

(2014) 09 KAR CK 0343

In the Karnataka High Court

Case No : Income Tax Appeals Nos. 829 and 831 of 2008

Commissioner of Income Tax

APPELLANT

Vs

First Securities P. Ltd.

RESPONDENT

Date of Decision : 02-09-2014

Acts Referred:

Forward Contracts (Regulation) Act, 1952 — Section 2
Income Tax Act, 1961 — Section 43, 43(5), 43(5)(c), 72, 73
Securities and Exchange Board of India Act, 1992 — Section 12
Securities Contracts (Regulation) Act, 1956 — Section 2

Citation : (2015) 370 ITR 72 : (2015) 230 TAXMAN 463

Hon'ble Judges : Rathnakala, J;N. Kumar, J

Bench : Division Bench

Advocate : K.V. Aravind, Advocates for the Appellant; S. Parthasarathi, Advocates for the Respondent

Judgement

N. Kumar, J.—The assessee in both the appeals are common and the substantial questions of law in these two appeals are also the same, hence, both the appeals are taken up together for consideration to dispose of in this common judgment. The Revenue has preferred these two appeals against the finding of the Tribunal upholding the claim of the assessee on the ground that under the proviso (c) of section 43(5) of Income-tax Act, 1961 (hereinafter referred to as "the Act"), the nature of jobbing and arbitrage cannot be considered as a speculative transaction.

2. The assessee is a share broker and a member of both National Stock Exchange and Bangalore Stock Exchange Ltd. The assessee had drawn a composite income and expenditure statement in which the income from various sources like brokerage, handling charges, commission, profit on sale of current investments, etc., are reflected. The assessee filed a return of income showing a loss of Rs. 52 lakhs for the assessment year 2001-02. The remand report dated November 8, 2005, shows that the transactions are in the nature of jobbing and arbitrage, done to guard against loss which could have arisen in the ordinary course of the assessee's business as a member. The assessing authority came to

the conclusion that the assessee is a private company and not a banking company, therefore, the case falls squarely within the provisions and in terms of Explanation to section 73 of the Act. Therefore, held that the specific provisions by way of Explanation to section 73 of the Act necessarily suggests that the business loss should be considered as speculation business loss and loss arising therefrom needs to be treated as speculative loss. Therefore, he rejected the claim of the assessee for set off against other business profits but allowed to be carried forward by setting of the loss from speculation business. Aggrieved by the said order, the assessee preferred an appeal before the Commissioner of Income-tax (Appeals), who upheld the said order. It is against these two orders, the assessee preferred an appeal before the Tribunal and the Tribunal on a careful consideration of the provisions of law, the contents of the remand report and the materials on record, held that section 73 of the Act will come into operation only when the transaction is found to be a speculative transaction and not otherwise. The transaction must lead to a speculation business or activity and the result must be a loss. On satisfaction of both these conditions, section 73 of the Act will come into operation. However, proviso (c) to section 43(5) clearly shows that the transactions in the nature of jobbing and arbitrage are not to be considered as speculative transaction. Therefore, when the transaction is not to be treated as speculative transaction, the loss suffered by the transaction would be a business loss. It has to be allowed as such and, therefore, the Tribunal set aside the order of both the authorities and allowed the business loss. Aggrieved by the said order, the Revenue is in the appeal.

3. Learned counsel for the Revenue assailing the impugned order contended that Explanation to section 73 of the Act is squarely attracted to the facts of the case as the assessee is in the business of purchase and sale of shares of other companies and, therefore, by a deeming fiction, the said business is to be treated as a speculation business and any loss in the said business cannot be set off against other business profit but it has to be set off only against the profit accrued from speculation business and, therefore, the impugned order requires to be set aside.

4. Per contra, learned counsel for the assessee submitted that before section 73 or the Explanation to section 73 of the Act is attracted, the activity carried on by the assessee should be a speculative transaction. In the instant case, the transaction falls under section 43(5)(c) of the Act, which is not a speculative transaction and, therefore, the Tribunal was justified in upholding the claim of the assessee.

5. In the light of the aforesaid facts and the rival contentions, the substantial question of law that arise for our consideration is as under:

"Whether the Tribunal was correct in holding that the speculative loss incurred by the assessee in the course of trading in shares can be set off against income arising under other heads as it satisfy proviso (c) to section 43(5) of the Act and, consequently, the Explanation to section 73 is not attracted?"

6. The speculative transaction has been defined under sub-section (5) of section 43 of the Act, which reads as under:

"Section 43(5) of the Income-tax Act, 1961 "Speculative transactions" 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,

shall not be deemed to be a speculative transaction.

Explanation 1.--For the purposes of clause (d), the expressions--

(i) "eligible transaction" means any transaction,--

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), or the Securities and Exchange Board of India Act, 1992 (15 of 1992), or the Depositories Act, 1996 (22 of 1996), and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act;

(ii) "recognised stock exchange" means a recognised stock exchange as referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose;

Explanation 2.--For the purposes of clause (e), the expressions--

(i) "commodity derivative" shall have the meaning as assigned to it in Chapter VII of the Finance Act, 2013;

(ii) "eligible transaction" means any transaction,--

(A) carried out electronically on screen-based systems through member or an intermediary, registered under the bye-laws, rules and regulations of the recognised association for trading in commodity derivative in accordance with the provisions of the Forward Contracts (Regulation) Act, 1952 (74 of 1952), and the rules, regulations or bye-laws made or directions issued under that Act on a recognised association; and

(B) which is supported by a time stamped contract note issued by such member or intermediary to every client indicating in the contract note, the unique client identity number allotted under the Act, rules, regulations or bye-laws referred to in sub-clause (A), unique trade number and permanent account number allotted under this Act;

(iii) "recognised association" means a recognised association as referred to in clause (j) of section 2 of the Forward Contracts (Regulation) Act, 1952 (74 of 1952), and which fulfils such conditions as may be prescribed and is notified by the Central Government for this purpose;"

A reading of the aforesaid provisions makes it clear that the 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, it amounts to a speculative transaction. However, the said section culls out certain exceptions. One such exception is to be found in clause (c) of section 43(5) of the Act, which deals with 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 and arbitrage to guard against loss which may arise in the ordinary course of his business of such member, then such a transaction was not be deemed to be a speculative transaction.

