Bombay High Court
Commissioner Of Income-Tax vs Kamani Tubes Ltd. on 14 September, 1993
Equivalent citations: 1994 207 ITR 271 Bom
Author: . B Saraf
Bench: B Saraf, D Dhanuka
JUDGMENT Dr. B.P. Saraf J.

1. By this reference under section 256(1) of the Income-tax Act, 1961, at the instance of the Revenue, the Income-tax Appellate Tribunal has referred the following two questions of law for opinion :

"1. Whether, on the facts and in the circumstances of the case and in law, the Tribunal was justified in confirming the order of the Commissioner of Income-tax (Appeals) deleting the disallowance of Rs. 29,334 under section 40A(5) ?

2. Whether, on the facts and in the circumstances of the case and in law, the Tribunal was justified in upholding the decision of the Commissioner of Income-tax (Appeals) deleting the addition of Rs. 5,85,093 on account of price difference paid for settlement of contract otherwise than by actual delivery of goods ?"

2. Learned counsel for the parties are agreed that the controversy involved in question No. 1 is covered by the decision of this court in CIT v. Indokem Pvt. Ltd. [1981] 132 ITR 125. In that view of the matter, we answer question No. 1 in the affirmative, i.e., in favour of the assessee and against the Revenue.

3. As regards question No. 2, the submission of counsel for the assessee is that it is covered in favour of the assessee by the decision of the Supreme Court in CIT v. Shantilal P. Ltd. [1983] 144 ITR 57 and the decisions of this Court in CIT v. Asian Chemical Co. [1992] 197 ITR 634 and CIT v. Jaydwar Textiles [1993] 202 ITR 569. Mr. G. S. Jetly, counsel for the Revenue, however, does not agree with the above submission. He contends that the decisions relied upon by the assessee have no application to the facts of the present case. According to him, in the instant case, the assessee had paid the difference between the agreed price of the goods and the market price. It is not a case where any "liquidated damages" had been paid. The decisions of this court and the decision of the Supreme Court referred to above are applicable only to cases "where damages are paid for breach of contract and not to payments made in fulfilment of a contract whereunder purchase or sale of goods is settled otherwise than by actual delivery of goods". So far as the legal proposition advanced by Mr. Jetly is concerned, we do not find any difficulty in accepting the same in view of section 43(5) of the Act which defines "speculative transaction" to mean a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. The meaning and scope of this expression is no more res integra in view of the decision of the Supreme Court in CIT v. Shantilal P. Ltd. [1983] 144 ITR 57. In that case, the Supreme Court explained the distinction between "a settlement of the contract otherwise than by actual delivery of the goods" and "breach of contract". It was observed (at page 60) :

"…. A contract can be said to be settled if instead of effecting the delivery or transfer of the commodity envisaged by the contract the promise, in terms of section 63 of the Contract Act, accepts, instead of it, any satisfaction which he thinks fit. It is quite another matter where instead of such acceptance the parties raise a dispute and no agreement can be reached for a discharge of the contract. There is a breach of the contract and by virtue of section 73 of the Contract Act the party suffering by such breach becomes entitled to receive from the party who broke the contract compensation for any loss or damage caused to him thereby. There is no reason why the sense conveyed by the law relating to contracts should not be imported into the definition of 'speculative transaction'. The award of damages for the breach of a contract is not the same thing as a party to the contract accepting satisfaction of the contract otherwise than in accordance with the original terms thereof. It may be that in a general sense the lay may would understand that the contract must be regarded as settled when damages are paid by way of compensation for its breach. What is really settled by the award of such damages and their acceptance by the aggrieved party is the dispute between the parties. The law, however, speaks of a settlement of the contract, and a contract is settled when it is either performed or the promise dispenses with or remits, wholly or in part, the performance of the promise made to him or accepts instead of it any satisfaction which he thinks fit. We are concerned with the sense of law, and it is that sense which must prevail in sub-section (5) of section 43. Accordingly, we hold that a transaction cannot be described as a 'speculative transaction' within the meaning of sub-section (5) of section 43, Income-tax Act, 1961, where there is a breach of the contract and on a dispute between the parties damages are awarded as compensation…."

4. The above observation makes it abundantly clear that a transaction cannot be described as a "speculative transaction" within the meaning of section 43(5) of the Act where there is a breach of the contract and on a dispute between the parties damages are awarded as compensation. Section 73 of the Contract Act deals with the consequences of breach of contract and payment of compensation for loss or damage caused by breach of contract. This section, so far as relevant, reads :

"73. Compensation for loss or damage caused by breach of contract. - When a contract has been broken, the party how suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach. . . ."

