
(1975) 12 BOM CK 0011

Bombay High Court

Case No: Income-tax Reference No. 43 of 1966

Commissioner of
Income Tax

APPELLANT

Vs

Indian Commercial Co.
P. Ltd.

RESPONDENT

Date of Decision: Dec. 11, 1975

Acts Referred:

- Income Tax Act, 1961 - Section 28, 29, 30, 31, 32

Citation: (1977) 106 ITR 465

Hon'ble Judges: S.K. Desai, J; J.R. Vimadalal, J

Bench: Division Bench

Advocate: R.J. Joshi, for the Appellant; D.H. Dwarkadas, for the Respondent

Judgement

Vimadalal, J.

This is a reference at the instance of the Commissioner u/s 256(1) of the Income Tax Act, 1961, relating to assessment year 1962-63, corresponding to the accounting year ended March 31, 1962. The assessee-company was doing business in various commodities, and also had considerable export business. On 14th August, 1961, it entered into an agreement with M/s. Hindustan Steel Ltd. for purchasing for export 250 metric tones of Hot Pressed Naphthalene, f.o.b. Calcutta. Under clause III, delivery of the goods was to be so arranged that the entire quantity would be shipped from Calcutta before the 30th of September, 1961. Under clause V, it was provided that a letter of credit was to be opened by the assessee-company forthwith. It may be mentioned that clause XIII provided that title with respect to each shipment was to pass to the assessee-company when the Hindustan Steel Ltd. negotiated the documents and received the proceeds from the back. Under clause XI of the agreement, a performance bond was to be executed by the assessee-company concretely with the signing of the agreement for a sum equivalent to 3 per cent. of the contract value of the goods. It is not in dispute that a sum of Rs. 20,000 was paid by the assessee-company to M/s. Hindustan Steel Ltd., in lieu of that

performance bond, but the assessee-company failed and elected to open any later of credit, as it was required to do under the said agreement dated 14th August, 1961. There is one important fact which must be mentioned at this stage, and that is that as set out in para. 3 of the statement of the case, the assessee-company did not have any firm offer from any overseas party with reference to the goods in question. The price of the said goods having gone down in foreign markets, the assessee-company which had failed to open a letter of credit as required by the agreement between it and the sellers, negotiated with the sellers, viz., M/s. Hindustan Steel Ltd., for an amicable settlement, as otherwise it would suffer substantial loss. The assessee-company, therefore, addressed a letter, dated 30th October, 1961, stating that it had already paid Rs. 20,000 in lieu of performance bond and forwarding therewith a cheque for a further sum of Rs. 30,000 and requested M/s. Hindustan Steel Ltd. to accept the total sum of Rs. 50,000 "as a full settlement" which, it may be mentioned, included also another transaction between the parties for 250 tons for local sale. M/s. Hindustan Steel Ltd., by its letter dated 6th November, 1961, in reply, accepted the said cheque of Rs. 30,000 in addition to the said sum of Rs. 20,000 making a total of Rs. 50,000 in full settlement as a very special case, stating that the non-fulfillment of the contract had put them, apart from great financial loss, in a very awkward position. It also confirmed that the settlement included the transaction relating to the goods purchased by the assessee-company for local sale. These two letters exchanged between the assessee-company and M/s. Hindustan Steel Ltd. leave no room for doubt both those parties admittedly proceeded on the footing that the assessee-company had failed to fulfill the contract in question or, in other words, had committed breach thereof, and, indeed, that appears to be the correct position, for the simple reason that the assessee-company had not opened a letter of credit "forthwith", as required by clause V of the agreement dated 14th August, 1961, with the result that the Hindustan Steel Ltd. were under no obligation to deliver the goods. It was, therefore, contended on behalf of the assessee that the said sum of Rs. 50,000, comprising the amount of Rs. 20,000 paid by the assessee-company to M/s. Hindustan Steel Ltd. in lieu of performance bond deposit, together with the additional amount of Rs. 30,000 sent by the assessee-company with their letter dated 30th October, 1961, was in nature of a settlement in respect of the damages for breach of contract for which the assessee-company had become liable. It was, on the other hand, sought to be contended on behalf of the revenue that this was a loss arising from "speculative business" which could not be conducted from the other business from "speculative business" which could not be conducted from the other business income of the assessee.

2. It will be convenient, at this stage, to deal with the legal provisions applicable to the present reference. Section 43(5) of the Income Tax Act, 1961, lays down that in sections 28 to 41, and in section 43, unless the context otherwise requires, "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity "is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity". Explanation 2 to section 28 lays down that where speculative transactions carried on by an assessee are of such a nature as to constitute a business,

the business must be deemed to be distinct and separate from any other business.

