B. D. Bharucha, Bombay

Vs

Commissioner of Income-Tax, Central Bombay

(J. C. Shah, S. M. Sikri, V. Ramaswami - I JJ)

21.03.1967

JUDGMENT

RAMASWAMI, J.

This appeal is brought, by special leave, from the judgment of the High Court of Bombay dated August 27, 1962 in Income Tax Reference No. 18 of 1961.

The appellant is an individual having income from House Property, Government Securities, Cinema Exhibition and financing film producers an distributors. During the period from March 3, 1952 to November 5, 1952 the appellant advanced a sum of Rs. 40,000/-to a firm of film distributors known as Tarachand Pictures. The appellant thereafter entered into an agreement dated January 5, 1953 with Tarachand Pictures under which the appellant advanced a further sum of Rs. 60,000/-in respect of the distribution, exploitation and exhibition of a picture called "Shabab". According to cl. 2 of the agreement the distributors were to pay a lumpsum of Rs. 1,750/-by way of interest on the initial advance of Rs. 40,000/-. Clause 3 of the agreement read as follows :-

> "No interest will run henceforth on this sum of Rs. 40,000/-as also on the advances to be made as provided hereinabove but in lieu of interest it is agreed that the Distributors will share with the Financier profit and loss of the Distribution, Exploitation and Exhibition of the picture SHABAB in the Bombay Circuit, two-third going to the Financier and one-third to the Distributors."

Clauses 4 and 5 were to the following effect :-

> "4. The Distributors shall on or before the 15th of every month submit to the Financier a Statement of Account of the business done during the previous month in respect of the picture 'SHABAB' in the territories of Bombay Circuit."
>
> "5. The Distributors shall keep the proper accounts of the business of the picture 'SHABAB' and the same as well as all documents, reports and contracts will be available to the Financier or his agent for inspection."

Clause 7 read as follows :-

> "In case the picture is not released in Bombay within 15 months from the date hereof the Distributors shall be bound to immediately return all the moneys so far advanced to the Distributors by the Financier. In that event the Distributors shall be bound to return all the moneys together with interest thereon @ 9% per annum."

Clause 8 stated :

> "In case of any breach being committed by the Distributors of any of the terms herein provided this agreement shall at once terminate and the moneys paid by the Financier shall be at once repaid by the Distributors to the Financier with interest @ 9% per annum."

It appears that the distributor were not in a position to exhibit the film in Bombay within the stipulated time. When the film was ultimately released for exhibition it proved to be unsuccessful. The matter was taken to the City Civil Court and ultimately a consent decree was obtained in Suit No. 2061 of 1954 in the Bombay City Civil Court. In the end the appellant found that there was a balance of Rs. 80,759/-which was irrecoverable and he accordingly wrote it off as a bad debt on December 31, 1955 in the ledger account. For the assessment year 1956-57, the corresponding previous year being the calendar year 1955, the appellant claimed a loss of Rs. 80,759/-which he had written of as bad debt, under s. 10(2) (xi) of the Income-tax Officer disallowed the claim on the ground that the moneys advanced by the appellant under the agreement could not be regarded as a dealing in the course of his financing business, but the true nature of the transaction, as evidenced by the agreement, was a venture in the nature of a trade. The Income-tax Officer accordingly held that the loss was a capital loss and it could not be allowed as a bad debt under s. 10(2) (xi) of the Income-tax Act. The appellant took the matter in appeal to the Appellate Assistant Commissioner of Income-tax who dismissed the appeal. The appellant preferred a second appeal before the Income-tax Appellate Tribunal which by its order dated February 19, 1960 rejected the appeal, holding that the loss of Rs. 80,759/-was a capital loss and not a loss of stock-in-trade. The Tribunal took the view that the transaction was not a joint venture with the distributors or any partnership business and that it was also not a mere financing deal or a part of the money-lending activities of the appellant. According to the Appellate Tribunal, the true nature of the transaction was an investment of the capital for a return in the shape of share of profits, and the loss suffered by the appellant was therefore a capital loss and not a revenue loss. As required by the appellant, the Tribunal stated a case to the High Court under s. 66(1) of the Income-tax Act on the following question of law :-

> "Whether the aforesaid loss of Rs. 80,759/-is deductible under any of the provisions of the Act ?"

