

Malbros Investments Ltd. Vs. Dcit

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SooperKanoon Citation : sooperkanoon.com/73026

Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Mar-11-2004

Reported in : (2004)90ITD688(Delhi)

Judge : R Bahadur, T Chopra

Appellant : Malbros Investments Ltd.

Respondent : Dcit

Judgement :

1. This appeal is filed by the assessee against the order of the CIT (Appeals) dated 8.3.2002 for assessment year 1995-96. The only issue involved in the present appeal is against disallowance of the claim of bad debts amounting to Rs. 130 lacs.
2. During the course of hearing before us, Shri Ajay Vohra, Id. Counsel for the assessee filed a paper book dated 9.12.2002 running into 115 pages and again filed the second paper book in continuation. On behalf of the Department, Smt. Sudershan Parashar, CIT (DR), submitted written submissions. Id. Counsel in turn submitted his written comments thereon.
3. The assessee company is an investment company. During assessment year 1995-96 under reference, 51.72% shares in its equity capital were held by Eicher Tractors Limited (in short, ETL). In the subsequent assessment year 1996-97, the assessee company became 100% subsidiary of Eicher Limited. For assessment

year 1995-96, the assessee company filed its return of income declaring net loss of Rs. 58,18,510/-. In the P&L account, a sum of Rs. 130 lacs had been debited with the narration "bad debt written off". Assessing Officer made the original assessment vide order dated 13.12.1996 disallowing the claim of deduction of bad debts, inter alia, on the ground that the requisite conditions as envisaged Under Section 36 (2) of the I.T. Act, 1961 were not satisfied. CIT (A) upheld the disallowance vide order dated 8.9.1997. The assessee carried the matter in appeal before the Income Tax Appellate Tribunal and the matter was remanded back to the Assessing Officer for a fresh decision.

The High Court admitted reference by the department Under Section 256 (2) of the I.T. Act, 1961 and passed the following order on 30th August, 2000 : "In the circumstances, we dispose of this application with the observation that, the Assessing Officer shall reconsider the entire matter taking into consideration the relevant provisions of law in the background of the factual aspects and arrive at its own decision uninfluenced by any observations made by the Tribunal." 4. Assessing Officer made a fresh assessment vide order dated 16.3.2001 disallowing the claim of bad debt. CIT (A) upheld the disallowance. The assessee is aggrieved and has come up in appeal before us.

5. The factual matrix of the case concerning the controversy before us may now be indicated. M/s. ETL took over the management and control of Toto Bubbles India Limited (in short, TBIL) in July, 1991. The said company was incorporated under the Companies Act on 19.3.1981 and carried on business of manufacture and export of finished hand-tools.

The management of TBIL submitted report Under Section 23 of the Sick Industrial Companies (Special Provisions) Act, 1985 on 31st May, 1989 and again on 23rd June, 1990. After taking over the management of TBIL, ETL prepared a rehabilitation scheme on 17th August, 1991 and applied for financial assistance to financial institutions. Special terms and conditions under which the rehabilitation scheme has been sanctioned, have been placed at pages 111 to 115 of the paper book filed by the Id.Counsel. Clause III (2) of Appendix I of the scheme reads as under : "The company shall obtain from Eicher unsecured loans of Rs. 282 lacs for

financing a part of the cost of the rehabilitation scheme.

The unsecured loan shall not carry any interest during the implementation period and such unsecured loans may carry interest at the rate not exceeding the average rate of interest on the Institutional Rupee Loans for the Project or the rate of dividend paid on Equity capital, whichever is lower. The payment of interest on such unsecured loans and repayment thereof shall be subordinate to payment of interest and repayment of the Institutional Loans.

Such unsecured loans shall not carry interest for the year for which the company has not paid dividend on its equity capital. The company shall furnish an undertaking from Eicher in the form required by ICICI in this regard." The aforesaid loans of Rs. 282 lacs have been advanced to TBIL by ETL during the period 1991 - 1993. TBIL made a reference before the BIFR (Bureau of Industrial and Financial Reconstruction, New Delhi) on 27th November, 1993 under Section 15 of Sick Industrial Companies (Special Provisions) Act, 1985 whereby it was stated that the company has become a sick industrial company under Sick Industrial Companies (Special Provisions) Act, 1985.

6. TBIL took a loan of Rs. 130 lacs from M/s. Basu Associates. The letter of Basu Associates dated 24.2.1984 regarding the loan is placed at page 81 of the paper book, which reads as under : With reference to your request made to us for placement of Intercompany Deposit in your Company, we are placing the said deposit as per terms and conditions given below : It would be clearly understood that this is an Intercompany Deposit and no adjustment from this can be made in respect of other debt that we may owe to you.

On 22.3.1994, the aforesaid loan taken by TBIL from Basu Associates has been ratified by the Board of Directors of TBIL. From the extracts of the minutes of meeting of the Board of Directors, placed in the paper book at page 82, it appears that the unsecured loans have been taken by the company from Basu Associates in the normal course of its business.

There is no indication regarding any guarantee required to be given by the borrower. According to the assessee company, corporate guarantee in favour of

Basu Associates for giving the aforesaid loan of Rs. 130 lacs has been provided as per the authorization given by the Board of Directors of the assessee company on 25th March, 1994. Extracts from the minutes of meeting of the Board of Directors of the assessee company held on 25.3.1994, as placed at page 1 of the paper book, are reproduced hereunder : "RESOLVED that consent be and is hereby granted for executing a corporate guarantee in favour of M/s. Basu Associates for giving an unsecured loan for Rs. 130 lacs availed/to be availed by Toto Bubbles India Ltd. RESOLVED FURTHER that Mr. H.D.S. Malhotra or Mr. A Chatterjee - Directors or Mr. Ravi Sikka - authorised officials) hereinafter referred 'the said officials') be and are hereby authorized severally to execute the necessary documents, deeds including affixing the Common Seal of the Company thereon.

