(2006) 01 GUJ CK 0027

In the Gujarat High Court

Case No : Income Tax Reference No. 61 of 1995

Patel Brass Works — APPELLANT

Vs

Commissioner of Income Tax — RESPONDENT

Date of Decision : 16-01-2006

Acts Referred:

Income Tax Act, 1961 — Section 2(14), 2(47), 256(1), 45

Citation : (2006) 205 CTR 139 : (2006) 286 ITR 598

Hon'ble Judges : H.N. Devani, J;D.A. Mehta, J

Bench : Division Bench

Advocate : SN Soparkar, for the Appellant; Tanvish U Bhatt, for Respondent 1, for the Respondent

Judgement

D.A. Mehta, J.—The Income Tax Appellate Tribunal, Ahmedabad Bench has referred the following two questions u/s 256(1) of the Income Tax Act, 1961 (the Act) at the instance of the assessee:

[1] Whether, in the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the appellant was not entitled to deduction of loss of Rs. 80,000/- as business loss?

[2] Whether, in the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the appellant was not entitled to deduction of loss of Rs. 80,000/- as short term loss?

2. The assessment year is 1986-87, the relevant accounting period being Samvat Year 2041. The assessee, a registered firm, is engaged in the business of manufacturing spare-parts of diesel engines. In the profit & loss account, a sum of Rs. 80,000/- had been debited as capital loss on machinery. The facts in relation to the said entry are that the assessee entered into a contract for purchase of machinery worth Rs. 10,09,000/- with M/s Godrej Boyce Mfg. Co. P. Ltd., Bombay vide letter dated 17/7/1984. The order was confirmed by the suppliers vide their letter dated 24/7/1984 calling upon the assessee to pay

earnest money amounting to Rs. 1,16,000/- for confirmation of the order. The assessee paid the amount as claimed. It is the case of the assessee that, as per terms of the contract, the machinery was to be supplied within a period of 12 months. Subsequently, the assessee gave up its plan to expand the business and cancelled the order for supply of machinery as per telex message dated 18/4/1985. The assessee simultaneously requested supplier to return earnest money of Rs. 1,16,000/-. It appears that the assessee and the suppliers entered into correspondence on this aspect and ultimately, the suppliers decided to return Rs. 36,000/- after deducting Rs. 80,000/- as cancellation charges. It is this amount of Rs. 80,000/-, which is the bone of contention between the parties.

3. The assessee claimed the said amount as a business loss, and in the alternative, as a short term capital loss. The assessing officer negatived the claim of the assessee on both the counts. The assessee did not succeed in appeal either before Commissioner (Appeals) or the Tribunal.

4. Mrs. Swati Soparkar, the learned advocate appearing on behalf of the applicant assessee submitted that question No. 1 is not pressed, on instructions, in light of the ratio of the Apex Court decision in case of SWADESHI COTTON MILLS CO. LTD. Vs. COMMISSIONER OF Income Tax, U. P. (NO. 2)., . In relation to question No. 2, it was submitted that the Tribunal had committed an error in holding that there was no transfer of any capital asset giving rise to short term capital loss. According to the learned advocate, the assessee had acquired a valuable right in the form of the contract, namely, a right to acquire the machinery and on extinguishment of the said right, short term capital loss arose entitling the assessee to claim the same as such. Relying upon a decision of the Supreme Court in the case of Commissioner of Income Tax v. Mrs. Grace Collis, [2001] 248 ITR 323, it was submitted that it was not necessary that there should be a transfer of any asset for allowing such a loss; that it was sufficient if there was extinguishment of a right as distinct from and independent of transfer of the capital asset. It was submitted that the moment the contract was cancelled, the right possessed by the assessee was extinguished resulting in short term capital loss.

5. Mr. T.U. Bhatt, the learned standing counsel for respondent revenue relied upon the impugned order of Tribunal as well as the decision of Bombay High Court in the case of Bharat Forge Co. Ltd. Vs. Commissioner of Income Tax, , to submit that the assessee was never in possession of any capital asset and hence, there was no question of the assessee being entitled to claim any capital loss.

