INCOME-TAX REFERENCE

Before Mr. M. C. Chagla, Chief Justice and Mr. Justice Tendolkar.

THE COMMISSIONER OF INCOME-TAX, BOMBAY CITY I, BOMBAY, APPLICANT *v.* MESSRS. JAGANNATH KISONLAL, A FIRM, BOMBAY, RESPONDENT.*

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Indian Income-Tax Act (XI of 1922), s. 10 (2) (xv)—Moneys borrowed by assessee and another on joint and several liability from bank in accordance with commercial practice of assessee's business—Moneys so borrowed divided equally and used by assessee and joint-debtor in their businesses respectively—Assessee paying to bank other debtor's liability on his default and receiving only portion of moneys so paid to bank from Official Assignee on such debtor's insolvency—Whether assessee entitled to claim deduction for balance under s. 10 (2) (xv) of Indian Income-Tax Act?

An expenditure although incurred not of necessity and with a view to a direct and immediate benefit but voluntarily and on the grounds of commercial expediency e. g. for preserving the assets of the business or increasing its reputation and in order to facilitate the carrying on of the business may yet be an expenditure laid out or expended wholly and exclusively for the purposes of the business within the meaning of s. 10 (2) (*xv*) of the Indian Income-Tax Act, 1922.

In accordance with its commercial practice, J. K. (assessee firm) and one K. borrowed from a bank Rs. 1,00,000, on joint and several liability, out of which Rs. 50,000 were utilized for assessee's business and the balance by K. for his business. K. having failed to meet his liability, the assessee had to repay Rs. 1,00,000 with interest thereon to the bank. K. was adjudged insolvent and on his insolvency the assessee received from the Official Assignee only a sum of Rs. 18,805. After taking into consideration certain interest and insolvency expenses, the assessee claimed a sum of Rs. 31,740 as a deduction under s. 10 (2) (*xv*) of the Act in the year of account relevant for the assesment year 1951-52. The Income-Tax Appellate Tribunal allowed the assessee's claim. On reference at the instance of the Commissioner of Income Tax, Bombay City I,

Held, that the loss of Rs. 31,740 had accrued to the assessee in the transaction which was in the course of, incidental to and necessary for assessee's business; the assessee was, therefore, entitled to claim such loss as a deduction under s. 10 (2) (*xv*) of the Act.

Commissioner of Income-Tax v. *S. A. S. Ramaswamy Chettiar*[1] followed.

Commissioner of Income-Tax v. *S. R. Subramanya Pillai*[2], *Commissioner of Income-Tax* v. *Madan Gopal Bagla*[3] and *Montreal Coke and Manufacturing Co.*, v. *Minister of National Revenue*[4], distinguished.

Morgan (Inspector of Taxes) v. *Tate and Lyle Ltd.*,[5] relied on.

Smith's Polato Estates Ltd., v. *Bolland*[6] and *Lord's Dairy Farm, Ltd.*, v. *Commissioner of Income-Tax*[7] referred to.

At the instance of the Commissioner of Income-tax, Bombay City I, Bombay, the Income-tax Appellate Tribunal referred the following questions to the High Court of Judicature at Bombay.

(1) Whether the assessee's claim is sustainable under s. 10 (2) (*xv*) of the Act?

* Income-Tax Reference No. 55 of 1955.

1. [1946] 14 I. T. R. 236.
2. [1950] 18 I. T. R. 85.
3. [1952] 21 I. T. R. 142.
4. [1945] 13 I. T. R. (Suppl.) 1. (P. C.).
5. [1954] 26 I. T. R. 195.
6. [1949] 17 I. T. R. (Suppl.) 1.
7. [1955] Bom. 790.

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(2) Whether the assessee's claim that the loss was a business loss and, therefore, allowable as a deduction in computing the profits of the assessee's business is sustainable under law?

M. P. Amin, Advocate General for the Applicant.

N. A. Palkhivala, for the Respondent.

Chagla C. J.—The question that arises on this reference is whether a certain amount is an allowable deduction under s. 10 (*2*) (*xv*) of the Income-tax Act or in any event it is a business loss which can be deducted for the purpose of ascertaining the true profits of the assessee.

