(1978) 03 CAL CK 0049

Calcutta High Court

Case No: Income-tax Reference No. 31 of 1976

Hirji and Co. Private Ltd.	APPELLANT
Vs	
Commissioner of Income Tax	RESPONDENT

Date of Decision: March 21, 1978

Acts Referred:

- Income Tax Act, 1961 - Section 256(2)

Citation: (1978) 113 ITR 694

Hon'ble Judges: Sudhindra Mohan Guha, J; S.C. Deb, J

Bench: Division Bench

Advocate: S.R. Banerjee and S.N. Mukherji, for the Appellant;Ajit Sengupta and Prabir Majumdar, for the Respondent

Judgement

Sudhindra Mohan Guha, J.
In this reference u/s 256(2) of the Income Tax Act, 1961, the short point posed before us is " whether the loss of Rs. 42,327 incurred by the assessee-company in the sale of shares of M/s. Lajpat Potteries Pvt. Ltd. is capital in nature as held by the Income Tax authorities or whether it is a trading loss as claimed by the assessee ? "

2. The statement of the case relates to the assessment year 1969-70. The assessee is a limited company and it is not a dealer in shares. It carries on business as a distributor of cutlery and crockery manufactured by various producers and M/s. Lajpat Potteries Pvt. Ltd. was one of the companies that supplied goods to it for such distribution, Its memorandum of association authorises it, amongst others, to do business as financiers also.

3. M/s. Lajpat Potteries Pvt. Ltd. was incurring heavy Josses on account of indifferent management and was about to close down in 1963, and, then, the assessee being interested in a regular and ensured supply of goods from that company, in its own business interest, purchased in May and September, 1963, in all, 1,633 of its shares for Rs. 52,534, thereby to-acquire about 51% of its total subscribed capital of 3,200

shares and thus a controlling interest therein. However, even such intervention of the assessee did not save the situation, as that manufacturing company continued to show frightful losses even in the years that followed. All attempts to stop the loss failed and ultimately the factory itself was closed down in 1966. It was when matters reached such a head that in this assessment year the assessee for good sold those shares and realised only Rs. 10,000. The assessee-company claimed before the Income Tax Officer that the loss resulting from sale of those shares amounting to Rs. 42,327 was a revenue loss which should be allowed as a deduction in computing the business income. This claim was, however, disallowed by the Income Tax Officer.

4. The assessee went up in appeal before the Appellate Assistant Commissioner who held that the loss on the sale of shares was a capital loss and, therefore, refused to allow the loss as a deduction in computing the business income.

5. Thereafter the company came up in appeal before the Appellate Tribunal, The Tribunal, concurring with the findings of the Appellate Assistant Commissioner, held that the loss incurred in the sale of such capital asset could only be a capital loss and not a revenue loss. The appeal was, therefore, dismissed.

6. On these facts, as directed, the following question was referred to this court for answer :

" Whether, on the facts and in the circumstances of the case, the transaction which resulted in the loss of Rs. 42,327 was a revenue or a capital loss within the meaning of the Income Tax Act, 1961 ? "

7. The principle as to how the matter is to be approached was laid down by the Supreme Court in The Commissioner of Income Tax Vs. The Mysore Sugar Co., Ltd., . Their Lordships observed :

" That to find out whether an expenditure is on the capital account or on revenue, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt to consider a loss as amounting to a loss of capital. But this is not true of all losses, because losses in the running of the business cannot be said to be of capital. The questions to consider in this connection are : for what was the money laid out ? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an outgoing in the doing of the business ? If money be lost in the first circumstance, it is a loss of capital, but if lost in the second circumstance, it is a revenue loss. In the first, it bears the character of an investment, but in the second, to use a commonly understood phrase, it bears the character of current expenses."

