BOMBAY HIGH COURT

Pohoomal Bros

Vs.

Commissioner of Income-Tax

Income-tax Ref. No. 35 of 1957

(Chagla, C.J. and S.T. Desai, J.)

10.03.1958

JUDGMENT

Chagla, C.J.

1. In this reference we are concerned with the assessment of the well-known firm of Messrs. Pohoomal Bros, for the assessment years 1942-43 to 1946-47. The firm has its head office in Bombay and its branches in various parts of the World. We are concerned with three branches which were at Manila, Saigon and Kualalumpur, and the first important question that we have to decide on this reference concerns the assessment year 1942-43 which corresponds to the accounting period 6th April, 1941 to 26th March. 1942. Now the finding is that the business of the assessee in these three branches was carried on for nine months of the accounting period and the Japanese occupied these places in December, 1941 and no further business could be carried on. The assessee made a certain claim with regard to losses in these three branches resulting from the destruction of stock-in-trade by the invading Japanese. The A.A.C. estimated the loss which should be allowed at Rs. 1,42,500/- for the Manila Branch, Rs. 40,000/- for the Kualalumpur Branch and nil for the Saigon branch. Against this decision the Department went in appeal to the Tribunal and the Tribunal accepted the contention of the Department and disallowed these losses. The assessee has made this claim on the basis that these losses represent trading losses and from a commercial point of view these losses should be allowed. On the other hand, the view taken by the Tribunal was that, inasmuch as the losses were due to enemy action, that was a factor which was not incidental to the trade which the assessee was carrying on and that loss could not be allowed. The Tribunal also took the view that, in any case, these losses cannot be allowed as a revenue deduction : the most that could be said was that the whole capital invested by the assessee was lost and the capital losses could not be allowed as a deduction.

2. Now, the question that we have to consider is whether, when a trader loses part of his stock-in-trade or the whole of it, that is a loss that can be looked upon as a trading loss from a commercial

point of view. Mr. Joshi says that you must enquire into the cause of that loss; if the cause is incidental to the trade, then the loss should be allowed; but if the cause has nothing whatever to do with the carrying on of the business and is not a risk incidental to the business, then the loss should not be permitted. Mr. Joshi further contends that, if the stock-in-trade was destroyed by fire, then it could be said that fire may be looked upon as a risk which is associated with a trader having stock-in-trade and which may be stored in a particular place which may catch fire; but when we come to enemy action, it is impossible to suggest that the Japanese invasion was a risk which was incidental to the assessee carrying on business. Now, in our opinion, the principle suggested by Mr. Joshi is not the correct principle. We would like to consider the principle first apart from the authorities. The stock-in-trade of a trader constitutes the very basis for his carrying on his business for earning profits. If he makes profit out of that stock-in-trade, he must pay tax; if he makes losses, he is entitled to deduction. As we will presently point out, it has even been held that, if the stock-in-trade is insured and the insurance money which is paid in lieu of the destruction of the stock by fire is more than the book value of the stock-in-trade, the trader is bound to pay tax, not on the book value of the stock-in-trade, but on the amount which he actually receives in lieu of the stock-in-trade which is destroyed. The matter also be looked at in this way. The account which a trader maintains of his slock-in trade is ordinarily maintained in the following manner : he shows the opening balance at the beginning of the year of the stock in hand; he debits various purchases made and he credits various sales effected; and at the end of the year he shows the stock-in-trade in hand either at the market value or at cost price according to the system which he maintains. It is from the account so maintained that it is possible to determine whether at the end of the year the trader made profit or loss. Whatever stock-in-trade may be sold out is brought into the account as the cash equivalent of the stock-in-trade; but the stock-in-trade goes out of that account. If the cash equivalent is higher than the book value, the trader profits and so does the Taxing department; if the cash equivalent is less than the book value, the trader loses and so does the Taxing Department. If that be the true principle, then we fail to see what difference it makes to that principle if, instead of a particlular stock-in-trade realising a particular cash value, it does not realise anything at all. To that extent the trader's loss is greater. Therefore, in this case, this particular stock-in-trade, instead of realising a certain cash equivalent, did not realise anything at all; and from this point of view, the cause of the loss is irrelevant. Whatever may be the cause for the loss of the stock-in-trade, the essential fact to bear in mind is that the stock-in-trade has gone out of the business and it so happens that the stock-in-trade has realised no cash. It is illogical, in our opinion, to say that if the stock-in-trade had realised Rs. 5/-, we could have assessed the loss, but if the stock-in-trade realised nothing, the trader is not en-tided to that deduction. Any loss caused to the stock-in-trade must in its very nature be a loss incidental to the trade, and, therefore, when the authorities speak of a loss being incidental to the trade, they never contemplate a case in which the stock-in-trade itself is destroyed and this will be amply borne out when we look at the authorities.