RESOLVED FURTHER that 'the said officials' be and are hereby authorized severally to discuss, settle and finalise the terms and conditions of such guarantee for and on behalf of the Company and agree dot such amendments, modifications or revisions therein as are acceptable to M/s. Basu Associates and Tot Bubbles India Ltd. The Company. The said officials of the Company are hereby authorized severally to do all acts, deeds and things including signing the necessary forms, deeds and other documents as may be required to be done in connection with the said guarantee." 7. The deed of corporate guarantee has been executed on 22.4.1994 by the assessee company in favour of M/s. Basu Associates and is placed at page 2 & 3 of the paper book.

9. M/s. Basu Associates, invoked the guarantee issued by the assessee company and the assessee vide its letter dated 28.3.1995 sent a cheque dated 31.3.1995 for Rs. 130 lacs drawn on Indian Overseas Bank towards full and final settlement of the said loan. The amount of Rs. 130 lacs due from TBIL has been written off in the books of account for the year ended 31.3.1995 and deduction of the amount has been claimed Under Section 36(1)(vii) read with Section 36 (2) of the I.T. Act, 1961.

10. The Assessing Officer did not allow the claim of bad debt mainly on the ground that the conditions as stipulated Under Section 36 (2) have not been fulfilled

inasmuch as the amount of Rs. 130 lacs has never been taken into account in computing the income of the assessee company. Assessing Officer further observed that the assessee company has apparently stood guarantee for the loan taken by the TBIL from ETL and no commission for giving a guarantee has been charged. Any guarantee given by the assessee without charging guarantee commission cannot be considered as part of business activity of the assessee.

According to the Assessing Officer, the assessee company was merely a shareholder holding 25% equity in the share capital of TBIL and any guarantee given for a loan taken by TBIL cannot be considered as part of business activity of the assessee. Assessing Officer further held that neither the claim qualifies for deduction Under Section 36(1)(vii) as bad debt nor the same can be claimed as a business loss. In support of his findings, Assessing Officer placed reliance on the decisions of Madras High Court in Amar Chand Shobha Chand v. CIT 56 ITR 594 and CIT v. T.N. Krishnaswami 150 ITR 365.

11. In appeal, the CIT (A), vide the impugned order, has upheld the findings of the Assessing Officer. CIT (A) has indicated the chronology of events in para 14 of the impugned appellate order and sustained the disallowance with the following observations and findings vide para 15 & 16 of his order : (1) M/s. Basu Associates gave an Inter Corporate Deposit of Rs. 130 lacs to TBIL on 24.2.94. The letter from M/s. Basu Associates does not mention any guarantee or any reference to the appellant company. Similarly, TBIL's Board resolution dt. 22.3.94, ratifying the unsecured loan of Rs. 1.30 crores from Basu Associates has no reference to the appellant company or any guarantee.

(2) Though the deposit was already placed with TBIL on 24.2.94, the appellant company gave a guarantee for an unsecured loan of like amount from Basu Associates to TBIL on 22.4.94.

(3) The guarantee was given by the appellant company after TBIL had made a reference to BIFR and also after BIFR had appointed ICICI as the operating agency to examine the viability of TBIL.

(4) The appellant company did not charge any guarantee commission for giving the said guarantee. The contention that this was in keeping with the conditions imposed by ICICI is not correct as the condition for not charging of interest was with reference to Eicher advancing an unsecured loan of Rs. 2.82 crores and that such unsecured loan shall not carry interest during the implementation period. It may be noted that the chronology of events furnished by the A.R. shows that during 1991 to 1993 Eicher Tractors Limited advanced Rs. 2.82 crores to TBIL. Thus there was no condition imposed by ICICI requiring the appellant company not to charge any guarantee commission from TBIL.

(5) M/s. Basu Associates made a claim for immediate refund from TBIL on 10th August, 94 and invoked the guarantee given by the appellant company on the same day. Even though the repayment of the said amount was not due and BIFR had only reached a prima-facie conclusion that TBIL had become unviable.

(6) The appellant company has paid a sum of Rs.1.30 crores to M/s.

Basu Associates vide cheque dt. 31.3.95 and the covering letter is dtd. 29th March, 95.

(7) The Financial Year for the instant assessment year ended on 31.3.95. Thus, it cannot be said that the appellant company made any efforts to realize the debt from TBIL and that such efforts had failed during the previous year.

16. In view of the above discussion, I uphold the order of the A.O. in making the addition on account of bad debts written off of Rs. 1.30 crores and hold that the entire transaction is not a business transaction, but is a sham transaction arranged between companies of the same group. The evidence filed by the A.R. clearly shows that M/s. Basu Associates gave an Inter Corporate Deposit to TBIL for which no guarantee was mentioned at the time of placing such deposit on 24.2.94. There was also no mention of a guarantee on the appellant company when the Board of Directors of TBIL ratified the unsecured loan from Basu Associates on 22.3.94. Subsequently, the appellant company gave the guarantee, terming the same to be a guarantee for an unsecured loan from Basu Associate to TBIL. Giving this guarantee was not a part of the business activity of the appellant

company as this is the only guarantee they have given and that also without charging any guarantee commission. The appellant's contention that it did not charge any guarantee commission due to conditions imposed by ICICI is not correct.