5. Some of the illustrations appended to section 73 are helpful in understanding what amounts to a breach of contract. Illustrations (a), (c), (d) and (h) having a direct bearing on the controversy before us, are set out below :-

"(a) A contracts to sell and deliver 50 maunds of saltpetre to B, at a certain price to be paid on delivery. A breaks his promise. B is entitled to receive from A, by way of compensation, the sum, if any, by which the contract price falls short of the price for which B might have obtained 50 maunds of saltpetre of like quality at the time when the saltpetre ought to have been delivered. . . .

(c) A contracts to buy from B, at a stated price, 50 maunds of rice, no time being fixed for delivery. A afterwards informs B that he will not accept the rice if tendered to him. B is entitled to receive from A by way of compensation, the amount, if any, by which the contract price exceeds that which B can obtain for the rice at the time when A informs B that he will not accept it.

(d) A contracts to buy B's ship for 60,000 rupees, but breaks his promise. A must pay to B, by way of compensation, the excess, if any, of the contract price over the price which B can obtain for the ship at the time of the breach of promise. . . .

(h) A contracts to supply B a certain quantity of iron at a fixed price, being a higher price than that for which A could procure and deliver the iron. B wrongfully refuses to receive the iron. B must pay to A, by way of compensation, the difference between the contract price of the iron and the sum for which A could have obtained and delivered it. . . ."

6. From a reading of section 73 and the above illustrations, more particularly illustration (c), it is abundantly clear that failure to accept the goods in terms of the contract on the stipulated date amounts to a breach of contract and in such a case, the other party is entitled to receive compensation for loss or damage caused by such breach. In the case of a contract for the sale of goods, the measure of damages upon a breach by the buyer is the difference between the contract price and the market price at the date of the breach. Such payment cannot be termed as "payment made on periodical or ultimate settlement of the contract for purchase and sale of the commodity otherwise than by actual delivery or transfer of the commodity" contemplated by section 43(5) of the Act. That would happen only in cases falling under section 63 of the Contract Act which provides :

"63. Promise may dispense with or remit performance of promise. - Every promise may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit."

7. We may now consider the facts of the present case in the light of the above discussion to determine whether the payments made by the assessee can be held to be payments made in satisfaction of the contract as contemplated by section 63 of the Contract Act or these are payments by way of compensation for breach of contract within the meaning of section 73 of the Contract Act. The assessee carried on the business of manufacture and sale of metal tubes and rods. For that purpose, it used to purchase brass sheets from different parties for use as raw materials in the manufacture of its products. During the accounting year relevant to the assessment year 1975-76, the assessee entered into contracts for supply of brass sheets with four parties. The assessee took delivery of part of the goods, i.e., 23,116 kgs. in May, 1974, against orders for 61 metric tonnes placed with one of the parties. It also took part delivery of a part of the goods in June-July, 1974, against the contract for supply with another party. During the relevant period, in all, the assessee took part delivery of the goods from three out of the four parties. In the meanwhile, a strike took place in the factory of the assessee resulting in dislocation of production. During the strike period, the assessee did neither have the resources nor the need to purchase raw materials. By the time the strike ended, the price of those materials had fallen in the market. Situated thus, the assessee refused to accept the goods and agreed to pay the difference between the agreed price and the market price at the date

of refusal. Such payment amounted to Rs. 5,85,093. The assessee claimed deduction of the above amount in computation of its income. The Income-tax Officer disallowed the claim of the assessee on the ground that settlement of the contracts by payment of the price difference made the transaction speculative in nature and, therefore, the loss that arose to the assessee on payment of the price difference was a loss from speculative transaction which cannot be set off against other business income. The assessee appealed to the Commissioner of Income-tax (Appeals). It was contended by the assessee that the payment was by way of damages for breach of contract income. The Commissioner (Appeals) accepted the contention of the assessee and held that the amount was deductible in the computation of its income. The order of the Commissioner (Appeals) was upheld by the Income-tax Appellate Tribunal. The Tribunal observed :

"Once a contract is broken, there could be no cause of action founded on the contract itself which could be said to be capable of settlement. After the breach of contract, what can be settled is only the right to damages resulting from the breach itself. Therefore, the amounts paid by the assessee to the parties represented damages for the breach of contracts and did not represent payment of differences on the settlements made prior to or on the date of delivery."