3. There is a leading English decision which is the basis of all decisions on this particular point and that is to be found in J. *Gliksten and Son Ltd. v. Green*[1], Now that was really a converse case

where timber which was the stock-in-trade of the assessee was destroyed. The timber was insured and the insurance money which the assessee received was very much more than the book value of the timber; and the House of Lords held, confirming the decision of the Court of appeal and the trial Court, that the whole sum recovered was a trading receipt to be taken into account in computing the profits of the assessee. Mr. Justice Rowlatt, who always approached these matters with a robust commonsense, at page 375, points out the nature of a trading account; and he says :-

[1](1929) 14 Tax Gas 364

> "It starts with the stock-in-trade in hand at the beginning of the year on the left hand side, then the amount of purchases, and then the amount of expenses, and then there is the total. On the other side there is, of course, the amount of sales and the stock-in-trade that is left at the end of the year; that is totalled and the difference between the two would normally show the gross profit or the gross loss on the year's trading. But in the year in question, owing to the fire, some of the stock which they had at the beginning of the year and which they bought during the year is not accounted for either by the sales or by the stock-in-trade which is left, because it has been burnt." Then he asked the question :
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> "How do the Respondents bring that in? They bring that in as an item 'timber destroyed'. At what price do they bring that in?" The learned Judge said :
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> "The timber is gone and the Respondents have received money from the insurance companies in respect of the timber destroyed, but they do not bring in the money that they have so received instead of the timber. What they bring in is a figure being the estimated cost price of the timber." and the learned Judge says that this is not the correct way of accounting for the receipt of the insurance money and says :
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> "It seems to me that the Respondents must account for this timber that has been destroyed by fire; they have received the money from the insurance company in place of it. I can see no reason why that money should not be brought into the account instead of the timber." When the matter went to the Court of appeal, it was argued that the timber company did not trade in fires and, therefore, any profit it had made on insurance should not be allowed to be subjected to income-tax, This argument was rejected by the Master of the Rolls Lord Hanworth, who said :-
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> "....governed by ordinary business prudence, and mindful of the fact that untoward events take place both by land and by sea, the company take steps to insure an indemnity being paid to them whether they lose their stocks in transit to them by perils of the sea, or whether they lose it in situ on land by the perils and misfortune of fire."

The House of Lords confirmed the view of the Court of appeal, quoting with approval the remarks of Lord Justice Sergant :-

> "To my mind the book value of the timber in the Company's books has nothing at all to do with the amount of the loss or with the amount which has been recovered in respect of the loss. That amount is a gain of the Company in the course of its business no less than the

> sale price of the timber would have been if the timber had been sold in the course of ordinary sales during the continuance of the Company's business; and in estimating the balance of the profits or gains which the Company has to bring into account for the purposes of Income Tax, the amount of the excess of the sum recovered over the book value of the timber in the Company's books has to be brought into account just as fully and completely as if there had been a sale in the ordinary course of business at that price."

Therefore we must apply the same test to the loss of this timber as we would have applied if the timber had been sold in the ordinary course of business and had fetched no price whatever. Viscount Dunedin puts the matter in this way :-

> "....The whole question comes to be whether that is a turnover in the ordinary course of their business. I think it was. They had that amount of timber, which they got rid of and for which they got a certain price, and then they could begin again."

In that case the assessee got rid of the timber by reason of the fire and got insurance money which was profit. In this case the stock-in-trade has been got rid of by a process which has been neither profitable to the assessee nor to the Department.

