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Court : Chennai

Decided On : Sep-11-1964

Reported in : [1965]56ITR594(Mad)

Appeal No. : Tax Case No. 181 of 1962. (Reference No. 105 of 1962)

Appellant : Amarchand Sobhachand

Respondent : Commissioner of Income-tax, Madras.

Judgement :

S. RAMACHANDRA IYER C.J. - This reference arises out of the assessment for the year 1953-54 of Messrs. Amarchand Sobhachand, a partnership concern carrying on business at Madras as chemists and druggists. They did business in camphor, mercury and other products and in making forward contracts in artificial silk yarn. Another branch of the firm's activity was in money-lending. The accounts of the business were kept on the mercantile basis. For the assessment year 1953-54, the year of account was the previous Samvat year 2008, which ended on October 18, 1952. During that year, the assessee wrote off sum of Rs. 2,68,385 as bad debt in its money-lending business. This sum represented the entire balance due in respect of its dealings with another firm at Bombay, Bojaji Sobhachand. The assessee claimed a deduction in respect of the amount aforesaid in the course of the assessment for the year referred to above. To appreciate the justification for the claim a few more facts have to be mentioned.

The assessee-firm, at the material time, consisted of two major partners and two minors, who had been admitted to the benefits of the partnership. One of the major partners and the two minors are the sons of one S. Amarchand, and all of them put together have a 11/16 share in the assessee-firm. S. Amarchand was a partner in Messrs. Bojaji Sobhachand, to be referred hereafter as the Bombay firm; his share in that firm was 16 per cent.

The Bombay firm was acting for the assessee for a considerable time. They cleared the goods indented by the assessee firm foreign parts. They also ordered for goods on behalf of the assessee and paid for them. They represented the assessee in the speculative transactions entered into by them in their dealings in art silk yarn. Moneys were sent by the assessee to the Bombay firm for the purposes aforesaid; there were also advances to the firm. There were occasions when the Bombay firm had advanced sums of money to the assessee. The account between them was single running account, where the balance shifted in favour of one party or the other. The manner of keeping the accounts does indicate that there must have been some financial arrangement between the two firms. Interest was charged in the accounts on the outstanding balance during the Samvat years 2004 and 2005. But no interest was charged for the next two years. At the end of S.Y. 2007 (October 18, 1951), the account showed a debit balance against the Bombay firm to the extent of Rs. 2,02,823-12-3, which was carried forward to the next year. In arriving at this figure, the assessee had included a sum of Rs. 2,03,147-8-0, which was the loss sustained in certain yarn forward contracts entered into on its behalf. The assessee claimed that the amount was loss in its business during the year of assessment 1952-53. Although this claim was not accepted by the Income-tax Officer, it was ultimately

allowed on appeal by the Appellate Assistant Commissioner.

The Transactions during S.Y. 2008 did not long. Even during the previous year the Bombay firm began to sustain heavy losses and it ultimately crashed during the second quarter of the year S.Y. 2008. The firm was wound up and a receiver was appointed by the court in Bombay.

From November 8, 1951, to March 16, 1952, the assessee advanced various sums of money to the Bombay firm, amounting in all to Rs. 1,04,522-5-9. This amount added to the amount carried forward from the previous year resulted in a total debit of Rs. 3,02,358-8-6 for that year. During the same period, there were some credits in favour of that firm. After deducting those credits, it was found that a sum of Rs. 2,68,385-1-3 remained as the balance. The assessee purported on October 18, 1952, to write off this amount as a bad debt. As we said, this amount represented the net debit against the Bombay firm in respect of all the transactions which the assessee-firm had with that firm, namely, (i) advances to the Bombay firm as their agent; (ii) losses sustained in the speculative transactions; and (iii) monetary advances. Therefore, the amount sought to be written off cannot entirely represent a bad debt in a money-lending transaction. If it is proved that the amount is irrecoverable, it will be a loss in all the business carried on by the assessee with the Bombay firm. The circumstances that during S.Y. 2005 and 2006 interest was debited on the outstanding amount cannot have much significance in the case, for the balance represented not merely moneys which could legitimately be stated to have been advanced as loans, but also several sums advanced to the Bombay firm as the agent of the assessee-firm.

