

Commissioner of Income-tax Vs. Puttaiah Seshiah and Co.

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Court : Andhra Pradesh

Decided On : Jan-19-1983

Reported in : (1983)37CTR(AP)69; [1984]146ITR168(AP)

Judge : B.P. Jeevan Reddy and ;K. Punnayya, JJ.

Acts : [Income Tax Act, 1961](#) - Sections 28

Appeal No. : Case Referred No. 8 of 1978

Appellant : Commissioner of Income-tax

Respondent : Puttaiah Seshiah and Co.

Advocate for Def. : Srirama Rao, Adv.

Advocate for Pet/Ap. : M.S.N. Murthy, Adv.

Judgement :

Jeevan Reddy, J.

1. The question referred to us under s. 256(1) of the I.T. Act is :

'Whether on the facts and in the circumstances of the case, the assessee is entitled to the set off of loss Rs. 85,643 arising from payment of price differences in respect of unfulfilled contracts of sale against the profits ?'

2. The facts relevant to the case are the assessee is a registered firm carrying on business in manufacture and sale of groundnut oil. During the accounting year relevant to the assessment year 1971-72, it entered into as many as 148 contracts for sale of oil involving a total quantity of 2,318 tonnes. Out of these contracts the assessee performed 135 contracts by delivery of oil of 2,112 tonnes but in respect of 13 contracts involving 206 tonnes, he could not performed the contracts by supplying the oil for want of wagons; he settled them by paying the price difference. For the relevant assessment year, he claimed set off for the amount of loss arising from payment of price difference against the profits of his business which was disallowed by the ITO holding that since the 13 contracts were settled otherwise than by delivery of goods, they are speculative transactions and, hence, the losses arising therefrom cannot be set off against profits from regular business. On appeal, the AAC agreed with the ITO. On further appeal, however, the Tribunal took a contrary view. On a consideration of the relevant provisions of the Act, the Tribunal observed that unless the Department proves that 'the transactions entered into by the assessee which resulted in payment of price difference without there being actual delivery of goods,

constituted speculation business', the set-off as claimed by the assessee must be allowed. Aggrieved by the decision of the Tribunal the Revenue applied for and obtained this reference.

'Speculative transaction' is defined in sub-s. (5) of s. 43 of the I.T. Act 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.' Explanation 2 to s. 28 Act provides that 'where speculative transaction 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.' Sub-section (1) of s. 73 of the Act declares that 'any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business.'

3. The definition of speculation business makes it clear that the intention of the parties is made immaterial and irrelevant. If a contract is settled otherwise than by the actual delivery or transfer of the commodity or scrips, it will be a speculative transaction notwithstanding the fact that at the time the transaction was entered into, the parties intended to effect delivery of commodity or scrips, as the case may be. On the same analogy, even if the parties, at the time of entering into the contract, merely intended to indulge in speculation, i.e., where they never intended to deliver the commodity or scrips, but if on account of some one or other reason, they actually deliver or transfer the commodity or scrips in pursuance of the contract, it will not be a speculative transaction. It is obvious that Parliament, by this definition, sought to exclude any enquiry or investigation into the intention of the parties. Now, s. 28 is one of the sections dealing with heads of income which are chargeable to tax under the Act. Section 28 deals with profits and gains of business or profession. According to this section, the profits and gains of any business or profession carried on by an assessee have to be assessed under this and the following sections. While so providing Parliament put in Explan.2 to s. 28, which corresponds to Explan. (1) to s. 24(1) of the 1992 Act. The idea behind this Explanation is to treat the speculative transactions as a distinct and separate business from other business, if the speculative transactions are of such a nature as to constitute a business; it is referred to as 'speculation business.' Then s. 73(1) says that any loss arising from a speculation business can be set off only against the profits and gains, if any, of another speculation business but not against the profits and gains from any other business. It is the interpretation of Explan. 2 to s. 28 which mainly falls for considerations before us. The contention of Sri. M. S. N. Murthy the learned standing counsel for the Department, is that so long as the speculative transactions are business transactions they must be treated as and must be deemed to constitute a distinct and separate business called 'speculation business', while the contention of Sri Srirama Rao, the learned counsel for the assessee, is that for this Explanation to apply the several speculative transactions must be such as to constitute one business, and that, then alone they can be treated as a separate business. In other words, the contention of Mr. Rao is that a common thread must run through several speculative transactions before they can be treated as a distinct or separate business called 'speculation business'. His contention is that if the transactions which are held as speculative transactions by virtue of the definition contained in s. 43(5), are part and parcel of the general business done by an assessee and are not speculative per se, the Explanation has no application. The counsel submits that while for determining whether a transaction is a speculative transaction or not, the definition under s. 43(5)

is relevant, for the purpose of determining whether they constitute speculative business or not, one has to look to and consider the intention of the parties at the time of entering into those transactions. Both the counsel relied upon certain supporting their rival points.

