(1989) 09 MAD CK 0021

In the Madras High Court

Case No : Tax Case No. 408 of 1979

Commissioner of Income Tax — APPELLANT

Vs

Inden Biselers — RESPONDENT

Date of Decision : 07-09-1989

Acts Referred:
Income Tax Act, 1961 — Section 28, 28(1), 36, 36(1), 36(2)

Citation : (1990) 81 CTR 185 : (1990) 181 ITR 69

Hon'ble Judges : Venkataswami, J;V. Bhaskaran Nambiar, J

Bench : Division Bench

Advocate : J. Jayaraman, for the Appellant; Janaradhana Raja, for the Respondent

Judgement

Bhaskaran, J.—In this tax case, the following question of law has been referred at the instance of the Revenue :

Whether, on the facts and in the circumstances of the case, the sum of Rs. 2,09,768 was allowable as a deduction for the purpose of determining

the total income of the assessee for the assessment year 1963-64 ?

2. The brief facts leading to this reference are as follows :

The assessee, Inden Biselers, Madras, a firm exporting minerals and ores to foreign countries, has entered into a contract for supply of 1,50,000

tons of iron ore to the State Trading Corporation. To facilitate transport, the assessee entered into an agreement with one Central Mining

Corporation, a proprietary concern, on June 15, 1960. Under the terms of the said agreement, the said Corporation undertook to ply all its ten

Fargo trucks, purchased under the hire-purchase scheme of Sundaram Finance Private Ltd., exclusively to the assessee. The Corporation had to

transport iron ore from the mines to the assessee''s place. The assessee also, in consideration of the Corporation plying all its lorries exclusively for

the assessee, undertook to pay Sundaram Finance Private Ltd., from whom the Corporation got the lorries under a hire-purchase scheme, a sum

of Rs. 21,240.30 towards insurance premium and advance payment for the ten vehicles.

3. During the year ended March, 31, 1961, the Corporation transported 15,078 tons and the freight charges for this came to Rs. 2,10,889. For

the year ending March 31, 1962, the transport was 7,892 tons and the freight charges being Rs. 76,998. During the year ending March 31, 1963,

there was no transport by the Corporation for the assessee. The contract itself is only for a period of three years. As the Corporation defaulted in

payment to Sundaram Finance Private Ltd. in respect of the ten lorries as per the hire-purchase agreement, the assessee had to intervene and

guarantee the payment of instalments to the said Sundaram Finance Private Ltd. for the release of the lorries seized by Sundaram Finance Private

Ltd. for the default committed by the Corporation. The assessee also entered into tripartite agreement with the proprietor of the Corporation and

Sundaram Finance Private Ltd., to take over the rights under the agreement entered into between the Corporation and Sundaram Finance Private

Ltd. in respect of the ten lorries in consideration of its paying a sum of Rs. 67,104 to one Sharma on behalf of the Commissioner. However, there

is no transfer of the vehicles in the name of the Commissioner or the assessee.

4. The assessee had been paying the instalments due to Sundaram Finance Private Ltd. from the Commissioner. For the advances paid by the

assessee, the freight charges due from the assessee to the Corporation towards transport of order had been adjusted. During the year ending

March 31, 1963, a sum of Rs. 2,19,431 was outstanding from the Corporation to the assessee. The financial position of the Corporation was so

bad that the assessee could not recover any amount from the Corporation. During the last year of the agreement, viz., the year ending March 31,

1963, there was no transport of iron ore by the Corporation for the assessee. As the amount of Rs. 2,19,431, which was outstanding as on March

31, 1963, became irrecoverable, the assessee claimed the said sum for the assessment year 1963-64 as a bad debt, business expenditure or

alternatively lass to be deducted from the total income.

5. The Income Tax Officer, in the assessment order, held that there was no bad debt which satisfied the conditions of section 36(2) of the Income

Tax Act. He also held that the amount has not been proved to be in irrecoverable debt but that the amount had been advanced by the assessee not

in the course of its business but, in fact, for enabling the Corporation to acquire the lorries for its business and, therefore, it could not be said to

have been made for the purpose of the assessee''s business. In that view, he held that the claim is not allowable even u/s 37 of the Income Tax Act.

