SUREME COURT OF INDIA

Essen Private Ltd.

Vs.

Commissioner of Income-Tax, Madras

(J Shah, S Sikri and V Ramaswami JJ.)

16.03.1967

JUDGMENT

RAMASWAMI J.

1. This appeal is brought, by special leave, from the judgment of the Madras High Court dated October 9, 1962, in T. C. No. 136 of 1960.

2. The appellant-company is a private limited company incorporated under the Indian Companies Act. It carries on business as managing agents of several concerns. It also derives income from insurance agency. Amer- Hind Manufacturers Limited was one of the companies for which the appellant-company was appointed managing agents from July 16, 1950. It was previously managed by another company called "American Agencies Limited". Amer-Hind Manufacturers Limited was engaged in the manufacture of carbon paper, ink and other allied products. It was in need of large funds for carrying on its manufacturing operations. The managing agency agreement between the appellant-company and Amer-Hind Manufacturers Limited provided that the appellant-company should lend or advance the necessary amounts required by the managed-company. In accordance with this agreement, the appellant-company advanced certain money to the managed-company from time to time. The total amount thus advanced up to December 31, 1954, amounted to Rs. 3,40,956 and odd. It appear further that the appellant-company along with S. N. N. Sankaralinga Iyer who was a director of the company guaranteed the loan of about Rs. 2 lakhs obtained by the managed-company from the Indian Overseas Bank Ltd., Madras. Amer-Hind Manufacturers Ltd. later on failed in its business. The bank pressed for the repayment of the loan but Amer-Hind Manufacturers Ltd. was unable to repay. Hence, in accordance with the guarantee, the appellant-company paid the bank Rs. 81,593-8-0 representing the total amount due by Amer-Hind Manufacturers Ltd. On payment, the bank released to the appellant-company the stock pledged by Amer-Hind Manufacturers Ltd. from which the appellant-company was able to realise Rs. 44,905 and odd. The balance due to the appellant company from the managed company under this account was Rs. 36,693 and odd. The total amount thus due to the appellant company from Amer-Hind Manufacturers Ltd. under the above account as well as in respect of advances under current account came to Rs. 4,03,203. Even thereafter the business of Amer-Hind Manufacturers Ltd. did not improve and the appellant-company found that there was no prospect of realising the amount due from Amer-Hind Manufacturers Ltd. It was written off in the books of account of the appellant-

company during the previous year ending December 31, 1955. Thereafter, the appellant-company claimed allowances in respect of Rs. 4,03,203 in computing the profits of its business for the assessment year 1956-57. While examining this claim, the Income-tax Officer held that there was no prospect of the appellant-company recovering the amount from Amer-Hind Manufacturers Ltd. But the Income-tax Officer observed that under the terms of the managing agency agreement it was not obligatory on the part of the appellant-company to advance the amount and therefore the loss sustained by the appellant-company was a capital loss and it was not liable to be deducted as a business expenditure. The appellant-company preferred an appeal to the Appellant Assistant Commissioner of income-tax who also rejected the claim. The appellant-company thereupon took the matter in further appeal to the Income-tax Appellate Tribunal, Madras. The Appellate Tribunal found that the appellant-company was carrying on the business of managing agents, that the business of managing agency continued in the relevant year of account, that sub-clause (19) of clause 13 of the memorandum of association of the appellant-company empowered it to lend moneys and also to guarantee the performance of contracts, and that the advances in question and the agreement guaranteeing payment to the bank were only in pursuance of the aforesaid objects. The Tribunal accordingly held that the loans advanced and payments made to the bank under the guarantee were in the course of the business of the appellant-company, and allowed the claim. Thereafter, the Appellate Tribunal referred the following question of law for the decision of the High Court under section 66(1) of the Income-tax Act :

"Whether there are materials for the Tribunal to hold that the debts in question was incurred in the course of the business so as to make its loss deductible under section 10(2)(xi) ?"

3. After hearing the reference, the High Court held that the appellant- company acquired the managing agency on condition of giving loans and making advances and the loss arising out of such advances would only be capital loss as it related to the structure or framework of the managing agency business. The High Court accordingly answered the question against the assessee.

