Privy Council Appeal No. 32 *of* 1939

The Commissioner of Income Tax, Central and United Provinces, Lucknow - - - - - - - - *Appellant*

v.

Messrs. Motiram Nandram - - - - - - - *Respondents*

FROM

THE HIGH COURT OF JUDICATURE AT NAGPUR

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 14TH NOVEMBER, 1939

Present at the Hearing:

LORD THANKERTON
SIR GEORGE RANKIN
MR. M. R. JAYAKAR

[*Delivered by* SIR GEORGE RANKIN]

In this case the respondents have not been represented before their Lordships.

The appeal is brought by the Commissioner of Income-tax, Central and United Provinces, Lucknow, from a decision of the High Court at Nagpur given upon a reference made to that Court under section 66 (2) of the Indian Income-tax Act, 1922. The question of law is as to the admissibility of a deduction of Rs.39,500 in computing the profits of the assessees' business. The year of assessment in respect of which the question arises is the year 1933-4 and as it is not contested that the sum in question was expended or lost in the "previous year," 1932-3, the deduction, if permissible, is claimed for the proper year.

By the terms of section 10 of the Act the profits or gains of a business are to be computed after making certain allowances, one of which is provided for by the terms of clause (ix) of sub-section 2 as follows:—

> (ix) any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains.

The assessees are a Hindu undivided family consisting of three brothers who carry on business under the style of Motiram Nandram at Hinganghat in the district of Wardha in the Central Provinces with a branch at Balaghat. Until 1930 their business or businesses consisted in dealing in cloth and in yarn and as moneylenders. But by an agreement in writing dated 17th December, 1930, they agreed to become organising agents to a Bombay firm which under the name

of the White Kerosene and Mineral Oil Company imported and dealt in kerosene motor spirit and fuel oils. The terms of this agreement are of importance for the decision of this appeal but it will be sufficient to state their effect so far as is necessary to exhibit the course of dealing to which it looked forward.

The agreement refers to the Bombay firm as " the company " and to the assessees as " the organising agents." It recites that the assessees were carrying on business as cloth merchants; that they had requested the company to appoint them organising agents in a defined territory known as Eastern Central Provinces; and that they had offered to deposit with the company Rs.50,000. The company by the agreement appointed the assessees to be organising agents for five years in respect of the territory specified. Clause 4 recited that in consideration of such appointment the assessees had on 8th and 12th December, 1930, deposited Rs.3,000 and Rs.22,000—in all Rs.25,000. It provided that on or before 17th January, 1931, they should deposit a further Rs.25,000. " The said sum of Rs.50,000 shall remain at the disposal of the company for the purposes of the company's business and shall carry interest at the rate of 7 per cent. per annum until the deposit is returned by the company to the organising agents out of the selling agents' deposits as hereinafter provided."

The assessees undertook the duty of finding suitable selling agents for the company's goods in the territory in question. These agents were to be recommended by the assessees but were to be appointed by the company, and were to enter into agreements with the company under which they should make deposits with the company which the latter could use for the purposes of its business. The deposits were to be received on behalf of the company by the assessees, who were authorised to retain and appropriate them to the extent of Rs.50,000 towards the return of their own deposit with the company. In respect of all contracts made by the company with the selling agents, the assessees guaranteed to the company the due payment of the price of such part of the indented goods as was not covered by the security deposits of the selling agents. If the assessees could not find selling agents who were willing to make deposits they were to recommend persons for appointment by the company as selling agents on a salary to be paid by the company. But the assessees were to be responsible to the company for the fulfilment of all obligations to the company of all selling agents and were to countersign all indents by selling agents for goods.

The assessees' commission was to be at the following rates:—a guarantee commission of 1 per cent. on all goods sold in the territory through selling agents; a commission of four annas on every eight Imperial gallons of kerosene, and of two annas six pies on every gallon of motor spirit. Out of this commission the assessees were to pay commission to the selling agents.

The assessees were also to get a certain commission on fuel oil sold in the territory by the company; and were to be at liberty to canvass for orders for fuel oil but not to effect sales, save through selling agents, without special permission of the company. Appropriate terms of commission were specified for such business. The commission account was to be made out every three months and the assessees were to be paid their commission within a fortnight of the adjustment of the account. The company was to provide the assessees with certain staff and office accommodation and to make certain allowances for the remuneration of a representative of the assessees at Hinganghat.

The assessees duly completed the deposit of Rs.50,000 as provided for by clause 4 of the agreement, but the scheme was short-lived as the company in 1931 became insolvent before the assessees had recovered more than Rs.10,500 from deposits made by selling agents. The sum of Rs.39,500 was outstanding and repayable by the company but though the assessees on 14th October, 1931, and 23rd November, 1931, recovered judgment for that sum together with certain interest (amounting in all to Rs.42,272) in the High Court at Bombay nothing was in fact realised in satisfaction thereof.

The assessees claim to deduct the sum of Rs.39,500 from the profits of their business or businesses in the year of account (1932-3) and this if permitted would convert their "total income" finally assessed by the Assistant Commissioner at Rs.19,189 into a loss of over Rs.20,000. The Income-tax officer refused to allow the deduction on the ground that the bad debt was a capital loss. The Assistant Commissioner took the same view, holding that "the deposit was neither a loan nor an advance towards the cost of goods nor did it represent money laid out for business, but that it was merely a security deposit, the object of which was to finance the company and to secure and acquire a new business or a new source of income." The Commissioner agreed in this opinion and stated the facts of the case for the opinion of the Court, framing the question of law as follows:—

> Having regard to the terms of the agreement (Exhibit A) and the other circumstances of the case, was the Assistant Commissioner justified in holding that the item of Rs.39,500 was not a trading loss but a loss of capital?

