Madan Gopal Bagla

Vs

Commissioner of Income-Tax, West Bengal

Civil Appeal No. 6 of 1954

(Bhagawati JJ)

08.05.1956

JUDGMENT

BHAGAWATI, J. -

This is an appeal with certificate under section 66A(2) of the Indian Income-tax Act 1922, from the judgment and order passed by the High Court of Judicature at Calcutta on a reference under section 66(1) of the Act, whereby the High Court answered the referred question in the negative.

The appellant is a timber merchant. On 5th February, 1930, he obtained a loan of Rs. 1 lakh from the Bank of India on the joint security of himself and one Mamraj Rambhagat. On the same day Mamraj Rambhagat obtained a loan of Rs. 1 lakh from the Imperial Bank of India, Bombay, on the joint security of himself and the appellant. The appellant paid off his loan of Rs. 1 lakh to the Bank of India but Mamraj Rambhagat failed to make good the amount of his loan to the Imperial Bank of India, Bombay. This sum of Rs. 1 lakh was realised by the Imperial Bank of India from the appellant with interest thereon of Rs. 626 on 24th March, 1930.

Mamraj Rambhagat failed in his business and his estate went into the hands of the receivers on 25th April, 1930. The appellant opened a ledger account in the name of Mamraj Rambhagat and the total amount of Rs. 1,00,626 was debited to this account. The appellant received the dividends from the receivers; Rs. 31,446 on 30th October, 1930, Rs. 9,434 on 25th April, 1934, and Rs. 4,716 on 17th May, 1938, aggregating to Rs. 45,596, leaving a balance of Rs. 55,030 unpaid, which sum he wrote off as bad debt in the assessment year 1941-42 (the account year being 1997 Ramnavmi) and claimed as an allowable deduction undersection 10 of the Act.

The Income-tax Officer disallowed the claim holding that the said loss was a capital loss, and so did the Appellate Assistant Commissioner. It was argued on behalf of the appellant before the Appellate Assistant Commissioner that it was the usual custom in Bombay to secure loans on joint security from banks by persons carrying on business. It was stated that this manner of securing loans on joint security was preferred by banks and it was also in the interest of the traders as lower rate of interest was charged, if the loan was on joint security. It was also stated that the appellant used to borrow money on joint security frequently and certain old pro-notes jointly executed were submitted before the Appellate Assistant Commissioner. Reference was made to the case of Commissioner of Income-tax, Madras v. S. A. S. Ramaswamy Chettiar, where it was held that it was a custom amongst Nattukottai Chettiars to stand surety for one another for borrowing from banks for the purpose of lending out at higher rates of interest and that the loss incurred under the agreement of guarantee by the Chettiar firm should be allowed as a deduction. The Appellate Assistant Commissioner, however, distinguished the on fact and held that even though the appellant stood

surety for Mamraj Rambhagat in course of securing finance for his business of timber, it was the loss of a sum borrowed by another, the sum, borrowed was capital in its nature and the loss suffered by the appellant on account of Mamraj Rambhagat's failure to pay was a capital loss.

On appeal taken by the Department before the Income-tax Appellate Tribunal, the Tribunal was of the opinion that the Appellate Assistant Commissioner had not expressed any opinion in his order as to whether there was such custom or not nor had he asked the appellant to establish the custom. The Tribunal in these circumstances held that the custom was accepted by the Department. The Tribunal did not see any distinction between the money lending business and timber business which were both financed by this type of borrowing and differing from the Appellate Assistant Commissioner followed the decision in Commissioner of Income-tax, Madras v. S. A. S. Ramaswamy Chettiar and came to the conclusion that the loss suffered by standing surety was and allowable loss and upheld the contention of the appellant.

At the instance of the respondent the Tribunal stated a case to the High Court under section 66 (1) of the Act and referred the following question for its decision :

"Whether on the facts found the sum of Rs. 55,030 is allowable as a bad debt under the provisions of section 10(2)(xi) of the Indian Income-tax Act."

