

# COMMISSIONER OF INCOME-TAX, U.P.

v.

## NAINITAL BANK LTD.

September 15, 1966.

[J. C. SHAH, V. RAMASWAMI AND V. BHARGAVA, JJ.]

*Indian Income-tax Act, 1922, s. 10(2)(xv)—Jewellery pledged with bank stolen—Bank crediting cost of jewellery to constituents accounts and setting off against such credit amounts advanced to them—Amounts so credited whether expenditure laid out for the purpose of the business.*

Jewellery pledged with the respondent bank by its constituents was stolen by dacoits. The bank settled the claims of the constituents by crediting the value of the jewellery against the amounts advanced to the constituents. When the market value of the jewellery pledged exceeded the amount advanced the difference was paid by the bank to the constituent; where the market value of the jewellery was less than the amount advanced the difference was recovered from the constituent. Under the adjustments made in this manner the Bank in the year 1952 made a total payment of Rs. 48,891 and in the year 1953 the Bank paid Rs. 1,21,760. In the returns for the assessment year 1953-54 and 1954-55 the Bank claimed in computing its taxable income the amounts so paid to the constituents. The claim was disallowed by the assessing and appellate authorities but the High Court in reference under s. 66(2) of the Indian Income-tax Act, 1922 allowed it. The Commissioner of Income-tax appealed to this Court by certificate.

It was urged on behalf of the appellant that (1) by writing off either partially or wholly the amounts due from its constituents in its books of account the Bank merely forbore to enforce its demand against its constituents and such forbearance was not expenditure within the meaning of s. 10(2)(xv) of the Indian Income-tax Act, 1922, (2) in any case the expenditure was not laid out wholly and exclusively for the purposes of the business since the bank was under no legal obligation to pay the cost of jewellery.

HELD: (i) In its normal meaning the expression "expenditure" denotes "spending" or "paying out or away" i.e., something that goes out of the coffers of the assessee. A mere liability to satisfy an obligation by an assessee is undoubtedly not "expenditure"; it is only when he satisfies the obligation by delivery of cash or property or by settlement of accounts there is expenditure. But expenditure does not necessarily involve actual delivery or parting with money or property. If there are cross-claims—one by the assessee against a stranger and the other by the stranger against the assessee—and as a result of accounting the balance due only is paid, the amount which is debited against the assessee in the settlement of accounts may appropriately be termed expenditure within the meaning of s. 10(2)(xv). [350 E-G]

It could not be said that there was by the settlements mere forbearance to recover the amounts advanced to the constituents. The settlements were bilateral: each constituent admitted his liability to repay the amount which had been advanced to him, and the Bank admitted liability to pay to the Constituent the value of the jewellery pledged with it. When the Bank paid to the constituent the difference between the value of the jewellery pledged with it and the amount due by the constituent the Bank in effect paid the value of the jewellery against payment by the constitu-

A ent of the amount due by him. In making payment of that difference the Bank in truth laid out expenditure equal to the value of the jewellery pledged. [351 A-C]

(ii) The Bank could have if so advised taken its stand strictly on its legal obligations and could have recovered the amounts due by the constituents at the same time denying liability to make any compensation for the loss of jewellery pledged with it. But such a stand might very well have ruined its business, especially in the rural areas in which it operated. In choosing to compensate the constituents and thus maintaining their goodwill the Bank laid out expenditure for the purpose of its business. [351 G-H]

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 601 & 602 of 1965.

C Appeals from the judgment and decree dated April 12, 1962 of the Allahabad High Court in I.T.R. No. 484 of 1960.

*R. M. Hazarnavis, R. H. Dhebar and R. N. Sachthey*, for the appellant (in both the appeals).

*S. T. Desai, B. P. Singh and Naunit Lal*, for the respondent (in both the appeals).

D The Judgment of the Court was delivered by

*Shah, J.* The Nainital Bank Ltd., has its head office at Nainital and a branch at Ramnagar. Currency notes of the value of Rs. 1,06,000/- and a large quantity of jewellery pledged with the Bank by its constituents were stolen by dacoits on June 11, 1951 from the premises of the Bank. The Bank claimed in its return for the assessment year 1952-53 the loss of currency notes as a permissible deduction. The departmental authorities disallowed the claim. But the claim was allowed by the High Court of Allahabad and that order was confirmed by this Court see *Commissioner of Income-tax v. Nainital Bank Ltd.*(1).

F In regard to the loss of jewellery the Bank settled the claims of the constituents who had pledged their jewellery. The terms of settlement were these: when the market value of the jewellery pledged exceeded the amount advanced, the difference was paid by the Bank to the constituent: when the market value of the jewellery was less than the amount advanced, the difference was recovered from the constituent. Under the adjustments

G made in this manner, in the year 1952 the Bank made a total payment of Rs. 48,891/- and in the year 1953 the Bank paid Rs. 1,21,760. In its returns for the assessment years 1953-54 and 1954-55 the Bank claimed in computing its taxable income the amounts so paid to the constituents. The Income-tax Officer disallowed the claims and the order was confirmed in appeal to the Appellate Assistant Commissioner. An appeal to the Income-tax Appellate Tribunal was also unsuccessful.

1. [1965] 1 S.C.R. 340 : 55 I.T.R. 707.

The Tribunal submitted a statement of the case and referred the following question to the High Court of Allahabad for opinion :

“Whether on a true interpretation of s. 10 (1), s. 10 (2) (xi) and s. 10 (2) (xv) of the Indian Income-tax Act, the claims for the losses of Rs. 48,891/- and Rs. 1,21,760/- were permissible in the assessment years 1953-54 and 1954-55 respectively ?”

