

(1978) 05 DEL CK 0015

In the Delhi High Court

Case No : Income Tax Reference No. 45 of 1969

M.R. Dhawan and Co.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 16-05-1978

Acts Referred:

Citation : (1978) ILR Delhi 393 : (1979) 119 ITR 412

Hon'ble Judges : T.V.R. Tatachari, J; S. Ranganathan, J

Bench : Division Bench

Advocate : S.C. Manchanda, S.L. Aneja, B. Kirpal and M.L. Varma, for the Appellant;

Judgement

S. Ranganathan, J.

(1) This is a consolidated reference by the Income Tax Appellate Tribunal in the case of Shri M. R. Dhawan for the assessment years 1955-56, 1956-57, 1958-59, 1959-60 and 1960-61 u/s 66(1) of the Income Tax Act, 1922. A common question of law has been referred for the decision of this Court for all the above assessment years. The question reads as follows:

"Whether on the facts and in the circumstances of the case, the loss claimed by the assessed in the transactions entered in the "difference account" were rightly disallowed u/s 24(1) of the Income Tax Act, 1922 ?"

(2) It is indeed surprising that- the question which arises for our consideration in this case had not come up before this or any other court earlier. The assessed is a stock broker who is a member of the Delhi and other stock exchanges and, as the narration of facts below will show, the problem is so inherent in his business and of such a nature that it must have actually arisen in a number of cases and in a number of years. It must have been dealt with in such cases on some basis satisfactory or acceptable to both parties, for learned counsel on both sides stated that the question has not been directly taken to Court in any earlier case and that the matter is rest Integra before us-

(3) The question raised is a pure question of law as to the interpretation of Explanation 2 to Section 24(1) of the Indian Income Tax Act, 1922 defining a speculative transaction. The Explanation, in so far as it is relevant for our present purposes, read as follow :

"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 scripts."

There is a proviso to this Explanation which carves out certain exceptions but as it is not the case of either party that the transactions in the present case are covered by any of the exceptions we shall leave the proviso out of account. The short question for decision in this case is whether certain contracts entered into by the assessed M. R. Dhawan for purchase and sale of certain shares on the Stock Exchange were "settled otherwise than by the actual delivery of the scripts" so as to fall within the terms of the above Explanation.

(4) Before proceeding further we may mention that by amendments to the Indian Income Tax Act, 1922 made by the Finance Act, 1953, speculative transactions in the nature of a business were segregated for separate consideration. Losses sustained by an assessed in speculative transactions are considered as a class by themselves and such losses can be set off only against profits made in speculative transactions, whether in that year or in subsequent assessment years. This provision was introduced into the Act with a view to putting an end to a practice of purchasing losses which was so wildly rampant that Chagla C.J. in the case of Keshavlal Premchand Vs. Commissioner of Income Tax, Ahmedabad, took judicial notice of it. It will be seen that the wording of the Explanation is deliberately made direct and simple so as to cut out any indefiniteness attaching to the idea of "speculation". "Speculation", in common parlance, connotes an intention to speculate, gamble, take a chance or risk and the determination of the question whether a transaction was or was not a speculative one was beset with problems on account of difficulties in ascertaining the intention with which the parties entered into the transaction. The Act, Therefore, proceeded to give a definition which steered clear of the intention of the parties. Instead, a very simple and objective test for determining whether a transaction is a speculative transaction or not was laid down. Under this definition, all that has to be done is to find out whether the contract was periodically or ultimately settled by actual delivery, transfer or otherwise. If the goods or commodities in respect of which the contracts were entered into were actually taken delivery of pursuant to the contract it would not be a speculative transaction even though the commodity or script may be a highly speculative one by its very nature and even though, at the time when the contracts were entered into the parties might have had no idea of taking delivery at all. On the other hand, if the contract is settled otherwise than by actual delivery then it will be a speculative transaction notwithstanding that the nature of the commodity was

not one lending itself to possibilities of speculation or that the intention of the parties at the time when the contracts were entered into might have been to take actual delivery but this intention could not be effectuated for one reason or the other. These principles have been laid down in a series of decisions: JUVVI SUBBARAMAIAH AND CO. Vs. COMMISSIONER OF Income Tax, ANDHRA PRADESH., , HOUSEN KASAM DADA (INDIA) LTD. Vs. COMMISSIONER OF Income Tax, CALCUTTA., ; Abdul Gani Haji Habib and Others Vs. Commissioner of Income Tax, Commissioner of Income Tax Vs. Ratan Lal Mohanlal, ; P.L.KN. Meenakshi Achi Vs. Commissioner of Income Tax, Madras., ; A. Muthukumara Pillai Vs. Commissioner of Income Tax, . Indeed there is no controversy before us regarding this principle.