The assessee is a commission agent and he along with one Kishorilal borrowed a sum of Rs. 1,00,00 from a bank on joint and several liability. Rs. 50,000 out of this sum were taken by the assessee for his business and Rs. 50,000 were taken by Kishorilal. Kishorilal failed to meet his obligation and was adjudicated insolvent. Therefore, under the joint and several liability, the assessee had to pay to the Bank the whole amount of Rs. 1,00,000. In the insolvency of Kishorilal the assessee received a sum of Rs. 18,805 and he, therefore, claimed the balance of Rs. 31,740 for the assessment year 1951-52, after taking into consideration certain interest and insolvency expenses and the Tribunal held that this was a permissible deduction under s. 10 (*2*) (*xv*) or in any event it was a business loss which was allowable as a deduction in computing the profits of the assessee's business.

Certain specific findings which are given by the Tribunal must be looked at in order to arrive at a proper conclusion in this reference. The sum of Rs. 50,000 was borrowed by the assessee for the purpose of his business and he used to borrow moneys on joint and several liability from the Banks. The Tribunal finds that it is a commercial practice in the business which the assessee does to borrow money from Banks on joint and several liability. The Tribunal has also found that the Bank would not advance Rs. 50,000 to the assessee and to Kishorilal on their individual security, but they would only be prepared to advance Rs. 1,00,000 on joint and several liability of the assessee and Kishorilal. The Tribunal further points out that the assessee could have borrowed Rs. 50,000 from a moneylender on his own security but in that case he would have had to pay a much higher rate of interest than what he had to pay to the Bank by borrowing Rs. 1,00,000 on joint and several liability of himself and Kishorilal.

On these facts the question is whether it could be said that this sum of Rs. 31,740 was an amount expended wholly and exclusively for the purpose of the assessee's business. The view has been consistently taken by this Court that amounts spent by a businessman for commercial expendiency are permissible deductions. The view has also been consistently taken that it is not for the Department to tell a businessman how he should conduct his business; it must be left to the business-

man himself. All that the Department is concerned with, is to test every expenditure made by the businessman and claimed as a deduction under s. 10 (2) (*xv*) and to determine whether the purpose of that expenditure was the furtherance of the business, because it is from the profits made by that business that the businessman pays tax to the Department, and any moneys spent in the interest of the business or any moneys spent in the course of the business and which is incidental to the business must be considered as a permissible deduction. We have also taken the view that there may be cases which may not fall strictly within the ambit of s. 10 (2) (*xv*), even so in order to ascertain the true profits of the business from a commercial point of view certain business losses must be deducted. The Advocate General has put forward the contention that it was not absolutely necessary for the assessee to have borrowed this sum of Rs. 1,00,000 on the joint and several liability of himself and Kishorilal. He says that it is not established that it was absolutely impossible for the assessee to have got this money without undertaking the liability of paying for the default of his surety. Now, if the assessee required Rs. 50,000 for his business, it was for him to decide which was the best way of getting that money and if he came to the conclusion that he should go to a Bank rather than to a money-lender and to get a sum of Rs. 1,00,000 on the joint and several liability of himself and Kishorilal and take Rs. 50,000 for his own business, he was the best judge of the interest of his own business. The finding of the Tribunal is clear and explicit that what the assessee was doing was not something out of the ordinary, but in borrowing this money on joint and several liability he was following a practice which was established as a commercial practice. Therefore, the transaction was clearly in the course of the business and incidental to the business and it is this transaction which was necessary for the business which resulted in a loss to the assessee, he having to pay the liability of the surety.

Various decisions have been referred to by the Advocate General for the proposition that an expenditure of the nature we have before us has not been permitted by the other High Courts as a deduction which properly falls within the ambit of s. 10 (2) (*xv*). In the first place, reference is made to two decisions of the Madras High Court. The first is *Commissioner of Income-tax* v. *S. A. S. Ramaswamy Chettiar*.[8] That was a case where the assessee was carrying on a money-lending business and he guaranteed a loan granted by a bank in Rangoon to a Chettiar firm. As the loan was not repaid by the borrower, the assessee was called upon to make good a certain amount under his agreement of guarantee, and the assessee sought to deduct this sum as a business loss when estimating his profits, and the Madras High Court upheld the

8. (1946) 14 I. T. R. 236.