As the appellant company has made the payment of Rs. 1.30 crores to M/s. Basu Associates vide cheque dt. 31.3.95, it cannot be said that it had taken all reasonable steps to recover the amount from TBIL and had failed in such steps. It may also be mentioned that at the end of the F.R. relevant to the instant assessment year it can not be said that there was no ray of hope for recovery of the said amount from TBIL as after the winding up of the company, there may be assets from which the appellant company could have recovered the debt. Thus, it cannot be said that the debt had become bad. This transaction was not a part of the normal business transaction of the appellant company and hence cannot also be allowed as a loss incidental to business." 12. The assessee company is aggrieved with the order of the Id. CIT (A) and has come up in appeal before us.

13. Shri Ajay Vohra, Id. Counsel for the assessee, assailing the conclusion of the Id. CIT (A) on the issue, argued that deduction of the amount of Rs. 130 lacs claimed by the assessee deserves to be allowed either as bad debt written off as per the provisions of Section 36(1)(vii) read with Section 36(2) or in the alternative as a business loss incurred during the regular course of business of providing guarantees. Id. Counsel submitted that Eicher Limited, a well known industrial group in India, took over management and control of TBIL under a memorandum of understanding with the erstwhile promoters of TBIL with the sole intention to create synergy with its existing manufacturing activities and enlarged its expertise. He further added that the expectations of Eicher Group were that with its revival, TBIL would be able to give handsome returns to various companies of the group including the assessee company, which had invested 25% in the share capital of TBIL. Id. Counsel invited our attention to page 80 of the paper book which shows that after take over by the group, the group companies held the following shareholdings in TBIL :

Particulars	No. of shares	%age
Eicher Tractors Limited	76,000	6%
Malbros Investments Limited	312,000	25%
Eicher Finance Limited	312,000	25%
Pivotal Investments & Finance Pvt. Ltd.	300,000	24%
Other Financial		

Companies : ICICI 70,000 5.5% IFCI 70,000 5.5% RIICO 110,000 9%

Ld. Counsel further submitted that during revival efforts by ETL, the assessee company secured a loan for working capital from a third party, Basu Associates giving guarantee of its repayment. Shri Vohra stated that although the assessee company stepped into the shoes of Basu Associates for recovery from TBIL, there was absolutely no chance of any recovery in view of the adverse financial position of TBIL, as reflected in its balance sheet as on 31st March, 1995, showing excess of liabilities over assets amounting to Rs. 19.34 crores. The said balance sheet is placed in the paper book of the assessee company at pages 83 and 84, Id. Counsel submitted that the amount of Rs. 130 lacs was written off in the books as on 31st March, 1985 and claimed deduction as bad debt/loss incidental to business. Regarding the statutory conditions as contained Under Section 36(1)(vii) read with Section 36(2) of the Act, Id. Counsel submitted that the debt has become bad and has been written off as irrecoverable in the accounts of the assessee company for the relevant previous year. Alternatively, it is contended that the loss arising to the assessee on account of invocation of guarantee by M/s. Basu Associates is in the nature of loss incidental to business Under Section 29 of the Act. Ld. Counsel further added that the financing of industrial enterprises and giving of guarantee are specific objects of the assessee company and the guarantee was issued in consideration of securing the substantial business investment held by the assessee in TBIL. In support of his contentions, Id. Counsel placed reliance on the following decisions : 14. Mrs. Sudarshan Parashar, Id. CIT DR, putting up a stout defence of the impugned order of the Id. CIT (A) submitted that with a view to delineate the contours of the controversy arising before us, the following three questions would need adjudication : "(a) Whether on the facts and circumstances of the case, the guarantee transaction resulting in the creation of a debt by TBIL in favour of the appellant company on 31.3.1995 was a genuine transaction or a sham transaction; (b) Whether on the facts and circumstances of the case, the appellant company had executed guarantee in favour of TBIL in the ordinary course of its business.

(c) Whether on the facts and circumstances of the case, the debt of Rs. 130 lacs had become bad on 31.3.1995 itself when the appellant company paid this amount to M/s. Basu Associates." 15. Regarding the first question, Id. DR submitted that

the letter of Basu Associates dated 24.2.1994 placing an inter-corporate deposit of Rs. 130 lacs in TBIL for a period of 180 days at 19% interest does not speak of any corporate guarantee given by the assessee company. She further referred to minutes of meeting of Board of Directors of TBIL held on 22.3.1994 (placed at page 92 of the paper book) wherein it is stated that unsecured loans have been obtained by the TBIL in the normal course of business from Basu Associates to secure the loan. She stated that Board resolution passed by the Board of Directors of the assessee company on 25.3.1994 as well as the corporate guarantee executed on 22.4.1994 are subsequent events much after the loan has been actually allowed by Basu Associates to TBIL and the only intention for (sic) these subsequent developments is to foist liabilities on the assessee company for considerations other than business considerations.

Ld. CIT (DR) vehemently asserted that the letter dated 24.2.1994 which purports to be loan agreement does not say a word about the requirement of executing any guarantee by the assessee or by anybody else as a pre-condition to placing the loan with TBIL. The document dated 24.2.1994 does not indicate that any request has been made by the assessee to Basu Associates for giving any loan to TBIL. Ld. DR emphasized that the ex-post facto consent by the assessee to execute a corporate guarantee after TBIL had already availed of the loan given to them by Basu Associates, was purely voluntary and was without any legal or contractual obligation.