4. It was submitted on behalf of the appellant-company that the High Court has erred in law in not keeping in view the scope of the question referred to it. It was pointed out that the question referred to the High Court was, "Whether there are materials for the Tribunal to hold that the debt in question was incurred in the course of the business so as to make its loss deductible under section 10(2)(xi)" and it was contended that the High Court had no justification in observing that the advances made and the losses incurred by the appellant-company related to the structure or framework of the managing agency business and therefore the loss arising out of stressed on behalf of the appellant-company that no such question was referred for the decision of the High Court. In our opinion, the argument put forward on behalf of the appellant-company is well- founded and must be accepted as correct. The scope of the question referred to the High Court was, "Whether there were materials for the Tribunal to hold that the debt in question was incurred in the course of the business of the appellant-company". On this point the High Court has accepted the finding of the Tribunal that large sums of money had been advanced by the appellant-company on "current account" to the managed-company. The High Court also found that the appellant-company guaranteed the borrowing of the managed-company from the Indian Overseas Bank Limited and sustained loss as a result of its fulfilled the terms of the guarantee. It has also been found by the Tribunal that according to sub-clause 19 of clause 13 of the memorandum of association the appellant-company was entitled to lend moneys and the guarantee the performance of contract. Clause 14 of the agreement states as follows.

"That the agents may, at their option, lend and advance to and for the use of the company, money to the extent that may be necessary for the needs of the company from time to time, the same to run at a rate of interest to be fixed by the board of directors of the company from time to time."

5. The Appellate Tribunal was of the opinion that the mere presence of an option to make loans in clause 14 of the agreement did not take away the necessity of the managing agent of finance the managed company. In the course of its order, the Appellate Tribunal has stated as follows :

"It was notorious that the old managing agents could not deliver the goods, they having no funds and the managed-company was placed in a strait jacket as regards finance. Apart from clause 14 of the agreement, it is patent on the face that the assessee was taken in as managing agent replacing the old one just because it had resources and could find funds for making the managed company work. There is thus no substances in the objection of the Appellate Assistant Commissioner."

6. The Appellate Tribunal also referred to the fact that the appellant- company was carrying on the business of managing-agents as was evident from clause 3 of the memorandum and articles of association and nothing had been mentioned to show that the business had stopped. The Appellate Tribunal accordingly found that "the making of advanced and the payment of moneys on guarantees was made in the course of business". In the judgment under appeal the High Court, however, criticised the findings of the Tribunal as hazy and indecisive. The High Court has proceeded further to remark that "the appellant-company acquired the managing agency on condition of giving loan and making advances and if this was the true state of affairs the loss arising out of the loans and advances would only be a capital loss as it related to the structure or framework of the managing agency business." Later on, the High Court stated that "it seems to be fairly clear that the appellant-company made the advance only as an outlay for the strengthening of the capital structure of its managing agency business to put it on a firm and stable foundation vis-a-vis the managed-company, so that the machinery, so that the machinery of the profit apparatus might be an effective and remunerative operation". Accordingly, the High Court reached the conclusion that the nature of the payment was of a capital kind and the claim of the appellant-company could not be sustained under section 10(2) (xi) of the Income-tax Act. In our opinion, the High Court was not justified in criticising the finding of the Tribunal as hazy and indecisive and thereafter upsetting the findings of fact recorded by the Tribunal. We consider that the High Court was in error in disregarding the findings of fact which the Appellate Tribunal has recorded. As we have already indicated, there was proper material before the Appellate Tribunal in support of its finding that the debt in question was incurred in the course of the business of the appellant-company so as to make it deductible under section 10(2) (xi) of the Income-tax Act. The Appellate Tribunal has found in this case that it was part of the managing agency business to provide funds to the managed-company and there was no justification for the High Court to disregard the finding of the Tribunal on this aspect of the case. Reference has also been made to sub-clause (19) of clause 13 of the memorandum of association which clearly indicates that the moneys advanced by the appellant-company and the guarantee given by it in respect of the loans advanced to the managed company by the bank were all in the course of the managing agency business. We consider that the High Court has exceeded its jurisdiction in traversing into the findings of fact reached by the Appellate Tribunal in the present case. As regards the question actually referred to it, the High Court should have held that there was proper material in support of the finding of the Tribunal that the loan advanced by the appellant-company to the managed-company and the payments made by it under the terms of the guarantee given to the bank were in the course of the appellant-companys business and the claim for allowance of the loss sustained by the appellant-company was therefore admissible under section 10(2) (xi) of the

Income-tax Act. We accordingly set aside the judgment of the High Court, dated October 9, 1962, and hold that the question referred to it should be answered in the affirmative and in favour of the assessee as indicated above.

7. The appeal is accordingly allowed with costs here and in the High Court.

8. Appeal allowed.