The said reference was heard by the High Court and in its judgment the High Court held that the Tribunal had proceeded on an erroneous assumption as to the facts of the case and the application of the money. Since no part of the loan, which had been taken from the Imperial Bank of India by Mamraj Rambhagat on the joint security of himself and the appellant, was applied to the appellant's own business, there was no question of an allowable deduction in relation to the business of the appellant. The High Court held that the Tribunal was in error even in law inasmuch as under section 10 (2) (xi) it is only a trading or business debt of the trade or business of the appellant, which cold be claimed as a loss and as the debt claimed was not in respect of the business of the appellant, which was the business of trading in timber and not of a person carrying on the business of standing surety for other persons, the suffered by the appellant was capital loss and not a business loss at all. Regarding the decision relied upon by the tribunal, the High Court referred to a later decision in Commissioner of Income-tax, Madras v. S. R. Subramany Pillai, which held that the earlier decision must be read as confined to its peculiar facts and not applicable to business other than money lending business of Nattukottai Chettiars. The High Court, therefore, answered the referred question in the negative. Hence this appeal.

The sole question for our determination in this appeal is whether the loss of Rs. 55,030 suffered by the appellant in this transaction was a capital loss or was a trading loss or a bad debt incurred by the appellant in the course of carrying on his business of timber. It is clear that no part of the monies borrowed on the joint security of the appellant and Mamraj Rambhagat in his own business. These monies were not required to finance the timber business of the appellant. If any monies had been borrowed by the appellant in his timber business, they would certainly have been his capital and whatever loss. The manner in which these monies were sought to be connected with the timber business and treated as a trading loss or bad debt of the timber business was by showing that it was the custom amongst the persons carrying business in Bombay to borrow monies from banks on joint security and if A wanted monies for financing his business, he could do so by asking B to join him as surety, but he could not ask B to join him as such unless he stood surety for B in the loans, which B borrowed in his turn from the bank. A's joining B as surety was thus a consideration for B' joining A as surety in his transaction with the bank and, therefore, although no part of the monies borrowed

by B came into the business of A, A joined B as surety for the purpose of financing his own business, which he could not do without B joining him as surety in the loan which he himself obtained from the bank for the purpose of financing his own business. The transaction of A's joining B as surety in the matter of B's procuring a loan for the financing of his business was thus an essential operation of the financing of A's business and was, therefore, and incident of A's business and any loss incurred by. A in the transaction could thus be treated a trading loss in the course of carrying on of A's business. The loss incurred by the appellant in the transaction of his joining Mamraj Rambhagat procured from the Imperial Bank of India could, it was urged, thus be treated as a trading loss or bad debt of the appellant's timber business.

It is necessary, therefore, to see what is the exact nature and scope of the custom said to have been accepted by the Department. The custom stated before the Appellate Assistant Commissioner was that persons carrying on business in Bombay used to borrow monies on joint security from the banks in order to facilitate getting financial assistance from the banks and that too at lower rates of interest. A businessman could procure financial assistance from the banks on his own, but he would in that case have to pay a higher rate of interest. He would have to pay a lower rate of interest if he could procure as surety another businessman who would be approved by the bank. This, however, did not mean that mutual accommodation by businessmen was necessarily an ingredient part of that custom. A could procure B, C or D to join him as surety in order to achieve this objective, but it did not necessarily follow that if A wanted to procure B, C or D to thus join him as surety in the loans, which B, C or D procured in their turns from the banks for financing their respective businesses. Unless that factor was established, the mere procurement by A of B, C or D as surety would not be sufficiency to establish the custom sought to be relied upon by the appellant so as to make the transaction of his having joined Mamraj Rambhagat as surety in the loan procured by Mamraj Rambhagat from the Imperial Bank of India, a transaction in the course of carrying on his own timber business and to make the loss in the transaction a trading loss or a bad debt of the timber business of the appellant. The old promotes jointly executed by the appellant and others, which were submitted before the Appellate Assistant Commissioner did not carry the case of the appellant far enough and stopped short of proving the charge alleged by the appellant in its entirety. The transaction in question could not, therefore, be deemed to be one entered into by the appellant in the course of or in carrying on his timber business. Procuring finances for his timber business would no doubt be an essential operation in the course of his carrying on his business, but the same thing could not be predicated of this transaction of his joining Mamraj Rambhagat as surety for procuring Rs. 1 lakh from the Imperial Bank of India, which was wholly to finance Mamraj Rambhagat's business and not the timber business of the appellant.