16. Ld. DR next referred to assessee's letter dated 25.4.1994 placed in the paper book at page 117. The corporate guarantee dated 22.4.1994 was sent to Basu Associates under this letter. Ld. DR pointed out that this letter brings out two clear admissions by the assessee. First, M/s.

Basu Associates never insisted that only the appellant should give corporate guarantee. IF at all any guarantee was insisted upon it could have been given by any company of Eicher group. Second, the appellant did not execute the corporate guarantee in the ordinary course of its business but it was executed as a "special case". From this letter dated 25.4.94 it is very clear that the guarantee was given voluntarily and the appellant was not legally or contractually obliged or bound to

give this guarantee.

17. Ld. DR next referred to page 116 of the paper book which contains a letter dated 21.2.1994 said to be written by the assessee to Basu Associates. With regard to this document, Id. DR observed vide para 23 & 24 of her written submissions as under : "23. Document No. 116 of Paper Book dated 9.12.2002 filed by the appellant is a letter dated 21.2.1994 purported to have been written by the appellant to M/s. Basu Associates. This letter is a futile attempt on the part of the appellant to create an impression that the appellant had given its guarantee dated 22.4.94 because the lender M/s. Basu Associates had asked for it. At best it can only be a conjecture. But there is nothing on record in the form of any letter from the lender from which it can be conclusively established that the lender had made it very clear to the appellant that unless a corporate guarantee was given in their favour and that too by the appellant they would not release the loan of Rs. 130 lacs. On the other hand the letter dated 12.2.94 purporting to be the loan agreement is an unequivocally worded document containing specific terms and conditions of loan and this document does not contain any condition of a corporate guarantee to be given by the appellant either before or after releasing the loan to TBIL. A unilateral or voluntary surety or guarantee as proposed in the appellant's letter dated 21.2.94 cannot be equated with a legally binding guarantee as contemplated by Supreme Court in the case of CIT v. Birla Brothers Pvt. Ltd. 77 ITR 751 discussed above in para 18.

24. Even otherwise, the appellant being a limited company, its letter dated 21.2.94 can have no legal sanctity. Nothing has been brought on record to show that the authorized signatory Sh. Ravi Sikka, who issued this letter, had previously been duly authorized by an appropriate company resolution to give to M/s. Basu Associates an undertaking that the appellant company would be executing a corporate guarantee in their favour. Such a resolution should have preceded the letter dated 21.2.94. Further, even the resolution dated 25.3.94 neither mentions the letter dated 21.2.94 nor ratifies the contents thereof or actions taken thereunder. Clearly, the letter dated 21.2.94 is an unauthorized document and no cognizance can be taken of it. It has to be ignored." Ld. DR placed reliance on the decision of Supreme Court in the case of CIT v. Birla Brothers Private Limited 77

ITR 751 and extracted the following observations of the Hon'ble Supreme Court at page 755 of the report : "Neither under any custom nor under any statutory provision or any contractual obligation was the assessee bound to guarantee the loan advanced by the bank to the selling agent. It is difficult to see how it was in the interest of the assessee's business that the guarantee was given. There was even no material to establish that the managed company was under any legal obligation to finance the selling agent or to guarantee any loans advanced to the selling agent by a third party. It is incomprehensible in what manner the guaranteeing of the loan advanced to the selling agent indirectly facilitated the carrying on of the assessee's business. It is equally difficult to appreciate the observations of the High Court that it was in the larger interest of the assessee's business that the guarantee was given." 18. Ld. DR very strongly urged that the guarantee dated 22.4.1994 is not a genuine transaction and has not been given during the course of business of the assessee company. The corporate guarantee was not given by the appellant company in the ordinary course of its business. While it is true that giving of guarantee figures in the objects clauses in the memorandum of association it is also true that in practice and in reality the appellant was not ordinarily engaged in the business of providing such corporate guarantees to its customers. It is also not denied by the appellant that it had not given any such guarantee previously in the course of its normal business and this was its first such guarantee. Moreover, if the appellant had to give any such corporate guarantee on behalf of any other person such as TBIL then it should have charged, as a normal business practice, some guarantee commission, may be at concessional rate. While the normal guarantee commission charged by banks and other financial bodies ranges between one to two percent, the appellant in this case has not charged any guarantee commission. If TBIL could agree to an interest burden @ 19% on the loan it could have certainly agreed to a guarantee charge of 1% or so which would have amounted to a petty amount of Rs. one lakh and thirty thousand only. Clearly, the guarantee was given by the appellant for other than normal business considerations whatever those may have been. The A.O. was therefore justified in drawing support from the decision of Madras High Court in the case of CIT v. T.N. Krishnaswami (1984) 150 ITR 365 where it has been held that if the assessee did not receive any consideration for giving

guarantees, the loss incurred on transaction of guarantee was not allowable as bad debt.

19. Ld. DR further added that assessee's own letter dated 25.4.1994 admits that this guarantee was given by the assessee as a "special case" implying thereby that the guarantee was not given during the ordinary course of business. Therefore, any loss resulting from such a guarantee cannot be allowed as a deduction either as a bad debt or as a business loss.

20. In the written submissions, Mrs. Prashar disputing any nexus or connection between the corporate guarantee and the assessee's own business, observed vide para 30 onwards as under : "30. There is no real link or proximity between the corporate guarantee and the assessee's own business interest At page 222 of the paper book dated 9.12.2002 the appellant has stated that "if the appellant had directly advanced the money, it would have had to be advanced without interest. By so arranging a debt that a third party advanced the money on a guarantee of the appellant, the appellant saved it's funds for better alternative utilization". The appellant had also submitted before the A.O. and before CIT(A)-XV that "the issuing of guarantee was also guided by the consideration that if TBIL could raise the necessary resources and overcome the liquidity crunch, TBIL would make substantial profits, which would subsequently enhance the value of investments held by the appellant in TBIL". Therefore, according to the appellant, the guaranteeing of debt was directly related to it's business interest.