Before the High Court the claim for deduction under s. 10 (2) (xi) was abandoned by the Bank, and the High Court negatived the claim of the Bank for deduction of the amount under s. 10 (1). But the High Court held that having regard to the true nature of the settlements made with the constituents the amounts credited as the value of jewellery against the claim of the constituents for amounts advanced to them must be regarded as expenditure within the meaning of s. 10 (2) (xv) and since such credit was given by the Bank in the interest of its business, the amounts paid were liable to be deducted in computing the taxable income. The Commissioner of Income-tax has appealed with certificate granted by the High Court under s. 66 A (2) of the Income-tax Act.

In these appeals counsel for the Commissioner raised two contentions: that by writing-off either partially or wholly the amounts due from its constituents in its books of account the Bank did not expend or lay out expenditure within the meaning of s. 10 (2) (xv); and that in any event the expenditure was not laid out wholly and exclusively for the purposes of the business of the Bank. In its normal meaning the expression “expenditure” denotes “spending” or “paying out or away” *i.e.* something that goes out of the coffers of the assessee. A mere liability to satisfy an obligation by an assessee is undoubtedly not “expenditure”: it is only when he satisfies the obligation by delivery of cash or property or by settlement of accounts there is expenditure. But expenditure does not necessarily involve actual delivery or parting with money or property. If there are cross claims—one by the assessee against a stranger and the other by the stranger against the assessee—and as a result of accounting the balance due only is paid, the amount which is debited against the assessee in the settlement of accounts may appropriately be termed expenditure within the meaning of s. 10 (2) (xv).

Counsel for the Commissioner submitted that when the Bank advanced a loan to its constituent it incurred expenditure and when the Bank failed to recover under an arrangement with the constituent the amount due to it, there was merely an act of forbearance to enforce the demand and such an act of forbearance was not expenditure within the meaning of s. 10 (2) (xv). Mere forbearance to realize a claim, it may be accepted, is not expenditure within the meaning of the Act; but we are not called upon to consider whether

A the advances made by the Bank to its constituents may in certain  
circumstances constitute expenditure. Nor can it be said that  
there was by the settlements mere forbearance to recover the amount.  
The settlements made by the Bank with its constituents were in  
their nature bilateral: each constituent admitted his liability to  
B repay the amount which had been advanced to him, and the Bank  
admitted liability to pay to the constituent the value of the jewellery  
pledged with it. When the Bank paid to the constituent the difference  
between the value of the jewellery pledged with it and the  
amount due by the constituent, the Bank in effect paid the value  
of the jewellery against payment by the constituent of the amount  
C due by him. In making payment of that difference the Bank in  
truth laid out expenditure equal to the value of the jewellery  
pledged.

It was urged by the Commissioner that the Bank was under  
no legal liability to pay to the constituents the value of the jewellery  
pledged with it. It was said that the Bank was, as a pledgee, a  
bailee of the jewellery and was in law required to take as much  
D care of the pledged jewellery as a person of ordinary prudence  
would take under similar circumstances of his own jewellery of  
the same bulk quantity and value, and the Bank having provided  
an adequate number of watchmen, it was not liable for the loss of  
the property pledged. Granting that on proof that it had taken  
as much care of the jewellery pledged with it as it would have taken,  
E if it belonged to it, the Bank could enforce its rights and recover  
the full amount due from the constituents, the question still remains  
whether in admitting liability for the value of the jewellery pledged,  
the Bank laid out expenditure for the purpose of the business.  
The question is not about the strict enforcement of the legal rights  
and obligations between the Bank and its constituents. The sole  
F question is whether the Bank in incurring the expenditure acted  
in the interest of and for the purpose of its business. The Bank  
is carrying on banking business and advances loans on the security  
of jewellery. The credit of a banking business is very sensitive:  
it largely thrives upon the confidence which its constituents have  
in its management. To maintain that confidence the management  
has often to make concessions and thereby to preserve the good-  
G will of the business and its relations with the clientele. The Bank  
could have if so advised taken its stand strictly on its legal obliga-  
tions, and could have recovered the amounts due by the constituents  
at the same time denying liability to make any compensation for  
the loss of jewellery pledged with it. But such a stand might very  
well have ruined its business, especially in the rural areas in which  
H it operated. The Bank had evidently two courses open: to enforce  
its rights strictly according to law, and thereby to lose the good-  
will it had built up among the constituents, or to compensate the  
constituents for loss of their jewellery, and maintain its business

connections and goodwill. In choosing the second alternative, in our judgment, the Bank laid out expenditure for the purpose of its business. Paying to the constituents the price of the jewellery stolen in a robbery or a burglary was therefore expenditure for the purpose of the business. There can be no doubt that the expenditure was wholly and exclusively in the interest of the business. The expenditure was laid out for no other purpose.

We hold accordingly that the settlements with the constituents and the consequent posting of entries in the books of account cannot be regarded as forbearance to enforce the claim of the Bank to recover the loans advanced. The settlement consisted of two constituent elements—paying by the Bank of the value of the jewellery pledged with it against receipt from the constituent of the amount which was recoverable by the Bank. The first element of the transaction would appropriately be deemed expenditure and such expenditure having been laid out for protecting and furthering the business of the Bank was properly admissible under s. 10 (2) (xv) of the Income-tax Act, 1922.

The appeals therefore fail and are dismissed with costs. There will be one hearing fee.

*Appeals dismissed.*

G.C.