Thus, sand is a minor mineral which can be regulated by the State Government under the MMDR Act. In this case, in violation of the ban imposed by the State Government, the appellant unlawfully extracted beach sand and transported and the minerals were exported. According to the Revenue since the export was from illegal mining and transportation, they cannot be given the benefit of refund of service tax paid in such illegal export.

18. The appellant's submission is that as long as the export is made, they are eligible for the benefit. Action by the State Government under MMDR Act is a separate proceeding altogether for which show cause notices have been issued by the State Government. It is also their submission that export is not controlled under the MMDR Act and there is no violation of either the Customs Act or the Foreign Trade Policy framed under the Foreign Trade (Development & Regulation) Act, 1992 and therefore, the export is not illegal even if it is held that the mining

of the sand was illegal. It is also their contention that since the mining was done by their sister unit, any illegality in mining cannot be held against them.

19. Thus, while the export itself is not illegal the product emanated from illegal mining in violation under the MMDR Act. The question is can the Government incentivize such an export by providing refund? Conversely, if tax could have been collected on an illegal activity, can such a tax be collected notwithstanding the action under some other law? Can the Government profit from an illegal activity by collecting tax on it while on the other hand, taking action against the person under some other law? Does it not amount to the Government endorsing the illegal activity? These fundamental questions do not appear to have been addressed in the context of service tax.

20. However, in the context of Income Tax, these questions were examined and answered. In the case of **Commissioner Of Income-Tax vs S.C. Kothari (1968 69 ITR 1 Guj)**, the Hon'ble High Court was dealing with a case where the assessee was engaged, inter alia, in forward trading of vegetable oils. Forward trading was subject to regulation under the Forward Contracts (Regulation) Act, 1952 in violation of which the assessee conducted some forward trading transactions and in such transactions incurred losses. The assessee also did some forward trading which was as per regulations. The assessee wanted the losses incurred in the forward trading which was allegedly illegally conducted to be taken into account to determine the tax liability which the department opposed. The assessee argued that the transactions were not illegal and also that they were eligible to

reckon the losses in calculating the income tax. The Hon'ble High Court held that the transactions were illegal because there was violation of the Forward Contracts (Regulation) Act. Nevertheless, such losses can be set off against the other profits to calculate Income tax under the Income Tax Act, 1922. Relevant extracts of this judgment are below:

"17. That immediately takes us to a consideration of the second question. This question raises a point of considerable importance to the revenue and broadly stated the point is whether a loss arising in an unlawful business is liable to be taken into account in computing the business income of the assessee under section 10 of the Income-tax Act, 1922. Now it is well-settled in England that the Income tax Act is not restricted in its application to lawful business only. Once it is found that the transaction in question is trade, manufacture, adventure or concern in the nature of trade within the meaning of the Income-tax Act, the words of the section are not to be cut down by the consideration that the trade is tainted with illegality. The taint of illegality or wrong-doing associated with income, profits and gains is immaterial for the purpose of taxation. Even if a trade is illegal, it is still a trade within the meaning of the Income-tax Act, and its income profits and gains are chargeable with income-tax. See Wheatcroft's Law of Income Tax, paragraph 1-411, page 1196, Simon's Income-tax, second edition, Volume 2, paragraph 480.

18. The principle was laid down by Rowlatt J. in the well known case of Mann v. Nash. The profit which was sought to be taxed in that case was profit arising from illegal use of gaming machines and it was held that this profit was chargeable with income-tax. Rowlatt J. pointed out that the broad position taken to repel the claim of the revenue was :

".... that the Income Tax Acts when they tax the profits of any trade, adventure, manufacture or concern in the nature of trade - because those are the widest words - impliedly exclude profits of illegal trades, or to put it in another way, that an illegal trade is not a trade within the meaning of the Income-tax Acts."

and posed the question in these terms :

"That is the question... It is simply a question of the construction of the words used: Is this a trade within the meaning of the Income Tax Acts or is it not ?"