Section 73(1) enacts that any loss, computed in respect of a speculation business carried on by the assessee, cannot be set off except against profits and gains, if any, of another speculative business. The question that arises in the present case, therefore, is whether the sum of Rs. 50,000 which was paid by the assessee-company to M/s. Hindustan Steel Ltd. as a settlement arising out of the non-fulfillment of the contract in question could be said to make the contract itself a speculative transaction within the terms of section 43(5), and if so, whether that speculative transaction amounts to speculation business within the terms of Explanation 2 to section 28 which has already been referred to above.

3. I will turn first to the first part of that question, viz., whether the contract in question can be said to be a speculative transaction within the terms of section 43(5). In the case of [COMMISSIONER OF Income Tax, WEST BENGAL Vs. PIONEER TRADING COMPANY PRIVATE LTD.](#), the facts were very analogous to the facts of the present case. In that case, the Calcutta High Court took the view (at page 352) that Explanation 2 to section 24(1) of the Indian Income Tax Act, 1922 (which is identical in terms with section 43(5) of the present Act) makes a transaction a speculative transaction, if it involves the settlement of a contract which, in the opinion of that court, means that the contract must be settled before its breach, because after the breach has occurred, the cause of action is no longer based on the contract itself, but it is based on its breach. It was laid down in that case that if the settlement has been arrived at after the breach of contract, what is settled is not the contract, but damages for breach of the contract were realised in that manner, and such a transaction could not be characterised as a speculative transaction within the terms of Explanation 2 of section 24(1) of the 1922 Act. It appears that this decision of the Calcutta High Court was followed by that High Court itself in the case of [Daulatram Rawatmull Vs. Commissioner of Income Tax \(Central\)](#), and has also been followed by the Mysore High Court in the case of [Bhandari Rajmal Kushalraj Vs. Commissioner of Income Tax, Mysore](#). The Madras High Court has, however, taken a different view on this point in the case of [R. Chinnaswami Chettiar Vs. Commissioner of Income Tax](#), in which it has cited and differed from the view of the Calcutta High Court in the [COMMISSIONER OF Income Tax, WEST BENGAL Vs. PIONEER TRADING COMPANY PRIVATE LTD.](#). In that case the Madras High Court has held (at page 359) that the word "settled" is used in section 43(5) of the present Act without any restriction as to whether the settlement was before or after the breach and that the question as to whether the settlement was before or after breach of the contract was immaterial, if actual delivery of the goods was absent. With respect to the learned judges of the Madras High Court who decided [R. Chinnaswami Chettiar Vs. Commissioner of Income Tax](#), I prefer the view taken by the Calcutta High Court in the [COMMISSIONER OF Income Tax, WEST BENGAL Vs. PIONEER TRADING COMPANY PRIVATE LTD.](#), which has been followed by that court itself in [Daulatram Rawatmull Vs. Commissioner of Income Tax \(Central\)](#), as well as by the Mysore High Court in [Bhandari Rajmal Kushalraj Vs. Commissioner of Income Tax, Mysore](#), already cited above. In my opinion, once a contract is broken, there can be no cause of action founded on the contract itself which

can be said to be capable of settlement. After the breach of a contract, what can be settled is only the right to damages resulting from the breach itself, though, undoubtedly, the breach, in the ultimate analysis, must arise from the contract. On a breach of contract occurring, the rights of the parties are crystallized as on the date of the breach and it is only those rights that can thereafter be the subject-matter of a settlement. For these reasons, I prefer the view taken by the Calcutta High Court in the said two cases as well as by the Mysore High Court in [Bhandari Rajmal Kushalraj Vs. Commissioner of Income Tax, Mysore](#), and do not agree with the view taken by the Madras High Court in [R. Chinnaswami Chettiar Vs. Commissioner of Income Tax](#), on this point. Reliance was also placed by Mr. Joshi on the decision of the Supreme Court in the case of [Davenport and Co. Pvt. Ltd. Vs. Commissioner of Income Tax, West Bengal-II](#), where the Supreme Court has, in interpreting Explanation 2 to section 24(1) of the Indian Income Tax Act, 1922 (which) is identical with section 43(5) of the present Act as already stated above) taken the view (at pages 721-722) that for Income Tax purposes the expression "speculative transaction" means what the definition of that expression in Explanation 2 to section 24(1) says, and that the question as to whether a transaction is speculative in a general sense or under the Contracts Act is not relevant for that purpose. According to the Supreme Court, a transaction which is otherwise speculative would not be a speculative transaction within the meaning of Explanation 2 if actual delivery of the commodity has taken place : on the other hand, a transaction which is not otherwise speculative in nature may yet be speculative according to that Explanation, if there is no actual delivery of the commodity. We are bound by this interpretation of the relevant statutory provision by the Supreme Court and, with respect I also agree with the same. That decision can, however, be of on assistance to Mr. Joshi in the present case on the question as to whether section 43(5) is applicable where a settlement has taken place after the breach of contract. That is a question which is not dealt with at all by the Supreme Court in [Davenport and Co. Pvt. Ltd. Vs. Commissioner of Income Tax, West Bengal-II](#), .