He also held that, even according to the assessee, by March 31, 1962, the amounts were irrecoverable, the financial position of the Corporation

having deteriorated to a deplorable extent. He then held that, in any event, the claim did not relate to the previous year relevant to the assessment

year 1963-64. On appeal, the Appellate Assistant Commissioner also rejected the contention of the assessee that the claim was allowable either as

an expenditure u/s 37(1) of the Income Tax Act or as a bad debt. He, however, held that Rs. 9,662.86 being the amount credited to the interest

account and subsequently written off and Rs. 3,242 being the legal charges incurred in connection with the suit filed against the Corporation were

allowable. Thus, he disallowed the claim of the assessee for deduction of Rs. 2,09,768 from total taxable income. Aggrieved by the order passed

by the Appellate Assistant Commissioner, the assessee preferred an appeal to the Income Tax Appellate Tribunal.

6. Before the Tribunal, it was contended on behalf of the assessee that the loss or expenditure incurred by the assessee by advancing for the

Corporation outstanding payments due to the financing company in order to maintain the continuous supply of iron ore to the Corporation through

its vehicles was intimately connected with the business of the assessee and was a proper deduction either on the ground f business expenditure or

as a trading loss or at any rate, as a bad debt. The advance was only to the Corporation the transport contractor, to enable the contractor to

perform his duties of transportation, the advances to be set off against freight charges. As a matter of fact, the assessee had credited to the

Commissioner substantial amounts for transport of iron ore. In view of the defective manner win which the Corporation carried on the transport

business and the grand committed by it, its lorries were seized by the creditors and, therefore, the assessee had to step in and pay the instalments in order to continue the transport of iron ore by the assessee to the State Trading Commissioner. Thus, it was purely a business and working

arraignment by the assessee to advance the necessary amount for facilitating the contract.

7. The Department contended that the amount advanced is not an unrealised sale price, that the amount was advanced to some one absolutely

foreign to the assessee''s business, that it is merely an advance, that its realisation did not go to swell the profits of the assessee and that, therefore,

the claim cannot be allowed as a bad debt. It is also conceded that it is not an expenditure but a mere advance by the assessee also cannot claim

the same as an expenditure u/s 37(1) of the Income Tax Act. It is further contended that the amount has been advanced to enable the Corporation

to purchase the lorries and, therefore, the advance related to a capital item and not incidental to the assessee''s business in view of the fact that a

tripartite agreement has been entered into between the assessee, the Corporation and Sundaram Finance Private Ltd., under which the assessee

had a right to take over the lorries which originally Sundaram Finance Private Ltd. had, under the hire-purchase agreement entered into by it with

the Corporation.

8. The Accountant Member and the Judicial Member of the Income Tax Appellate Tribunal passed separate orders. The Accountant Member

held that the claim of the assessee for the deduction of a sum of Rs. 2,09,768 is allowable on all the three counts as an expenditure u/s 37(1) of the

Income Tax Act. He has also held that it is a bad debt u/s 36(1)(vii) of the Income Tax Act and also a trading loss while computing the income

chargeable to Income Tax under the head ""Profits and gains of business or profession"" u/s 28(1) of the Income Tax Act. For coming to the above

conclusion, he had elaborate discussion and cited several decisions. Finally, he allowed the appeal holding that the assessee is entitled to deduction

of a sum of Rs. 2,09,768 on all the grounds, viz., as business expenditure, bad debt as well as trading loss.

9. The Judicial Member agreed with the Accountant Member with regard to the finding that the loss is allowable as a trading loss. However, he

disagreed with the Accountant Member that the same is also allowable under other grounds, viz., as business expenditure and bad debt. The result is, the assessee succeeded before the Income Tax Appellate Tribunal with the result that the entire sum of Rs. 2,09,768 was ordered to be

deducted from the total income of the assessee. At the instance of the Revenue, the Tribunal has formulated the question of law as stated earlier

and referred it to this court for opinion.

