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Court : Kerala

Decided On : Mar-08-1960

Reported in : [1961]43ITR554(Ker)

Appeal No. : Income-tax Referred Case No. 10 of 1957

Appellant : A.

Respondent : Thomas and Co., Ltd. V. Commissioner of Income-tax, Bangalore.

Judgement :

RAGHAVAN J. - The question of law that is referred to us in this reference under section 66(2) of the Indian Income-tax Act is :

'Whether, on the facts and circumstances of the case, the Tribunal was correct in holding that the amount of Rs. 4,05,071-8-5 claimed by the assessee company as a deduction was not admissible either under section 10(2)(xi) or 10(2)(xv) ?'

2. The assessee is public limited company carrying on business as promoters and financiers of companies as managing agents of companies and estates and as forwarding clearing and steamer agents. It has a few trading lines also. The directors of the company are A. V. Thomas S. Sankara Narayan Iyer and J. Thomas. There is another private limited company by name the Southern Agencies Pondicherry Ltd., with the three directors A. V. Thomas, S. S. Natarajan and C. S. Ramakrishan Karayalar. This company hereinafter referred to as 'the Agencies, ' was carrying on business on lines similar to those of the assessee

company. A. V. Thomas as is clear from the above is a director of both the above said companies and he has controlling powers in both of them.

3. Between September 14, 1948, and December 31, 1948, A. V. Thomas advanced large sums of money amounting to Rs. 6,05,071-8-5 out of the funds of the assessee company to the Agencies and these payments were later approved by the directors on September 1 1950 This amount has been shown in the books of the assessee company in the ledger accounts for the year 1948 relating to the Rodier Textile Mills limited as amounts paid towards purchase of shares. It may be mentioned at this stage that Agencies promoted the above company the Rodier Textile Mills Limited, and the above amount of Rs. 6,05,071-8-5 was for purchasing shares of the said Rodiers. The Rodiers was not successful and was not put into commission. Hence, on the failure of the issue of the share of the Rodiers a sum of Rs. 2,00,000 was repaid by the Agencies to the assessee company on December 7, 1951. The balance of Rs. 4,05,071-8-5 was written off in the accounts of the assessee company on December 31, 1951, and was shown as a deduction from the profits for that year. This write-off was approved by the directors at their meeting held on October 28, 1952. The chairman of the board of directors at the annual general body meeting of the assessee company held on December 15, 1952, made a reference to this debt and said that the advance was made to the Agencies to acquire shares in the Rodiers for the assessee company, with a view to gain by securing their agency for handling their goods. He also observed that since the advance became partially irrecoverable it was a trade loss sustained in the ordinary course of business of the company and hence it might be return off.

4. The assessee company claimed this amount of Rs. 4,05,072 as a bad debt in its income-tax return for the assessment year 1952-53. The Income-tax Officer disallowed the claim holding that the writing off was premature for according to him the first installment of Rs. 2,00,000 was received only on December 7, 1951 and hence it was too early to write off the whole amount in the accounts for the year ending on December 31, 1951. The assessee company appealed to the Appellate Assistant Commissioner who dismissed the appeal holding that the advance was not the business debt of the company but one made with a view to acquire capital

asset and hence the loss was a capital loss. In view of this finding the Appellate Assistant Commissioner held that the question regarding the claim of bad debt was premature or did not arise. Thereupon, the assessee company again appealed to at the Appellate Tribunal. The Tribunal dismissed the appeal on the ground that the full settlement of the debt on receipt of Rs. 2,00,000 was guided purely by personal and not business motives as there was no reason why the assessee should have received so much less than the other creditors who had been paid much more. According to the Tribunal the advances was not one made in the usual course of business but was paid only for personal motives brought about by the common ownership and management of the assessee company and the Agencies. The assessee company applied to the Tribunal for referring a question of law under section 66(1) which was dismissed. Under section 66(2) the assessee company filed O.P. No. 171 of 1956 and the High Court directed the Tribunal to refer the above question of law and hence this reference.

