

IN THE INCOME TAX APPELLATE TRIBUNAL  
AHMEDABAD %SMC+BENCH

**Before: Shri Rajpal Yadav, Judicial Member  
and Shri Amarjit Singh, Accountant Member**

**ITA No. 2521/Ahd/2015  
Assessment Year 2011-12**

Rasiklal Dayarambhai Thakkar, Prop. Of Al Cotton Industries, Chitrod Dholavira, S.H. 52, Nandasar, T.A. Rapar, Kutchh PAN: ADZPT4432F (Appellant)	Vs	The JCIT, Patan Range, Patan (Respondent)
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**Revenue by: Shri Sumit Kr. Verma, Sr. D.R.  
Assessee by: Shri U.S. Bhati &  
Shri Abhimanyu Bhati, A.Rs.**

Date of hearing : 26-07-2018  
Date of pronouncement : 19-09-2018

**आदेश/ORDER**

**PER : AMARJIT SINGH, ACCOUNTANT MEMBER:-**

This assessee's appeal for A.Y. 2011-12, arises from order of the CIT(A), Gandhinagar, Ahmedabad dated 30-07-2015, in proceedings under section 143(3) of the Income Tax Act, 1961; in short %the Act+.

2. The assessee has raised following grounds of appeal:-

*“1.0 The learned Commissioner of Income tax (Appeals) erred in law and on facts in partly confirming order passed by the Id. A.O.*

*2.0 The learned Commissioner of Income-tax (Appeals) erred in law and on facts in upholding loss of Rs.41,70,417/- as speculation loss.*

*3.0 The learned Commissioner of Income tax (Appeals) erred in law and on facts in stating that the appellant had not entered into any business transactions with the three parties M/s Rushi Cottex Private Limited, M/s Raturaj Cotton Company and M/s Manish*

*cotton Corporation. He has further erred in mentioning that necessary evidences in connection with negating claim of speculation loss were not placed on record etc.*

*4.0 Without prejudice to the above ground No. 2, the learned Commissioner of Income-tax (Appeals) further erred in law and on facts in failing to adjudicate the contention of the appellant that a few speculative transactions would not constitute "Speculative Business" thereby making him eligible to set-off or carry forward and set-off as business loss."*

3 The return of income declaring income of Rs. 5,72,010 was filed on 27<sup>th</sup> Sep, 2011. Subsequently, the case was selected under scrutiny by issuing of notice u/s. 143(2) on 28<sup>th</sup> Sep, 2012. The assessee is an individual doing the business in the name of proprietorship concern M/s. Al Cotton Industries engaged in the business of trading of cotton bales as well as beans like Mag, Madh etc. During the course of assessment proceedings, the assessing officer has noticed that the assessee has debited an amount of Rs. 41,13,481/- under the head sales and purchases Settlement in the profit & loss of its proprietary concern, Al Cotton Industries. On verification, the assessing officer noticed that amount of Rs. 41,13,481/- pertained to payment made by the assessee in respect of sale of cotton bales which were settled without any physical delivery. During the year under consideration, the assessee was asked to justify its claim of the above expenses in view of the provision of section 43(5) of the act. The assessee has explained that the cotton market is very volatile throughout the world. The price of cotton keeps changing from time to time depending on the position of demand and supply. Further, the trend in the international market also affects the price in local market. He further stated that in the course of business of trading in cotton some time they have to enter into forward contract in order to maximize their profits. He further stated that his proprietary concern has also entered into forward contract in the relevant financial year and there were six forward contracts entered into with three different parties of Ahmedabad. It is also stated that terms of contracts could not be complied with one or other reasons and ultimately these contracts were repudiated by the other parties and assessee have to pay liquidated damages for breach of contract. The details of these contracts are given as under:-

Name of The Party	Sauda Date	Bales & Quality	Sauda Rate	Date of Delivery	Reasons for Breach of Contract	Damages paid	Remarks
Rushi Cottex Pvt. Limited, A'bad	2.4.10	600 (S/6)	26,500	19.4.10	No stock	29,800	Debit Note Dated 27.4.10 ForRs.890842
-do-	4.4.10	500 (V797)	18,500	19.4.10	Quality issue	22,049	Debit Note Dated 27.4.10 ForRs.798383
-do-	17.4.10	300 (V797)	19,500	22.4.10	Quality issue	22,000	Debit Note Dated 27.4.10 ForRs.404928
-do-	19.4.10	300 (V797)	19,500	22.4.10	Quality issue	22,300	Debit Note Dated 27.4.10 ForRs.377933
Manish Cotton Corp. A'bad	4.1.11	100 (S/6)	42,800	13.2.11	Instant rise in prices	53,300	Debit Note Dated 20.3.11 ForRs.483547
Ruturaj Cotton Co; A'bad	9.1.11	500 (S/6)	42,800	8.2.11	Instant rise in price	48,200	Debit Note Dated 30.3.11 forRs.1214784