The reference was first heard by two learned judges of the Court of the Judicial Commissioner, Central Provinces, who gave judgment on 30th September, 1935, Subhedar A.J.C. being in favour of the assessees and Pollock A.J.C. being against them. On 6th November, 1936, after the High Court of Judicature at Nagpur had been established, Gruer J. as third judge agreed with Subhedar A.J.C. The judgment appealed from is thus a judgment answering the question referred in the negative by a majority of two judges to one.

The view taken by Subhedar A.J.C. was that the deposit was made by the assessees in the course of their money-lending business and Gruer J. also concluded "that the transaction should be looked upon as a variation or extension of

the assessees' moneylending business." Pollock A.J.C. on the other hand considered that "the deposit was money invested in acquiring a new business and that it was not a loan made in the course of the assessees' moneylending business, nor money laid out in the ordinary course of an existing business."

Their Lordships are of opinion that the character of the expenditure which the assessees now seek to bring within clause (ix) of section 10 (2) must be determined with reference to the business of organising agents in which the assessees engaged upon the terms of the agreement of 17th December, 1930. This business was of a different nature from that of moneylender, and the principle that money is the stock in trade or circulating capital of a moneylender cannot of itself determine the question which arises in this case. Subhedar A.J.C. considered that "the assessees had nothing to do with the oil business in which the company and the selling agents were alone interested" and Gruer J. makes a similar observation: "Paragraph 13 provides that the organising agents are not to effect any sales of the company's goods themselves. Their duties were to organise the network of selling agents to be guaranteed by them but appointed by the company. Thus they were not actually carrying on the company's business itself." But apart from the fact that the assessees under the agreement were to be at liberty to canvass for orders and, with special permission, to effect sales, the question is not whether the assessees were engaging in the business of merchants in oil. They were entering upon the business of organising agents for a firm of importers—a business different in character from that of moneylender. They had undertaken to find suitable persons to be appointed as selling agents, and to guarantee the fulfilment of all obligations incurred towards the company by such selling agents, some of whom might be working on a salary basis without having given security. · The nature of the deposit of Rs.50,000 must be considered in relation to this business.

Both of the learned judges who found in favour of the assessees appear to have considered that the course of business indicated in the agreement of 17th December, 1930, bore analogy to the case of a proprietor of an estate borrowing money and appointing the lender to be manager of the estate. But this in their Lordships judgment is to rewrite the agreement. The assessees might have recouped themselves out of deposits made by selling agents at any time, but though the interest at 7 per cent. would have ceased to be payable the agency would still have gone on till the end of five years, and the assessees' work and commission as well as their liabilities under their guarantee might meanwhile have been heavy. It is impossible to regard the provision for a deposit as unconnected with the fact that the assessees were guaranteeing the selling agents' obligations. The deposits of the selling agents and of the organising agents were alike deposits by way of security according to the scheme of the agreement, though its language—save for the

use of the word " deposit "—is not express upon the point in the case of the organising agents.

When the deposit is considered in relation to the organising agency, the special terms of the agreement of 17th December, 1930, are important since various suggestions have been made as to the true character of the deposit. One suggestion is that the deposit should be looked upon as the purchase price of goods paid to the company in advance and thus a mere trading expense; but this cannot be accepted. It would be a highly inaccurate statement of the effect of the agreement. The Rs.50,000 was doubtless laid out with a view to earning profits in the business of organising agents in addition to the interest of 7 per cent., but it was not so laid out with reference to any particular transaction carried out in the course of such business. It was in one aspect a loan made to the company, but it was not a loan made in the course of carrying on the business of organising agents or in the course of the business of a moneylender. It was not a recurring expenditure. On the other hand, it was contemplated that in whole or in part the deposit should be returned to the assessees by the receipt of deposits from selling agents; so that if the Rs.50,000 does fall to be regarded as invested in a business of organising agents, it was invested with a prospect that it might be a temporary investment and not a permanent one—in other words that the capital might later be withdrawn from the business. The question in such a case as the present must be " what is the object of the expenditure ? " and it must be answered from the standpoint of the assessees at the time they made it—that is, when they were embarking upon the business of organising agents for the company. The deposit was clearly exacted by the company as a condition of the assessees being given an agency which they hoped to manage profitably. Their Lordships think that the purpose of being permitted to engage in such a business must be considered to be a purpose of securing an enduring benefit of a capital nature, and that the deposit cannot, upon a true view of the terms of the agreement and the circumstances of the case, be regarded as an expenditure made in the course of carrying on an existing agency, or any other business. They think that the view taken by the Income-tax authorities is correct, that this appeal should be allowed and that the question referred to the Court by the letter of reference dated 1st March, 1935, should be answered in the affirmative. They will humbly advise His Majesty accordingly. The assessees must pay the costs of the reference in the Judicial Commissioners' Court and High Court: also the costs of this appeal.

(20956—3A) Wt. 8075—41 180 11/39 P. St. G. 338

In the Privy Council

THE COMMISSIONER OF INCOME TAX, CENTRAL AND UNITED PROVINCES, LUCKNOW

v.

MESSRS. MOTIRAM NANDRAM

DELIVERED BY SIR GEORGE RANKIN

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