8. It is argued by Mr. Banerjee, learned counsel for the assessee, that the assessee purchased those shares in its business interest and sold them as their retention was against its interest and hence the loss incurred in their sale should be taken as a trading loss. According to him, Lajpat Potteries Pvt. Ltd. was one of the principal

suppliers of goods to the assessee. So it was, in the business interest of the assessee, to see that the said supplier continued its manufacturing activities. The intention of such purchase was to enable the assessee to have a controlling interest over that manufacturing company and the idea was to run the business to the best interests of the assessee. In the circumstances, it was contended that the said loss was incidental to the assessee''s business. It was further contended that with the same object the assessee had during all these years also advanced amounts to the company in its anxiety to salvage it. Thus, in short, it is argued that those shares were not the capital assets of the assessee and, therefore, the said loss cannot be in the nature of a capital loss. In this behalf Mr. Banerjee contends that it was apprehended by the assessee that there might be a fall in the supplies of cutlery and crockery manufactured by M/s. Lajpat Potteries Pvt. Ltd. and that for getting rid of such impediment the assessee purchased those shares; and, therefore, the acquisition of shares was made in the interest of the principal business of the assessee as distributor of goods. Thus, the amount spent for the acquisition of such shares was not in the nature of capital expense because no asset of an enduring nature was created thereby. In support of his argument he relies on the decision of the Supreme Court in Commissioner of Income Tax, West Bengal Vs. Royal Calcutta Turf Club, . In this case the Royal Calcutta Turf Club was an association of persons whose business was to hold race meetings on a commercial basis. The turf club did not own any horse or employ jockeys. If there were not sufficient number of efficient Indian jockeys to ride horses the assessee''s business interest would have been seriously affected and it might have had to abandon its business altogether if it did not take steps to make jockeys of necessary calibre available. Accordingly, it started a school for training of Indian boys as jockeys and incurred expenditure in running the said school in order to prevent the extinction of its business. In these circumstances, it was held by the Supreme Court that the said expenditure was wholly and exclusively laid out for the purpose of the business of the turf club and was, therefore, an allowable deduction.

9. The aforesaid case has no bearing on the instant case before us, because it is not the finding of the Tribunal that the assessee''s business would have been seriously affected if the goods were not supplied to it by that company. On the other hand, the finding of the Tribunal is that the assessee was the distributor of various concerns and one of them was that company. Mr. Banerjee then cites the case of Badridas Daga Vs. The Commissioner of Income Tax, , but it deals with the misappropriation of certain amounts by an agent and, therefore, reliance on it was misplaced by him.

10. Similarly, the case of Commissioner of Income Tax U.P. Vs. Nainital Bank Ltd., cited by him deals with a dacoity and it has no application to the facts and the circumstances of the instant case before us.

11. Mr. Banerjee also cites the case of BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., . In this case, a company was amalgamated with the assessee-company. The assessee-company took over certain assets and the price was to be satisfied by allotment of some fully paid up shares and the balance amount was to be treated as a loan which would carry simple interest at 6%. Thereafter, in a supplemental agreement it was stated that the intention was not to treat the balance as a loan and accordingly the original agreement was modified with retrospective effect to the effect that the balance shall be paid by the assessee-company and until the amount was paid in full the assessee-company shall pay simple interest at 6% on so much of the balance as remained due. In accordance with these agreements, the assessee-company paid interest on the balance outstanding in the relevant accounting year and it was held by the Supreme Court that the interest paid by the assessee-company was a permissible deduction u/s 10(2)(xv) of the Indian Income Tax Act, 1922. Since the transaction of acquisition of assets was closely related to the commencement and carrying on of the business of the assessee-company, the interest paid on the unpaid balance of the consideration for the assets acquired was also held to be a business expenditure.

12. The aforesaid case being ex facie distinguishable on facts, we will now pass on to the case of Mallett v. Staveley Coal and Iron Co. Ltd. [1928] 13 TC 772 cited by Mr. Banerjee. In this case, the colliery company had a certain acreage under lease, and in two cases they surrendered some of their acreage and had to pay to get the reversioner to accept the surrender. The opinion of Rowlatt J., namely, that it was a capital expenditure, was upheld by the Court of Appeal and, therefore, this case does not support the arguments of Mr. Banerjee.