It is claimed that In view of the aforesaid transactions, the assessee has incurred a loss of Rs. 41,13,481/- . It is claimed that the loss is not of speculative nature on the ground that these transactions were entered during normal course of business as per trade practice and all contracts settled or adjusted without delivery cannot be speculative. A contract if so settled due to inability of supplying party for any reason, it would be breach of contract. The assessing officer has not accepted the explanation of the assessee because of the following reasons:-

*"4.1.21 Thus, in view of entire legal and factual matrix of the issue discussed above, the aforesaid four points raised by assessee can be rebutted as under:-*

*i. Speculative transactions are also the transactions entered into normal course of business whether they are done as trade practice or otherwise. Intention behind such transaction is not at all material while deciding their nature for the purpose of the Act.*

*ii. It is true that all contracts settled or adjusted without delivery cannot be speculative so far the provisions of the Act are concerned. But, exception is available only to those transactions which are covered under the proviso (a) to (d) to sub-section (5) to section 43 of the Act. More specifically, in the context of impugned assessee only genuine hedging transaction could have been so covered. But, no such claim of any hedging in respect of impugned transactions has been made by the assessee.*

*iii. There is no distinction in the Act regarding the contract settled by mutual consent to avoid delivery or contract settled otherwise so far the definition of 'speculative transaction' is concerned. However, in view of aforesaid decision of Hon'ble Supreme Court in the case of CIT v. Shantilal Pvt. Ltd. and other relevant judicial decisions, only those transactions settled in respect of sales & purchase of a commodity without delivery can be treated as non-speculative in which a dispute arose and matter was decided after arbitration. Hence, all other such transactions are definitely speculative ones only.'*

*iv. The argument that impugned transactions are reflected in the books of accounts and supported by stock register, etc. is misplaced because it cannot be presumed by any stretch of imagination that speculative transaction means those transactions which are not reflected in the books of accounts or which are not supported by stock register, etc."*

Consequently, the assessing officer has disallowed an amount of Rs. 41,13,781/- on the ground that it is not allowable as business expenditure because it was a loss arising out of speculative transactions which in view of the provisions of section 73 of the act cannot be set off u/s. 70 of the act.

4. Aggrieved assessee has filed appeal before the Id. CIT (A). The Id. CIT(A) has dismissed the appeal of the assessee. The relevant part of the decision of the Id. CIT (A) is reproduced as under:-

*"In the present case, appellant has incurred losses under the head " sale & purchase settlement" for six transactions for Rs.41,70,417/-. The first transaction pertains to loss arising for transaction with Rushi Cottex Private Limited for Rs.8,90,842/- for which appellant has claimed that it has entered for sale transaction of 600 bales for "S-6" on 02/04/2010 and delivery period was fixed for 17 days but as appellant was not having any stock, it has settled the transaction at Rs 29,800 as against Sauda Rate for Rs.6,500/-. The details submitted by appellant clearly prove that transaction is settled otherwise than delivery of actual goods hence loss incurred by appellant squarely falls within the definition of speculative loss as per section 43(5) of the Act. It is not the case of appellant that transaction was hedging transaction hence even exception provided in section 43(5) referred supra does not apply to present case. The stock settled otherwise than delivery of goods hence it cannot be said that such losses are business losses. It is pertinent to note that appellant has not entered into any business transactions with above three parties in year under consideration but mainly incurred*

losses on account of settlement of contracts Otherwise then delivery of goods. The appellant has claimed before AO that disputes were resolved with the intervention of reputed local market but he has not submitted any proof in support of such claim either before AO or in appellate proceedings. The appellant has also argued that settlement in respect of above eight contracts were facilities with the help of Shri Swami Surajgar Shambhuqar, a member of Radahnpur Cotton Ginners Association but no confirmation of said party is produced before undersigned. Even the claim of appellant that three parties have offered above amount as income in their respective returns cannot be accepted because disallowance of losses was made treating such losses as speculative loss and mere by offering losses by parties as income would not render loss as business loss.