(5) It is in the context of the above statutory provision that the facts of the present case have to be considered. The assessed M. R. Dhawan is an individual. He is a dealer in shares. He is also a member of the Delhi Stock Exchange as well as Stock Exchanges at certain other places in India. In regard to his transactions in shares, he maintained two trading accounts in his books- One was called the "securities account" and the other was called the "difference account". It appears that these two sets of accounts were being maintained by him right from the inception of his business. In answer to a query raised by the Income Tax Officer the assessed explained the position regarding these accounts : in his letter dated 21st March, 1960:

"In account No. 1, i.e. Securities account, all the purchases and sales in respect of which actual deliveries pass are entered. After taking into account, the value of the Closing stock on the last day of the accounting year, the net trading profit or loss made in this account, is worked out. In account No. 2, i.e. Difference Account entries in respect of such contracts of which physical deliveries are not taken for the various reasons mentioned in the subsequent part of this letter are made. The net balance would thus show the profit or loss made on such transactions in which the physical deliveries have not passed. It is only through accountancy convenience that these two separate accounts have been maintained in the General Ledger; otherwise there will be nothing wrong if all these entries are passed in one account, i.e. Securities account."

The letter proceeds to explain why physical deliveries were not taken in the transactions recorded in the Difference Account :

" THE various reasons on account of which the physical deliveries do not take place, and the profit or loss of which has been debited or credited to the Difference account are as under: (a) Our business is direct either with the members of the Stock Exchange or with the members of the public as Principal to Principal. If a contract for purchase of certain company's shares is made either with a member of the Stock Exchange or any member of public, it is customary to fix a date for delivery. For instance,, if on the first of any month, we entered into a contract for purchase of certain number of shares of any company, the delivery of such shares will have to be taken by us on the settlement date

according to the rules of the Stock Exchange- If however before the settlement date, we entered into a contract for the sale of the shares of the same company, then, on the settlement day, the delivery will be effected for the net quantity of the shares, i.e. if our sales are more, then we will have to give delivery and if our purchases are more we will have to take delivery. It may however be mentioned here that if subsequent to the first contract, no contract is made with the same party up to the date of the settlement, then physical delivery of the shares have to pass. It will thus be appreciated that the intention at the time of making the original contract is to give or take the delivery as the case may be. Such deliveries are effected by the subsequent contract made up to the day of settlement. The procedure followed is that if we have to deliver 100 shares and take delivery of 80 shares, then instead of actually delivering 100 shares and taking the delivery of 80 shares, only balance 20 shares are delivered. In the books of account, entries in respect of 80 shares (whether profit or loss) will be made in the Difference Account whereas in respect of 20 shares, the entries will be made in the Securities Account. It will not be out of place to mention here that if entries in respect of sale of 100 shares and purchase of 80 shares were passed in the securities account, the result would have been the same. (b) According to the rules of the Stock Exchange it is permitted to set off the contracts of sales and purchases to effect the delivery of minimum number of shares. It will be appreciated that it will not be possible for the members to function, if delivery in respect of all the sales and purchases were to pass physically. The Stock Exchange acts as the Clearing House in the same way in which the Reserve Bank of India acts as the Clearing House for the Banks. In the case of banks, if physical delivery of cash has to pass for each cheques, it would become impossible to enter into the numerous transactions. The subsequent contracts are made either in the ordinary course of business or to guard against the loss which may rise in ordinary course of business. The speculation business is such where from the inception of the contract there is no intention to give or take the delivery, and in such cases, the contracts are settled by payment of the difference on the settlement day; whereas in our case definite date is fixed for actual delivery of shares and not for the payment of difference. The test to distinguish a speculative contract from the other contracts is did the parties at the time of entering into the contract intend that delivery was to be taken and given or was it intended that only the differences should be adjusted on a given date. The test would be is the contract such that the purchaser was precluded from taking delivery."