5. The claim for deduction is made by the assessee company under section 10(2)(xi) AND 10(2)(xv) of the Act. Before we discuss the facts and circumstances of the case we would note the ingredients of these two sub-sections. For claiming relief under section 10(2)(xi) the bad or doubtful debt should be in respect of the assessee's business or trading activity. To sustain the claim under section 10(2)(xv) the expenditure must be laid out wholly and exclusively for the purposes of the business of the assessee and secondly it should not be the nature of a capital expenditure or personal expenses of the assessee. At the outset we would dispose of one argument advanced by the learned counsel for the assessee. The learned Advocate-General urges that the view of the Appellate Tribunal that the settlement was guided by personal motives should not be sustained as the assessee involved in this case is a limited liability company and the personal motives if at all of the managing director could not be the personal motives of the assessee company. We consider that this argument has some force and therefore if the Advocate-General is able to convince us that the expenditure has been laid out wholly and exclusively for the purposes of the business and is not in the nature of a capital expenditure the assessee is entitled to succeed under section 10(2)(xi) if the learned Advocate-General convinces us that the amount claimed as a bad or

doubtful debt was really expended or incurred in respect of the assess companys business or trading activity. The learned Advocate-General has invited our attention to several clause of the object clause of the memorandum of association of the assessee company. He argues that the assessee company was established among other things,

(1) to be interested in promote and undertake the formation and establishment of such institutions,

(2) to subscribe for purchase hold underwrite etc. share stocks and debentures and

(3) assist any company financially or otherwise by issuing or subscribing for or guaranteeing the capital share etc. The argument of the learned Advocate-General is that because the assessee company had the above objects in its memorandum of association the present transaction should be considered as one falling within the usual cores of its business. But we would make it clear that the test is not whether the transaction is authorised by the memorandum of association but whether it is performed in the course of its business and thus it is in the nature of a business or trading activity of the company. We would respectfully adopt the reasoning of their Lordships of the Patna High Court in *Sitalpore Sugar Works Ltd. v. Commissioner of Income-tax*. Their Lordships observe :

'It is of course true that every transaction which is covered by the memorandum of association of the company cannot be said to be necessarily performed in the course of its business (see, for example the opinion of Lord Clyde in *Commissioner of Inland Revenue v. Hyndland Investment Co. Ltd.*) The question is not whether the transaction is within the powers of the company but the question is whether the transaction is in the nature of a business or a trading activity. In dealing with this question it is of course a relevant circumstance that the transaction is authorised by the articles of association but that circumstance is not a conclusive circumstance. It must be further shown that the company and that the connection is so proximate that the transaction can be taken to have been performed in the ordinary course of the business of the company. To put it in other words it is the nature of the companys transaction which must determine whether

it is carrying on the trade or not; it is not sufficient to demonstrate that the transaction is within the company's power (see the opinion of Lord Justice Atkin in the Korean Syndicates case).'

In *Kishan Prasad & Co. Ltd. v. Commissioner of Income-tax* their Lordships of the Supreme Court observe :

'The circumstance whether a transaction is or is not within its powers has no bearing on the nature of the transaction or on the question whether the profits arising therefrom are capital accretion or revenue income.'

Hence the question before us is not whether the company was competent to do a particular business under the object clauses of its memorandum of association but the real question is as to what was the nature of the transaction actually done by the company. So we have to find out the nature of this expenditure from the facts and circumstances of the present case. Of course the memorandum of association is a relevant circumstance in that enquiry but it is by no means conclusive circumstance. There is no evidence, much less a finding in the case that the company was actually buying and selling agencies or that the attempt in the present case was to get such an agency of the Rodiers with a view to resell the same. Therefore it has to be held that the attempt of the assessee company to get the agency of the Rodiers was not trading activity but was an attempt to acquire a capital asset with a view to make profits by operating such agency and not by reselling the same. In such circumstances the observations of their Lordships of the Supreme Court in *Kishan Prasads* case.

'It seems that the object of the assessee company in buying the shares was purely to obtain the managing agency of their mill which no doubt would have been an asset of enduring nature and would have brought them profits but was from the inception no intention whatever on the part of the assessee company to resell the shares either at a profit or otherwise deal in them',

will apply to the present case also.