The Income-tax Officer disallowed the claim of the assessee to write off Rs. 2,68,385-1-3, on the ground that the advances to the Bombay firm were only in the nature of accommodation and had no connection with the business which the assessee-firm had with it. In coming to that conclusion the officer was influenced by the fact that S. Amarchand, whose sons had a substantial interest in the assessee-firm, was himself a partner in the Bombay firm, and that, therefore, it was more likely that the remittances to the Bombay firm were made with a view to save the crashing firm rather than as advances for the carrying on of the assessee's business with it. An appeal to the Appellate Assistant Commissioner was unsuccessful. He held that the advances were made only as an accommodation by reason of the long-standing relationship between the two firms. He referred to the fact that no interest was charged for the outstanding balances as against the Bombay firm during the last two years. The assessee then filed an appeal before the Appellate Tribunal, which confirmed this part of the assessment. The Tribunal stated :

'It is stated that the Bombay firm was acting as the adatia of the assessee for a long time past that the balance had arisen only in the course thereof. It is also stated that the assessee had received interest on the account for a number of years in the past except for S.Y. 2007 so that it must be regarded as a money-lending account. We are unable to accept this contention. The account is purely an accommodation account to enable the Bombay firm to get over the financial crisis that was threatening it in S.Y. 2007. The fact that interest was charged cannot make it a money-lending account. The transactions in this account are totally unconnected with the normal business of the assessee.'

The Tribunal was then directed to refer the following question under section 66(2) of the Act :

'Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the debt of Rs. 2,68,385 was not one incurred in the course of money-lending business of the assessee ?'

From what we have stated above, it will be clear that the sum of Rs. 2,68,385, which was purported to be written off in the assessee's accounts on October 18, 1952, did not represent solely the loss in the money-lending part of the assessee's business.

In order to entitle the assessee to claim a deduction for a bad and doubtful debt in its money-lending business, the conditions prescribed in section 10(2)(xi) must be satisfied, namely, that it should represent a loss incurred in the course of the business which, at the time when it was a good debt, went to swell the

assets of his business. In other words, the debt should be one which would have come into the balance-sheet as a trading debt in the business or trade that is in question. The contention of Mr. Padmanabhan, who appeared on behalf of the assessee, is that notwithstanding the fact that moneys were advanced to the Bombay firm in respect of various businesses aforesaid, it should still be regarded as a debt incurred in the course of the money-lending business. Support for that contention was sought from the decision of the Allahabad High Court in *Gayaprasad and Chotey Lal, In re*. There, an assessee entered into an agreement to finance a litigant, stipulating for payment, in the event of success, of a sum of Rs. 21,000 in addition to the litigation expenses to be advanced by the assessee. But, if the case were to be lost, the assessee was to receive nothing. The case was won, and the assessee obtained a sum of Rs. 15,000 in addition to the return of the sums he had expended. The former sum was sought to be assessed to tax. The Allahabad High Court held that the sum of Rs. 15,000 was assessable as profits from business. Niamatullah J. observed :

'In the case before us there can be little doubt that the assessee embarked upon a transaction of loan in which unusual conditions were stipulated. He agreed to advance such sums as were needed by Kanhaiya Lal for the prosecution of his appeal and stipulated for its return together with profits on the sums advanced. The profits were not calculated at a given rate of interest, but in a lump sum. It may be, as the learned advocate for the assessee agrees, that there was an element of speculation in the transactions. At the same time, it cannot be gainsaid that the transaction was one of loan from which the lender expected to derive considerable pecuniary profit.'

Relying on this observation, Mr. Padmanabhan argues that, whenever a sum of money is advanced under an agreement, it should be regarded as a loan and if the creditor happens to be a money-lender, any loss sustained by the non-receipt of such advances should be regarded as a bad debt in the money-lending business. But we are by no means sure that the agreement in the Allahabad case can be said to evidence the case of a loan. A loan generally implies that there is a condition express or implied for return or repayment. In that case the express stipulation in the agreement was that the debtor was not bound to return the sum advanced if he were not to succeed in the litigation. The money received by the assessee in that case can therefore only be regarded as profits earned in the course of business, if the assessee had made it his business to finance litigation; it may also be one made in the course of an adventure in the nature of a trade if the activity was not a part of his regular business.