4. Mr. Joshi relied on an earlier judgment reported in *Strong and Company of Romsey Ltd. v. Woodifield*[2], In that case., a brewing company, which also owned licensed houses in which they carried on the business of inkeepers, incurred damages and costs to a certain amount on account of injuries caused to a visitor staying at one of their houses by the falling in of a chimney; and the House of Lords held that the damages and costs were not allowable as a deduction in computing the company's profits, and the Lord Chancellor, at page 219 says :-

> "In my opinion, however, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade or it may be connected with something else quite as much as or even more than with the trade. I think only such losses can be deducted as are connected with it in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation, or fall on the trader in some character other than that of trader."

With respect, we agree that this is the correct test. Now can it be said that, when the stock-in-trade of a trader is destroyed, that loss falls on him in some character other than that of a trader, or that this loss is incidental to some other vocation or business? As we said before business can only be carried on and business can only earn profits provided there is a stock-in-trade, and if the stock-in-trade itself is destroyed, it is not only a loss but a calamity as far as the business is. concerned;

5. There is a judgment of the Patna High Court in *Motamal Jethumal v. Commissioner of Income*

Tax[3]*,* which is really based on (1929) 14 Tax Cas 364 (A); but there is a significant passage in the judgment of Mr. Justice Manohar Lall at page 163 (of ITR) , where the learned Judge says :-

> "Supposing the timber had been sold to a customer and he had failed to make any payment at all and the amount due from the customer had been lost or had become irrecoverable, it cannot be seriously argued that such a loss would not have been a trading loss."

So the learned Judge here, while he is dealing with a case of loss by fire, applies with respect, the correct principle, that if the sale of the stock-in-trade did not in fact fetch any price, then the whole value of the stock-in-trade would be a trading loss; and Mr. Justice Meredith at page 164 (of ITR) , points out :

[2](1906) 5 Tax Cas 215

[3]1947-15 ITR 155

> "There is no question of its (i.e. the stock-in-trade) being a capital loss in the case of stock-in-trade, though that might be so in the case of a building destroyed by fire."

Therefore, any suggestion, which suggestion seems to have been accepted by the Tribunal, that the loss of stock-in-trade can be looked upon as a capital loss, is negatived by this learned Judge.

6. Mr. Joshi has drawn our attention to a very recent decision of the English Court reported in *London Investment and Mortgage Co. v. Inland Revenue Commrs*[4]*.* and at page 282 Lord Evershed, Master of the Rolls, derives the principle from Cliksten's case and also from another English case of *Newcastle Breweries, Ltd. v. Inland Revenue Commrs*[5]*.,* as being that

> "where a trader is dealing in any kind of commodity and where for any reason part of that commodity, his stock-in-trade, disappears or is compulsorily taken or is lost, and is replaced by a sum of cash by way of price or compensation, then prima facie that sum of cash must be taken into the account of profits or gains arising to the trader from his trade."

What is to be noticed is what the learned Master of the Rolls emphasises, namely, that the stock-in-trade may be lost "for any reason". If it is lost - and that is the material fact - and it is substituted by a sum of cash, then that sum must be taken into the account of profits and gains of the business. If that be the true principle with regard to profits made by a trader, and if that be the true principle which the Taxing Department is entitled to avail itself of, the principle must be equally true in the converse case, and the converse case is that if the stock-in-trade is destroyed for any reason and no cash takes the place of the stock-in-trade and the assessee receives no value for it, then the loss must be looked upon as a total loss which the assessee would be entitled to bring into account in submitting his assessment with regard to that business.

7. The other contention urged by Mr. Joshi is that, even assuming the assessee was entitled to a

deduction in respect of this loss, he has failed to prove the actual amount of the loss. Now that, in our opinion, is a question of fact and the A. A. C. on an estimate, has come to the conclusion that the loss in respect of Manila was Rs. 1,42,500/- and in respect of Kualalumpur it was Rs. 40,000/-. Unless that finding is disturbed by the Tribunal, that finding must stand. Just as it is not always possible to determine the profits from actual evidence or actual materials and the Taxing Department estimates the profits, similarly, if for reasons over which the assessee has no control there are no actual materials to show what was the stock-in-trade which was destroyed, it was open to the A. A. C. to estimate the loss from such materials as were available, and the materials available in this case were the previous balance sheets and profit and loss accounts of the business.

8. In our opinion therefore, the assessee is entitled to succeed with regard to the deductions which he has claimed for losses which the A. A. C. has estimated at Rs.