19. The learned judge then proceeded to answer this question by saying that the trade carried on by the assessee, though illegal, was trade within the meaning of the Income Tax Act. He said:

"I myself cannot see why this letting out of the machines in a commercial way, with a view to the reception of profits in a commercial way, is not trade adventure,, manufacture or concern in the nature of trade. On the words, it clearly is. The question really is whether as a matter of construction those words are to be cut down by an overriding consideration that the trade is tainted with illegality. The great mainstay of Mr. Field's argument, quite rightly from his point of view, was the case of Duggan, decided in the Irish Free State, and that decision of the Supreme Court seems to have gone upon this principle, that no construction could be admitted which recognised that the State should come forward and seem to take a profit from what the State prohibited, because the State ought to have prevented it; and it was argued, if I may venture to say so, in a somewhat rhetorical style : Does the State keep its revenue eye open and its eye of justice closed ? I must say, I do not feel the force of that conservation at all. Would it have made any difference, I ventured to ask in the argument, if the State had kept both its eyes open and prosecuted the man for the lottery and taxed him for the profits at the same time ? That would at any rate have protected the State from the reflections which were made upon it in the words I have quoted. But, in truth, it seems to me that all that consideration is misconceived. The revenue representing the State, is merely looking at an accomplished fact. It is not condoning it; it has not taken part in it; it merely finds profits made from what appears to be a trade, and the revenue laws happen to say that the profits made from trades have to be taxed, and they say : "Give us the tax". It is not to the purpose in my judgment to say : 'But the same State that you represent has said they are unlawful'; that is immaterial altogether and I do not see that there is any contact between the two propositions."

20. The same view was taken by the Court of Session, Scotland, in *Lindsay v. Commissioners of Inland Revenue*. That case arose out of a bootlegging partnership entered into between three persons for the purpose of getting whisky into the United States by committing a breach of the laws of both Great Britain and of United States and the question was whether the profits made by them were assessable to tax. The Court of Session held that the profits arising from the sales of whisky were assessable to income tax. Lord Sands observed :

"The third question is whether the profits of the adventure are exempt from income tax because their acquisition was tainted with offence against the criminal law. The tax is imposed upon profits of trade. Crime, such as house-breaking, is not trade, and therefore the proceeds are not caught by the tax. It does not follow, however, that there cannot be a business answering to the description of trade, albeit it is tainted with illegality. Trafficking in drugs, for example, is of the nature of trade, albeit such trafficking may in the circumstances be illegal. I respectfully adopt the dictum of Lord Haldane, in delivering the judgment of the Privy Council in the case of *Smith*, that once the character of business has been ascertained as being of the nature of trade, the person who carries it on cannot found upon elements of illegality to avoid the tax."

21. Lord Morison also held that an illegal trade is a trade for the purpose of the income-tax law and "the burglar and the swindler, who carry on trade or business for profit, are as liable to tax as an honest business man, and, in addition, they get their deserts elsewhere". Finlay J. also took the same view in *Southern (H.M. Inspector of Taxes) v. A.B. Ltd.* He also regarded the question as one of construction. He said :

"The question always is, I think, a short question of construction: is there trade.... carried on within the meaning of Case I ?" and held that once you find a trade, profession, employment or vocation, and find profits derived from that, then, at once, the tax is leviable and it would be irrelevant to the taxing statute whether the trade is lawful or unlawful. **Viscount Haldane, delivering the opinion of the Privy Council, also said to the same effect while construing the Canadian income tax law in *Canadian Minister of Finance v. Smith*, where the question was whether profit made from a business of illicit traffic in liquor carried on by the taxpayer in Ontario contrary to the provisions of the Ontario Temperance Act were taxable under the Canadian income tax laws :** "Construing the Dominion Act literally, the profits in question, **although by the law of the particular province they are illicit, come within the words employed... There is nothing in the Act which points to any intention to curtail the statutory definition of income, and it does not appear appropriate under the circumstances to import any assumed moral or ethical standard as controlling in a case such as this the literal interpretation of the language employed...**"

22. These decisions clearly show that even where a trade is illegal, it would still be a trade within the meaning of

the Income-tax Act and if any profits are derived from such trade, they would be assessable to tax under the Income-tax Act. The assessee cannot be heard to say that the profits from the trade carried on by him are not assessable because the trade is illegal. To permit any such contention to prevail would be to put a premium on dishonesty. Now up to this point there was no dispute between the assessee and the revenue but at this point their argument ended. **The assessee contended that if profits arising from an illegal business are assessable to tax, equally losses arising from such business should be liable to be taken into account in computing the business income of the assessee and in principle there was no distinction between profits and losses of such business. The revenue, on the other hand, urged that losses from illegal business should not be allowed to be taken into account, for to do so would be to encourage breaches of law on the part of the assessee and to permit the assessee to profit by his own wrong. The revenue invoked the principle that no person can benefit by an unlawful act; no person can be permitted in support of his claim to put forward an act which is an unlawful act and pleaded that this principle should be projected into the income-tax law and losses arising from unlawful acts of the assessee should not be permitted to be taken into account. We do not think the contention of the revenue is well-founded on principle and we find ourselves unable to accept it. We are of the view that illegal business is business within the meaning of the Income-tax Act and if profit from illegal business are assessable to tax, there is no reason either on principle or on authority for refusing to take into account losses from illegal business.**