(6) It will be seen that the above letter practically admits that, in respect of the transactions entered in the Difference Account, physical delivery of the shares was not actually taken. But it is argued: (a) that the accounts would have shown the same result even if all the shares had been shown as received or delivered ; (b) that, having regard to the nature of a transaction on a stock exchange, it would be impossible to do anything else; (c) that the transactions must be deemed to involve some sort of constructive delivery of all the shares purchased

and sold; (d) that, according to the rules of the Stock Exchange, there was always implicit at the time of purchase or sale an intention to give and take delivery and (e) that "the subsequent contracts are made in the ordinary course of business or to guard against the loss which may rise in ordinary course of business". Naturally, the Income tax Officer concluded that the transactions in the Difference account were speculative transactions. The net result of these transactions segregating them from the consolidated trading result of both the accounts returned by the assessed as the profit or loss from the share business for the several years were as follows :

Assessment year. Profit (P) or Loss (L) 1955-56 Rs. 29,758.00 (L) 1956-57 Rs. 1,27,295.00 (L) 1957-58 Rs. 66,765.00 (L) 1958-59 Rs. 70,960.00 (L) 1959-60 Rs. 1,43,342.00 (L) 1960-61 Rs. 1,20,058.00 (L)

He, Therefore, treated the losses, figures which have been set out above, as losses in speculative transactions allowable for set off for only against profits in such transactions.

(7) Aggrieved by the order of the Income Tax Officer, the assessed preferred appeals to the Appellate Assistant Commissioner. The appeals for 1955-56 and 1956-57 were heard in the first instance in October, 1961. By an order dated 24-10-1961, the Appellate Assistant Commissioner considered it necessary to call for a remand- report from the Income Tax Officer. It had been contended before him:

(i) that the transactions in both sets of accounts formed part and parcel of the same business and they could not be treated as separate businesses, merely because, for the sake of convenience two separate accounts were kept; (ii) that, on every one of the transactions entered in the Securities Account, there had been actual delivery given or taken of the excess of the purchases over sales or of sales over purchases, as the case may be for e.g. in the transactions finalised on 27-5-55, 2900 shares were actually taken delivery of and the position was similar on 22-4-55 also; and (iii) that the settlements through the clearing house involved constructive delivery of all the shares dealt in and this was sufficient to take I he transactions out of the definition: vide Duni Chand Rataria Vs. Bhuwarka Brothers Ltd., .

The appellate Assistant Commissioner observed :

".... .The only test that can be applied in such cases is to find out whether the transactions resulted in the, actual or constructive delivery of the shares or not. For this purpose it will be necessary to examine the assessed"s accounts in a detailed manner. The assessed has placed before me two instances in which the stock exchange acted like a clearing house and assessed took delivery of shares purchased in excess of his sales during the period covered by the settlement. It is, however, necessary to find out whether this has been so on every settlement or whether the assessed on some dates had paid or received differences for the entire transaction without resorting to actual delivery of shares in respect of

excess purchase or excess sale during the settlement period. The I.T.O. is directed to examine the assessed's accounts and send me a report giving actual instances....,"

(8) The two transactions on which reliance has been placed by the learned counsel for the assessed were examined by the Income Tax Officer. He accepted the plea of the assessed's representative that all transactions in the Differences Account were on the exact pattern of those settled on 27-5-55 and that the assessed had taken or given delivery of excess purchases or sales. But he pointed out that these excess shares were accounted for in the Securities account. In respect of the balance, which alone found place in the Differences Account, no delivery was given or taken. He, Therefore, reiterated his original view that the losses recorded in the Differences Account were losses in speculative transactions-