10. Thiru J. Jayaraman, senior standing counsel for Income Tax, contended that the said amount is not deductible from the income of the assessee

for the assessment year 1963-64 under any of the three grounds as found by the Accountant Member. As stated earlier, though the Revenue had

contended earlier that the expenditure will be of capital nature, learned senior standing counsel for the Department did not pursue that point, before

us. The admitted fact is that the assessee did not acquire the vehicles pursuant to the tripartite agreement between the assessee, the Corporation

and Sundaram Finance Private Ltd. though the assessee had advanced money to the Corporation to pay off its dues payable to Sundaram Finance

Private Ltd. As pointed out earlier, both the Accountant Member and the Judicial Member of the Tribunal agreed in giving deduction of the said

sum from the total income of the assessee on the ground of trading loss. Therefore, it has to be seen whether the said amount can be treated as a

trading loss.

11. u/s 28 of the in computing the income chargeable to Income Tax, a loss other than capital loss, which is merely incidental to the trade, is

allowable on ordinary principle of commercial trade though it may not be allowable under any of the specific clauses either u/s 36 or u/s 37 of the

Income Tax Act. In the decision reported in Badridas Daga Vs. The Commissioner of Income Tax, , it has been held as follows (headnote) :

While section 10(1) of the Indian Income Tax Act, 1922, imposes a charge on the profits and gains of a business, it does not provide how these

profits are to be computed. Section 10(2) enumerates various items which are admissible as deductions but they are not exhaustive of all

allowances which could be made in ascertaining the profits of a business taxable u/s 10(1). Profits and gains which are liable to be taxed u/s 10(1)

are what are understood to be such under ordinary commercial principles.

When a claim is made for a dedication for which there is no specific provision u/s 10(2), whether it is admissible or not will deepened on whether, having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and be incidental

to it. The loss for which a deduction is claimed must be one that springs directly from the carrying on of the business and is incidental to it, and not

any loss sustained by the assessee even if its has some connection with his business. IF that is established, then the deduction must be allowed,

provided that there is no provision against it, express or implied, in the Act.

Loss sustained by a business by reason of embezzlement by an employee or agent is not an admissible deduction u/s 10(2)(xi) of the Act, for when

an agent or employee misappropriates moneys belonging to his employer in fraud of him and in breach of his obligations to him, it cannot be said

that he owes these moneys under an agreement. Nor can a claim for deduction of loss by embezzlement by admitted u/s 10(2)(xv), because

moneys which are withdrawn by the employee out of the business till without authority and in fraud of the employer can in no sense be said to be

an ''expenditure laid out or expended wholly or exclusively'' for the purpose of the business.

Loss resulting from embezzlement by an employee or agent in a business is, however, admissible as a deduction u/s 10(1) of the Indian Income

Tax Act if it arise out of the carrying on of the business and is incidental to it. It makes no difference in the admissibility of the deduction whether

the employee occupies a subordinate position in the establishment or is an agent with large powers of management. It is a question turning on the

facts of each case whether the embezzlement in respect of which deduction is claimed took place in the carrying on of the business.

12. Section 10(1) of the old Act, corresponding to section 28(1) of the present Act, deals with profits and gains of business or profession. Section

10(2)(xi) of the old Act, corresponding to section 36(1)(vii) of the present Act, deals with bad debt. Section 10(2)(xv) of the old Act,

corresponding to section 37(1) of the present Act, deals with expenditure incurred exclusively for the purpose of the business by the assessee.

According to the above decision, even though the expenditure is not admissible for the computation of the total income either as a bad debt or as

an expenditure wholly incurred for the purpose of business, still, it can be allowed as an expenditure as a trading loss if it arises directly from carrying on the business and in incidental to the business.

13. In that case, the assessee carried on business as money-lender, dealer in shares and bullion and commission agent through an agent who held a power of attorney which conferred on him large powers of management including authority to operate on bank accounts. The agent withdrew from the bank account large amounts and applied them in satisfaction of his personal debts incurred in speculative transaction. On being informed on the true state of affairs, the assessee canceled the power of attorney and called upon the agent to pay the amounts withdrawn by him. He also filed a suit against the agent to recover the amount drawn by him from the bank account. He was able to recover only a sum of Rs. 28,000 leaving a balance of Rs. 2,02,442, which became irrecoverable. The assessee claimed that amount as trading loss in computing his income. The Income Tax Officer disallowed the claim holding that it was not a trading loss. On a reference to the High Court by the Tribunal at the instance of the assessee, the High Court also answered the question against the assessee. On appeal by special leave to the Supreme Court, the Supreme Court allowed the claim of the assessee holding as follows (headnote) :