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contention of the assessee and emphasised the fact that as it was the custom among the Nattukottai Chettiars to stand surety for one another when they borrowed from banks for the purpose of lending out at higher rates of interest, the loss that the assessee claimed must be regarded as a loss incurred by the assessee in carrying on his money-lending business. That case was considered by the Madras High Court in a later decision in *Commissioner of Income-tax* v. *S. R. Subramanya Pillai.*[9] In that case there was a joint borrowing by the assessee, who was a bookseller, with another person and the joint borrowing was necessitated by the business needs of both the borrowers and by the insistence of money-lenders who required the joint security of the two persons. The other person failed in his business and the assessee had to repay the creditors the whole of the joint borrowing and he also spent a certain amount in an unsucccessful attempt to recover the amount due from the other person, and the assessee claimed to deduct both the amount of the legal expenses and the amount paid by him to the creditors, and the Madras High Court held that this amount could not be deducted under s. 10 (2) (*xv*) or as a business loss. At p. 94 the learned Judges give the reason for disallowing this expenditure. The reason is that the loss claimed by the assessee in this case did not arise in the course of or as a result of his business as a bookseller. They further say that the business of bookselling did not require the assessee to guarantee the debts of third persons like the person whose debts the assessee had guaranteed. Therefore, the facts on which that decision proceeded are very different from the facts before us, because, as pointed out, in the case before us the Tribunal has found that there is a commercial practice in this business to borrow money from Banks on joint and several liability; and again at p. 95 this point is emphasised by the learned Judges when they say :

> "Here there was no evidence of any usage or custom in the book selling trade to raise money by the execution of joint promissory notes with other people and the instances of such a joint borrowing by the assessee in the present case cannot be relied on as evidence of any such commercial practice."

This clearly goes to show that if a commercial practice had been established in that case, the decision would have been different.

The third decision relied upon by the Advocate General is a decision of the Calcutta High Court reported in *Commissioner of Income-tax* v. *Madan Gopal Bagla.*[10] In that case the assessee, who was a timber merchant, obtained a loan of Rs. 1,00,000 from the Bank of India, Bombay, on the joint security of himself and another man called Mamraj. On the same day Mamraj obtained a loan of Rs. 1,00,000 from the Imperial Bank of India, Bombay, on the joint security of himself and

9. (1950) 18 I. T. R. 85.

10. (1952) 21 I. T. R. 142.

the assessee. The assessee paid off his debt to the Bank of India in due time, but Mamraj failed to pay his. The Imperial Bank realised from the assessee the debt which he owed jointly with Mamraj. Later on Mamraj became an insolvent and the assessee claimed the amount which he had to pay less the dividends received from the estate of Mamraj as a permissible deduction, and the Calcutta High Court rejected the contention of the assessee. The Advocate General has rightly pointed out that in this case the Tribunal which decided in favour of the assessee did find that it was the usual custom in Bombay to secure loans on joint security and it was on this ground that the Tribunal came to the conclusion that if such a custom existed it would be sufficient to make the loss which the assessee had suffered as an allowable deduction in the computation of his profits. When we look at that judgment, the learned Judges emphasise certain aspects of the matter which distiguish that case from the case before us. At p. 146 in the judgment the learned Judges say :

> "It seems to have been overlooked that no part of the loan which had been taken from the Imperial Bank on the joint security of the assessee and Mamraj Rambhagat was applied to the assessee's own business. What had been applied to the assessee's business was the other sum of Rs. 1,00,000 which had been borrowed from the Bank of India."

Therefore, obviously, the view of the Calcutta High Court is that inasmuch as the loan of Rs. 1,00,000 which has been used for the business of the assessee had been paid, the loss incurred by the assessee with regard to the other loan with which the assessee's business had nothing whatever to do could not be considered to be a business loss or a loss falling under s. 10 (2) (*xv*). In the case before us it has been found that Rs. 1,00,000 had to be borrowed jointly and severally and that was the only way that the assessee's business could have got Rs. 50,000 that it required. It is not possible in the case before us to distinguish the two loans as separate transactions and attribute the loss with regard to one transaction to one busines and the loss with regard to the other transaction to the other business.