8. Hence this reference at the instance of the Revenue.

9. Learned counsel for the Revenue contends that it is a case of fulfilment of the contract by payment of the difference between the contracted price and the market price on the due of delivery within the meaning of section 63 of the Contract Act. On the other hand, the contention on behalf of the assessee is that it is a case of breach of contract for which compensation had been paid by the assessee. On a careful consideration of the rival submissions in the light of the provisions of sections 63 and 73 of the Contract Act and the ratio of the decision of the Supreme Court in CIT v. Shantilal P. Ltd. [1983] 144 ITR 57, we are of the clear opinion that it is a case of breach of contract and the payments made by the assessee are by way of damages caused thereby. It clearly falls in illustration (c) of section 73 set out above. It is not a case of performance of the contract within the meaning of section 63 of the Act. The payment of Rs. 5,85,093 by the assessee, therefore, cannot be termed as a "speculative transaction" within the meaning of section 43(5) of the Act.

10. The controversy may be examined from one more angle. Even if in a given case, a particular transaction is held to be a speculative transaction within the meaning of section 43(5) of the Act, such a finding would not resolve the controversy regarding the applicability of Explanation 2 to section 28 and section 73 of the Act without a further finding that the assessee carried on business in such speculative transactions. It is only where the speculative transactions carried on by an assessee are of such a nature as to constitute business that Explanation 2 to section 28 gets attracted and such business, which is referred to as "speculative business", is deemed to be distinct and separate from other business and section 73 of the Income-tax Act becomes applicable to the set off and carry forward of loss from such business. This is evident from sections 70, 71, 72 and 73 of the Act.

11. Section 70 of the Act provides for set off of loss against income under the same head. Section 71 provides for set off of loss against income under another head. Section 72 contains provisions for carry forward of business losses to the following assessment year and set off thereof against the

income of that year. All these sections do not apply to loss in a speculation business which, under section 73, can be set off only against the profits of another speculative business. Sections 72 and 73, so far as relevant, read :

"72. Carry forward and set off of business losses. - (1) Where for any assessment year, the net result of the computation under the head 'Profits and gains of business or profession' is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off or, where the assessee has income only under the head 'Capital gains' relating to capital assets other than short-term capital assets and has exercised the option under sub-section (2) of that section or where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and -

(i) it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year :

Provided that the business or profession for which the loss was originally computed continued to be carried on by him in the previous year relevant for that assessment year; and

(ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on : . . . ."

"73. Losses in speculation business. - (1) Any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off against profits and gains, if any, of another speculation business.

(2) Where for any assessment year any loss computed in respect of a speculation business has not been wholly set off under sub-section (1), so much of the loss as is not so set off or the whole loss where the assessee had no income from any other speculation business, shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and -

(i) it shall be set off against the profits and gains, if any, of any speculation business carried on by him assessable for that assessment year; and

(ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on. . . ."

"Speculation business" has been defined in Explanation 2 to section 28 of the Act as under :

"Explanation 2. - Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as 'speculation business') shall be deemed to be distinct and separate from any other business."

12. From the above definition, it is clear that there is a clear distinction between "speculative transaction" and "speculation business". Only those speculative transactions carried on by an assessee are deemed to be distinct and separate from any other business which are of such a nature as to constitute "business" (which is referred to as "speculation business").

13. From a reading of the above provisions, it is clear that there is a departure from the scheme of the Act regarding set off of losses from business (other than speculation business) against any income under the same head, set off against income from another head and carry forward and set off of business losses (contained in sections 70, 71 and 72). Under section 73(1) losses from speculation business can be set off only against profits of another speculative business. Similarly, a loss in speculative business can be carried forward to a subsequent year and set off only against the profits of any speculation business carried on in that year [section 73(2)].

14. On a careful reading of the provisions of sections 72 and 73, Explanation 2 to section 28 of the Act, it is abundantly clear that all these provisions are applicable only to treatment of profits and losses from a "speculation business". There is a perceptible difference between "speculative transaction" and "speculation business". An isolated transaction of settlement of a contract otherwise than by actual delivery of the goods might amount to "speculative transaction" within the meaning of section 43(5) of the Act but in the absence of something more to show that the nature of the transactions was such as to constitute a business, it cannot be termed as "speculation business" which has been treated as distinct and separate from other business. The expression "business" has been defined in clause (4) of section 2 of the Act to include :

"any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."