The entire controversy is covered by the ratio of decision of Hon'ble Supreme Court in the case of CIT V/s Shantilal P Limited 1.44 ITR 57 wherein it is held as under :

**Facts**

The assessee-company contracted to sell a certain commodity to a party, but was unable to effect delivery due to a sharp rise in price of the commodity. The dispute which arose due to non-fulfilment of the contract was referred to arbitration and was settled by an award, with the result that the assessee was obliged to pay compensation by way of damages to the other party. Its claim for deduction of the amount so paid as a business loss was disallowed by the ITO on the ground that the transaction was a speculative transaction as defined in section 43(5). The AAC, however, allowed the assessee's claim on the ground that the impugned payment represented a settlement of damages on breach of the contract, which was distinct from a settlement of the contract. The Tribunal dismissed the departmental appeal preferred against the AAC's order. On reference under section 257:

Tribunal had allowed the said claim of the assessee on the view that since the settlement was made long after the delivery as contemplated in the contracts, the claim of the assessee was based on breach of contract and did not come within the meaning of settlement of contract as used in section 43(5) of the Act. The High Court of Punjab and Haryana disagreed with the said view and held that such claim of the assessee could not be allowed because the contracts were in the nature of speculative transactions. The High Court did not agree with the finding recorded by the Tribunal that the compensation was for breach of contract and, in this regard, the High Court has observed that there was no evidence to show whether the persons with whom the assessee had contracted to sell certain items gave any notice to the assessee alleging breach of contract on the part of the assessee or filed suits against the assessee claiming compensation and there was no evidence to show as to why the assessee was not able to perform his part or as to how the damages were calculated or as to what was the agreed rate before the breach of contract and what rate prevailed on the date of delivery and that merely because the contract had not been performed by the agreed date, it could not be said that it was due to the default of the assessee and that if the default of the assessee was not established, the question of liability would not arise and, consequently, the question of payment of damages would not arise.

It is further observed that in case of V.N. Sarsetty v. CIT [1987] 163 ITR 727 (Kar), the assessee had entered into a contract for sale of cotton and the assessee was required to deliver the cotton to the buyer before the end of April, 1969, and the agreement provided that the buyer could extend the time for the deliver/ of the goods. The assessee failed to deliver the cotton till May 23, 1969, in spite of repeated demands from

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.....  
In the result, the appeal is partly allowed.”

5. We have heard the rival contentions and perused the material on record carefully. The impugned issue is pertained to the transactions of sales and purchase of cotton bales without any delivery. It is claimed that the seller (assessee) has committed a breach of the contracts by not making delivery of goods therefore breach of damages were settled. However, the assessing officer has not satisfied with the explanation offered and stated that transactions were purely speculative in nature as no actual delivery was made. During the course of assessment, the assessing officer has noticed that assessee has debited a sum of Rs. 41,13,481/- under the Head Sale and Purchase Settlement in the P & L a/c of his proprietary concern, Al Cotton Industries. This amount was claimed on account of transaction of cotton bales without any physical delivery in the previous year. It is noticed that the assessee has incurred losses under the head sale & purchase settlement in respect of six transactions to the amount of Rs. 41,70,417/-. The assessee has claimed that he has entered into six forward contracts with three parties and has paid liquidated damages for breach of contracts. After perusal of the material on record, we find there is no specific written contract entered into by the assessee which specify the nature of contract and terms/conditions of the contract. During the course of appellate proceedings, the Ld. Counsel has referred page number 11 of the paper book as purchase contract. After perusal of the referred page we have noticed that it is a simply half page letter in the format of invoice stating that as per Telephone Talk, 5/6 cotton 600 Bales on spot basis and Risk and Sellers Account. The Id. counsel has also referred the page no. 6 to 8 of the paper book relating to letter dated 20/11/2013 of the All Gujarat Cotton Ginners Association regarding Souda Settlement in respect of cotton. We find it is a one page simple letter without any prescribed rules / regulations and resolution etc which can demonstrate the terms /conditions and working of liquidated damages under the particular circumstances. The assessee has referred the decision of the Hon<sup>ble</sup> Supreme Court in the case of CIT vs. Shantilal Pvt. Ltd. 144 ITR 57 (SC) and judgements in the cases of CIT vs. Kamani Tubes Ltd 207 ITR 298 (Bom) and CIT vs Gora

Mal Hari Ram Ltd. 191 Taxman 94 (Del). We find that that the facts of these cases are distinguishable from the case of the assessee. In the case of Kamani Tubes Ltd a strike took place in the factory of the assessee resulting in dislocation of production and agreed to pay the difference between the agreed price and the market price at the date of refusal. In the case of Gora Mal Hari Ram the assessee had paid a sum of Rs. 7,46,300 to Raj Agro Mills Limited on account of bargain settlement for split fatty acid distillate and another sum of Rs. 5,87,388 to Kuok Oils and Grains Private Limited, Singapore on account of price difference on the basis of a wash out contract for palm fatty acid distillate. However in the case of the assessee It is noticed that the assessee has claimed six sauda at the price of Rs.26.500,18500,19500,19500,42800,42800, for bales of cotton with other particulars with three different parties during the year under consideration on the different dates as mentioned above in the table. Against the above sale prices the assessee has claimed damage for the breach of contract without supplying any goods at the price of Rs 29800, Rs 22049, Rs 22000, Rs 22300, Rs 53300, Rs 48200 which are extraordinarily and even much higher than the sale price. There was no evidence to show as to why the assessee was not able to perform his part or as to how the damages were calculated or as to what was the agreed rate before the breach of contract and what rate prevailed on the date of delivery . We observe that the liquidated damages are damages whose amount the parties designate during the formulation of a contract for the injured party to collect as compensation if the other party breaches certain parts of the contract. It is also required to establish what actions or failures to act constitute a breach. We are of the view that the actual damages should be reasonable under the circumstances and the estimates are determined in a genuine manner by applying appropriate formula ,in consonance with fluctuating factors such as exchange rates, loss etc. We observe that if the payment is by way of damages and not by way of settlement of contract then the question of actual delivery or transfer of the goods would be irrelevant but we have noticed that in the case of the assessee he has claimed