Learned counsel next referred to the decision of the Patna High Court in *Deoniti Prasad Singh v. Commissioner of Income-tax*, where the assessee, a zamindar, who took promissory notes from his tenants, in lieu of arrears of rent, was held entitled to claim a deduction for such of the debts represented by the promissory notes as had become bad and irrecoverable. It was found in that case that during the previous years the department had treated bonds and promissory notes taken by the zamindar for arrears of rent from his tenants as investments in the assessee's money-lending business. They, therefore, became the stock-in-trade, as it were, in such business and the 10(2)(xi). That was a plain case of a money-lender writing off a bad debt.

The decision in *Commissioner of Income-tax v. Mysore Sugar Co. Ltd.* where the manufacturer of sugar could not recover the advances made to the sugar-cane growers against future supply of sugar-cane, was concerned with the question whether it was a capital or a revenue expenditure.

It may be that where an assessee has several lines of business and a loss is sustained in them, such loss might become a trade loss, which he would be entitled to claim a deduction of in computing the assessable profits. Such a case will be slightly different from the case of a money-lender writing off a bad and irrecoverable debt.

In *Reids Brewery Co. Ltd. v. Male*, a brewery company made loans to its customers on taking security. When the security was found insufficient to cover the loans, the assessee proceeded to write off the loans as a bad debt; it was held that they were entitled to do so, as in arriving at the profit, for purposes of assessment to income-tax, the assessee would be entitled to deduct the amount of such losses or bad debts. Pollock B.,

holding that the moneys lent were capital investments in the business, observed :

'What it is is this. It is capital used by the appellants, but used only in the sense that all money which is laid out by persons who are traders, whether it be in the purchase of goods be they traders alone, whether it be in the purchase of raw material be they manufacturers, or in the case of money-lenders, be they pawnbrokers or money-lenders, whether it be money lent in the course of their trade, it is used and it comes out of capital, but it is not an investment in the ordinary sense of the word.'

The money-lending in that business being found to be an adjunct to the business in brewery, the losses on the advances made were regarded as loss in the business.

In the case of a banking or money-lending business, whether the accounts are maintained on the cash basis or mercantile system, allowance for bad and doubtful debts is given on the principle that moneys embarked in such business for the purpose of lending out to earn interest are in the nature of stock-in-trade of the person doing that business and a bad debt in such business would be in the nature of loss in the stock-in-trade. The assessee in the present case has not been able to show that the entire sum of Rs. 2,68,385 claimed by him as a loss in respect of money advanced by it to the Bombay firm is of such a nature. As the Supreme Court has observed in *A. V. Thomas & Co. Ltd. v. Commissioner of Income-tax*, a question under section 10(2) (xi) can only arise if there is a bad or doubtful debt. After citing with approval the definition of a 'debt' by Rowlatt J. in *Curtis v. J & G. Oldfield Ltd.* the Supreme Court observed :

'A debt in such cases is an outstanding which if recovered would have swelled the profits. It is not merely handed over to someone for purchasing a thing which that person has failed to return even though no purchase was made. In the section a debt means something more than a mere advance. It means something which is related to business or results from it. To be claimable as a bad or doubtful debt, it must first be shown as a proper debt.'

In the case before us, we have already found that part at least of the advances made by the assessee to the Bombay firm must have been moneys sent to its agent for discharging its own obligations to third parties. They can, by no stretch of imagination, be said to be money lent. We are, therefore, unable to regard the sum involved in this reference as a bad and doubtful debt, which the assessee would be entitled to write off as one incurred in its money-lending business.