23. Undoubtedly, the aforesaid decisions to which we have referred were all decisions where profits made from illegal trade were sought to be taxed but the principle on which the courts held that the profits were liable to be taxed was that the illegal trade was trade within the meanings of the Income-tax Act. These decisions did not proceed upon any general principle of law that the profits from an illegal business should be taxed because not to do so would be to put a premium on dishonesty or to permit the assessee to set up his own wrong against the claim of the revenue to payment of rightful tax. This principle was, no doubt, invoked but that was for the purpose of arriving at a proper determination of the meaning of the taxing statute, namely, whether trade within it included illegal trade and it was because the courts came to the conclusion that illegal trade was included within the meanings of trade as used in the Income-tax

Acts that they regarded the profits made from illegal trade as chargeable to tax. **The basic rule which these decisions laid down was that the income-tax law is not concerned with the legality or illegality of the business. Once it is found that there is a business, legal or illegal, the income-tax law says that the profits of the business shall be chargeable to tax.** Now, the word "profits" is to be understood as observed by Lord Halsbury in *Gresham Life Assurance Society v. Styles* "in its natural and proper sense - in a sense which no commercial man would misunderstand". The observations of the Privy Council in *Pondicherry Railway Co. v. Commissioner of Income-tax* and of the Supreme Court in *Badridas Daga v. Commissioner of Income-tax*, *Calcutta Co. Ltd. v. Commissioner of Income-tax* and *Commissioner of Income-tax v. Bai Shirinbai K. Kooka* show that the profits to be assessed are real profits and they must be ascertained on ordinary principles of commercial trading and commercial accounting. What are chargeable to income-tax in respect of a business - and again we may repeat here whether legal or illegal - are the profits of the pervious year and in assessing the amount of profits of the pervious year, account must necessarily be taken of all losses incurred; otherwise we would not arrive at the true profits : vide *Commissioner of Income-tax v. Chitnavis*. The losses incurred in any particular transaction of the business must, therefore, necessarily be taken into account in order to arrive at the true profits of the business and such profits may be either positive in the sense that they are actual profits or they may be negative in the sense that they are losses. When, therefore, it is said that the profits of a business are assessable to tax, it does not mean that the profit must represent a positive figure of excess of income over outgoing. There may instead be a loss in that the outgoings may exceed the income and in such a case that would also be liable to be taken into account in the assessment of theses. **There is in principle no distinction between profits losses of a business and if the profits of an illegal business are assessable to tax, equally the losses arising from illegal business must be held to be liable taken into account in computing the income of the assessee.**

24. This appears to be clear on principle but apart from principle there are two decisions of the Allahabad High Court which support the view we are taking. The first decision to which we may refer in this connection is a decision of a Division Bench of the Allahabad High Court in the matter of *Chunnilal Kalyan Das*. The Division Bench held in this case that the profits or losses arising from wagering agreements were liable to be taken into

account in the assessment for income-tax purposes. **It is no doubt true that the wagering agreements under the law of contract are merely void and no illegality is involved in entering into wagering agreements and therefore it might be suggested that this decision would not apply to a case where the business carried on by the assessee is unlawful. But it may be pointed out that the Division Bench did not base the decision on the fact that the wagering agreements were merely void but laid down a general principle application alike to illegal transactions as to void transactions and the decision, therefore, lends support to our view.** The second decision of the Allahabad High Court in Chandrika Prasad Ram Swarup v. Commissioner of Income-tax is more in point. That was a decision given by a Full Bench of the Allahabad High Court and two of the learned judges of the Full Bench, namely, Iqbal Ahmed J. and Allsop J. dealt with the effect of illegality of the transaction on the assessability to tax. Iqbal Ahmed J. said :

"The question of the legality or illegality of transactions entered into by a firm is totally irrelevant in calculating the net profits or the loss incurred by the firm in a particular year. **For example if the assessee-firm had entered into a wagering contract which resulted in huge loss, it would not have been open to the income-tax department to decline to take that loss into account simply because the contract by way of wager was void in law.** The income assessable to tax is the actual income of an individual or of a firm irrespective of the manner in which the income was derived. Legality or illegality of transaction culminating in profit or loss is, therefore, foreign to the scope of an enquiry into the income of an individual or of a firm for the purpose of taxing the same". Allsop J. also observed : "I am also inclined to agree with my brother Iqbal Ahmed that losses actually incurred must be set off against profits even if they are incurred in pursuance of activities which are illegal."