(i) the theory that once moneys were put into the bank they had ''got home'' and their subsequent withdrawal from the bank would be de hors the business was inapplicable to a business such as banking or money-lending;

(ii) as the business of the appellant consisted in lending moneys, realising them and making fresh loans, a continuous operation on the bank account by the agent was incidental to the conduct of the business;

(iii) once it was established that the agent was in charge of the business, that he had authority to operate on the bank account, and that he withdrew moneys in the purported exercise of that authority, his action was referable to his character as agent and any loss resulting from misappropriation of funds by him was a loss incidental to the carrying of the business; and

(iv) the loss sustained by the appellant as a result of misappropriation by the agent was one which was incidental to the carrying on of the business and should, therefore, be deducted in computing the profits u/s 10(1) of the Act.

14. In the decision reported in The Commissioner of Income Tax Vs. The Mysore Sugar Co., Ltd., , the facts are briefly as follows : The assessee

was a manufacturer of sugar. He used to advance seedings, fertilisers and money to sugarcane growers under an agreement by which the growers

agreed to sell the next crop of the sugarcane grown by them exclusively to the assessee at current market rates and to have the advances adjusted

towards the price of the sugarcane to be delivered to the company. In a certain year, owing to drought, the sugarcane growers could not grow

sugarcane and the advances remained unrecovered. A Committee appointed by the Government recommended that the assessee should ex gratia

forgo some of the dues. The assessee, accordingly, waived its rights in respect of Rs. 2,87,422 and claimed this amount as a deduction under

sections 10(2)(xi) and 10(2)(xv) of the old Income Tax Act. The Income Tax Officer declined to make deduction as claimed by the assessee. On

appeal, the Appellate Assistant Commissioner has also rejected the claim of the assessee. On further appeal, the Tribunal also held that the claim

will not fall u/s 10(2)(xv) of the old Act as an expenditure wholly for the purpose of the business or u/s 10(2)(xi) of the old Act as a based debt,

since the advances were made a to ensure a steady supply of quality sugarcane and the loss, if any, must be taken to represent a capital loss and

not a trading loss. However, the Tribunal referred the question for the opinion of the High Court. The Mysore High Court held that the expenditure

was not in the nature of a capital expenditure but is only a revenue expenditure and as such deductible in computing the profit of the business for

the year in question u/s 10(1) of the old Act. On appeal by the Department, the Supreme Court upheld the order of the High Court holding that it

is a revenue expenditure. The Supreme Court, while considering the claim for deduction of any expenditure from the total income of an assessee,

observed as follows (at p. 652) :

The clauses (sub-clauses u/s 10(2) of the old Act) expressly provided what can be deducted; but the general scheme of the section is that profits

or gains must be calculated after deducting outgoing reasonably attributable as business expenditure but so as not to deduct any portion of an

expenditure of a capital nature. If an expenditure comes within any of the enumerated classes of allowances, the case can be considered under the

appropriate class; but there may be an expenditure which, though not exactly covered by any of the numerated classes, may have to be considered in finding out the true assessable profits and gains.

15. In the decision reported in Commissioner of Income Tax U.P. Vs. Nainital Bank Ltd., , the facts are, the assessee, a bank, carried on the

business of banking having many branches. In the course of its business, large amounts were kept in the premises of the branch office at Ramnagar.

There was a dacoity and cash and jewels were carried away by the dacoits. During the relevant assessment year, the bank claimed the said

amount as a deduction in computing its income from the banking business on the ground that it was a trading loss. The Income Tax Officer

disallowed the claim on the ground that it was not a loss incidental to the banking business. On appeal, both the Appellate Assistant Commissioner

and the Tribunal confirmed that finding. The Allahabad High Court held that the loss by dacoity was incidental to the banking business and was,

therefore, a trading loss and that the assessee was entitled to a deduction of the same u/s 10(1) of the old Act. The revenue appealed to the

Supreme Court. The Supreme Court unheld the finding of the Allahabad High Court observing as follows (at p. 715) :

The retention of the money in the bank is a part of the operation of banking. The retention of money in the bank premises carries with it the

ordinary risk of its being subject of embezzlement, theft, dacoity or destruction by fire and such other things. Such risk of loss is incidental to the

carrying on of the operations of the business of the banking. In this view, we are clearly of the opinion that the loss incurred by dacoity in the

present case is incidental to the carrying on of the business of banking.

