

INCOME TAX REFERENCE NO. 896 OF 1998

v/s.

Mr. Suresh Kumar with Ms. Samiksha Kanani, for the Applicant.
Mr. Nitesh Joshi with Mr. B. D. Damodar i/b. Kanga & Co., for the Respondent.

**CORAM: M.S.SANKLECHA, &
A.K.MENON, JJ.**

RESERVED ON : 2nd AUGUST, 2016.
PRONOUNCED ON : 9th AUGUST, 2016.

JUDGMENT (Per M. S.Sanklecha,J.)::-

This Reference under Section 256(1) of the Income Tax Act, 1961 (the Act), by the Income Tax Appellate Tribunal (Tribunal), seeks our opinion on the following substantial question of law:-

“Whether on the facts and in the circumstances of the case, the Tribunal was correct in holding that the loss on sale of actionable claim by the assessee was a business loss allowable as a deduction in the accounting period ending 31.12.1977?”.

2 The Assessment Year involved is A. Y. 1978-79.

3 Numerous questions were raised by the Revenue before the Tribunal for Reference to this Court. However, only the above question has been referred in the context of the following facts as set out in the statement of case dated 30th June, 1986 :-

“(15) As already stated, while considering the question as to whether the interest income constituted real income of the assessee, the right of the assessee to recover a sum of Rs.103 lakhs from Varun, was sold by the assessee as an actionable claim to M/s. Pearl Thread Mills Ltd., for Rs.45 akhs and the balance of Rs.57,84,590/- was written off by the assessee as a bad debt. The assessee claimed deduction of the letter amount as a business loss. The contention was negatived by the Commissioner (Appeals). He held that it was not the business of the assessee company to advance loans to Varun, that the loans were advanced as a part of an investment programme find that it was not, therefore, a business loss. He further held that the deduction of the amount, in any case, be allowed during the assessment year 1978-79. The assessee questions the correctness of this finding. We have already set out at length of the circumstances under which the loans made to Varun and we have already held that the amount were advanced not by way of investment but purely in an attempt to prevent the State Bank Proceeding against the assessee, as a guarantor. In our view, the guaranteeing by the assessee of the loan by the State Bank to Varun was only as part of the business activity of the assessee. The advancing of the loans to avoid filing suit by the State Bank against assessee was only an act of business expediency, as otherwise, the business of the assessee would have been affected. The investment by the assessee was the share capital of Varun contributed by the assessee and this is different from the loan advanced. It may also be noted that treating the interest on the loan as income of the assessee, the Income Tax Officer has himself treated the advance by the assessee as a trade advance loan. On this basis, he had treated the interest income as business income. The Commissioner (Appeals) was not, therefore, justified in holding that the loss of the assessee was not a business loss.

(16) In view of the above finding, the alternative contention of the assessee that, in case the loss is held to be a loss of investment, should be allowed as short term capital loss, does not arise for consideration. Further, this aspect will arise for consideration only in the subsequent assessment year because the actual assignment of the actionable came took place only during the accounting period relevant to the subsequent assessment year.

(17) The Commissioner (Appeals) was also not correct in holding that the business loss, in any case can be treated as loss in the subsequent assessment year. The reasoning adopted by the Commissioner (Appeals) is that in the meeting of the Board of Directors of the assessee company held on 27.10.1977, they approved only a package arrangement by which Mr. Khatau one of the directors agreed to take the assignment of the actionable claim in the name of himself and/or his nominee that actually the assignment was in favour of Pearl Thread Mills Ltd., who was not a part to the agreement dated 27.10.1977 and that the actual transaction was completed only by executing the assignment deed dated 30.3.1978 after approving draft of the assignment deed 9.3.1978. The Commissioner (Appeals), therefore, held that on 27.10.1977, there was only an understanding between the shareholders and the directors to sell the debt and that the actual sale took place only in the subsequent year. Although, this reasoning will hold good for working out the capital loss, it does not, in our view held good with regard to the writing of the balance amount. By the arrangement entered into on 27.10.1977, one of the directors had agreed to take assignment of the actionable claim for Rs.45 lakhs in this same or in the name of himself or in the nominee. This arrangement was final and it is clear that there was no chance of the assessee recovering the balance amount of Rs.57,84,590/-. A reading of the agreement will show that there were no prospects of realizing any amount from Varun and that the assignment of the actionable claim for Rs.45 lakhs was only to reduce the loss of the assessee. It is, therefore, clear that the balance amount had become a loss and the directors and the shareholders had treated the same as such. In light of what has been stated earlier, they were also justified in doing so. The assessee had actually written off the balance amount during the