Mr. Padmanabhan then contended that, from the materials now available, it will be easy to disassociate the moneys sent to the Bombay firm by the assessee for business purposes and those lent, and that the Tribunal should be directed to find out which part of the sum now claimed really represented advances made in the course of the money-lending transactions of the assessee. It is, however, unnecessary to consider whether this could be done at this stage, as we are of opinion that the learned counsel is well-founded in his contention that the question referred to us must be reframed to include within its ambit, trade or business loss as well. While it is undoubted law that the High Court can dispose of under section 66 only those questions which are referred to it and that it cannot raise and answer new questions which have not been so referred, it can, without raising a new and different question, reframe the question once formulated so as to bring out the real controversy between the department and the assessee, on the materials disclosed. In the present case it is plain that the assessee claimed the deduction as loss in his entire business it had with the Bombay firm. Paragraph 5 of the statement of the case submitted by the Tribunal refers to this when it states :

'The applicant submitted that they were having business transactions over several years with the Bombay firm, that the debt owed by the Bombay firm was a consolidated debt arising out of a running account and not in respect of any individual transaction of business and neither the applicant nor the Bombay firm maintained any account under separate heads of business.'

The materials on record also show that the assessee, though it claimed the deduction as a bad debt, intended

to claim it as a trade loss as well.

But even if we were to reframe the question so as to include within its ambit a trade loss, the position of the assessee, in the present case, cannot in any way be better. In order to entitle any assessee to get deduction for a trade loss, one has to see whether the loss was incidental to the carrying on of the business. There is also another fact to be taken into account. A substantial part of the sum now claimed was already allowed in the previous year as a trade loss. The rest of the moneys were advanced during S.Y. 2008 for the purpose of saving the Bombay firm, which was fast declining. Such advances were made, presumably, at the instance of S. Amarchand, who was interested in saving the Bombay firm. One of the partners of the assessee in his statement before the Income-tax Officer admitted that the Bombay firm stated sustaining losses even in S.Y. 2007. He no doubt stated that it started making some profits during the beginning of the next year. But by April or May, 1952, that firm crashed without any hope of being retrieved. Admittedly, interest was not charged on the outstanding balances during S.Y. 2007 and 2008; the reason given was that the firm was not in good circumstances.

The officers of the department found that the advances were not made in the regular course of the assessee's business with the Bombay firm but with a view to save that firm from its financial collapse. It was certainly not the assessee's business to save crashing firms. Its advances during the latter part of S.Y. 2007 and during S.Y. 2008 cannot, therefore, be regarded as either moneys lent or advances made in the course of a business. If the recovery of such moneys becomes impossible, they cannot be treated as business or trade loss.

Learned counsel would, however, contend that as the Bombay firm was making some profits at the beginning of S.Y. 2008, the advances must be regarded as one made in the course of business to finance the latter firm. But no attempt has been made by the assessee to show the exact position of the Bombay firm during S.Y. 2007 and 2008. Its accounts were not produced before the income-tax authorities. The mere fact that the firm started making some profits in the beginning of S.Y. 2008 cannot necessarily mean that it was not declining and that the assessee advanced the moneys knowing it was so declining but hoping that it might, by reason of the financial help, recover. The Tribunal has found that the advances made by the assessee were purely by way of accommodation. It is however unfortunate that the Tribunal should have used this expression as the word 'accommodation' sometimes connotes an idea of a loan. Learned counsel for the assessee was not slow to take advantage of the use of this expression by the Tribunal and he contended that as the Tribunal has found that the moneys were given by way of accommodation, they should be regarded as accepting the advances as loans. We are, however, unable to accept that contention. The word 'accommodation' in the context can only mean that the moneys were given as a favour with a view to oblige the Bombay firm and not in the course of the regular business of the assessee or as a part of the financial arrangement between the two firms. That this must be so is plain from the order of the Income-tax Officer as well as the Appellate Assistant Commissioner.

We are, therefore, of opinion that the assessee has not been able to show that the sum of Rs. 2,68,385 was either a bad or doubtful debt in its money-lending business or one representing a loss sustained in the course of its business. The question referred to us will, therefore, be answered in the affirmative and against the assessee, who will pay the costs of this reference. Counsels fee Rs. 250.

Question answered in the affirmative.

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