6. On the contrary it is in evidence in the case that the amount now claimed to be deducted as a trade or business loss or as a bad or doubtful debt was advanced to secure the agency of the Rodiers with a view to make profits by handling their goods. The minutes of the 17th annual general meeting of the assessee company dated December 15, 1952, discloses the following in the speech of the chairman :

'You are aware that an advance was made to the Southern Agencies (Pondicherry) Ltd., to acquire for us shares in Rodier Textile Mills Ltd. It was felt that when the promotion and working of Rodier Textile Mills Ltd., became a fail accompli, our company stood considerably to gain by securing their agency for handling their goods.'

This clearly shows that the object of advancing the amount was to secure the agency of the Rodiers for handling their goods. The question before us is whether this advance was made in the course of business trade activity of the assessee company or was only for the purpose of acquiring a capital asset. In this connection we would extract a passage from the judgment of Lawrence J. in the Kings Bench Division in *Henderson v. Meade-King Robinson & Co. Ltd.* The learned judge observes at page 105 :

'It is found in the case that the loan was made solely for the purpose of obtaining a continuance of the selling agency and that there was no other motive, and the question is whether the selling agency was in the nature of capital or of revenue.'

Later on the learned judge observes :

'The question in every case is what is the object of the expenditure. The object in the present case was to secure a continuance of the respondent company's agency for the whaling companies just as the object of the payment by the company in *Athertons case 2* was to secure a contented staff. In both cases the object might have failed but the question is : was the object of the payment of a capital nature. It was no part of the business of the respondent company to buy and sell agencies. It follows that money expended in securing agencies or the continuation of agencies was not the capital which the company turned over in its business but the capital which it utilised to be the source of income which would

accrue to it for its activities in the agency. Such expenditure is not in my opinion an allowable deduction under the Income-tax Acts.'

In Commissioner of Income-tax v. Vazir Sultan & Sons his Lordship Bhagwati J. observes as follows at page 187 :

'In the case before us the agency agreement in respect of territory outside the Hyderabad State was as much an asset of the assessee's business as the agency agreement within the Hyderabad State and though expansion of the territory of the agency in 1939 and the restriction thereof in 1950 could very well be treated as grant of additional territory in 1939 and the withdrawal thereof in 1950 both these agency agreements constituted but one employment of the assessee as the sole selling agent of the company. There is nothing on the record to show that the acquisition of such agencies constituted the assessee's business or that these agency agreements were entered into by the assessee in the carrying on of any such business. The agency agreement in fact formed a capital asset of the assessee's business worked or exploited by the assessee by entering into contracts for the sale of the charminar cigarettes manufactured by the company to the various customers and dealers in the respective territories. This asset really formed part of the fixed capital of the assessee's business. It did not constitute the business of the assessee but was the means by which the assessee entered into the business transactions by way of distributing those cigarettes within the respective territories. It really formed the profit-making apparatus of the assessee's business of distribution of the cigarettes manufactured by the company. If it was thus neither circulating capital nor stock-in-trade of the business carried on by the assessee it could certainly not be anything but a capital asset of its business and any payment made by the company as and by way of compensation for terminating or canceling the same would only be a capital receipt in the hands of the assessee.'

This observation of the Supreme Court directly applies to the present case. In the present case as we have already observed the object of the advance was to secure the agency for handling the goods of the Rodiers not with a view to resell it and make a profit thereby but with a view to resell it and make a profit thereby but

with a view to make profits by operating the agency. It is also clear as we have already indicated that though the articles of association of the assessee company authorised the company to buy and sell agencies it had no such trade or business of buying and selling agencies. Therefore the advance made for securing the agency for handling the goods of the Rodiers was only an attempt to acquire a capital asset and not any set taken in the doing of a business or trade activity.

If that be so the deduction claimed by the assessee company cannot be brought under either section 10(2)(xi) or 10(2)(xv). Therefore our answer to the question referred to us is in the affirmative, against the assessee and this answer will be sent to the department. The assessee will pay the costs of the department which we fix at Rs. 250.

Question answered in the affirmative

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