Learned counsel for the appellant laid particular emphasis on the finding by the Appellate Assistant Commissioner that "it was in the course of securing finance for the business of timber that he stood surety with Mamraj Rambhagat." This finding merely records the statement of fact, but does not go so far as to establish the custom sought to relied upon by the appellant. The old promotes submitted by the appellant before the Appellate Assistant Commissioner merely related to his own transactions, where he had been joined by others as surety and did not establish that the others had been similarly accommodated by him in the matters of loans which they had in their turn procured from the banks. The solitary instance of the appellant's having joined Mamraj Rambhagat in the transaction in question could not be sufficient to establish the custom sought to be relied upon by him and we do not see any reason to enlarge the scope of the so-called custom beyond what is warranted by the facts as set out in the order passed by the Appellate Assistant Commissioner.

The custom among the Nattukottai Chettiars held proved in Commissioner of Income-tax, Madras v.

S. A. S. Ramaswamy Chettiar' was that they stood surety for one another, when they borrowed from banks for the purpose of lending out at higher rates of interest. It was, moreover, an essential element in the carrying on of a money lender's business that money, which was thus lent out should be procured and that could not be done unless it was borrowed on the joint security of Nattukottai Chettiars, who stood surety for one another. Unless that type of suretyship was resorted to, a Nattukottai Chettiar by himself- lending business. The following passage from the judgment at page 238 is very apposite :

"It is their custom to borrow from banks for the purpose of lending out the sums so obtained at higher rates of interest. The banks require such overdrafts to be guaranteed by other Chettiars. The Chettiars stand surety for one another in these borrowings. If a Chettiar refused to accommodate another money-lender in this way, he would not be able to obtain a guarantor for his own essential borrowings. The assessee in this case borrowed money on the guarantee of others and in turn stood surety for other Chettiars."

There were thus elements of mutuality and the essential ingredient in the carrying on of the money-lending business, which were elements of the custom proved in that case, both of which are wanting in the present case before us.

It is significant to note that this case was distinguished by the learned Judges of the Madras High Court in Commissioner of Income-tax, Madras v. S. R. Subramanya Pillai, where it was held that decision must be confined to its own peculiar facts and does not apply to businesses other than Nattukottai Chetty money-lending business. In that case the asses see was a bookseller, who borrowed from time to time jointly with one L a sum of Rs. 16,200 out of which the assessee took a sum of Rs. 10,450 for his business needs and L took the balance. 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. L failed in his business and the assessee had to repay the creditors the whole of the joint borrowing. The assessee had also to spend a sum of Rs. 658 in an unsuccessful attempt to recover the amount due from L. The assessee claimed to deduct the sum of Rs. 658 and also the sum of Rs. 5,049, which he had to pay the creditors on account of L's share of the joint loan, in the computation of his business profits. It was held that the assessee was not entitled to deduct these sums in the computation of his business profit either under section 10(2) (xi) or section 10(2) (xv) or as business loss.

This case furnishes the proper analogy to the present case and points to the right conclusion in regard to the claim of the appellant.

The following passage from the judgment of the learned Chief Justice under appeal correctly sums up, in our opinion, the whole position :

"The debt must therefore be one which can properly be called a trading debt and adept of the trade, the profits of which are being computed. Judged by that test it is difficult to see how the debt in respect of the business of the assessee. The assessee is not a person carrying on a business of standing surety for other persons. Nor is he a money- lender. He is simply a timber merchant. There seems to have been some evidence before the Appellate Assistant Commissioned that he had from time to time obtained finances for his business by procuring loans on the joint security of himself and some other person. But it is not established, nor does it seem to have been alleged, that he in his turn was in the habit of standing surety for other persons along with them for the purpose of securing loans for their use and benefit. Even if such had been a capital loss to him and not a

business loss at all."

The result, therefore, is that the appeal fails and must stand dismissed with costs.

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