7. Section 73 of the Act deals with how losses in speculation business has to be dealt with, which reads as under:

"73. (1) 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.

(2) Where for any assessment year any loss computed in respect of a speculation business has not been wholly set off under sub-section (1), so much of the loss

as is not so set off or the whole loss where the assessee had no income from any other speculation business, shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and--

(i) it shall be set off against the profits and gains, if any, of any speculation business carried on by him assessable for that assessment year; and

(ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

(3) In respect of allowance on account of depreciation or capital expenditure on scientific research, the provisions of sub-section (2) of section 72 shall apply in relation to speculation business as they apply in relation to any other business.

(4) No loss shall be carried forward under this section for more than four assessment years immediately succeeding the assessment year for which the loss was first computed.

Explanation.--Where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares."

A reading of the aforesaid provisions makes it clear that any loss computed in respect of a speculation business carried on by the assessee has to be set off only against the profits earned in such speculation business. There is a total prohibition for setting off such loss against profits and gains arising from any other business. However, an Explanation was added by the Taxation Laws (Amendment) Act, 1975, which came into effect from April 1, 1977, providing for a deeming clause.

"Explanation.--Where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares."

As per the said Explanation, where any part of the business of a company other than a company whose gross total income consists of mainly purchase and sale of shares of other companies, then such company shall for the purpose of section

73 of the Act, that is, for setting off the losses be deemed to be carried on as a speculation business to the extent to which the business consists of purchase and sale of such shares.

8. The High Court of Calcutta in the case of R.P.G. Industries Limited Vs. Commissioner of Income Tax and Another, has held as under (page 320):

"The statement of objects and reasons for the added Explanation to section 73 and the notes on clauses appended to the Bill explaining the proposed amendment are also quoted below ([1973] 89 ITR (St.) 107):

"Statement of objects and reasons

The object of this Bill is to amend the Income-tax Act, 1961, the Wealth-tax Act, 1957, the Gift-tax Act, 1958, and the Companies (Profits) Surtax Act, 1964. The proposals relating to the amendments to these enactments have been formulated after a detailed examination of the recommendations of the Direct Taxes Enquiry Committee (Wanchoo Committee) and the Forty-seventh Report of the Law Commission on the Trial and Punishment of Social and Economic Offences, the latter in so far as they relate to direct taxes. Opportunity has been taken to sponsor some amendments on the basis of suggestions received from various other quarters as well. Technical difficulties arising in the operation of some of the provisions of these enactments have also been taken into account in formulating these proposals.

2. The main objectives of the amendments proposed to be made are to unearth black money and prevent its proliferation; to fight and curb tax evasion; to check avoidance of tax through various legal devices, including the formation of trusts and diversion of income or wealth to members of family; to reduce tax arrears and to ensure that in future, tax arrears do not accumulate; to rationalise the exemptions and deductions available under the relevant enactments, and to streamline the administrative set up and make it functionally efficient.

3. The Notes on Clauses, appended to the Bill, explain the various provisions thereof."

"Treatment of losses in speculation business--section 73.

19.1 Section 73 of the Act provides that any loss computed in respect of speculation business carried on by an assessee will not be set off except against the profits or gains, if any, of another speculation business. Further, where any loss, computed in respect of a speculation business for an assessment year is not wholly set off in the above manner in the said year, the excess shall be allowed to be carried forward to the following assessment year and set off against the speculation profits, if any, in that year, and so on. The Amending Act has added and Explanation to section 73 to provide that the business of purchase and sale of shares by companies which are not investment or banking companies or companies carrying on business of granting loans or advances will be treated on the same footing as a speculation business. Thus, in the case of aforesaid

companies, the losses from share dealings will now be set off only against profits or gains of a speculation business. Where any such loss for an assessment year is not wholly set off against profits from a speculation business, the excess will be carried forward to the following assessment year and set off against profits, if any, from any speculation business.

19.2 The object of this provision is to curb the device sometimes resorted to by business houses controlling groups of companies to manipulate and reduce the taxable income of companies under their control.

19.3 This provision will come into force with effect from April 1, 1977 and will apply in relation to the assessment year 1977-78, and subsequent years.'"

9. Therefore, it has no application to a contract entered into by a member of the NSE or Bangalore Stock Exchange, whose business is in trading of shares on behalf of his clients, which is known as jobbing or arbitrage. Any loss which may arise in the course of such business, shall not be deemed to be a speculative transaction. If the nature of the transaction by the assessee is not a speculative transaction at all, then, the Explanation to section 73 of the Act has no application. The loss sustained by the assessee is a business loss which can be set off against the income from the other sources. Therefore, the prohibition under section 73 of the Act is attracted only to set off the loss in a speculative business against the profit from other business, because loss from speculation business should be set off only from a profit of speculation business. Therefore, the Tribunal was justified in setting aside the order passed by the authorities and allowing the claim of the assessee. The substantial question of law is answered in favour of the assessee and against the Revenue. We do not see any merit in these two appeals. Accordingly, the appeals are dismissed.