21. More recently, the **Hon'ble High Court of Madras in the case of CIT vs K. Thangamani T.C.(A) Nos.391 and 392 of 2004** framed the following substantial questions of law:-

"1. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the refunds collected illegally by production of bogus TDS certificates by the assessee could under no circumstances be the income of the assessee?

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2. Whether in the facts and circumstances of the case, the Tribunal was right in holding that amounts earned fraudulently cannot be treated as income and taxed?"

22. Hon'ble High Court answered these questions as follows:

"23. The income tax Act considers the income earned legally as well as tainted income alike. There is nothing like an illegal income so far as the Tax Collector is concerned. Even if the assessee was prosecuted by Law Enforcing authorities for commission of offence, the income earned by the offender still would be an income liable for assessment. It is not a defence in such cases that the State is also becoming a party to the illegal act by sharing the booty.

24. There was a clear factual finding recorded by the Assessing Authority as well as Commissioner of Income Tax (Appeals) to the effect that the assessee had indulged in filing bogus TDS certificates and got refund of the amount from the income tax department. It was also the admitted case of the assessee before the income tax department as well as before the Central Bureau of Investigation during the course of investigation into the offence that he had indulged in the act of fabricating TDS certificates and collecting refund from the income tax department. It was only on account of the said factual matrix that the Assessing Officer assessed the income received by the assessee, by getting refund from the income tax department. However, the Income Tax Appellate Tribunal without any basis set aside the order of the Assessing Authority as well as Commissioner (Appeals) and as such we are of the considered view that the Tribunal committed a serious error by holding that the booty received by the assessee can under no circumstances be the income of the assessee.

25. In such view of the matter, we do not find any ground to sustain the order of the Income Tax Appellate Tribunal. Accordingly the order dated 25.10.2002 is set aside and both the tax cases are allowed. The substantial questions of law are decided in favour of the revenue."

23. The Hon'ble Supreme Court addressed this question in **COMMISSIONER OF INCOME TAX v. PIARA SINGH (1980 SUPP. SCC 166)**. The Substantial question of law before the Supreme Court was as to whether the loss which arose from the confiscation of the currency notes was an allowable deduction under Section 10(1) of the

Income Tax Act, 1922 and while upholding the judgment of the High Court and dismissing the appeal filed by the revenue, the Hon'ble Supreme Court observed thus:-

"5. In our judgment, the High Court is right. The Income Tax Authorities found that the assessee was carrying on the business of smuggling. They held that he was, therefore, liable to income tax on income from that business. On the basis that such income was taxable, the question is whether the confiscation of the currency notes entitles the assessee to the deduction claimed. The currency notes carried by the assessee across the border constituted the means for acquiring gold in Pakistan, which gold he subsequently sold in India at a profit. The currency notes were necessary for acquiring the gold. The carriage of currency notes across the border was an essential part of the smuggling operation. If the activity of smuggling can be regarded as a business, those who are carrying on that business must be deemed to be aware that a necessary incident involved in the business is detection by the Customs authorities and the consequent confiscation of the currency notes. It is an incident as predictable in the course of carrying on the activity as any other feature of it. Having regard to the nature of the activity possible detection by the Customs authorities constitutes a normal feature integrated into all that is implied and involved in it. The confiscation of the currency notes is a loss occasioned in pursuing the business; it is a loss in much the same way as if the currency notes had been stolen or dropped on the way while carrying on the business. It is a loss which springs directly from the carrying on of the business and is incidental to it. Applying the principle laid down by this Court in *Badridas Daga v. CIT* the deduction must be allowed."

24. The settled legal position is therefore, the taxation should not consider legality or illegality of the acts in question. So long as the acts in question fall under the taxing statute, tax must be paid regardless of whatever action is necessary and may be taken under any other law which has been violated. Conversely, if any benefit is available under the tax laws, it is available regardless of the illegality of the underlying act.

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25. While the above case laws all pertain to the Income Tax, the underlying principle is that if one is covered by the taxing statute, tax must be paid even for illegal acts; conversely, one is entitled to any benefits due under the tax law for such illegal exports. Just like the Income tax act, the Service tax law (Chapter V of the Finance Act, 1994), the Customs Act, 1962 and the Central Excise Act, 1944 also do not exclude illegal acts from their ambit. Therefore, illegality of the activities does not provide immunity from the tax laws.