31. But when this claim of the appellant is tested against the actual facts and ground realities it is seen that nothing could be farther from truth than this claim. Admittedly, M/s. TBIL was a potentially sick company at the time when the appellant and Eicher Tractors made investments in the said company. Admittedly, in Nov.93 M/s. TBIL made reference to BIFR as it's accumulated losses had exceeded it's net worth. As shown at page 179 of the paper book dated 9.12.2002 the losses as on 31.3.93 had accumulated up to Rs. 777.44 lacs. Thus in November 1993 it had become very clear that TBIL had become chronically sick industrial company and the appellant had full knowledge of this fact. TBIL being a group company in which the appellant had substantial equity, the appellant was

also aware of what was written against para 57 in Annexure V of Form A of the Reference to BIFR. Please see para 3 & 4 above and pages 206 and 207 of the appellant's paper book dated 9.12.2002.

With all this information available to the appellant, when it decided through its resolution in March 1994 to give guarantee to M/s. Basu Associates for Rs. 130 lacs it was crystal clear to everybody that the appellant, for reasons best known to it but for certainly imprudent reasons or reasons unconnected with its business, was sinking its good money without any legal obligation to do so.

32. The appellant was certainly living in a world of make-believe if it expected that TBIL, with its chronic industrial sickness, would be able to recover to good health in a short period of only six months because the ICD of Rs. 130 lacs had been placed with it only for six months and that also at the high interest rate of 19% when actually it had asked for earlier debt to be waived and fresh funding at a nominal cost repayable over 12 years. Please see para (II) (a) at page 207 of the appellant's paper book dated 9.12.2002." 21. Mrs. Prashar, learned CIT (DR) concluded the Department's case with the following observations in the written submissions : "33. To conclude, it is a totally false explanation of the appellant that the issuing of guarantee was guided by the consideration that with the loan money of Rs. 130 lacs TBIL would overcome the liquidity crunch and would make, within six months, substantial profits which would subsequently enhance the value of investments held by the appellant in TBIL. On the facts and circumstances discussed above, the link between the giving of guarantee and the business interest of the appellant is too weak and far-fetched and too remote to justify the appellant's act of giving guarantee and, therefore, in the light of the decision of Supreme Court in the case of CIT v. Birla Bros. Pvt. Ltd. 71 ITR 751 (SC) the deduction on account of bad debt cannot be allowed. The whole arrangement between the appellant, TBIL and M/s. Basu Associates was a sham arrangement aimed at wrongfully claiming the deduction of Rs. 130 lacs for the purpose of reducing the tax liability of the appellant.

34. The debt of Rs. 130 lacs had not become bad debt on 31.3.1995 and therefore it could not be allowed as deduction in the accounting year relevant to assessment

year 1995-96. In terms of para 3 at page 2 of the corporate guarantee, the lender M/s. Basu Associates had agreed to have assigned all their claims in favour of the appellant - guarantor upon such payment being received by the lender from the appellant guarantor. The appellant paid the amount of Rs. 130 lacs to M/s. Basu Associates vide their cheque dated 31.3.1995 of Indian Overseas Bank, Greater Kailash, Delhi. This cheque was sent to them at their Calcutta address. Obviously, the cheque could not have been presented in their bank by M/s. Basu Associates before 31st March and since it was an outstation cheque it could have been collected by the bank of M/s. Basu Associates on 31st March, 1995 and therefore their debt could not have been assigned to the appellant on 31st March, 1995. Hence the debt in question did not become a debt at all in the hands of the appellant on 31.3.1995.

35. Even if it can be said that the debt in question became the debt of the appellant on 31.3.1995 it cannot be said that the debt had become bad on the same day. The appellant had not made any effort to realize this amount or any part thereof from the debtor M/s. TBIL.

The appellant did not even write a letter to TBIL asking for return of their money. Under these circumstances and in accordance with the decisions of the various judicial authorities the debt cannot be said to have become bad and cannot be, therefore, allowed as a deduction. In fact, if one were to accept that the amount became bad debt immediately on its payment to M/s. Basu Associates one has no option but also to accept that the moment of giving the guarantee itself the amount had become bad. In other words, it must be said that giving of guarantee was not a commercial decision and in the ordinary course of assessee's business because it could not be assessee's business to guarantee the payment of bad and irrecoverable amounts. Obviously, there is no escape from the conclusion that the appellant had given guarantee to M/s. Basu Associates for some extraneous considerations." 22. In the rejoinder filed by Shri Ajay Vohra, Id. Counsel, it has been contended that even though the corporate guarantee has been executed with Basu Associates on 22.4.1994 after loan has been given to TBIL, the assessee has assured Basu Associates vide letter dated 21.2.1994 regarding the execution of the corporate guarantee for repayment of the loan. Id. Counsel

further submitted that securing of a loan of TBIL was entirely in the course of finance and investment business of the assessee and loss arising from invocation of guarantee represents business loss. According to the Id. Counsel, any of the Eicher Group companies holding equity in TBIL could have issued the guarantee and at the time the guarantee was given, it was beyond the realm of imagination that the guarantee would be invoked in future resulting in loss to the company issuing the guarantee. He stated that the Eicher group genuinely believe that given its proven track record and management expertise, it could turn around TBIL. Id. Counsel disputed the submission of the Id. CIT DR that the corporate guarantee given without authorization by a special resolution of the Board of Directors of the assessee company was invalid and contrary to Companies Act. Shri Vohra submitted that since the assessee company is engaged in business of financing industrial enterprises, provisions of Section 370(2)(b)(v) of the Companies Act, 1956, would be applicable and no such special resolution is required to be passed prior to execution of the corporate guarantee. Id. Counsel further submitted that the deduction of Rs. 130 lacs claimed as bad debt/business loss deserves to be allowed to the assessee.

