

D.S. Bist and Sons Vs. Commissioner of Income-tax, Delhi (Central)

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Court : Delhi

Decided On : Sep-21-1983

Reported in : [1984]149ITR276(Delhi)

Judge : H.C. Goel and; S.S. Chadha, JJ.

Acts : [Income Tax Act, 1961](#) - Sections 36 and 256(1)

Appeal No. : Income-tax Reference No. 213 of 1972

Appellant : D.S. Bist and Sons

Respondent : Commissioner of Income-tax, Delhi (Central)

Judgement :

Chadha, J.

1. This reference under s. 256(1) of the I.T. Act, 1961 (hereinafter referred to as 'the act'), at the instance of the assessed raises the following question :

'1. Whether, on the facts and in the circumstances of the case and on a true and proper interpretation of the agreement dated August 20, 1963, entered into with Shri W. L. Kohli, the Appellate Tribunal was legally justified in holding that while the assessed firm and its partners transferred certain assets to the purchasers for the respective agreed prices on the terms and conditions mentioned there in but the distribution of the total price over the assets was not in accordance with the

commercial principles

2. Whether, on the facts and in the circumstances and on a true and proper interpretation of the agreement dated August 20, 1963, the Appellate Tribunal was legally justified in restricting the allowance of loss claimed by the assessed at Rs. 4,27,898 to Rs. 1,50,000 ?'

2. The assessed is a registered firm doing business in timber. The assessment year in question is the year 1964-65 and the corresponding the previous year in the year ended September 30, 1963. The point in dispute giving rise to this reference is an amount of Rs. 4,27,898 written off in the account of one Bist Industrial Corporation Ltd. (hereinafter referred to as 'the company'). The company was floated by the partners of the assessed firm and they had a controlling interest in the company. The paid-up capital of the company was Rs. 25 lakhs with the face value of the shares being Rs. 50 lakhs. On March 30, 1963, the assessed's account with the face value of the shares being Rs. 50 lakhs. On March 30, 1963, the assessed's account with the company showed a credit balance of Rs. 9,25,693. The idea for the promotion of the company was to set up a factory. The machinery of the company was under installation and up to June 30, 1963, fixed assets to the extent of Rs. 62,18,000 were installed. Expenditure to the extent of Rs. 21,52,108 was capitalised, but it was not appropriated to the fixed assets up to June 30, 1963. An amount of Rs. 5,58,624 represented loss as per profit and loss account made up to June 30, 1963, which was appropriated to fixed capital assets in the subsequent years.

3. The partners of the assessed firm entered into an agreement on August 20, 1963, with one Mr. W. L. Kohli, managing director of M/S. Kohli Finance (P) Ltd. Under this agreement the partners of the assessed firm were to sell shares in the company of the face value of Rs. 20 lakhs was to be made by installments starting with January 7, 1967. The shares were to remain in the custody of the bank and were to be given delivery of only on payment of installments by the purchaser. In the event of failure to pay the installments, the bank was required to hand over the cover contain in share certificates together with the event transfer with the relevant transfer deeds and, in that event, the assessed was entitled to sell the said shares

in the manner prescribed in the agreement assessed firm was to transfer the debt against the company in favor of the purchaser for a sum of Rs. 5 lakhs and this amount of Rs. 5 lakhs was also to be paid by installments. This arrangement was carried out by the assessed on its part to an extent in the year of account and as consequence it scaled down its debt against the company which had risen to Rs. 9,35,839 to Rs. 5,00,000. It wrote of an amount of Rs. 4,27,898 being the amount of Rs. 4,35,839 by which the debt was scaled down as reduced by an amount of Rs. 7,941 representing credits. The assessed claimed before the ITO a deduction of the amount of Rs. 4,27,898.

4. The ITO rejected the claim of the assessed on the ground that the agreement dated August 20, 1963, between the partners of the assessed firm and Mr. Kohli was not valid and that the condition regarding the mode of sale of the shares etc., had not been complied with by either party. On appeal at the instance of the assessed, the AAC confirmed the disallowance of the amount on the ground that it represented a loss which was not incurred for business considerations and the debt had not become bad. The assessed then went in appeal to the Income-tax Appellate Tribunal.

5. The main contention of the assessed before the Tribunal was that the ITO and the AAC had taken up altogether different positions. It was pointed out that the loans advanced by the assessed to the company constituted a business activity of the firm and accordingly the loss of the amount in connection with the loan was clearly a business loss. It was pointed out that the AAC was mainly influenced by the fact that there was a debit balance in the profit and loss account amounting to Rs. 5,58,624 which, according to the AAC, greatly reduced the value of the shares of the company. The submission made was that the business of the company was in formative stage, that there were bound to be teething troubles, that in such a transitional stage according to recognised accounting principles the company was bound to capitalise the loss, that this did not in any manner reduce the value of the shares of the company, that this did not in any manner reduce the value of the shares of the company, that even otherwise the payment for the shares was to be made for the discount. It was contended that the agreement as commercially expedient. The Tribunal agreed with the stand of the assessed 'that it was not

possible in the circumstances of the case to reject the agreement as invalid or bogus'. The Tribunal further held that 'there is nothing to suggest that the parties were not dealing with each other at arms' length and there is no suggestion of any collusion between the partners of the assessed firm on the one hand and Kohli on the other. It was, therefore, but proper that the AAC proceeded on the assumption that the agreement was a valid agreement and the only controversy that could arise was regarding the exact effect of the terms of the agreement'.