(9) The appeals for 1955-56 and 1956-57 along with the appeals turn the subsequent assessment years 1957-58 to 1960-61 came up for hearing before another Appellate Assistant Commissioner in 1966 who, by his order dated 30-4-1966, held that the segregation of the transactions recorded in the Differences Account and the Securities Account was not justified. The Appellate Assistant Commissioner appears to have agreed in respect of the transactions entered in the differences account delivery was neither taken nor given of the scrips. But, notwithstanding the above finding, he held that the assessed carried on one integral business of which these transactions also formed a part and this being so the profit or loss should be considered of the business aia whole and that the segregation of the transactions in the Differences Account was not justified. He observed :

"But the I.T.O. is not applying the rest to any whole transaction but to the part result of a group of transactions, jointly finalised on clearing dates. He cannot give separate treatment to part results of a group of transactions jointly finalised. In a way by strict application, I will even say that all the transactions are speculative in nature. The circumstances that out of the total volume of business done by the assessed between one clearing date and another a small fraction happens to be performed by actual delivery, would not take away the impress which everyone of the contracts (including the fraction performed by actual delivery) had at the time it was entered into, namely of its being capable of performance by adjustment. When all the transactions are speculative in nature, all the transactions constitute one and distinct business in terms of Explanation (1) to Section 24(1) of the Act. We can call it by any name, all the transactions constitute one and only one business. Two different modes of finalisation of a group of transactions by balancing the purchase and sale quantity cannot convert the results of the two modes into two separate business, simply because entries are made in two different ledger Accounts. By all tests laid down by the authorities, the two modes of finalization of transactions are the two features of the same business and then two results are required to be

adjusted and considered as the results of one business....."

(10) The department preferred appeals to the Tribunal. The Tribunal summarised the position thus :

"From the facts as emerge from the above quoted letter of the assessed and also from the findings given by the Appellate Assistant Commissioner, it is clear that only the resultant number of shares, after crossing out the equivalent number of purchases and the sales thereof, were taken delivery of and whatever differences arose in the prices of the crossed out shares on the basis of the market rate on the settlement date, was either received or paid by the assessed accordingly. It has Therefore to be considered as to whether in respect of those shares also, in the purchase and sale of which actual delivery was not made but the one crossed the other, it could be taken to an actual delivery of the shares. We are not impressed by the fact that since the volume or transactions might have been tremendous the actual delivery of shares would have been cumbersome or even unpractical. What we have to consider is whether the transactions were such as were not encompassed within the provisions of Explanation 2 to section 24(1) of the Income Tax Act, 1922."

After extracting the definition in the Explanation and referring to the decisions, of the Supreme Court in the case of Duni Chand Rataria Vs. Bhuwalka Brothers Ltd., and of the Calcutta High Court in the D. M. WADHWANA Vs. COMMISSIONER OF Income Tax, WEST BENGAL., the Tribunal held :

"In view of our discussions above we are of the opinion that the Appellate Assistant Commissioner was clearly in error in thinking that even though part of transatotion in the purchase and sale of share scrips was settled without actual delivery of the share scrips, the loss arising on suctransactions was not a loss in speculative transaction within the meaning of Explanation 2 to section 24(1) of the Income Tax Act, 1922. We accordingly hold that the loss arising to the assessed in the differences accountant in the various years under consideration was a loss sustained" by him in a business consisting of speculative transactions and Therefore could be set off only against the profits and gains of like business and not against his other business profits."

(11) The assessed is dissatisfied with the order of the Tribunal and hence the reference before us.

(12) The Departmental authorities and the Tribunal did not look into the relevant rules of the Delhi Stock Exchange. But Sri Mahehanda referred us to these bye-laws and Regulations in order to bring out his contentions and it may be convenient to refer to the relevant ones at this stage. Under by-law 9, only a member or a person authorised by him, will be allowed on the floor of the Exchange. Except as provided in the bye-laws and regulations there can be no dealings in Securities on the Exchange (Bye-Law 20). Bargains in Securities can be, under Bye-Law 48, of the following kinds :

"(i) for "spot delivery" i.e. for delivery and payment on the same day as the date of the contract or the next day ; (ii) for "hand delivery" i.e. for delivery and payment within the time or on the date stipulated when entering into the bargain which time or date shall not be more than fourteen days following the date of the contract ; (iii) for the "clearing" i.e. for clearance and settlement through the Clearing House in the manner prescribed in these ByeLaws and regulations; (iv) for "Special delivery" i.e. for delivery and payment within any time exceeding fourteen days following the date of the contract as may be stipulated, when entering into the bargain and permitted by the Board of Directors or President as provided in these Bye-Laws and regulations."