By its judgment dated August 27, 1962, the High Court answered the Reference in the negative and against the appellant.

On behalf of the respondent it was submitted that the High Court was right in taking the view that the appellant had advanced a sum of Rs. 1,00,000/-not with a view to earn interest thereon but with a view to making an investment in the business of Tarachand Pictures and get a return on the said investment by way of a share of profits in the said business. It was contended that the money was not had for any definite term and no rate of interest had been fixed under of 3. The argument was also stressed that cl. 3 of the agreement stipulated that the appellant was to share with the distributors not only the profit but also the loss of the business, and in the case of no money-lending transaction is there a covenent between the parties that the money-lender will share the loss of the business for which the money is lent. In other words, it was argued that no money-lending transaction can have the attribute of the money-lender sharing the risk of the loss of the business for which the money is lent, nor could it be a feature of any purely financial deal. We are unable to accept the argument of the respondent that the transaction between the parties under the agreement dated January 5, 1953 was not a money-lending transaction or a transaction in the nature of a

financial deal in the course of the appellant's business. If c. 3 of the agreement is taken in isolation there may be some force in the contention of the respondent that the term under which the appellant undertook to share the loss took the transaction out of the category of a money-lending transaction and the loss suffered by the appellant was therefore a capital loss. In the present case, however, cl. 3 of the agreement dated January 5, 1953 cannot be read in isolation but it must be construed in the context of cl. 7 which provides that in case the picture was not released in Bombay within 15 months from the date of the agreement, the distributors will return all the moneys so far advanced to them by the appellant together with interest thereon at 9% per annum. It is the admitted position in the present case that the picture was not released by the distributors till the stipulated date, namely, April 4, 1954 but it was released on May 28, 1954 and cl. 7 of the agreement therefore came into operation. The result therefore is that on and from April 4, 1954 there was a contract of loan between the parties in terms of cl. 7 of the agreement and the principal amount became repayable from that date to the appellant with interest thereon at 9% per annum. It follows therefore that the appellant is entitled to claim the amount of Rs. 80,759/-as a bad debt under s. 10(2) (xi) of the Income-tax Act and the loss suffered by the appellant was not a loss of capital but a revenue loss.

To find out whether an expenditure is on the capital account or on revenue account, 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 it is not true of all losses, because losses in the running of the business cannot be said to be of capital. The distinction is brought out for example, in Reid's Brewery Co. Ltd. v. Male (1). In that case, the brewery company carried on, in addition to the business of a brewery, a business of bankers and money-lenders making loans and advances to their customers. This helped the customers in pushing sales of the product of the brewery company. Certain sums had to be written off and the amount was held to be deductible. In the course of his judgment Pollock B. said :

> "Of course, if it be capital invested, then it comes within the express provision of the Income-tax Act, that no deduction is to be made on that account."

but held that :

> "... no person who is acquainted with the habits of business can doubt that this is not capital invested. What it is is this. It is capital used by the Appellants but used only in the sense that all money which is laid out by persons who are traders, whether it be in the purchase of goods be they traders alone, whether it be in the purchase of raw material be they manufacturers, or in the case of money-lenders, be they pawnbrokers or money-lenders, whether it be money lent in the course of their trade, it is used and it comes out of capital, but it is not an investment in the ordinary sense of the word."

In the present case, the conditions for the grant of the allowance under s. 10(2) (xi) of the Income - Act are satisfied. In the first place, the debt is in respect of the business which is carried on by the appellant in the relevant accounting year and accounts of the business are admittedly kept on mercantile basis. In the second place, the debt is in respect of and incidental to the business of the appellant. It has also been found that the debt had become irrecoverable in the relevant accounting year and the amount had been actually written off as irrecoverable in the books of the appellant.

For these reasons, we hold that the judgment of the Bombay High Court dated August 27, 1962 should be set aside and the question referred to the High Court must be answered in the affirmative

and in favour of the appellant. We accordingly allow this appeal with costs here and in the High Court.

V. P. S. Appeal allowed.

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