
(1992) 11 BOM CK 0061

In the Bombay High Court

Case No : Income-tax Reference No. 434 of 1977

Indequip Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 16-11-1992

Acts Referred:

Income Tax Act, 1961 — Section 10(2), 256(2), 271(1), 28, 36

Citation : (1993) 202 ITR 417

Hon'ble Judges : U.T. Shah, J;B.P. Saraf, J

Bench : Division Bench

Advocate : S.J. Mehta, for the Appellant; Dr. Balasubramaniam, for the Respondent

Judgement

Dr. B.P. Saraf, J.—By this reference u/s 256(1) of the Income Tax Act, 1961, made at the instance of the assessee, the Income Tax Appellate Tribunal has referred the following question of law to this court for opinion :

"Whether the claim of the applicant to deduct u/s 28 or section 36, Rs. 1,38,148 in computing its income from business has been rightly rejected ?"

2. The assessee is a private limited company. It carried on business as dealers and suppliers of mill gin stores and clothes. It was also supplier of Burshane gas. The relevant assessment year is 1970-71. The previous year was the year ended on March 31, 1970.

3. In the course of its business the assessee used to sell coal, glue products, Burmashell oil and allied products to various textile mills including one M/s. Manekchowk and Ahmedabad Manufacturing Company Limited of Ahmedabad. It was one of the biggest purchasers of the products supplied by the assessee. From the year 1962 onwards, the aforesaid textile mill was in financial difficulties and the assessee started advancing monies to it from time to time. The advances were recorded by the assessee in its books of account in a separate loan account opened for that purpose in the name of the textile mill company. At the end of

the previous year relevant to the assessment year 1968-69, the net debit balance in the loan account was Rs. 16,46,593 and that balance swelled to Rs. 18,38,837 at the end of the previous year relevant to the assessment year 1970-71. In view of the unsatisfactory financial condition of the textile mill company and also the various proceedings going on in different courts for recovery of debts from it, the assessee-company, on its own, by a resolution decided to write off 50% of the amount due from it on the goods account and 50% on the loan account. This was also in terms of the consent given by the assessee-company in some proceedings pending before the High Court in regard to the winding up of the textile company. This entry, however, was later reversed by the assessee. Fresh entries were made whereby the entire amount due on the goods account was first written off as a bad debt and the balance left thereafter amounting to Rs. 1,38,146 was only written off from the loan account. Both these amounts were claimed as deductions by the assessee in computing its taxable income for the relevant assessment year.

4. The Income Tax Officer did not accept the reversal of the entries by the assessee. According to him, the amount attributable to the written off debt from goods account was only 50 per cent. thereof and the balance 50 per cent. was on account of the amount of loan advanced by the company. He, therefore, allowed as deduction only the amount written off in the goods account and disallowed the amount which was written off in the loan account as the same, in his opinion, amounted to capital loss which was not an allowable deduction u/s 36 or any other provision of the Act, which was relevant in computing the income u/s 28 of the Act. On appeal, the Appellate Assistant Commissioner approved the decision of the company to write off the full amount from the goods account. The Appellate Assistant Commissioner, therefore, allowed full deduction on account of the amount to the extent of debts which were due from the textile mill company on account of goods supplied to it as a bad debt u/s 36(1)(vii) of the Act. He, however, did not allow the deduction for the balance of Rs. 1,38,148 which was written off from the loan account as, according to him, it was a capital loss which was not deductible in computing income u/s 28 of the Act. The decision of the Appellate Assistant Commissioner was approved by the Tribunal. As a result, the claim of the assessee to the extent of Rs. 1,38,148, which was the amount written off from the loan account, remained disallowed. According to the assessee, the Tribunal was not justified in its conclusion. Hence the reference.

5. Learned counsel for the assessee submits that the assessee is entitled to claim deduction not only of bad debts which are specifically provided for u/s 36(1)(vii) of the Act, but also such other losses, which are incurred by him in connection with his business. According to learned counsel, the loans were given by the assessee to the textile mill company to enable it to run the mill, which was in financial difficulties. The object of the loan, according to the assessee can go on supplying goods to it. With this object in mind, the assessee, despite the difficult financial position of the textile mill company, not only continued to supply goods to it on credit but also started advancing money by way of loan. The activity of

advancing loan, in addition to selling goods, started in the year 1962 and continued all throughout thereafter. It is an admitted position that the assessee maintained two different accounts. One was the goods account which reflected the amount due from the textile mills on account of supply of goods on credit and another the loan account, which reflected the amount of loan given by it. The approach of all the authorities below including the Tribunal while disallowing the claim of the assessee for deduction of any part of this loan written off by the assessee was that it was a capital loss. It had nothing to do with the business of the assessee.