15. It is evident from the above definition, that "an adventure in the nature of trade" has also been included in the expression "business". Dealing with the effect of inclusion of "an adventure in the nature of trade" in the definition of "business", the Supreme Court, in G. Venkataswami Naidu and Co. v. CIT [1959] 35 ITR 594 (at pages 607-608) observed :

"When section 2, sub-section (4), refers to an adventure in the nature of trade it clearly suggests that the transaction cannot properly be regarded as trade business. It is allied to transactions that constitute trade or business but may not be trade or business itself. It is characterised by some of the essential features that make up trade or business but not by all of them; and so, even an isolated transaction can satisfy the description of an adventure in the nature of trade. Sometimes it is said that a single plunge in the waters of trade may partake of the character of an adventure in the nature of trade. This statement may be true; but in its application due regard must be shown to the requirement that the single plunge must be in the waters of trade. In other words, at least some of the essential features of trade must be present in the isolated or single transaction. On the other hand, it is sometimes said that the appearance of one swallow does not make a summer. This may be true if, in the metaphor, summer represents trade; but it may not be true if summer represents an adventure in the nature of trade because, when the section refers to an adventure in the nature of trade it is obviously referring to transactions which individually cannot themselves be described as

trade or business but are essentially of such a similar character that they are treated as in the nature of trade."

16. It was further observed (at page 609) :

".... [It] is impossible to evolve any formula which can be applied in determining the character of isolated transactions which come before the courts in tax proceedings. It would besides be inexpedient to make any attempt to evolve such a rule or formula. Generally speaking, it would not be difficult to decide whether a given transaction is an adventure in the nature of trade or not. It is the cases on the border line that cause difficulty...."

17. In deciding the character of transactions, what is important to consider is the distinctive character of such transactions. In each case, it is the total effect of all the relevant facts and circumstances that the determines the character of the transactions. Reference may also be made to the decision of this Court in CIT v. Principal Officer, Laxmi Surgical P. Ltd. [1993] 202 ITR 601, where it was held that it is not possible to evolve any legal test or formula which can be applied in determining whether a transaction is an adventure in the nature of trade or not. The answer to the question must necessarily depend in each case on the total impression and effect of all the relevant factors and circumstances proved therein which determine the character of the transaction.

18. The essential features of "business" are no more res integra. It was held by the Supreme Court in State of Andhra Pradesh v. H. Abdul Bakshi and Bros. that the expression "business", though extensively used, is a word of indefinite import. In taxing statutes it is used in the sense of an occupation or profession which occupies the time, attention and labour of a person, normally with the object of making profit. To regard an activity as business, there must be a course of dealings either actually continued or contemplated to be continued with a profit motive.

19. In State of Gujarat v. Raipur Manufacturing Co. Ltd. , the Supreme Court held that the whether a person carries on business in a particular commodity must depend upon the volume, frequency, continuity and regularity of the transactions of purchase and sale in a class of goods and the transactions must ordinarily be entered into with a profit-motive. By the use of the expression "profit-motive" it is not intended that the profit must in fact be earned. Nor does the expression cover a mere desire to make some monetary gain out of a transaction or even a series of transactions. It predicates a motive which pervades the whole series of the transactions effected by the person in the course of his activity. Moreover, the burden of proving that the transactions carried on by an assessee were of such a nature as to the constitute "speculation business" is on the taxing authorities. If the authorities come to a conclusion without the making necessary investigation in that regard, such an inference cannot be sustained.

20. In the instant case, even if the transaction of payment of the sum of Rs. 5,85,093 by the assessee to the four suppliers for its failure to take delivery of the goods in terms of the contract is held to be a "speculative transaction" within the meaning of section 43(5) of the Act, there is nothing to justify its being described as "speculation business" within the meaning of Explanation 2 to section 28 of the Act. On a careful consideration of the facts and circumstances of the case, it is obvious that it is

not characterised by any of the features of trade or business. It cannot, therefore, be described even as an adventure in the nature of trade. The transaction was not only an isolated transaction carried out by the assessee in the peculiar facts and circumstances of the case including the occurrence to strike in the factory, but it is also in no way similar in character to trade. It cannot, therefore, be treated as in the nature of trade.

21. That being so, we are of the clear opinion that the Tribunal was justified in affirming the order of the Commissioner of Income-tax (Appeals) and holding that the Income-tax Officer was not justified in disallowing deduction of Rs. 5,85,093 by reference to section 43(5) of the Act. As already observed, no such disallowance can be made in the absence of clear findings that : (i) the transactions in question were speculative transactions, and (ii) that those transactions were of the such a nature as to constitute a business. There being no such finding, payment of the above amount cannot be treated as loss from speculation business. Explanation 2 to section 28 and section 73 of the Act are, therefore, not attracted.

22. Having regard to our above opinion, we answer question No. 2 in the affirmative, i.e., in favour of the assessee and against the Revenue.

23. We make no order as to costs.