damages to the tune of Rs 41,70.417/ for breach of the contract and contract was for the supply of the goods. We are of the view that in such nature of breach of contract a party to the contract settled the amount of damages by paying the difference between the contract price and the market price on the due date of performance and what is to be settled the damage consequent to breach of the contract. But in the case of the assessee, we have perused the detail of the contracts and the nature of transactions from the material on record as elaborated in the above cited table. It is noticed from the above that the assessee has claimed six sauda at the price of Rs.26.500,18500,19500,19500,42800,42800, for bales of cotton with other particulars with three different parties during the year under consideration on the different dates as mentioned above in the table. Against the above sale prices the the assessee has claimed damage for the breach of contract without supplying any goods at the price of Rs 29800, Rs 22049, Rs 22000, Rs 22300, Rs 53300, Rs 48200 which are extraordinarily and even much higher than the sale price. The assessee has also mentioned general reasons of not supplying of goods viz. on account of no stock, quality issue and instant rise in price. We observe that the assessee has given vague reasons for making huge compensation on account of instant rise in price and other reasons without substantiating the same with any supporting materials. The above facts demonstrate that assessee has claimed damages for payment of breach of contract much higher than the purchase price of the cotton bales, and could not justify how the huge amount paid even more than the purchase price can be treated as damage for breach of contract. There are no such specific terms and conditions in the purchase contract. After perusal of the material on record, we find there is no specific written contract entered into by the assessee which specify the nature of contract and terms/conditions of the contract. The above facts demonstrate that the amounts of damage are extraordinary level against the difference between the contract price and the market price on the due date of performance of the contract. The assessee has claimed liquidated damages

even much more than the settled price of the goods therefore the same cannot be termed as breach of contract but it is clear a case of settlement of claim without delivery under section 43(5) of the act. The term speculative transactions has been defined in sub-section (5) of section 43 of the Act as under:-

(5) "speculative transaction" means 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:

**Provided** that for the purposes of this clause—

- (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 shares 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 transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member; [or]
- [(d) an eligible transaction in respect of trading in derivatives referred to in clause [(ac)] of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) carried out in a recognised stock exchange; [or]]
- [(e) an eligible transaction in respect of trading in commodity derivatives carried out in a recognised association [, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013 (17 of 2013),]]

shall not be deemed to be a speculative transaction.

It is envisaged from the provision of section 43(5) of the act that all contractual business transactions in respect of purchase or sale of any commodity, if ultimately settled otherwise than delivery are fallen in the category of speculative transaction. It is noticed that the exceptions are provided in the proviso of section 43(5) that shall not be deemed to be speculative transactions. The nature of transactions in the case of the assessee is not covered by the aforesaid exception laid down into section 43(5) of the act. Inter alia it is crystal clear that the assessee has settled these transactions otherwise than delivery of actual goods, therefore, the claim of loss falls within the definition of speculative loss as per section 43(5) of the act. As demonstrated above in this order, the case of the

assessee is also not covered by the exceptions provided in section 43(5) of the act.

Looking to the above, we do not find any error in the decision of Id. CIT(A). Therefore, the appeal of the assessee is dismissed.

6. In the result, the appeal of the assessee is dismissed.

Order pronounced in the open court on 19-09-2018

**Sd/-**  
**(RAJPAL YADAV)**  
**JUDICIAL MEMBER**  
**Ahmedabad : Dated 19/09/2018**

**Sd/-**  
**(AMARJIT SINGH)**  
**ACCOUNTANT MEMBER**

**आदेश का प्रतिलिपि अप्रेषित / Copy of Order Forwarded to:-**

1. Assessee
2. Revenue
3. Concerned CIT
4. CIT (A)
5. DR, ITAT, Ahmedabad
6. Guard file.

By order/आदेश से,

उप/सहायक पंजीकार  
आयकर अपीलालय आधिकरण,  
अहमदाबाद