Bye-law 52 (a) clarifies that bargains in cleared securities are deemed to be for the current clearing unless otherwise stipulated when entering into the bargain 52(b) enables the exchange to fix the clearing days and 52(c) provides that "no bargains in cleared securities" made for a period beyond the current and ensuring clearing shall be recognised". Bye-law 52(e) is important. It runs :

"Bargains in Cleared Securities entered into during a clearing be closed by purchase or sale during the clearing or carried over to the ensuing clearing. All bargains entered into during the clearing that remain outstanding at the close of business on the last business days shall be performed by delivery and payment on the days fixed for the purpose".

Bye-law 83 which provides for delivery and payment in Cleared Securities through the Clearing House is important :

"83 .(1) Payments of differences in respect of all bargains for the clearing in Cleared Securities shall be made through the Clearing House. (2) Deliveries of all bargains for the clearing in Cleared Securities shall be made under instructions from the Clearing House. (3) Provided however that any member who holds for account of his different constituents contracts both for sale and purchase in the same clearing that off-set each other shall be entitled to off-set such contracts and in that case he shall be entitled to give and take delivery outside Clearing House."

By-Law 91 directs that the Exchange shall maintain a Clearing House and explains its functions :

"The Clearing House shall act as the common agent of the members for clearing contracts between members and for the delivering securities to or receiving Securities From members and for receiving or paying any amounts payable to or payable by such members in connection, with any of the contracts and to do all things necessary or proper for carrying out the foregoing purposes."

Bye-law 96 entitles the Clearing House "at its discretion to deliver securities which it has received from a member (or to instruct a member to give direct delivery of Securities which he has to deliver) under these Bye-laws and regulations to another member who is entitled Under these Bye-laws and

Regulations to receive delivery of Securities of a like kind" and members giving and receiving such delivery shall be deemed to have made a contract with each other as sellers and buyers. Only members are entitled (vide Bye-law 106) to clear and settle contracts through the clearing House. Bye-law 113 requires all clearing form- to be in a form prescribed by the Regulations. Bye-law 349 provides that a member will be guilty of misconduct if he transacts his own business or that of his constituents in fictitious names or "if he makes a fictitious transaction or gives an order for the purchase or sale of Securities the execution of which would involve no change in ownership or executes such an order with knowledge of its character."

(13) To come now to the relevant regulations, they are as follows:

"8.10 On Clearance Days members shall submit to the Clearing House Delivery Orders (form No. 6) and Receive orders (form No. 7) showing the balance of the different kinds of Securities of which delivery is to be given or taken through the Clearing House along with the margin of 10 per cent. 8.11 (a) The Delivery orders and Receive orders shall be deemed to be orders by a member to the Clearing House to deliver on his account each kind of Security, as specified in the Delivery order (form No. 6) and to credit him with the value thereof and to receive on his account each kind of Security as specified in the Receive order (form No. 7) and to debit his account with the value thereof. (b) The credits and debits referred to in Sub-clause (a) shall be contingent upon actual delivery and receipt of the Securities and the value in each case shall (subject to alteration of making up prices as provided in these Bye-laws and Regulations) be determined at the making-up prices fixed for the clearing. 8.13 On Delivery Day, members who have to give delivery of Securities as specified in the Delivery Orders (form No. 6) shall deliver to the Clearing House such securities together with the necessary transfer forms in toto of trading unit duly signed and witnessed and showing on the reverse the name of the member delivering the Securities. 8.14 The particulars of the Securities to be delivered shall be entered in the Securities Particulars Form (form No. 11) and a separate form shall be submitted for each kind of Security. Receipts shall be issued to members on presentation of such forms duly filled in and specifying the quantity, the names of the transferor and the certificate or destructive members of the securities delivered. 8.15 (a) The account of a member delivering Securities will be credited by the Clearing House with the value thereof as value thereof at the making-up price. (b) The account of a member by whom Securities are to be received shall be debited by the Clearing House with the value thereof at the making up price. 8.30(a) *** ***
*** *** (b) Securities which are to be delivered to a member shall, unless it is otherwise ordered by the Board of Directors or unless there be a debit balance to his account, be delivered to him by the Clearing House on application on the Settling Day or as soon thereafter as practicable. The member taking the delivery of Securities from the Clearing House shall sign Therefore with a form attached to the Clearing House Securities Particulars Form (form No. 12). 8.40 The Clearing House shall handover to the delivering members Clearing House