13. Since by following the principles laid down in Kishan Prasad and Co. Ltd. Vs. Commissioner of Income Tax, Punjab, , Commissioner of Income Tax v. Ramnarain Kapur and Co. P. Ltd. [I968] 69 ITR 719, Commissioner of Income Tax, Bombay City I Vs. Ramnarain Sons Ltd., and Ramnarain Sons (Pr.) Ltd. Vs. Commissioner of Income Tax, Bombay, , the Tribunal has held that by the acquisition of the controlling interest in that company the assessee acquired a Benefit of an enduring nature and hence it was a capital asset. Mr. Banerjee argues that the principles laid down in these cases arc not applicable to the facts and circumstances of the present case, but we are unable to accept his argument for the reasons stated later on.

14. Lastly, he refers to the decision of the Supreme Court in Kettlewell Bullen and Co. Vs. Commissioner of Income Tax, Calcutta, and Gillanders Arbuthnot and Co.,Ltd. Vs. The Commissioner of Income Tax, Calcutta, . These two cases deal with the question as to whether the compensation received for cancellation of the managing agency agreement is a revenue or a capital receipt. We are, however, not concerned with any such question in this reference.

15. The assessee is not a dealer in shares and, as found by the Tribunal, those shares were not the stock-in-trade of the assessee. The assessee held those shares for five years and then sold those shares. Accordingly, Mr. Ajit Sengupta, learned counsel for the revenue, argues that, as those shares were not the stock-in-trade but investments in the nature of capital, the said loss incurred by the assessee in selling those shares must be regarded as a capital loss.

16. Mr. Sengupta also argues that, by the acquisition of the controlling interest in that company, the assessee acquired a source of supply of those goods and, therefore, the assessee also acquired a benefit of an enduring nature and, accordingly, the said loss cannot be a revenue loss. Mr. Sengupta cites the case of Pingle Industries Ltd., Secunderabad Vs. Commissioner of Income Tax, Hyderabad, . In" this case, under certain leases, the assessee acquired the right to win stones from the quarry. The stones were not lying on the surface but were to be extracted methodically and skillfully before they were dressed and sold. It was held that the amount paid for the lease was a capital expenditure because the stones in situ were not the assessee''s stock-in-trade in a business sense but a capital asset from which after extraction he converted the stones into stock-in-trade.

17. He also refers to the case of English Crown Spelter Co. Ltd. v. Baker (Surveyor of Taxes) [1908] 5 TC 327. In this case, the English company carried on the business of zinc smelting, for which it required large quantities of " blende ". To get supplies of blende, a new company called the Welsh Crown Spelter Company was formed which received assistance from the English Company in the shape of advances on loan. Later, the English company was required to write off 38,000 odd. The question arose whether the advance could be said to be an investment of capital, because, if it was, the English company would have no right to deduct the amount. If, on the other hand, it was money employed for the business, it could be deducted. Bray J., who considered these questions, observed at pages 337, 338 :

" If this were an ordinary business transaction of a contract by which the Welsh Company were to deliver certain blende, it may be at prices to be settled hereafter, and that this was really nothing more than an advance on account of the price of that blende, there would be a great deal to be said in favour of the appellants.....It is impossible to look upon this as an ordinary business transaction of an advance against goods to be delivered .....I can come to no other conclusion but that this was an investment of capital in the Welsh Company, and was not an ordinary trade transaction of an advance against goods..... "