Then reliance is placed on a decision of the Privy Council in *Montreal Coke and Manufacturing Co.* v. *Minister of National Revenue,*[11] where the assessee company for the purpose of financing its business redeemed their existing bonds before maturity and reborrowed the amount at lower rates on less onerous conditions as to payment, and in carrying out these financial operations they had to expend a certain amount, and the question was whether this was a permissible deduction. The Privy Council held that it was not a permissible deduction. Strong reliance is placed on certain passages in the judgment of Lord Macmillan. Lord Macmillan emphasised the fact that it was not the business of the assessees to engage in financial operations and it is to their proper business that the assessees

11. (1945) 13 I. T. R. (Supplement) P. 1.

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had to look for their earnings, and the learned Law Lord points out (p. 5) :

"Of course, like other business people, they must have capital to enable them to conduct their enterprises, but their financial arrangements are quite distinct from the activities by which they earn their income."

The Advocate General says that here too the assessee was indulging in a financial operation for the purpose of his business, but his real business was commission agency business, and, therefore, the moneys expended for this financial transaction should not be allowed as a permissible deduction under s. 10 (2) (*xv*) or as a business loss. Now, the Privy Council in that case was considering the Income-tax Act as applicable to Canada at the relevant time and what was sought to be deducted was a deduction in respect of disbursements or expenses wholly and necessarily laid out and expended for the purpose of earning the income. Whereas under our law the expenditure has to be for the purpose of the business, the provision that the Privy Council was considering was a very different provision where the expenditure had to be for the purpose of earning the income. The difference between an expenditure for earning the income of the business and an expenditure for the business itself is obvious and apparent. An expenditure may not help an assessee to earn the income or to increase the income, and yet from the point of view of commercial expediency it may be necessary for the business; for instance, it may be necessary to preserve the assets of the business or to increase the reputation of the business. It may not bring in results in the sense of increased income and yet a commercial man may think that those expenses are necessary from a commercial point of view for the purpose of the business.

The distinction between these two provisions was considered by the House of Lords in *Morgan* (*Inspector of Taxes*) v. *Tate & Lyle Ltd.*[12] There the House of Lords was considering expenditure incurred by a sugar refining company in a propaganda campaign to oppose the threatened nationalization of the industry, and the House of Lords by a majority held that the expenditure being to preserve the assets of the company from seizure and so to enable it to carry on and earn profits, the expenditure was a permissible expenditure.

Lord Morton in his judgment refers to the decision of *Ward & Co. Ltd.* v. *Commissioner of Taxes,*[13] where on very similar facts the Privy Council had held that the expenditure was not a permissible expenditure, and Lord Morton points out at p. 203 that this case was of no assistance to the Crown having regard to the difference in language which was pointed out by the Privy Council. Whereas under the Canadian Law or the New Zealand Law which the Privy Council was considering the expenditure must have been incurred for the direct purpose of producing profits, under the English Law and where the provi-

12. (1954) 26 I. T. R. 195. 13. [1923] A. C. 145.

sion is similar to our law, as Lord Cave pointed out in *British Insulated and Helsyq Cables* v. *Atherton*,[14] a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expendiency, and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade. Therefore, the decisions of the Privy Council, which are based upon a different provision of the law, cannot be of much assistance to us in construing the language of our own section.

In answer to this the Advocate General relied on an earlier decision of the House of Lords reported in *Smith's Potato Estates, Ltd.* v. *Bolland*,[15] where legal and accountancy expenses incurred by a tax payer with a view to reducing the assessment made upon him were not held to be admissible deductions, and what is relied upon is a passage in the judgment of Lord Simonds at p. 12 :

> "But it is, I think, important to emphasise that the words 'for the purposes of the trade' in their context, i. e. where a computation of 'profits' for the ascertainment of taxable income is being made, must mean 'for the purpose of enabling a person to carry on and earn profits in the trade.' These familiar words I cite from Lord Davey's speech in *Strong and Co. of Romsey* v. *Woodifield*.[16] They have been cited and applied over and over again, and, if they are kept firmly in mind, they dispose *in limine* the argument....."