23. We have carefully considered the rival submissions and also gone through the facts and material on record. Various judicial pronouncements relied upon by both sides have also been gone through by us. In our considered opinion, the assessee company is not entitled to deduction of Rs. 130 lakhs either as a bad debt Under Section 36(1)(vii) read with Section 36(2) or as a loss incidental to business.

From the factual matrix of the case, it is manifestly clear that the guarantee for securing repayment of the loan has not been given during the course of business by the assessee company and the said guarantee transaction is not incidental to the business of the assessee company.

The assessee company is a subsidiary of ETL which hold 51.72% share in the equity capital of the assessee company during the assessment year under reference. The assessee is an independent and distinct legal entity separate from its parent company ETL. The business of ETL cannot in any manner be treated as business of the assessee company. ETL entered into memorandum of

understanding on 13.7.1991 with TBIL taking over management and control of the said company. The assessee company acquired in July, 1992, 3,12,000 shares in TBIL which is 25% of its share capital. Despite acquiring 25% shareholding in TBIL, this by itself would not justify the contention that guarantee given to Basu Associates for the loan allowed to TBIL is a part of business of the assessee company. No commission or consideration for giving the guarantee to Basu Associates has been received by the assessee.

Assessee has not carried out any business of giving guarantees for loans and no such guarantee has been given to any other lender by the assessee. Therefore, the guarantee transaction is not related to business of the assessee and claim of deduction cannot be allowed either as a business loss or as a bad debt Under Section 36(1)(vii).

24. A very intriguing feature of the guarantee transaction to which our attention has been invited by the Id. CIT DR is that the guarantee transaction is much later to the date of advancing the money by Basu Associates to TBIL. As per the loan agreement at page 81 of the paper book, loan of Rs. 130 lacs has been granted on 24.2.1994 on the terms and conditions contained therein. The letter clearly says that an inter-corporate deposit is being placed with TBIL at the request of TBIL. There is no indication regarding guarantee for repayment of the loan taken from the assessee company. Even in the minutes of the meeting of Board of Directors placed at page 82 of the paper book, there is no indication regarding any guarantee given by the assessee for repayment of the loan. Guarantee has been executed by the assessee on 22.4.1994 whereas loan has been given by TBIL on 24.2.1994.

Regarding the contention of the Id. Counsel that the assessee had given an assurance to Basu Associates vide letter dated 21.2.1994 that corporate guarantee would be executed for repayment of the loan by TBIL, Id. CIT DR strenuously countered by urging that such a letter is merely a self serving document produced by the assessee which has no legal significance. We feel that the circumstances of the case clearly indicate that the loan transactions had been entered into on 24.2.1994 in the absence of any legal or contractual obligation on

the part of the assessee guaranteeing repayment of the said loan to Basu Associates. The corporate guarantee has been executed much after the date of loan without any consideration received from TBIL and in any case, there was no contractual or legal obligation on the assessee company to execute any such guarantee after the loan has already been allowed by Basu Associates on the terms and conditions as specified in the loan agreement dated 24.2.1994 available at page 81 of the paper book.

25. At this stage, we need to consider the argument of the Id. Counsel that one of the objects as included in the object clause of the memorandum of association of the company was to give guarantees and provide securities to any other company. Id. Counsel further added that guarantee transaction is thus a part of business of the assessee company. We see no merit in the contention. It is the general accepted practice that memorandum of association of the companies are drafted so as to include a broad spectrum of objects and activities in the object clause even if no such activities are actually intended to be carried out by the company. In the instant case before us, as we have already mentioned hereinbefore, no business of giving guarantees for repayment of loans etc. has been carried out by the assessee and in fact, no guarantee has been given to any party for repayment of loan. The impugned guarantee transaction is the solitary transaction which has been entered into without charging of any commission. For these reasons, we are inclined to concur with the contention of the Id. CIT DR that the guarantee furnished by the assessee to Basu Associates was not in the normal course of assessee's business and is, therefore, not liable for deduction either as a bad debt Under Section 36(1)(vii) or as a business loss.

26. In so far as statutory conditions for allowing deduction of bad debt as per Section 36(1)(vii) are concerned, Clause (i) of Sub-section (2) of Section 36 lays down : "(2) In making any deduction for a bad debt or part thereof, the following provisions shall apply - (i) no such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee."

The aforesaid condition is clearly not satisfied in the instant case inasmuch as neither has the debt been taken into account in computing the income of the assessee nor it represents money lent in the ordinary course of business of banking or money lending. Deduction, therefore, has rightly been disallowed under Section 36(1)(vii) read with Section 36(2). The alternative contention of the assessee that the loss arising out of the guarantee transaction is incidental to business has been rightly rejected by the revenue on the ground that giving of the guarantee was not a part of the business activity of the assessee company as this is the only guarantee they have given and that too without charging any guarantee commission. The contention of the assessee that it did not charge any guarantee commission due to conditions imposed by ICICI is not correct. We have already reproduced above relevant extracts from the rehabilitation scheme dated 21.7.1992, available at pages 111 to 115 of the paper book, whereby it was laid down that TBIL shall obtain from ETL unsecured interest free loans of about Rs. 282 lacs for financing a part of the cost of rehabilitation scheme. The said loan had already been advanced by ETL during the period 1991-93. There was thus no restriction either on ETL or for that matter on any other company for furnishing guarantees for loans to TBIL without consideration. Moreover, there was no legal or contractual obligation on the assessee company to furnish any guarantee for repayment of loan to TBIL without consideration. The contention of the Id. Counsel is, therefore, liable to be rejected.

