

**COMMISSIONER OF INCOME-TAX  
BOMBAY CITY-III, BOMBAY**

v.

**SHANTILAL PRIVATE LIMITED BOMBAY**

*July 21, 1983*

[R. S. PATHAK, E. S. VENKATARAMIAH AND A. N. SEN JJ.]

*Income-tax Act, 1961—Sub-s. (5) of s. 43—Speculative transaction. A transaction where there is a breach of contract and damages are awarded as compensation by an arbitration award is not a speculative transaction.*

*Words and phrases—Speculative transaction—Meaning of.*

The respondent assessee claimed that a sum of Rs. 1,50,000 paid by them as compensation for being unable to fulfil a contract was a business loss. The Income tax officer rejected the claim on the ground that the transaction was a speculative transaction as defined by sub-s. (5) of s. 43 of the Income-tax Act, 1961. The Appellate Assistant Commissioner held that the loss was a business loss and not a speculative loss on the view that the payment made represented a settlement of damages on breach of the contract, which was distinct from a settlement of the contract. The Income Tax Appellate Tribunal confirmed the order of the Appellate Assistant Commissioner. On the request of the Commissioner of Income-tax the Appellate Tribunal has referred the question whether the loss suffered by the assessee was not a loss in a speculative transaction within the meaning of s. 43(5) of the Income-tax Act, 1961.

Answering the question in the affirmative,

**HELD:** A transaction cannot be described as a "speculative transaction" within the meaning of sub-s. (5) of s. 43 where there is a breach of the contract and on a dispute between the parties damages are awarded as compensation by an arbitration award. [474 A-B]

Sub-s. (5) of s. 43 speaks of the settlement of a contract. A contract can be said to be settled if instead of effecting the delivery or transfer of the commodity envisaged by the contract the promisee, in terms of s. 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 s. 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" What

is really settled by the award of such damages and their acceptance by the aggrieved party is the dispute between the parties. [473 A, C-G]

*Commissioner of Income-Tax, West Bengal v. Pioneer Trading Company Private Ltd.*, 70 ITR 347; *Bhandari Rajmal Kushlraj v. Commissioner of Income-Tax, Mysore*, 96 ITR 401 approved.

*R. Chinnaswami Chettiar v. Commissioner of Income-Tax, Madras*, 96 ITR 353 overruled.

*P. L. KN. Meenakshi Achi v. Commissioner of Income-Tax, Madras*, 96 ITR 375; *A. Muthukumara Pillai v. Commissioner of Income-Tax, Madras*, 96 ITR 557 and *Devenport & Co. P. Ltd. v. Commissioner of Income-Tax, West Bengal II*, (1975) 100 ITR 715 not relevant to the point raised.

CIVIL APPELLATE JURISDICTION : Tax Reference Case No. 4 of 1978.

Tax Reference Under Section 257 of the Income Tax Act, 1961 made by the Income Tax Appellate Tribunal, Bombay (Bench 'C').

*D. V. Patel, T. A. Ramachandran & Miss A. Subhashini* for the Appellant.

The Judgment of the Court was delivered by

PATHAK, J. In this tax reference made under S. 257 of the income Tax Act, 1961, we are called upon to express our opinion on the following question of law:

“Whether, on the facts and in the circumstances of the case, the Tribunal was right in confirming the order of the Appellate Assistant Commissioner that the loss suffered by the assessee was not a loss incurred in a speculative transaction within the meaning of Sec. 43 (5) of the Income-tax Act, 1961?”

The assessee, M/s Shantilal Pvt. Ltd., Bombay, is a private limited company. In the assessment proceedings for the assessment year 1971-72 it claimed a sum of Rs. 1,50,000 paid by it as damages to M/s Medical Service Centre as a business loss. During the previous year relevant to the said assessment year the assessee had contracted to sell 200 Kilograms of Folic Acid USP at the rate of Rs. 440 per Kilogram to M/s. Medical Service Centre and the delivery was to be effected on or before November 1, 1969, within about three months of the date of entering into the contract. The

A case of the assessee is that as the price of the commodity rose very sharply to as high as Rs. 2,000 per Kilogram during the period when the delivery was to be effected, the assessee was unable to fulfil the contract, giving rise to a dispute in regard to the payment of compensation between the parties. The dispute was referred to arbitration and by an award dated August 25, 1970 the arbitrator directed the assessee to pay Rs. 1,50,000 as compensation to M/s. Medical Service Centre. A consent decree in terms of the award was made by the High Court.