16. In the decision reported in Indore Malwa United Mills Ltd., Indore Vs. State of Madhya Bharat and Others, , the facts are, the assessee-

company, carrying on the business of manufacturing cloth, was empowered by its memorandum of association to borrow money for purposes of its

business and invest its funds in loans. The managing agents borrowed on behalf of the company more amount than the requirements of the

company''s business and invited the surplus funds, in pursuance of the resolution of the directors, with themselves. The managing agents went

liquidation and the debt due from them to the company became irrecoverable and bad debt. The assessee-company claimed deduction in respect

of the same. The assessing authority allowed only a portion as bad debt and disallowed the amount due from Karimbhai Ibrahim and Sons Ltd. on

the ground that the said borrowings were not made for the purpose of the business of the company. On appeal, the appellate authority also took

the same view. On further appeal, the Madhya Pradesh High Court confirmed the finding of the appellated authority on the ground that the losses

incurred by the company were really de hors the business of the company, though they might involve fraudulent conduct of the managing agents.

The Supreme Court, while allowing the appeal, held as follows :

...bringing into the company''s till a larger amounts than the company''s business demanded at a particular point of time by agents would not make

the borrowings or the lending of money to themselves any the less incidental to the sanctioned business operations and loss being incidental to the

company''s business, claim for its deduction must be allowed.

17. In the instant case, the assessee carried on the business of exporting iron ore to foreign countries through the State Trading Corporation. In

order to supply 1,50,000 tons of iron ore to the State Trading Corporation, the assessee entered into an agreement with the Corporation, a

transport company, which owned ten lorries under the hire-purchase agreement entered into by it with Sundaram Finance Private Ltd. In order to

carry on the business of regular supply of iron ore by the assessee to the State Trading Corporation, the Corporation had to regularly transport

iron ores from various mines to the places indicated by the assessee. As the transport Corporation was in financial strain, in order to pay off its

dues under the hire-purchase agreement to Sundaram Finance Private Ltd. and to clear off its other debts, the assessee had been making advances

to the transport Corporation on the understanding that the freight charges payable by the assessee to the Corporation for transporting iron ore are

to be adjusted from the advances paid by the assessee. the statement of case shows that, in fact, during the first year of the three-year period, the

freight charges payable by the assessee to the Corporation came to Rs. 2,10,389. During the second year of the agreement also, a sum of Rs.

76,993 has been paid by the assessee as freight charges. Only during the third year, the Corporation did not transport any iron ore and, as such,

no liability as freight charges payable by the assessee to the Corporation arose. After adjusting the freight charge towards the liabilities, a sum of

Rs. 2,09,768 remained payable by the Corporation to the assessee at the end of the assessment year 1963-64.

18. Transport of iron ore is absolutely necessary for the business of the assessee. In order to maintain a regular supply, the assessee had advanced

money to the Corporation. However, owing to the default committed by the Corporation, a large sum remained payable to the assessee by the

Corporation even after adjusting freight charges. As pointed out earlier, the advances do not result in making a capital asset. Therefore, in the light

of the various decisions cited, there is no difficulty in holding that the amount claimed by the assessee was only a revenue amount and as such,

trading loss incurred incidental to the business of the assessee. We, therefore, answer the question in favour of the assessee and against the

Revenue.

19. Though learned senior standing counsel for the Revenue argued at length questioning the finding of the Accountant Member of the Tribunal that

the claim can also be allowed as a bad debt falling u/s 36(1)(vii) of the Income Tax Act as well as an expenditure wholly incurred for the purpose

of the business falling u/s 37(1) of the Income Tax Act, we feel that it is not necessary to go into that contention to answer the reference as we

agree with the finding of the Tribunal that the expenditure is allowable as a trading loss. As that conclusion is sufficient, we answer the reference

against the Revenue and in favour of the assessee. The Revenue will pay the costs of the assessee. Counsel''s fee Rs. 500.