6. The contention of the assessee is that all the authorities including the Tribunal failed to look at the controversy from the angle of a businessman which they were obliged to do. If they had done so, this claim would have been allowed. Reliance in this connection has been placed on the decision of the Supreme Court in Indore Malwa United Mills Ltd., Indore Vs. State of Madhya Bharat and Others, and the decision of this court in Vassanji Sons and Co. P. Ltd. Vs. Commissioner of Income Tax, Bombay City-I, and T.J. Lalvani Vs. Commissioner of Income Tax, Bombay, .

7. We have carefully gone through these three decisions. The principles for allowing the claim for deduction of such amounts in computing business income are well settled. It was held by the Supreme Court in Badridas Daga Vs. The Commissioner of Income Tax, (headnote) :

"When a claim is made for a deduction for which there is no specific provision u/s 10(2), whether it is admissible or not will depend on whether, having regard to the 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 it 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."

8. This principle was followed by the Supreme Court in the case of Indore Malwa United Mills Ltd., Indore Vs. State of Madhya Bharat and Others, The Bombay High Court in the case of T.J. Lalvani Vs. Commissioner of Income Tax, Bombay, also allowed the deductions in view of the peculiar facts of that case as in that case there was no evidence for the finding recorded by the Tribunal that the loss in question had not been incurred by the assessee in the course of business so as to be deductible from the income of the business under the provisions of the Act. In Vassanji Sons and Co. P. Ltd. Vs. Commissioner of Income Tax, Bombay City-I, , this court allowed the deductions in view of its findings that the object of advancing money in that case was to provide finance for the company in which the assessee was substantially interested and that the debt in question could be regarded as springing directly from the carrying on of the business or trade and incidental to it. It is in this context that this court observed that the test and the

approach to be applied in such cases much be that of a businessmen. In this case it was made clear by this court that if such advances are only regarded as merely having some connection with the trade or business of the assessee, the loss on account thereof cannot be allowed as a deduction.

9. We have carefully considered all the three decisions referred to above. The principles that emerge from these decisions are well-settled. We are also in agreement with the observation of this court while determining such controversies, the approach of the authorities concerned should be that of a businessman. We want to simply add that the business approach would essentially mean the approach of a prudent businessman. The authorities as well as the court, while considering such controversies, should keep in mind a prudent businessman and consider whether he would have, under the given circumstances, acted in the manner the assessee did. Let us examine the facts of the present case from this test. The facts are clear. The textile mill company's financial condition was bad not only in the year under consideration, but as far back as in 1962. The assessee was simply a supplier of goods to it and the textile mill company was one of its buyers - may be big or the biggest. In any event it was not the sole buyer of the goods sold by the assessee. It is not a case where with the closure of the mill, the assessee's business also would have been closed. In such a situation, the connection of the assessee that it was one of its important customers, though one of the relevant to the extent that the assessee, in the given circumstances, might be justified in continuing the supply of goods on credit in view of its past business relations and in view of its importance in the list of buyers. But when the financial condition of the buyer company was dwindling, which ultimately resulted in its winding up, lending money in addition to supplying the goods on credit, in our opinion, by no stretch of imagination can be said to be the conduct of a prudent businessman. We need not go into any other factor that might have weighed in the mind of the assessee while advancing the loans in question to the textile mills in the instant case as we are certain in our mind that it had no connection with the trade or business of the assessee. The loan was not incidental to the carrying on of the business of supply of goods by the assessee. Under these circumstances, it is difficult to hold that such loans are loans in connection with the trade or business or incidental to the carrying on of the business of the assessee. The bad debt of the same or any part thereof, therefore, cannot be treated as an allowable deduction. It is nothing but plain and simple capital loss. As such, we do not find any infirmity in the conclusion arrived at by the Tribunal in the instant case.

10. In the premises aforesaid, the question referred to us is answered in the affirmative and in favour of the Revenue.

11. No order as to costs.