Delivery orders (form No. 36) showing the number of Securities to be delivered and the names of the members to whom deliveries are to be made."

(14) The transactions of the assessed on the Stock Exchange, it is common ground, were carried out in accordance with the Bye-laws and Regulations set out above. Payments of differences were effected through the Clearing House and delivery of bargains were taken or given under instructions from the Clearing House in respect of the transactions in question. The differences account principally comprised of transactions in the shares of the Indian Iron and Steel Company, which were admittedly "cleared Securities". We believe that these shares were of a highly speculative nature but, as mentioned earlier, this is an irrelevant consideration. It is common round that all the transactions were of the same nature as those that were settled on 27-5-1955. So it would perhaps be useful to explain what happened on his "settlement day." On 27-5-1955, the account of settlement was as under :

I.T.R.45/69: Purchases Sales Rate No. From No. To Rate* Rs. Rs. 33/12/71 3,700
Uttam Prakash 500 Vishenji 33/12/9 33/12/61 900.00 -do- Khetsi , 1.700
H.B.Relan 4,208 Chunnumal 33/1 .00 33/12/6 800 Rameshwar Dass Kishau
Gupta Chand Jain 33/12/7 I Co Hansamal Ram Kumar 33/12/4 10 K.S.Jain
33/12/6 100 ManoharLalGupta 4,700 & Co. - 33/12/3 200 Lakhi Ram 7.600

The persons whose names are mentioned above are all members of the Stock Exchange, like the assessed. Between the previous settlement day and 27-5-1955, the assessed had agreed to purchase from the various persons mentioned on the left side column the number of shares specified against each at the respective rates mentioned. According to the rules of the Stock Exchange, the Stock Exchange fixes the prevailing rate for the "settlement" of transactions. On 27-5-1955, it was Rs. 33/1. The Indian Iron shares were, what were called, "Clearing Shares" and the procedure on the Stock Exchange in regard thereto was that each Member's account was settled at that rate. Thus the assessed who had agreed to purchase 7600 shares at rates above the settlement rate incurred a loss of Rs. 54981710 in respect of these shares; he, however, made a profit of Rs. 3691213 on the 500 shares agreed to be sold at Rs. 33/12/9. Thus, there was a resultant loss to him of Rs. 5129-14-9 on these transactions which was debited to the Difference Account on 31-5-1955. Now what about the delivery of the shares ? The rules of the Stock Exchange also provide that, in the case of a member, he need not give or take delivery of all the shares agreed to be sold Or purchased by him. It was sufficient if he gave or took delivery of the surplus of sales over purchases and vice versa. Thus, on 27-5-1955, the assessed was obliged to take delivery of only 2900 (i.e. 7600 minus 4,700) shares. These shares, as well as their value of Rs. 95,881-4-0 were debited to the Securities Account. We may also mention that these 2900 shares were to be delivered to the assessed, not necessarily by the members with whom he had entered into contracts of purchase. The Stock Exchange, on the same basis as above, finalised the accounts of all its members and depending upon the outcome in

each case, gave appropriate directions to any of its Members to deliver to stay other specified member (s) a specified number of shares. Thus, the assessed received 2900 shares from such member(s) of the Exchange as had been directed to deliver those shares to the assessed. Will this delivery be sufficient to ask the transactions of purchase and sale of 7600 and 4700 shares out of the definition of speculative transactions, is the question which arises in the present case. *

(15) Shri Manchanda contended that, under the regulations of the Stock Exchange, delivery had to be given in respect of all bargains whether it was spot delivery, or hand delivery or special delivery or delivery through the Clearing House. He referred to a passage from page 511, para 762 of Halsbury (3rd Edd.), Vol. 36 :

".... .All bargains must be completed in the prescribed manner and necessarily involve an obligation on the parties to- take or to make delivery or to pass the name of someone who will do so. This obligation attaches as soon as the bargain is made, and the parties can only get rid of it by subsequently entering into converse bargain with each other."