accounting period relevant to the assessment year under appeal. In the profit and loss account of the assessee for the year ending 31.12.1977, the balance amount was actually shown as a loss on account of assignment of the actionable claim. The position has been explained in the report of the auditors and also in the notes on the balance sheet. What was postponed to the subsequent accounting period was only the assignment of the actionable claim for Rs.45 lakhs. The assessee is, therefore, entitled to claim the loss during the accounting period ending on 31.12.1977.”

4 The question as framed for our opinion consists of two sub-questions. Therefore, for the convenience of consideration, we consider the two sub-questions separately as under:-

- (i) The first is - Whether the loss on sale of actionable claim was a business loss allowable as a deduction to compute its profits and gains from business? and
- (ii) Second – if the answer to (i) is in the affirmative - Whether the loss on sale of actionable claim is allowable as deduction in the subject Assessment Year or in the following Assessment Year?

5 **Re: sub-question (i):-**

(a) Mr. Suresh Kumar, learned Counsel appearing for the Revenue states that the loss on account of actionable claim was not a business loss allowable as deduction to arrive at its profits and gains of business and in support, submits as under:-

- (i) The Respondent-Assessee is not in the business of providing loans. Therefore, the amount of Rs.103 lakhs which were advanced to M/s. Varun Shipping Company Ltd., was in the nature of investment; and

(ii) The amounts were advanced to M/s. Varun Shipping Company Ltd., when it was making a loss and in such a case, no prudent businessman would advance a loan to a company which is suffering losses.

(b) Per contra, Mr. Joshi, learned Counsel appearing for the Respondent-Assessee submits as under:-

(i) The amount of Rs.103 lakhs were advanced in M/s. Varun Shipping Company Ltd., on account of business expediency. The advance of Rs.103 lakhs was only to ensure that the State Bank of India does not enforce the guarantee given by the Respondent to the Bank in respect of the loan advanced by it to M/s. Varun Shipping Company Ltd.; and

(ii) In any event, the very fact that the Assessing Officer while passing the Assessment Order had treated the interest on the amount advanced to M/s. Varun Shipping Company Ltd., as income of the assessee, chargeable to tax under the head '*profit and gains of business*' would conclude the issue in favour of the Assessee. Such treatment by itself establishes that the Revenue had accepted the amount of Rs.103 lakhs advanced were not in the nature of investment but a part of Respondent-Assessee's business activity. Consequently, any loss on account of non-recovery of the amount advanced to M/s. Varun Shipping Company Ltd., has been treated as a business loss and allowed by the impugned order of the Tribunal;

- (c) We have considered the rival submissions. The primary submission on behalf of the Revenue is that the Respondent- Assessee is not in the business of advancing loans. However the same is not supported by any evidence such as the object clause of the Memorandum of Association etc., We find that merely because normally the Respondent-Assessee does not grant loans, it does not follow that the grant of advance to M/s. Varun Shipping Company Ltd., cannot be considered to be a loan but has to be considered as an investment. It is a settled position in law that even a single/ solitary transaction could by itself be classified as a business transaction (see *G. Venkataswami Naidu & Co., v/s. CIT 35 ITR 594* and *CIT v/s. Sulej Cotton Mills 100 ITR 706*);
- (d) The other contention on behalf of the Revenue is that no prudent businessman would advance a loan to a company making a loss. This is not acceptable for the reason that the manner in which an Assessee carries out its business is entirely for the Assessee to decide. The Assessee is under no obligation to maximize its profits. The Apex Court in *S. A. Builders Ltd., v/s. CIT(A) 268 ITR 1*, has observed to the effect that the Assessing Officer cannot put himself in the arm chair of a businessman and decide how the business is to be conducted, by the businessman;
- (e) The submission of Respondent-Assessee was that the amount of Rs.103 lakhs were advanced to M/s. Varun Shipping Company Ltd., was on account of business expediency so as to ensure that the State Bank of India does not adopt proceedings to enforce the guarantee given by the Respondent-Assessee for the loan granted to