The Advocate General says that even the provision "for the purpose of the trade or business" has been construed in the same way as "for the purpose of earning income". That in our opinion, is not correct because Lord Simonds while referring to Lord Davey's remarks does not emphasise the fact that expenditure must be for earning profits in the trade, but the expenditure must be for the purpose of carrying on and earning profits in the trade. Therefore, an expenditure which helps the assessee in carrying on the business or makes it possible for him to carry on the business would fall within the ambit of s. 10 (2) (*xv*) and certainly be a business loss which would be a permissible deduction.

Finally, the Advocate General drew our attention to the test we ourselves had laid down in this connection in *Lord's Dairy Farm Ltd.* v. *Commissioner of Income-tax*.[17] In considering the particular loss with which we were dealing there we suggested that the the test that should be applied must be whether the loss was caused in the course of the business of the assessee and the loss was incidental to that business, and we said that if those two tests were satisfied the loss must be looked upon as a trading loss. If we were to apply the same test here, it is clear on the findings of the Tribunal that the loss which the assessee is claiming is a loss caused in the course of his business and it is incidental to his business. Therefore, in our opinion, even

14. [1926] A. C. 205.
15. (1949) 17 I. T. R. Suppl. 1.
16. [1906] A. C. 448.
17. [1955] Bom. 790.

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though it may be said that the case does not fall under s. 10 (2) (*xv*), it would certainly be a trading loss.

One further argument that was advanced by the Advocate General which need not detain us very long is that in any view of the case the expenditure incurred by the assessee was a capital expenditure and not a revenue expenditure. It is difficult to understand this contention. It is said that a man who borrows capital should not be put in a better position than a man who invests his own capital and it is said that if the man who invested his capital lost part of the capital he could not claim that loss as a business expenditure, similarly a man who borrows capital and loses part of that capital should not be permitted to claim the loss as a business loss. We are in entire agreement with that proposition, but the question is whether in this case the assessee has lost any part of his borrowed capital. He wanted to borrow only Rs. 50,000, that money he obtained, he put it in his business, and he has not claimed any loss with regard to that capital. The loss that he is claiming is the loss which was caused to him by reason of the fact that he could only get the sum of Rs. 50,000 by undertaking joint and several liability for Rs. 1,00,000, Rs. 50,000 of which went to Kishorilal and with which the assessee had nothing whatever to do. Therefore, on the facts of this case it is an entirely untenable position to take up that the assessee is claiming the sum as representing loss of borrowed capital.

We will, therefore, answer both the questions in the affirmative. The Commissioner to pay the costs.

Attorneys for Applicant : *N. K. Petigara.*

Attorneys for Respondent : *Manilal Kher Ambalal & Co.*

Answer accordingly.

P. M. P.

APPELLATE CIVIL

Before Mr. M. C. Chagla, Chief Justice and Mr. Justice Tendolkar.

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KIKABHAI ABDULALI BOHARI, PETITIONER *v.* THE INCOME-TAX APPELLATE TRIBUNAL, BOMBAY AND OTHERS, RESPONDENTS.*

Indian Income-tax Act (XI of 1922), ss. 2 (2), 33, 66 (1)—Who can apply for reference under s. 66 (1)—Who can appeal under s. 33—Practice and Procedure of Reference.

A firm G. D. was assessed to Income-tax as an unregistered firm. G a partner appealed to the Appellate Assistant Commissioner contending that he alone was the proprietor and that he should be taxed as an individual and not as an unregistered firm. The appeal was dismissed. Upon attachment of K's property for recovery of tax on the ground that K was a partner of the firm, K appealed to the Tribunal contending that he was not a partner in the firm. The Tribunal held that K was not a partner. G applied for reference to the Tribunal under s. 66 to refer the question of law as to whether the appeal preferred by K was

* Special Civil Application No. 2722 of 1955.