27. The string of judicial authorities cited by the Id. CIT DR on behalf of the revenue fully supports the view being taken by us sustaining the disallowance of the claim of bad debt of Rs. 130 lacs by the assessee. The decision of Madras High Court in CIT v. T.N.Krishnaswami 150 ITR 365 squarely applies to the facts of the instant case before us. In the said case, it has been held that unless the guarantee is under a legal obligation to give the guarantee or the guarantee has been given as part of, or incidental to, the assessee's business the guarantor cannot claim the amount he was forced to pay under the terms of the guarantee as bad debt or as a business loss or as a business expenditure. The brief facts of the said case are that the assessee, a money-lender, had given a letter of guarantee to a company for the loan given by the company to one G for a sum of Rs. 50,000 guaranteeing due repayment of the said sum of Rs. 50,000 together with the

interest thereon. On G defaulting in the payment, the company recovered the sum of Rs. 50,000 together with interest of Rs. 2,083 from the assessee. As the steps taken by the assessee to recover the sum from G did not materialize, the assessee wrote off the sum of Rs. 52,083 as a bad debt and claimed deduction thereof in his assessment for the year 1973-74. This claim was rejected by the ITO. The Tribunal, however, held that though the transaction as a result of which the assessee came to pay Rs. 52,083 to the company was not one in the course of the assessee's money-lending business, the payment of the said amount by the assessee to the company in discharge of the loan taken by G should be taken to have arisen in the course of the money-lending business carried on by the assessee and, hence the assessee was entitled to claim the amount as a bad debt for the year 1973-74. The High Court held that the Tribunal had specifically found that the furnishing of guarantee had not been done in respect of any other borrower or on any other occasion, that giving of guarantee was not part of the assessee's line of business nor was it closely interlinked with his business as a financier. Even for the guarantee given to the company to secure repayment of the loan taken by G, he had not received any consideration and as, normally, business involves earning of profit, the assessee could not be taken to have given the guarantee in the course of his business. The deduction claimed was not, therefore, allowable either as a bad debt or as a business loss.

28. The Madras High Court in its aforesaid judgment has referred to various decisions involving more or less similar fact situations. The High Court referred to the decision of Punjab & Haryana High Court in Brij Mohan Laxmi Narain 36 ITR 147. In that case, the assessee whose main business was money-lending stood surety for certain loans advanced by a bank to a company of which the assessee was a director. When the bank pressed for payment, the assessee sold his house and paid a certain sum towards satisfaction of the loan. The amount borrowed by the company became irrecoverable. The assessee claimed the amount paid by him as an allowable deduction either as a bad debt under Section 10(2)(xi) or as a business expenditure. The court held that the transaction of guarantee did not arise out of the assessee's money-lending business and was not related to it in any way, that there was no consideration for the guarantee given by the assessee to the bank and the loss which the assessee sustained in the enforcement of the

guarantee was a capital loss and did not amount to a business loss and, therefore, the assessee was not entitled to claim deduction either under Clause (xi) or Clause (xv) of Section 10(2), nor in general terms of the I.T. Act. After referring to the findings of the Punjab High Court, their Lordships observed at page 370 of the report, "The said decision applies on all fours here. Here also, as pointed out earlier, there was no consideration for the guarantee given by the assessee to the company for repayment of the loan advanced to Shri Gandhi and, therefore, the transaction of guarantee cannot be said to have been given in the course of the assessee's business as a financier and, therefore, it has to be held that the deduction claimed is not a business loss or a bad debt arising out of the assessee's business." 29. In CIT v. Birla Bors. P. Ltd. 77 ITR 751 (SC) relied by the Id. CIT (DR), the assessee-company carried on business of banking and financing and also of managing agency. One of the managed companies appointed a selling agent and the assessee-company stood as guarantee for a loan of Rs. 6 lakhs which was advanced by a bank to the said selling agent. The selling agent failed to pay the loan which at the relevant time stood at Rs. 5,60,199 and, thereafter, the assessee treated the selling agent as his debtor for the amount. The selling agent ultimately went into liquidation and the assessee was not able to recover any part of the amount. He, therefore, wrote off the sum of Rs. 5,60,199 in its accounts and claimed deduction thereof as a bad debt under Section 10(2)(xi) of the Act. The Supreme Court laid down the proposition that unless the guarantor is under a legal obligation to give the guarantee, or the guarantee has been given as part of or incidental to the assessee's business, the guarantor cannot claim the amount he was forced to pay under the terms of the guarantee as a bad debt or as a business loss or as a business expenditure.

30. In our considered opinion, the aforesaid decisions cited by the Id. CIT DR fully support the Department's case.

31. We may next refer to the decisions relied upon by the Id. Counsel in support of his contentions. We have carefully gone through these decisions and find that these are entirely distinguishable on facts and do not support the assessee before us. The first decision cited by the Id. Counsel is CIT v. Williamson Magor and Co. Ltd. 117 ITR 85 (Calcutta). In this decision, the findings of fact recorded by the

Tribunal are that the guarantee has been furnished during the course of business of the assessee. The High Court took note of the fact that the revenue had not challenged this basic finding and, therefore, allowed the claim of bad debt. This decision has been rendered in the context of admitted facts of the case and does not support assessee's case.