18. Next he refers to the decision in Charles Marsden & Sons Ltd. v. Commissioners of Inland Revenue [1919] 12 TC 217. Herein an English company carried on the business of paper-making. To arrange for supplies of wood pulp, it entered into an agreement with a Canadian company for the supply of 3,000 tons per year between 1917 and 1927. The English company made an advance of 30,000 against future deliveries to be recouped at the rate of 1 per ton delivery. The Canadian company

was to pay interest in the meantime. Later, the importation of wood pulp was stopped, and the Canadian company neither delivered the pulp nor returned the money. Rowlatt J. held this to be a capital expenditure and not admissible as a deduction. He was of opinion that the payment was not an advance payment for goods observing that no one pays for goods ten years in advance," and that it was a venture to establish a source and money was adventured as capital. Mr. Sengupta also cites the decision in Commissioners of Inland Revenue v. Huntley & Palmers Ltd. [1928] 12 TC 1209. In this case, the respondent-company manufactured biscuits and sold them in tins purchased from a company of tin box manufacturers in which it was closely interested. With one exception, the directors of both companies were the same, and the respondent-company owned the whole of the other company''s shares and was entitled to one half of its profits, after setting aside certain sums for dividends and reserves. The respondent-company regarded the other company as essential to its business and it took all the steps to maintain it as a going concern. It advanced certain amounts and suffered a loss. It was held that the said loss was of a capital nature. The next case cited by him is James Waldie & Sons Ltd. v. Commissioners of Inland Revenue [1919] 12 TC 113, in which the advances in question were held to be capital employed in the business of the appellant-company.

19. Mr. Sengupta also referred to the decision of the Supreme Court in A. Vs. THOMAS AND CO. LTD. v. COMMISSIONER OF Income Tax., . In this case, T was a common director of the assessee-company and of a private company. The private company took up in 1948 the promotion of a textile mill and T financed the private company to the extent of Rs. 6,05,072. The board of directors of the assessee-company approved the action taken by T and in September, 1950, passed a resolution that the amount of Rs. 6,00,000 should be shown in its accounts as an advance for the purchase of shares in the textile mill and the sum of Rs. 5,072 as sundry advances due from the promoters of the textile mill. The project of promoting the textile mill, however, failed. The private company paid back to the assessee on December 7, 1951, the sum of Rs. 2,00,000. The assessee wrote off the balance on December 31, 1951, which was the date on which its accounting year ended, and claimed the balance as a bad debt or alternatively as a business expenditure for the assessment year 1952-53. It was held that the advances made by the assessee-company to the private company were not incidental to the trading activities of the assessee.

20. Mr. Sengupta also cites the case of Commissioner of Income Tax Vs. National Insurance Co. Ltd., . After making a review of a catena of cases, both English and Indian, this court held that the right of the assessee to manage life insurance business was not only a property but was also a capital asset and the compensation received by the assessee for its deprivation was not a revenue receipt.

21. The learned counsel for the revenue also relies on the decision in Stott v. Hoddinott (Surveyor of Taxes) [1916] 7 TC 85. In this case, the appellant was not a dealer in shares and the loss incurred on sale of shares was held to be a capital loss by Atkin J. in the following terms at page 91 :

" I think it is quite plain that if, in fact, that which has been done is an investment in the nature of capital, and that the loss that has been suffered is a loss in the nature of a capital loss, then such a loss could not properly be deducted when you are estimating the annual profits or gains for a particular year. In this case it appears to me that the Commissioners certainly have ample evidence before them upon which they could find that these losses were losses upon capital. "

22. The assessee before us is not a dealer in shares. Those shares were purchased and held by the assessee as not its stock-in-trade but as investment in the nature of a capital. Therefore, the loss incurred in selling those shares must be a capital loss.

23. That apart, the assessee by the acquisition of controlling interest in that company acquired a source of supply and this source must be held to be a benefit of an enduring nature and hence a capital asset. Therefore, this loss cannot be a revenue loss and it must be a capital loss.

24. In the premises, our answer to the question is that the loss of Rs. 42,327 was not a revenue but a capital loss and it is in favour of the revenue.

25. Each party to pay and bear its own costs.

Deb, J.

26. I agree.