B In the assessment proceedings, the Income Tax Officer rejected the claim of the assessee that the payment of compensation was a business loss. He found that the transaction was a speculative transactions as defined by Sub-s. (5) of s. 43. Income Tax Act, 1961. The Appellate Assistant Commissioner allowed the assessee's appeal on the view that the payment made by it represented a settlement of damages on breach of the contract, which was distinct from a settlement of the contract. Accordingly, he found that the loss must be regarded as a business loss and not as a speculation loss. The Income Tax Officer's appeal was dismissed by the Income Tax Appellate Tribunal by its order dated February 18, 1976. The Commissioner of Income Tax applied in reference for a decision on the question of law set out earlier, and in view of an apparent conflict between different High Courts on the point the Tribunal has made this reference.

C There is no doubt that the arbitration award granting compensation to M/s. Medical Service Centre proceeds on the footing that there was a breach of contract. The Tribunal took the view that the award of damages for breach of a contract did not bring the transaction within the definition of "speculative transaction" set forth in sub-s. (5) of s. 43, Income Tax Act, 1961. In this, the Tribunal found support in the view expressed by the Calcutta High Court in *Commissioner of Income-Tax, West Bengal v. Pioneer Trading Company Private Ltd.*,<sup>(1)</sup> *Daulatram Rawatmull v. Commissioner of Income-Tax (Central), Calcutta*<sup>(2)</sup> and by the Mysore High Court in *Bhandari Rajmal Kushalraj v. Commissioner of Income-tax, Mysore*,<sup>(3)</sup> which they preferred to the view expressed by the Madras High Court in *R. Chinnaswami Chettiar v. Commissioner of Income*

(1) 70 I.T.R. 347.

(2) 78 I.T.R. 503.

(3) 96 I.T.R. 401.

Tax, Madras,<sup>(1)</sup> P.L. K.N. Meenakshi Achi v. Commissioner of Income-Tax, Madras<sup>(2)</sup> and A. Muthukumara Pillai v. Commissioner of Income-Tax, Madras.<sup>(3)</sup> On careful consideration of the matter we are of opinion that the Tribunal is right. Sub-s. (5) of s. 43 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 ...."

Is a contract for purchase or sale of any commodity settled when no actual delivery or transfer of the commodity is effected, and instead compensation is awarded under and arbitration award as damages for breach of the contract? A contract can be said to be settled if instead of effecting the delivery or transfer of the commodity envisaged by the contract the promisee, in terms of s. 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 s. 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 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 layman 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 promisee 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 the law, and it is

(1) 96 I.T.R. 353.

(2) 96 I.T.R. 375.

(3) 96 I.S.R. 557.

A that sense which must prevail in sub-s. (5) of s. 43. Accordingly, we hold that a transaction cannot be described as a "speculative transaction" within the meaning of sub-s. (5) of s. 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 by an arbitration award. We are unable to endorse the view to the contrary taken by the Madras High Court in *R. Chinnaswami Chettiar* (supra) and approve of the view taken by the Calcutta High Court in *Pioneer Trading Company Private Ltd.* (supra) and by the Mysore High Court in *Bhandari Rajmal Kushalraj* (supra). The decisions of the Madras High Court in *P. L. K. N. Meenakshi Achi* (supra) and *A. Muthukumara Pillai* (supra) are not apposite and are not concerned with the point before us. Our attention was invited by learned counsel for the Revenue to the decision of this Court in *Devenport & Co. P. Ltd. v. Commissioner of Income-Tax, West Bengal II*<sup>(1)</sup> but this point did not arise there either.

D Accordingly, we answer the question referred in the affirmative, in favour of the assessee and against the Revenue. There is no order as to costs.

H.S.K.

*Question answered in affirmative.*

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[1] [1975] 100 I.T.R. 715.