26. This principle is also followed in the Customs Act. Under Section 112 of this Act, goods which are illegally imported are liable for confiscation under various clauses. Once confiscated, the ownership of the confiscated goods shifts to the Government. However, under section 125, the person from whom the goods are seized may be given an opportunity of redeeming them on payment of a fine if the goods are prohibited and shall be given an opportunity of redeeming them if they are other goods. This section reads as follows:

SECTION 125. Option to pay fine in lieu of confiscation (1)

Whenever confiscation of any goods is authorised by this Act, the officer adjudging it may, in the case of any goods, the importation or exportation whereof is prohibited under this Act or under any other law for the time being in force, and shall, in the case of any other goods, give to the owner of the goods or, where such owner is not known, the person from whose possession or custody such goods have been seized, an option to pay in lieu of confiscation such fine as the said officer thinks fit: Provided that where the proceedings are deemed to be concluded under the proviso to sub-section (2) of section 28 or under clause (i) of sub-section (6) of that section in respect of the goods which are not prohibited or restricted, the provisions of this section shall not apply:

Provided further that , without prejudice to the provisions of the proviso to sub-section (2) of section 115, such fine shall not exceed the market price of the goods confiscated, less in the

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case of imported goods the duty chargeable thereon.

(2) Where any fine in lieu of confiscation of goods is imposed under sub-section (1), the owner of such goods or the person referred to in sub-section (1), shall, in addition, be liable to any duty and charges payable in respect of such goods.

(3) Where the fine imposed under sub-section (1) is not paid within a period of one hundred and twenty days from the date of option given thereunder, such option shall become void, unless an appeal against such order is pending.

27. Thus, although the goods are illegally imported, duty as applicable, is collected. This rate would be the tariff rate read with any exemption notifications that may apply. Not only is the customs duty collected on the illegal imports but the benefit of any exemption notification is also available for such illegal imports. Similarly, when export goods confiscated under section 113 and thereafter allowed to be redeemed and exported, if any export duty is leviable, it has to be paid and if any exemption notification is available from such export duty, they can avail the benefit of the same.

28. Thus, unless there is any provision to the contrary, the charging sections of the tax laws apply to illegal acts as they apply to legal acts and therefore tax is leviable notwithstanding that action for the illegal actions may be taken under some other law. This does not amount to endorsing the illegal activity by the State but only the recognition that it has taken place. This taxes illegal businesses and does not absolve them of their tax liability by virtue of their illegality. Since tax is leviable on illegal activity, tax benefits or tax relief are equally available to illegal businesses.

29. The present case pertains to the Service Tax under Chapter V of the Finance Act, 1994. After 2012 amendment, relevant provisions of

this Act, viz., definitions of 'Service' and 'taxable service' and the charging section are as follows:

Section 65 B: Interpretations:

(44) "service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include—

(a) an activity which constitutes merely,— (i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or (ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of article 366 of the Constitution; or (iii) a transaction in money or actionable claim;

(b) a provision of service by an employee to the employer in the course of or in relation to his employment;

(c) fees taken in any Court or tribunal established under any law for the time being force.

(51) "taxable service" means any service on which service tax is leviable under section 66B;

SECTION 66B. Charge of service tax on and after Finance Act, 2012.— There shall be levied a tax (hereinafter referred to as the service tax) at the rate of fourteen percent. on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

30. Nothing in this Finance Act, 1994 says that the service must be legal for it to be covered as a taxable service just as the Income Tax Act, 1922 and the Income Tax Act, 1961 nowhere defined the income to be income from legal activities. The case laws discussed above with reference to income tax apply, in my opinion, equally to the service tax law as in both cases, the charging section does not exclude illegal businesses. Unless they are covered by the negative list, any illegal services (hawala operations, provision of accommodation entries, for example) are chargeable to service tax and there is no exclusion in the

charging section to illegal services. Conversely, an exemption notification which is available to legal services is equally available to illegal services or legal services provided to illegal businesses unless a contrary condition is in the notification.

31. Notification 41/2012-ST which provides for refund of the service tax is agnostic to the legality of the export and is available to both legal exports and illegal ones and also to legal exports of goods allegedly procured through illegal means such as the illegal mining in this case.

32. The appellant, is therefore, eligible for the benefit of the exemption notification no. 41/2012-ST and the impugned order is liable to be set aside.


(P. VENKATA SUBBA RAO)
MEMBER (TECHNICAL)

Pronounced on . 04.06.2021

