SK. AR. K. AR. SOMASUNDRAM CHETTIAR AND CO., MADURAI A

v.

COMMISSIONER OF INCOME TAX, MADRAS

JANUARY 15, 1992

[K. RAMASWAMY AND B. P. JEEVAN REDDY, JJ.] B

Income Tax Act, 1922—Section 24, third proviso, clause (a)—Requirements under—Contract—Construction—Contract spoken in first part and in second part—Co-relation—When the clause applies to speculative transaction, indicated.

C

Income Tax Act, 1922—Section 24, third proviso, clause (a)—Transactions entered into by assessee whether saved under.

The appellant-assessee, was a registered firm. It was carrying on business in cloth and yarn. Its cloth business consisted mainly in Gada manufactured by certain Mills. D

The Income Tax Officer while making the assessment relating to the assessment years of 1960-61 and 1961-62, held that the losses of Rs. 2,04,746 and Rs. 17,000 respectively sustained by the assessee in the two assessment years constituted losses in speculative transactions in the nature of business and, therefore, could not be set off except against profits from speculation. He carried forward the said loss to be set off against speculation profits, if any, in subsequent assessment years. E

The assessee's appeal was dismissed by the Appellate Tribunal, though its further appeal to the Tribunal was upheld. F

Before the Tribunal, the assessee, conceding that the transactions in question are speculative transactions within the meaning of the Explanation 2 to section 24, Income Tax Act, 1922, contended that the transactions in question were saved under clause (a) of the proviso to Section 24 of the Act. G

The Tribunal held that the transactions entered into by the assessee were in the nature of the hedging contracts and, therefore, saved under clause (a) of the proviso.

The Revenue obtained a reference to the High Court on the H

A question, "whether on the facts and in the circumstances of the case, the transactions resulting in the loss of Rs. 2,04,746 in the previous year relevant for the assessment year 1960-61 and in the loss of Rs. 17,000 in the assessment year 1961-62 were saved from being treated as speculative transactions by clause (a) of the third proviso to Section 24(1) of the Income Tax Act, 1922."

B

The assessee conceding that the transactions in question were speculative transactions, contended before the High Court that the transactions were saved by clause (a) of the third proviso to Section 24.

The High Court answered the reference in negative, i.e., in favour C of the Revenue, holding that the transactions in question were not saved by clause (a) of the third proviso.

The assessee-appellant challenged the view taken by the High Court in these appeals by special leave.

D On the question, whether the transactions in question were saved by clause (a) of the third proviso to Section 24 of the Income Tax Act, 1922, dismissing the appeals, the Court,

HELD : 1.01. When the first part of clause (a) speaks of a contract in respect of merchandise, it refers to a contract falling within the E definition of speculative transaction. But the further requirement of clause (a) is that such a contract in respect of merchandise must have been entered into by the merchant in the course of his business to guard against loss through future fluctuations "in respect of his contracts for actual delivery of goods sold by him." Clearly, the contracts referred to F in the latter part of clause (a) must be contracts for actual delivery of goods sold by him. It necessarily means contracts of sale by him and such contracts must be for actual delivery of goods. The words "for actual delivery of goods" have evidently been put in designedly. [55D-E]

1.02. There need not be co-relation between contract to contract G but there ought to be a co-relation between the contracts spoken to in the first part of clause (a) and the contracts spoken to in the latter part. Unless such co-relation exists between two sets of contracts, the clause is not attracted. [55E-F]

2. The assessee entered into a contract of purchase with the mills H and a contract of sale with another person. Then he entered into a

contract of purchase with such person in respect of the same goods. He then obtained delivery of the cloth from the mills and sold them to the third parties. So far as the first mentioned party is concerned he settled the contract by paying the difference, resulting in loss. It is evident that the course of transactions do not attract and cannot be made to fall within the four corners of clause (a). The contracts entered into by the assessee do not fall within nor are they saved by clause (a) of the proviso. [55H-56B, 55G]

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 1109-10 of 1976.

From the Judgment and Order dated 19.4.1973 of the Madras High Court in Tax Case No. 278 of 1967.

A.T.M. Sampath for the Appellant.

Dr. V. Gaurishankar, P. Parmeswaran, S. Rajappa and Ms. A. Subhashini for the Respondents.