32. The next decision cited by the Id. Counsel is CIT v. Gillanders Arbuthnot & Co. Ltd. 138 ITR 763 (Calcutta). This decision has been rendered in the backdrop of entirely distinguished set of facts and circumstances of the case. The assessee company bought up the share capital of the subsidiary and advanced unsecured loans to it. There was a running account between the assessee company and the subsidiary on account of which there was a debit balance of Rs. 87,546/- which was written off by the assessee during the relevant assessment year and was claimed as a bad debt. The Tribunal recorded, inter alia, the finding that loans were advanced to the subsidiary as an integral part of business activity of the assessee company. According to the High Court, the finding of fact arrived at by the Tribunal was not unreasonable or perverse and the loss was an allowable deduction. In the instant case, in view of the entirely distinguishable facts as discussed hereinbefore, this Calcutta High Court decision does not advance the case of the assessee.

33. The next decision cited by the Id. Counsel is CIT v. Amalgamations Pvt. Ltd. 226 ITR 188. This decision has been rendered on the basic premise that the business of the assessee was to furnish guarantees for debts borrowed by the subsidiary companies. In the instant case before us, no such business of furnishing guarantees has admittedly been carried out by the assessee. The decision of Hon'ble Supreme Court, therefore, does not help the assessee.

34. The next decision cited by the learned Counsel has been rendered by the Bombay High Court in the case of CIT v. K.M. Mody 141 ITR 903. The facts as recorded by the Tribunal in this case are that the said assessee carried on a composite business, one of the facets of which was film financing business and guaranteeing of loans was one of the modes of film financing. The assessee furnished guarantee for repayment of loan advanced by Western India Theatres

Ltd. to his brother for production of a film Jhansi Ki Rani. The High Court held that there was valid and sufficient consideration for the execution of the guarantee agreement. The financier was a leading distributor and had taken on lease a number of cinema theatres owned by the said assessee. The picture was a failure and the loss incurred as guarantor was allowed as business loss. The facts of the said case are thus entirely distinguishable inasmuch as the guarantee has been given during the course of business wherein giving of guarantee was an essential ingredient. The decision does not help the case of the assessee.

35. The next decision cited by the Id. Counsel is T.J. Lalvani v. CIT 78 ITR 176 (Bombay). The facts in this case are that the assessee was a dealer and commission agent in paper on a large scale. One Ebrahim Lookmanji, a big consumer of paper, had huge import licences for paper.

The assessee assisted Ebrahim Lookmanji to fully exploit his import licences by providing all the finance necessary and also by actually handling all his imports through his own bank guarantee. On these transactions, the assessee received a commission at 7 1/2 per cent on the landed costs of the imports. On 17th June, 1950, the assessee agreed to advance a loan of Rs. 6 lakhs to Ebrahim Lookmanji, as the agent for his Highness the Maharaja of Baroda. The loan advanced under this agreement as to be repaid at 6 per cent interest by annual instalments as specified therein, and as a security for the loan and interest, the plant and machinery including tools and equipment as well as the business assets and the stock-in-trade were hypothecated under the agreement. The Maharaja of Baroda changed his mind and the assessee made the advance contemplated by the agreement of 17th June, 1950, out of his own funds and resources. Two repayments of Rs. 1 lakh each were made by Ebrahim Lookmanji out of this advance in June and July, 1951.

The rest of the amount together with interest thereon remained outstanding and on the 31st March, 1953, a sum of Rs. 4,43,498/- was due and payable by Lookmanji to the assessee in respect of the said advance in the finance account. In the general goods account, which the assessee had with Lookmanji, there was a balance of Rs. 3,11,453/- on the 27th February, 1954. In respect of these

outstandings, which totalled Rs. 7,54,951/-, two suits were brought by the assessee against Lookmanji in the Bombay High Court. A consolidated decree in the two suits was passed by consent and in execution of the said decree, properties of Lookmanji were attached and brought up for auction. The amount actually realized by the auction was only about Rs. 2,10,000/- and ultimately Lookmanji was adjudged an insolvent. The assessee estimated the total amount of Rs. 7,54,951/-, which was due to him from Lookmanji under the said two accounts, as realizable only to the extent of Rs. 2,10,000/-, which was the highest bid recorded in the auction of Lookmanji's properties, and wrote off the balance of Rs. 5,44,951/- in his accounts on the 21st March, 1955, and in his assessment for the assessment year 1955-56 claimed the said amount of Rs. 5,44,951/- together with a further sum of Rs. 18,667/- which he had incurred towards legal expenses, as deduction from his profits. On these facts, the High Court held that the loan transaction was in the course of assessee's business. The financing by the assessee of the business of Lookmanji and of all its import of goods on Lookmanji's licence was an activity of the assessee in the course of its business and the loss arising on the loan, therefore, was a business loss. The facts of this case are entirely different. In the instant case before us, guarantee has been given after the loan has already been allowed by Basu Associates and this guarantee is without charging of any commission and is the only guarantee given at any time by the assessee. The Bombay decision therefore does not help the case of the assessee.

36. For the aforesaid reasons, we hold that the guarantee transaction does not form part of the normal business activity of the assessee nor is it interlinked with its business. The disallowance of claim of deduction has, therefore, been rightly sustained by the Id. CIT (A).

The appeal of the assessee is, therefore, dismissed.

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