4. On a consideration of the rival submissions we are of the opinion that the construction sought to be placed upon Expl. 2 by the learned counsel for the Revenue has to be accepted, as against the interpretation contended for by the learned counsel for the assessee. All that the Explanation says is that the speculative transactions must be such as to constitute a business; if so, they should be deemed to be a distinct and separate business from other business. If the speculative transactions already form part of one pattern or one activity, as the case may be, then there was no point or purpose in the Explanation stating that they should be deemed to be a separate and distinct business because they by themselves constitute a distinct or separate business as such. In other words, if several speculative transactions are connected by a common thread and by themselves constitute a speculative business as such, Expln. 2 is superfluous. Parliament would not have put in the Explanation merely for affirming an obvious and existing fact. Mr. Srirama Rao's interpretation, in our opinion, is also not consistent with the intention of Parliament underlying these provisions. The three provisions referred to above are parts of a single scheme. Parliament has first defined what is a speculative transaction and in doing so, as we have stated above, they totally excluded from consideration the intention of the parties. Having so defined the speculative transactions, Parliament provided that if these transactions are business transactions they must be treated as a separate and distinct business and then declared that the loss arising from speculative business can be set off only against the profits of any other business. It would not be consistent or reasonable to hold that while determining whether a transaction is a speculative transaction or not, the intention of the parties is not relevant, but that such intention is relevant while determining whether the speculative transaction constitutes a speculative business or not.

5. The view taken by us finds support from the following decisions. In *Hoosen Kasam Dada (India) Ltd. v. CIT.* : [1964]52ITR171(Cal) the Calcutta High Court observed thus :

'I now come to another point of view put forward by Mr. Mitra. According to him, we must not lose sight of the fact that in the proviso to section 24 not only the words 'speculative transactions' are mentioned, but they are followed by the words 'which are in the nature of a business'. He argues that if you have a business including a number of transactions of the same nature, then if you are going to single out certain specified transactions as speculative transactions they must form a distinct or separate group. He argues that, in the present case, the facts are otherwise. In other words, in a series of transactions in gunnies, some transactions were non-speculative and others were speculative and others were speculative. Under such circumstances, the proviso does not apply. I must admit that I am unable to understand the logic of this argument. Perhaps, it is putting forward the views of Messrs. Kanga and Palkhivala in another form. I must point that if that was so, the introduction of Explanation I would have been utterly superfluous. Explanation I says that where speculative transactions carried on are of such a nature as to constitute a business, the business shall be deemed to be distinct and separate from any other business. In considering the proviso, we are considering the profits and gains of a business. Other headings do not enter into the picture. But the proviso does not contemplate that the

speculative transactions should form a separate unit. On the other hand, it has been stated in Explanation I that they would be 'deemed' to be a distinct and separate unit. I cannot see any difficulty in separating the two kinds of business, viz., speculative and non-speculative, and considering them as separate groups. I might here point out that there is an unreported Division Bench judgment of this High Court, Sree Hanuman Investment Co. Ltd. v. Commissioner of Income-Tax (unreported judgment dt. February 13, 1962, in Reference No. 59 of 1957 - since reported in : [1963]48ITR915(Cal) . Mitter J. held there that the decided cases were one way and the interpretation of the proviso to section 24(1) should be as stated above. I respectfully agree.

6. In my opinion, it is not permissible to interpret the provision in any other way. It is quite clear to me that the words 'speculative transactions' have been defined in Explanation 2 for this very purpose, viz., to obviate nice questions of law that may arise with regard to the delivery or non-delivery of goods under a contract. The law has been simplified in this respect and the expression 'speculative transaction' has been defined for the Income-Tax Act. The Tribunal has, therefore, come to the right conclusion in thinking that this definition must be applied and the question of initial intention was irrelevant. Also I agree that the proviso to sub-section (1) to section 24 is a substantive provision of law.'

7. This decision was followed in Abdul Gani Haji Habib v. CIT : [1969]72ITR6(Cal) . In this case, the Calcutta High Court observed (p.13) :

'It may be that the speculative transactions were being carried on as part of the general business of the assessee jute and oil, but even then under Explanation 1 to sub-section (1) of section 24, such transactions shall be deemed to be distinct and separate from the general business of the assessee.'