6. The Tribunal then purported behind the agreement to ascertain its exact import in accordance with the realities of the situation as seen by it. The Tribunal felt that in examining that arrangement like the present one, one has necessarily to draw a harmonious and logical conclusion. The difficulties that the company were encountering, therefore, naturally depressed the value of its debts as well as the value of its shares and so far as the arrangement purported to transfer the shares at paid-up value and debt at depreciated value, it was held as a distorted presumably to enable the assessed to claim a loss which, to a certain extent, would have been suffered by the partners on their investments. It was further held that the very fact that a composite arrangement had to be arrived at in these circumstances clearly showed that it was possible to dispose of either the debt or the shares separately that it was not possible to dispose of either the debt or the shares separately and that consideration for both of them had to be considered together. Considering in accordance with commercial principles, the loss in respect of the shares was adjudged as the same in the case of the debt. The Tribunal held that assets worth Rs. 30 lakhs were transferred for a sum of Rs. 25 lakhs so that there was a depreciation to the extent of 16% both in respect of the shares and in respect of the debt. On that footing, the loss in respect of the shares and in respect of the debt. On that footing, the loss in respect of the debt was in a round sum Rs. 1,50,000 in place of Rs. 4,27,898 claimed on behalf of the assessed.

7. The main question arising in this reference is whether the distribution of the total price of Rs. 25 lakhs as agreed to between the parties to the contract dated August 20, 1963, could be re-written by the income-tax authorities. The Act does not clothe the taxing authority with any power or jurisdiction to re-write the terms of

the agreement entered into, particularly in view of the finding of the Tribunal that there is nothing to suggest that the parties were not dealing with each other at arms' length and there is no suggestion of any collusion between the partners of the assessed firm on the one hand and Kohli on the other. The commercial expediency of the contract is to be adjudged by the contracting parties as to its terms. There are no circumstances on record to show that the assessed had arranged to put a fictitious price in the agreement. The conclusion drawn by the Tribunal is based on conjectures and surmises.

8. Under the agreement dated August 20, 1963, the partners of the assessed firm were to sell shares in the company to Kohli or his nominees. The shares of the company are not regularly quoted at any recognised exchange and thus there is no authentic material available to assess its valuation. The current market value of the shares of a company may have changed or depreciated in value but the extent of the depreciation was not available. There is no measure available to gauge the depreciation. The value may change out of all recognition at a time through retention of profits, expansion of business or change in the nature of business or be adversely affected by change in the market conditions, production or even on the liquidity of the company. The price of the shares amounting to Rs. 20 lakhs was payable in five equal yearly installments of Rs. 4 lakhs each, the first installment being paid on January 7, 1967, and each subsequent installment payable thereafter on the 7th of January of each subsequent year, namely, January 7, 1968, January 7, 1969, January 7, 1970, and January 7, 1971, respectively. Thus the payment of the consideration was deferred for a considerable length of time. The agreement further provided that in the event of Kohli failing to pay the sum of Rs. 4 lakhs up to the date of the expiry of the period, the share certificates together with relative transfer deeds deposited with the bank could be received by the sellers and auctioned in the open market at the risk and cost of Kohli. There are several other factors which may come into consideration in fixing the price of the shares by two contracting parties. It is not uncommon that shares were being purchased/sold at inflated price may be made with a view to gain control over the management of the company's affairs. The agreement dated August 20, 1963, has been held to be a valid agreement entered into by two parties who were dealing with each other at arms' length. As the agreement is

genuine as held by the Tribunal and the two parties had independently come to that agreement as commercially expedient, the income-tax authorities cannot lightly overthrow that agreement unless there are cogent circumstances existing on record.

9. The assessed firm under the same agreement was to transfer the debt of Rs. 9,35,839 against the company in favor of the purchaser for a sum of Rs. 5 lakhs and this amount of Rs. 5 lakhs was also to be paid by installments. Clause 9 of the agreement deals with the assignment of the debt of Rs. 9,35,839. There is no doubt that the said sum of Rs. 9,35,839 was advanced for commercial consideration. The assessed had a controlling interest in the company which was mainly financed by them. The assessed firm was also the managing agents of the company and had received managing agency commission from the company. The authorities do not hold that the loan was not advanced in the ordinary course of business. Thus in case a loss resulted, it would be allowable as a deduction either as a bad debt or as loss incidental to business. The question at the time of the agreement was of the chances of the recovery of the debt from the company after the sale of the controlling shares in the company by the partners of the assessed firm and their family members. The assessed may have assessed that the chances of the recovery of the debt after transfer of the shares was limited and thus preferred to have realised the amount of Rs. 5 lakhs to be paid in installments. The recovery of the debt depends on several uncertain factors which may fluctuate from time to time. The debt of the company may have gone down in value, but it was for the two contracting parties to assess it.

10. We are of the opinion that the valuation of the shares and the valuation of a debt to a party proceeds on several divergent considerations. Unless there is solid material on record before the income-tax authorities, it is not permissible to re-write the terms of the commercial agreement entered into when the agreement is held as valid and genuine and not collusive and the two parties are held to be dealing at arms' length while entering into the agreement dated August 20, 1963. The invoking of the yardstick of a prudent commercial man by the Tribunal is tainted with several uncertainties in case of two different assets. No circumstances are available on record to come to the conclusion that the distribution of the total

price over the assets was not in accordance with commercial practice. Under the taxing system, it is up to the assessed to conduct his business in his wisdom. The assessed may enter into commercial transactions with another party who is ad idem with the assessed as to the terms and conditions. In the absence of any collusion between the two, it is not possible to vary the terms on the facts and circumstances of this case.

11. For the above reasons, we answer the reference in favor of the assessed and against the Revenue. The Tribunal was not legally justified in restricting the allowance of loss claimed by the assessed at Rs. 4,27,898 to Rs. 1,50,000. On the facts and circumstances of the case, we make no order as to costs.

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