[4](1957) 1 All England Reporter 277

[5](1927) 12 Tax Cas 927

1,82,500/- for the destruction of the stock-in-trade at Manila and at Kualalumpur.

9. Turning to the second branch of this reference, various expenses were claimed by the assessee for the years 1943-44 to 1946-47 and these expenses were allowed by the A. A. C. Broadly speaking, these expenses represent the salaries paid by the assessee to the staff who still continued at these places which were occupied by the Japanese, monies paid to their dependants in India, and also the rent paid for the premises in which the business was being carried out. Now. in this case, the assessee is met with a serious difficulty at the very threshold. The A. A. C. took the view that the businesses at these places were suspended for reasons beyond the control of the assessee and, therefore, the salaries, etc., paid or payable to employees at these places together with their messing expenses and rent payable must be allowed as a deduction. The Tribunal has not accepted that finding of fact and the view taken by the Tribunal is that the business at these places had come to an end. Now, whether the business was suspended or had come to an end is a question of fact, and if the Tribunal comes to that conclusion, it is binding on us. The only way it could have been challenged was by asking for a reference on the ground that there was no evidence to justify that finding. Now, curiously enough in the application for reference that the assessee made, it perfectly well understood the position, because in paragraph 10 of the application the assessee stated that the Tribunal allowed the appeal of the Department

> "on the ground more particularly mentioned in the said order, namely, in short that according to the Tribunal the business of the petitioner firm at the said branches came to an end when the Japanese conquered the said places and therefore the expenses incurred from the year 1943-44 to 1946-47 could not be allowed to the petitioner firm."

Therefore, the assessee had no doubt in its mind as to what was the finding of fact of the Tribunal, namely, that the business of the petitioner had come to an end. Now, notwithstanding that, for some reason which it is difficult to understand, that finding was not challenged and the

finding stands to-day uncontroverted and unchallenged. What Mr. Kolah has relied on is a question which we referred to the Tribunal under Section 66 (2) which was on the assumption that the petitioner firm's business remained in suspension, and Mr. Kolah says that by asking the Tribunal to submit a statement of the case on that question we tacitly, if not directly, accepted the contention of the assessee that the finding of the Tribunal on a question of fact that the business had come to an end was erroneous. Now that is an entirely erroneous view to take both of our powers under Section 66 (2) and of what actually happened on this occasion. It is unnecessary to repeat what is quite elementary, that our jurisdiction under that section is purely an advisory jurisdiction. We are not an appellate Court of facts, nor is it our function to find facts. We can only interfere with findings of fact if we are satisfied that facts have been found without any evidence or materials. But before we can say so, we must direct the Tribunal to state a case with regard to that question. The question as has now been framed, as we said before, assumes that the business was suspended. That was the finding of fact of the A. A. C, and if the assessee can satisfy us that on the record that finding has been accepted by the Tribunal, then certainly the question of law would arise on that assumption. But if on the record the finding still remains that the business came to an end, then whatever the legal position may be with regard to the business which has been suspended and has not come to an end, that legal position cannot be canvassed on the present state of the record. It may be unfortunate for the assessee, but we do not see how we can help the assessee, because it would not be open to him now to ask for a reference with regard to that question as such a reference would be time-barred. Nor will any useful purpose be served by Mr. Kolah's suggestion that we should call for a supplemental statement of the case. The statement of the case contains all the materials that we want and the statement of the case expressly states that the Tribunal has found that the business has come to an end. What possible useful purpose will be served by our asking the Tribunal again to tell us what they have found on this matter? Mr. Kolah wanted to take us through the affidavits filed and the judgment of the A. A. C. in support of his contention that the business was suspended and had not come to an end. But these arguments cannot be advanced before us when we are functioning as an advisory tribunal. Mr. Kolah also suggested - rather faintly - that the Tribunal, when it spoke of the business coming to an end, really meant that the business was suspended. Now, surely, it would be doing injustice to the Tribunal to assume that it does not know the distinction between a business being suspended and a business coming to an end; and if the Tribunal has advisedly used the expression "business coming to an end", we cannot assume that it meant something which is the exact contrary of the meaning of that expression. But Mr. Kolah says that, even assuming that the business had come to an end, he is entitled to the expense incurred in these branches. Mr. Kolah's argument is that, so long as the business of the assessee was being carried on - which undoubtedly was carried on - from the head office at Bombay and at other places, the mere fact that the branches at these three places were closed down would not justify the Department in refusing to the assessee the expenses incurred in respect of these branches; and Mr. Kolah says that admittedly the expenses were incurred in respect of these branches. Now the principle, as far as we can see. which applies is that, if an assessee has incurred a long-term liability, the fact that a part of the business is closed down would not justify the Department in