The Judgment of the Court was delivered by

B.P. JEEVAN REDDY, J. These appeals by the assessee are preferred against the judgment of the Madras High Court answering the question referred to it in favour of the Revenue. The question stated for the opinion of the High Court under Section 66 (1) of the Indian Income Tax Act, 1922 was "whether on the facts and in the circumstances of the case, the transactions resulting in the loss of Rs. 2,04,746 in the previous year relevant for the assessment year 1960-61 and in the loss of Rs. 17,000 in the assessment year 1961-62 were saved from being treated as speculative transactions by Clause (a) of the third proviso to Section 24(1) of the Income Tax Act, 1922."

The assessee is a registered firm carrying on business in cloth and yarn. Its Head-Office is at Madurai with branches at Vijayanagaram and Calcutta. Its trade in cloth consisted mainly in Gada manufactured by certain mills including Meenakshi Mills Ltd., Virudhnagar Textiles Ltd. and Loyal Textiles Mills Ltd. The assessment years concerned herein are 1960-61 (previous year ending on 12.4.1960) and 1961-62 (previous year ending on 12.4.1961). In his assessment orders, relating to these two assesment years, the Income Tax Officer held that the losses of Rs. 2,04,746 and Rs. 17,000 respectively sustained by the assessee in the said two assessment years constituted losses in speculative transactions in the nature of business and, therefore, could not

A be set off except against profits from speculation. He carried forward the said loss to be set off against speculation profits, if any, in subsequent assessment years. The assessee's appeal to the Appellate Tribunal proved unsuccessful. However, his further appeal to Tribunal was upheld. Before the Tribunal, the counsel for the assessee conceded that "the transactions in question are speculative transactions within the meaning of the explanation." (The refer-
B ence is to Explanation - 2 to Section 24). His contention, however, was that the transactions in question are saved under Clause (a) of the proviso to Section 24. The Tribunal examined the said contention with reference to the facts of the case and concluded that the transactions entered into by the assessee were in the nature of the hedging contracts and, therefore, saved under Clause (a) of the proviso. Dissatisfied with the order of the Tribunal,
C the Revenue asked for and obtained the above reference. Before the High Court as well, counsel for the assessee conceded that the transactions in question are speculative transactions but contended that they are saved by Clause (a) of the third proviso to Section 28. This is what the High Court has recorded :

D

> "In this case it has been conceded at all stages by the assessee that the transactions in respect of which the losses in question have occurred are speculative transactions as defined in Explanation 2, and, therefore, it is not necessary for us to consider the scope of the Explanation 2 to Section 24. The only question for consideration is whether the transactions which are admittedly
E speculative coming within Explanation 2 to Section 24(1), will fall within the scope of Clause (a) of the third proviso to that section."

The High Court disagreed with the interpretation placed by the Tribu-
F nal upon Clause (a) of the said proviso and held that on the material placed before it, it is not possible to hold that the transactions in question were saved by clause (a) of the third proviso. Accordingly, it answered the question referred in the negative-that is against the assessee and in favour of Revenue. The correctness of the view taken by the High Court is challenged in this appeal.

G

Section 24 of the 1929 Act insofar as it is relevant reads as follows :

> "24. Set off of loss in computing aggregate income :- (1) where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in section 6, he shall be entitled to
H have the amount of the loss set off against his income, profits or gains under any other head in that years :

Provided that in computing the profits and gains chargeable under the head 'Profits and gains of business, profession or vocation', any loss sustained in speculative transactions which are in the nature of a business shall not be taken into account except to the extent of the amount of profits and gains, if any, in any other business consisting of speculative transactions.

Explanation 2 : A speculative transaction means a transaction in which a contract for purchase and 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.

Provided that for the purposes of this Section :

(a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or

(b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and share through price fluctuations; or

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transactions in the nature of jobbing or arbitrate to guard against loss which may arise in the ordinary course of his business as such member;"

Explanation 2 to Section 24 defines what a speculative transaction is. It corresponds to the definition contained in Clause 5 of Section 43 of the Income Tax Act, 1961. The Madras High Court has taken the view that by virtue of the definition contained in Explanation 2, "whenever there is no actual delivery or transfer of the goods, the transaction should be taken to be of a speculative nature ..... If the actual delivery of the goods is not given under the settlement of the contract, then the intention of the parties at the time of contract is immaterial." It is not necessary for us to express any opinion on this aspect since it was conceded by the assessee's counsel before the High Court that the transactions in question were indeed speculative transactions as defined by Explanation 2. The only question with which we are concerned—and which alone has been considered by the High Court too—is whether the transactions in question are saved by Clause (a) of the third proviso to Section 24.