6. The Scheme of the Act envisages a conjoint reading of provisions of Sections 45, 2(47) and 2(14) of the Act. u/s 45 of the Act, any profits or gains arising from the transfer of a capital asset effected in the previous year shall be deemed to be the income of the previous year in which the transfer took place. Therefore, for the charge of capital gains tax or capital loss, the essential requirements are that there should be a transfer of a capital asset effected in the previous year. This would require ascertainment of the meaning of the terms transfer and

capital assets. Transfer? has been defined, in relation to a capital asset, to include various contingencies stipulated by sub-clauses of Section 2(47) of the Act. Sub-clause (ii) of Section 2(47) of the Act states that transfer includes the extinguishment of any right therein. That requires assigning meaning to the term therein?. In other words, for the purposes of transfer of a capital asset, it would suffice if there is extinguishment of any rights in a capital asset. However, even for the purposes of extinguishment of any rights, existence of a capital asset is a must.

7. Section 2(14) of the Act defines capital asset? to mean property of any kind held by an assessee. For the present, it is not necessary to refer to the exclusionary clauses. The definition stipulates existence of property of every description and such property must be held by an assessee.

8. As can be seen from the facts of the case, the assessee had entered into a contract for purchase of machinery. The contract had been executed and entered into by the parties to the contract. The contract was in subsistence till the point of time the assessee cancelled the contract. Therefore, till that point of time, the assessee did not have any right which could be termed to be property so as to fall within the definition of capital asset? as defined u/s 2(14) of the Act. The right that the assessee had till that point of time was to make payment of the balance amount and take delivery of the machinery for which the order had been placed by the assessee. In other words, the assessee was required to perform its part of the contract or show or express readiness and willingness to perform its obligation as emanating from the contract, namely, making payment of the balance amount towards machinery to be purchased, and then call upon the supplier to fulfill its part of the contract, namely, supply the machinery. Upon the supplier refusing to perform its part of the contract, the only right that could come into existence would be a right to sue for specific performance, and in the alternative, claim damages. However, in the present case, it was the assessee who was not willing to perform its part of the contract. Therefore, to claim that the assessee was in possession of a right which could be termed to be a capital asset within the meaning of section 2(14) of the Act, cannot be accepted and the Tribunal was justified in holding that the assessee was not in possession of any capital asset.

9. As already seen hereinbefore, the assessee was not holding any capital asset so as to enable the assessee to claim extinguishment of any rights in such a capital asset. Whether extinguishment per se is sufficient or whether it could operate as distinct and independent of transfer of a capital asset is not the issue in the present case, and hence, the decision in case of C.I.T. v. Mrs. Grace Collis (supra) relied upon by the learned advocate for the assessee, cannot carry the case of assessee any further. Even if the contention that extinguishment by itself is sufficient to constitute transfer is accepted, nonetheless, it is necessary for the assessee to establish that extinguishment is of any rights in a capital asset. The facts of the case reveal that the assessee never held any capital asset. The

endeavour on behalf of the assessee to contend that the assessee was holding a right, which itself was a capital asset, is not supported by the facts of the case. The only right that the assessee had, till the point of time it cancelled the contract, was to perform its part of the contract and seek performance of the contract from its suppliers. This could not be termed to be a capital asset, howsoever wide the definition of property may be cast.

10. In these circumstances, when the Tribunal came to the conclusion that the concluded contract between the assessee and the suppliers through the exchange of letters was not a capital asset in the hands of the assessee, and there was no transfer whatsoever within the meaning of Section 2(14) of the Act, it cannot be said to be incorrect. Even if the unilateral act of cancellation of contract would amount to extinguishment, it would be extinguishment only of the right to seek performance of the contract after showing the willingness to perform its part of the contract.

11. Therefore, in absence of any infirmity in the impugned order of Tribunal, question No. 2 is answered in the affirmative. The Tribunal was right in law in holding that the assessee was not entitled to deduction of Rs. 80,000/- as short term capital loss. The question is accordingly answered in favour of the revenue and against the assessee.

12. The Reference stands disposed of accordingly. There shall be no order as to costs.