M/s. Varun Shipping Company Ltd.,. This, we find is a possible course of action adopted by a business. Further, we find that the investment of the Respondent-Assessee in M/s. Varun Shipping Company Ltd., is reflected in its contribution to the share capital of M/s. Varun Shipping Company Ltd.,. This contribution can be considered to be an investment as any increase in profitability of M/s. Varun Shipping Company Ltd., would result in dividends and likely appreciation of the share price resulting in the investor earning more than the investment made. The advance of Rs.103 lakhs is not with the above objective/intention. In any case, it is very clear from the Assessment Order that the interest to the extent to which the Respondent-Assessee had waived, on the advance of Rs.103 lakhs to M/s. Varun Shipping Company Ltd., was treated as business income and not as income from other sources. In the above view, the amount of Rs.103 lakhs advanced to M/s. Varun Shipping Company Ltd., cannot be considered to be an investment in the present facts but appropriately a loan in the course of carrying on of business. Consequently, any loss on account of non-recovery of Rs.103 lakhs or any part thereof, would necessarily be a business loss in computing the profits and gains from business;

- (f) Therefore, the first sub-part of the question of law as framed is to be answered in the affirmative i.e. the loss on account of reduced recovery of the loan of Rs.103 lakhs advanced to M/s. Varun Shipping Company Ltd., is to be considered as a business loss and not as a loss on investment.

6 **Re: sub-question (ii):-**

- (a) Mr. Suresh Kumar states that the loss on sale of actionable claim cannot be allowed as deduction in the accounting period ending 31st December, 1977 i.e. the Assessment Year 1978-79. In the present facts, the actionable claim was transferred by the Respondent-Assessee to M/s. Pearl Threads Ltd., for Rs.45 lakhs by a deed of Assignment / Transfer on 30th March, 1978. This resulted in loss of Rs. 58 lakhs. This writing off of business loss, according to Mr. Suresh Kumar, can only take place on execution of the deed of sale/assignment of actionable claim under Section 130 of the Transfer of Property Act, 1882. The sale/assignment of actionable claim admittedly took place on 30th March, 1977. Therefore, it can be allowed as a loss only in the subsequent/following Assessment Year i.e. A. Y. 1979-80.
- (b) As against the above, Mr. Joshi, learned Counsel appearing for the Respondent-Assessee emphasized the undisputed fact that it was on 27th October, 1977 i.e. during subject Assessment Year, an arrangement was entered into by the Respondent-Assessee with one of its Director. By the arrangement, its Director agreed to takeover the actionable claim of Rs.103 lakhs for consideration of Rs.45 lakhs either in his own name or in the name of his nominee. This resulted in a loss of Rs.58 lakhs. This loss of Rs.58 lakhs was allowed for the accounting period 31st December, 1977 relating to the Assessment Year 1978-79. This according to him was permissible as Applicant was following a mercantile system of accounting. The Tribunal allowed the same on the above basis. In

the above view, it is contended by him that the question of law as framed does not arise from the order of the Tribunal. Thus, must be returned unanswered. Alternatively, it is submitted that the question of law as framed is academic in the present facts. This for the reason that the appeal has been allowed by the Tribunal on an issue which is accepted by the Revenue i.e. Mercantile System of Accounting and arrangement dated 27th October, 1977.

7 Before dealing with the merits of the contentions, we must point out that the question of law as framed does arise from the impugned order of the Tribunal. It was the case of the Revenue before the Tribunal that the sale of actionable claim only takes place when the deed of transfer is executed and not prior thereto. Consequently, the loss on sale actionable claim can only take place on the date of execution of the deed of transfer i.e. 30th March, 1978 i.e. next Assessment Year. This was an issue which did arise before the Tribunal, as it was urged on behalf of the Revenue. However, the Tribunal did not deal with the issue as urged and held that the loss was allowable in the subject Assessment Year 1978-79 as the Respondent-Assessee itself had considered the same to be a bad debt/loss consequent to an arrangement dated 27th October, 1977. It was under this arrangement that one of its director agreed to purchase the actionable claim at Rs.45 lakhs either in his own name or in the name of his nominee viz: Pearl Threads Ltd., being subsequently nominated.