A The Tribunal was of the opinion that Clause (a) of the third proviso is intended to save hedging contracts among others. It dealt with the concept of hedging contracts and held that for attracting Clause (a) of the proviso, the "contracts for actual delivery of goods manufactured by him or merchandise sold by him" need not necessarily be sale contracts but can also be purchase contracts. Applying the said interpretation it examined the transactions in B question and held them saved by the said Clause. The High Court, however, did not agree with the said interpretation. It took the view that "for a transaction to come under Clause (a), it should be one entered into by an assessee to guard against loss through future price fluctuations in respect of his sale contracts". It, however, agreed with the Tribunal that there need not be actual co-relation, contract to contract, between the purchase and sale C contracts contemplated by the Clause and that it is sufficient if a transaction either by way of purchase or sale is entered into with a view to guard against any future loss in that particular line of business. It held "for a transaction to come under Clause (a) it should be one entered into by an assessee to guard against loss through future price fluctuations in respect of his sale contracts ..... there need not be actual co-relation, contract to contract, but that D it is sufficient if a transaction either by way of purchase or sale is entered into with a view to guard against any future loss in that particular line of business." It, however, added a note of caution which we may set out in its own words. "But we are inclined to think that we will be doing considerable violence to the language used in Clause (a) if it is understood to cover all cases of purchases and sales entered into by an assessee with a view to guard E against his future loss in general in that line of business. It is true, a co-relation—contract to contract—may not be necessary. But the contract or contracts contemplated by Clause (a) has or have to guard against loss through price fluctuations in respect of contract or contracts of sale entered into by him of the same goods." Applying the said test the High Court F examined the transactions in question and came to the conclusion that they were not saved under the said Clause. It noted that both with respect to cotton bales and yarn, the assessee had initially entered into contracts of purchase of certain goods from the mills. He then entered into a contract of sale of the same goods to a party. Later, he entered into a contract to re-purchase the same goods from the same party. Subsequently, he took delivery of the goods G from the mills and sold them to other parties. So far as contracts of purchase and sale with the first mentioned party are concerned, he settled them by paying the difference. In the circumstances, the High Court held that it is not possible to say either that the sale contract entered into by the assessee with the purchaser, or the purchase contract entered into between them, would come under Clause (a). The only question now before us is whether the High H Court was right in its interpretation of Clause (a) of the third proviso of

Section 28 (which corresponds to Clause (a) of the proviso to the definition of speculative transactions contained in Clause 5 of Section 43 of the 1961 Act)? A

The proviso containing Clauses (a) to (c) is a proviso to Explanation 2 which defines what a speculative transaction is. Clause (a) of the proviso contemplates and applies to a manufacturer as well as a merchant. The assessee herein is not a manufacturer but only a merchant. The said Clause insofar as it is relevant to the merchant would read thus : B

> "a contract in respect of merchandise entered into by a person in the course of his merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of merchandise sold by him, shall not be deemed to be a speculative transaction". C

When the first part of Clause (a) speaks of a contract in respect of merchandise, it refers undoubtedly to a contract falling within the definition of speculative transaction. But the further requirement of Clause (a) is that D such a contract in respect of merchandise must have been entered into by the merchant in the course of his business to guard against loss through future fluctuations "in respect of his contracts for actual delivery of goods sold by him." Clearly, the contracts referred to in the latter part of Clause (a) must be contracts for actual delivery of goods sold by him. It necessarily means contracts of sale by him and such contracts must be for actual delivery of E goods. The words "for actual delivery of goods" have evidently been put in designedly. We agree with the learned Judges of the High Court that there need not be co-relation between contract to contract but there ought to be a co-relation between the contracts spoken to in the first part of Clause (a) and the contracts spoken to in the latter part. Unless such co-relation exists F between two sets of contracts, the Clause is not attracted. The Tribunal was not right in holding that the words "contracts for actual delivery of goods" occurring in the latter part of the definition do also take in contracts of purchase. Such an understanding is inconsistent with the scheme and spirit of the Clause.

G

If we examine the contracts entered into by the assessee on the above touch-stone, it would be evident that they do not fall within nor are they saved by Clause (a) of the proviso. The nature of transactions entered into by the assessee, as found by the High Court, has already been set out by us hereinbefore. The assessee entered into a contract of the purchase with the mills and a contract of sale with another person. Then he entered into a H

A contract of purchase with such person in respect of the same goods. He then obtained delivery of the cloth from the mills and sold them to the third parties. So far as the first mentioned party is concerned he settled the contract by paying the difference resulting in loss. It is evident that the said course of transactions do not attract and cannot be made to fall within the four corners of Clause (a).

B

We, accordingly, dismiss the appeal. No orders as to costs.

V.P.R. Appeals dismissed.