4. Turning to the facts of the present case, in the light of the above legal position, in the assessment year in question the assessee claimed the said sum of Rs. 50,000 paid to Hindustan Steel Ltd. as a deduction The Income Tax Officer held that the said transaction was a speculative transaction within sections 43(5), and did not allow the loss as s deduction from the other business income of the assessee-company. The Appellate Assistant Commissioner, on appeal, reversed that decision on the ground that what had really happened was that the assessee backed out of the contract by paying liquidated damages to M/s. Hindustan Steel Ltd., and the transaction was, therefore, not a speculative transaction. On further appeal to the Tribunal, the view taken was that the Explanation 2 to section 28, which was in the nature of a definition for the purposes of section 73(1), postulated the existence of more than one speculative transaction, and it, therefore, held the Appellate Assistant Commissioner had acted rightly in allowing the assessee"s claim. It is from that decision of the Tribunal that the following question has been submitted to us for decision :

"Whether, on the facts and in the circumstances of the case, the sum of Rs. 50,000 paid to Hindustan Steel Ltd. was liable to be disallowed as a loss in respect of a speculation business coming within the scope of section 73(1) read with Explanation 2 to section 28, and section 43(5) of the Income Tax Act, 1961 ?"

6. In the view which I have taken on the facts in the present case, viz., that the said sum of Rs. 50,000 has been paid to Hindustan Steel Ltd. after the breach by the assessee-company of its contracts, it must be held that the settlement as a result of which that payment was made, was not a settlement of the contract within the terms of section 43(5), but was a settlement of the assessee-company's for damages for the breach of that contract. Following the view taken by the Calcutta High Court, and by the Mysore High Court, in the case cited above, I hold that the contract itself cannot, by reason of such settlement, be said to be a speculative transaction. In that view of the matter, the further question as to whether the said transaction could be said to amount to "speculation business" within the terms of Explanation 2 to section 28 so as to attract the provisions of section 73(1) does not really arise for consideration. In view, however, of the fact that the point has also been argued before us, I would like to state briefly my views regard to that question also. There is a plethora of decisions on the concept of the word "business" in Income Tax law, but it is sufficient for the purposes of this references to refer to only one decision of the Supreme Court, and that is in the case of [Narain Swadeshi Weaving Mills Vs. The Commissioner of Excess Profits Tax](#), where the Supreme Court has approved of and laid down (at pages 772-773) the position that the term "business" connotes some real, substantial and systematic or organised course of activity or conduct with a set purpose; that whether a particular source of income is business or not must be decided according to our ordinary notions as to what a business is; and that each case must be decided on its own circumstances according to ordinary common sense principles. It is true that there is authority for the proposition that even a single or isolated transaction can, in a conceivable case, amount to "business", provided that it bears the clear indicia of trade, but that question cannot arise in the present case, in view of the fact that use of the plural "speculative transactions" in Explanation 2 to section 28 clearly shows that in order of constitute "speculation business" within the terms of that Explanation, a single transaction would not be sufficient. Moreover, there is nothing on record to show that it was a systematic or organised course of activity or conduct on the part of the assessee-company not on fulfill its contracts, and to settle the same with the other parties thereto, with the result that, even according to our ordinary notions and common sense principles, it cannot be said that a transaction of the nature of the transaction in question in the present case amounts to speculation business. If, therefore, I am wrong in the view which I have taken above, viz., that the said transaction does not amount to a speculative transaction within the terms of section 43(5), I would, in any event, hold that it does not amount to speculation business within the terms of Explanation 2 to section 28, and that section 73(1) of the Act is, therefore, not attracted in the present case. In that view of the matter, I would answer the question referred to us in favour of the assessee.

S.K. Desai, J.

7. I agree, and have nothing to add.

8. BY THE COURT :- The question referred to us is answered as follows :

On the facts and in the circumstances of the case, the sum of Rs. 50,000 paid to M/s. Hindustan Steel Ltd. cannot be disallowed as a deduction from the other business income of the assessee-company, having regard to section 43(5), Explanation 2 to section 28, and section 73(1) of the Income Tax Act, 1961. The Commissioner must pay the assessee's costs of the reference.