refusing to treat the discharge of that liability by the assessee as a deductible expenditure. The simple cases that strike one are of premises taken on long lease or of the services of a person employed on a fairly long tenure; and while the lease of the premises is subsisting or the control with the employee is subsisting, the fact that business is not carried on in the premises or the services of the employee are no longer required for that business would not justify the assessee in not paying the rent or not paying the remuneration of the employee. This principle is brought out in two cases referred to by Mr. Kolah and they are Commrs., of *Inland Revenue v. Falkirk Iron Co. Ltd.*[6], and *Hvett v. Lennard*[7],

10. In (1933) 17 Tax Cas 625, the assessee company had a lease of certain premises for a period of ten years and it carried on part of its business there for two years and then that part of the business came to an end. Part of the premises were sub-let and the assessee claimed the difference between the rent payable under the lease and the rent received from the sub-tenant. The House of Lords held that the assessee was entitled to the deduction. Lord Morison, at page 632. points out:

> "I think the question always is whether the actual expense incurred was necessary in order to enable the trader to earn the profits charged to Income-tax. That, I think, is mainly a question of fact."

[6](1933) 17 Tax Cas 625
[7](1940) 23 Tax Cas 346

And the learned Law Lord says:

> "The Commissioners have found that the rent which was deducted in respect of the Bristol premises was a necessary expenditure incurred in connection with the Respondents' business." The learned Law Lord looks upon it as a finding that it was necessary for the assessees to incur the expenditure of this sum in order to earn the profits on which they were charged to tax and from that point of view the learned Law Lord thought it was difficult to interfere with the Commissioners' finding. The other case of (1940) 23 Tax Cas 346, is a similar one. There also the premises were not occupied and the rent was claimed as a deduction. But have we got the facts here which would bring the assessee's case within the principles of these decisions?

11. Now it is true that the A. A. C. found, that according to the usual custom and agreement, part payments in India to family members of the employees were continued; and when we turn to the Tribunal's finding, they point out that the payments made in India related to the employees who were in fact entrapped in enemy territory, and they say:

> "We quite realise that in equity the assessee is perhaps entitled to claim the expenses incurred. The nature of the expenses is, however, such that there is no provision under the Income-tax Act under which such expenditure can be allowed When the business came to an end, it is not known what happened to all the employees. They were in enemy

> occupied territories. It is not known whether those employees were in fact carrying on other business or their own business. No enquiry has either been made to show that in every case payment has been made to a wife or a child of a person who was even alive, what to say of his being in the employment of the assessee."

Now it was incumbent upon the assessee to establish with regard to the claim for rent, that leases had been taken for a long period and they could not be terminated when the business came to an end as a result of enemy action; and with regard to salaries paid, that there were agreements with the employees which necessitated payment of salaries even after the business had come to an end and there was no business to which these employees could attend; in other words, that the position was that the contract of service could not he put an end to in law. There is no evidence at all on this aspect. Reliance has merely been placed by the assessee on the fact that it did make payments either to its employees or to their dependants and in respect of rent. But mere payments made in respect of a non-existent business is not sufficient to justify the assessee in claiming them as permissible deductions. It has got to go further and establish according to the principle laid down in the above two English cases, that the liability was initially incurred in respect of rent and salaries for the purpose of the business and that liability could not be put an end to when the business came to an end. As no such fact has been established by the assessee, in our opinion, the Tribunal was right in the conclusion it came to with regard to these expenses.

12. The result is that we will answer the first question in the negative. As stated in the judgment, the assessee is entitled to claim the loss of Rs. 1,82,500/-.
13. The answer to Question No. 2 is in the affirmative. The assessee is not entitled to claim the expenses mentioned in the petition.

14. No order as to costs.
Answered accordingly.