8. To the same effect is the decision of the Madras High Court in R. Chinnaswami Chettiar v. CIT : [1974]96ITR353(Mad) . In this case, the assessee a dealer in yarn entered into a number of forward contracts of which 4 transactions were found to be speculative because they were settled by paying the difference. The Court observed (p.363) :

'The transactions were not isolated transaction in the sense that they are totally unconnected with his business as a dealer in yarn. These speculative transactions, which form that of the business, by a fiction of law under Explanation 2 to section 28 of the Act, are deemed to be distinct and separate from any other business. The losses incurred in respect of these transactions, therefore, constituted a loss in a speculation business.'

9. In Juvvi Subbaramaiah and Co. v. CIT : [1964]51ITR742(AP) a Bench of this court observed that (head note) 'it is not open to an assessee to adjust the loss sustained in speculation business against his income derived from other business which are not of a speculative character, but he can lay a claim, to a set-off only against profits derived from another speculation business.'

10. As against these decisions, Mr. Srirama Rao relied upon the decision of the Bombay High Court in CIT v. Indian Commercial Co. P. Ltd. : [1977]106ITR465(Bom) . Vimadalal J., speaking for the Bench, answered the first question referred therein holding that the transaction concerned cannot be held to be a speculative transaction.

In that view of the matter, it was unnecessary for the court to answer the next question, as is noted by the learned judge himself, but yet, having regard to the fact that arguments were addressed on the further question as well, the learned judge proceeded to express his opinion. After the referring to the decision of the Supreme Court in *Narain Swadeshi Weaving Mills v. CEPT* : [1954]26ITR765(SC) on the meaning of the expression 'business', the learned judge observed (p.773) :

'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 commonsense principles.'

11. The learned judge then observed that because Explan. 2 to s. 28 uses the plural 'speculative transaction', a single transaction cannot fall within its mischief. On this reasoning the learned judge held that the single transaction concerned therein cannot be said to fall within the mischief of Explan. 2 to s. 28. It appears that the decisions of the Calcutta High Court or of the Madras High Court referred to above were not brought to the notice of the learned judge. This discussion too, we find, is cursory. In this circumstances, it is not possible to treat the opinion expressed by the learned judge as an authoritative pronouncement on the meaning and interpretation of Explan. 2 to s. 28. Mr. Srirama Rao then relied upon a Bench decision of this court in *Addi. CIT v. Maggaji Sermal* : [1978]114ITR862(AP) . That was again a case of a single transaction in a given year. After setting out the Explanation, the Bench observed (p.865) :

'It cannot be said, having regard to the meaning of speculation business, that the transaction in question was such as to constitute a speculation business. There was only one such transaction in both the cause, and they were isolated instances. Therefore, having regard to the meaning of speculation business, we agree with the finding recorded by the Tribunal that it is a loss in business and not a loss in speculation business.'

12. We are unable to see how the above observation supports in any manner the interpretation sought to be placed by the learned counsel upon the Explanation.

13. For the above reason, we answer the question referred to us in the negative, that is, in favour of the Revenue and against the assessee.

14. Mr. Srirama Rao then brought to our notice Circular No.23 (XXXIX) D of 1960 dated 12th September, 1960, which is also found referred to in the judgment of the Tribunal. The Board's circular reads as follows :

'The Board are unable to accept this suggestion as a general rule. It is already provided that if on the facts of any case it can be demonstrated that the forward transaction has been entered into only for safeguarding against loss through future price fluctuations, such a transaction should not be treated as a speculative transaction but as a case of hedging. However, the case of a bona fide ready delivery contract being settled by delivery to a substantial extent and by payment if differences for the balance is exceptional and, in such a case, the difference paid need not be treated as a loss arising in a speculative transaction.'

15. The contention of Mr. Srirama Rao is that in view of this decision of the Board which is binding upon the I.T. authorities, the assessee is entitled to have the said loss

set off against the profits from his regular business. On the other hand, it is contended by M. S. N. Murthy, the learned standing counsel for the Department, that the said decision of the Board applies only in the case of a single transaction where it has been performed to a substantial extent, but not in the case of several transaction where some are performed while others are not. It is, however, not necessary for us to express any opinion on this question because the Tribunal itself has not chosen to express its opinion on the applicability of this circular in its judgment. the applicability of this circular has also not been specifically referred to us. In this view of the matter, the only observation we can make is to observe that before passing final orders in the matter in pursuance of this opinion of ours, the Tribunal shall consider the applicability or otherwise of the said circular to the facts of this case and determine whether the assessee is entitled to any relief on the basis of the said circular. This decision shall be taken after hearing both the parties and in accordance with law. No costs.

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