8 However, we find merit in the contention on behalf of the Respondent-Assessee that this part of the question viz loss on sale of actionable claim is academic in the present facts and need not be answered. We find that the impugned order of the Tribunal has proceeded

on the basis that the amount of Rs.58 lakhs has been written off as loss in the year ending of 31st December, 1977 i.e. the previous year relating to Assessment Year 1978-79. This loss was claimed in its Profit & Loss Account and Balance Sheet for the year ending 31st December, 1977. Therefore, we need not examine the applicant's submission that the loss can only be claimed in the following Assessment Year 1979-80, as the finding of the Tribunal that the writing off of Rs.58 lakhs in the subject Assessment Year 1979-80 was on account of the arrangement dated 27th October, 1977 is not even attempted to be shown as not permissible in law. The arrangement dated 27th October, 1977 was one by which one of the directors of the Respondent-Assessee had agreed to take actionable claim at a consideration of Rs.45 lakhs. This resulted in the Respondent-Assessee being able to quantify the loss at Rs.58 lakhs on account of the actionable claim of Rs.103 lakhs being the amounts advanced to M/s. Varun Shipping Company Ltd. In these circumstances, the aforesaid sub-question as framed need not be answered, as it would be academic in the context of the order of the Tribunal, allowing loss of Rs.58 lakhs on the basis of the arrangement dated 27th October, 1977 as reflected in the Profit & Loss Account and Balance Sheet filed for the year ending 31st December, 1977. Therefore, the answer to the aforesaid sub-question need not be answered.

9 Before we close, we need to refer to the decision of this Court relied upon by Mr. Joshi i.e. in ***Commissioner of Income Tax, Delhi v/s. Nagri Mills Co., Ltd., 33 ITR 658*** – wherein this Court has observed as under:-

“ We have often wondered why the Income Tax authorities, in a matter such as this where the deduction is obviously a permissible deduction under the Income tax Act, raise disputes as to the year in which the deduction should be allowed. The question as to the year in which a deduction is allowable may be material when the rate of tax chargeable on the assessee in two different years is different; but in the case of income of a company, tax is attracted at a uniform rate, and whether the deduction in respect of bonus was granted in the assessment year 1952-53 or in the assessment year corresponding to the accounting year 1952, that its in the assessment year 1953-54, should be a matter of no consequence to the Department; and one should have thought that the Department would not fritter away its energies in fighting matters of this kind. But, obviously, judging from the references that come up to us every now and then, the Department appears to delight in raising points of this character which do not affect the taxability of the assessee or the tax that the Department is likely to collect from him whether in one year or the other.”

In the present facts also, Mr. Joshi, learned Counsel appearing for the Respondent-Assessee points out that there is, in fact, no change in the rate of tax prescribed in respect company for the Assessment Years 1978-79 and 1979-80. It is also stated that there is a positive income in both the Assessment Years and no advantage is gained by claiming a loss during the subject Assessment Year as against in the following Assessment Year. In the above view, if the facts stated are correct, we wonder whether such an exercise is at all called for in respect of assessment relating to Assessment Year 1978-79. However, we did not examine this issue in the present facts, as we have held that the loss is allowable as business loss in the subject Assessment Year.

10 Accordingly, the question of law as framed for our opinion, is answered in two parts as under:-

- (a) Sub-question (i) above, in the affirmative to the extent the Tribunal held that the loss of Rs.58 lakhs was a business loss allowable for the accounting year ending 31st December, 1977 i.e. Assessment Year 1978-79; and
- (b) Sub-question (ii) above i.e. loss on sale of actionable claim to be allowed in the subject Assessment Year is not answered as in the present facts as it would be academic in nature.

11 Accordingly, **Reference disposed of** in the above terms. No order as to costs.

(A.K.MENON,J.)

(M.S.SANKLECHA,J.)