He says that all transactions were, Therefore, intended to be and were also in fact, effected by actual delivery. He, however, likens the position of member of the Stock Exchange to that of a Bank vis-a-vis the Bankers' Clearing House. Just as the Clearing House for Banks gives effect to inter-bank transactions by cross adjustments between banks and avoids physical transfer of monies from bank to bank in respect of each, cheque/draft that is cleared, so also, says Mr. Manchanda, the Clearing House of the Stock Exchange assumes the responsibility of Clearing Contracts between members, delivering to or receiving Securities from them and/or receiving from or paying to the several members amounts that may be due in respect of their contracts. He says that the volume of transactions put through the Clearing House is so tremendous that it will well-nigh be a practical impossibility to effect deliveries in respect of each and every contract that is registered. That is why what is done is that the Clearing House considers the case of each member. He will have some sales and some purchases in respect of each Security during the clearing. These are set-off against each other and he is asked to give or take delivery only of the excess of sales over purchases or vice-versa. Thus, Sri Manchanda says, the settlement on 27-5-55 must be taken to mean that the assessed took delivery of the 7,600 shares he had agreed to purchase and gave delivery of the 4700 shares he had agreed to sell. Attractive as the argument is, we are unable to accept it. If one thing is clear in this case, it is that delivery is not effected of all the shares dealt in by the assessed. In fact, that is the basic difference between the Securities Account and the Difference Account. The moment the assessed receives delivery of any shares from the Clearing House, he takes them into the Stock of the Securities Account and further dealings therein are recorded in that account. When the assessed agrees to purchase or sell a share on the floor of the Exchange, he may

be doing it turn himself, and on behalf of a constituent. If it is on behalf of a constituent, then he has. to actually take delivery of those shares and "hand over to the constituent. He either dose this" by passing on the shares agreed to be purchased by him or where the purchases and sales in a clearing off-set each other, he has to make arrangements to purchase and deliver .the shares to the. constituent, outside the Exchange. In either case these shares go into the Security Account. So, the transactions on behalf of the constituent do not at all figure in the Difference account. So far as this account is concerned, Therefore, the purchases and sales are those deals entered into between the assessed and other members of the Stock Exchange on his own account. In regard to those deals, delivery is not a must, for the Bye-lawa provide that "Cleared Shares" need not be delivered but can be settled and cleared through the House. In doing so, the member can set off the purchases and sales during the clearing and give "delivery" or "receive" orders only in respect of the surplus of sales over purchases or vice versa. Thus, when the assessed is operating under a set of rules which specifically provide that all purchases and sales need not be taken delivery of but that it is enough if only the excess are delivered, it is difficult to accept an argument that all the shares must be taken to have been taken actual delivery of. The assessed's letter to the I.T.O., the accounts, the account settlement, the finding of the I.T.O. in the remand report and even the A.A.C's order are all agreed on this point that delivery was given only of the excess. For example in the settlement on 27-5-1955, the assessed received delivery only in respect of 2900 shares. Again, under the rules of the Exchange which have been set out above, the assessed need not have received even these 2900 shares from one or more of the persons with whom he contracted ; he received them from such members of the Stock Exchange as were directed by the Clearing House to give delivery to the assessed. Actually, from the account settlement on 27-5-1955 it will be seen that difference in respect of all the purchases of 7600 shares and sales of 4700 shares were settled and the assessed debited the Differences Account with Rs. 5169-14-9. This apart, 2900 shares (the excess) had to be taken delivery of by the assessed at the prevailing rate on the settlement day of Rs. "3 3/1 per share. However, the Department has been fair enough in accepting that there was delivery in respect of 2900 shares out of these transactions. Neither the parties nor the rules contemplate delivery in respect of all the transactions except in respect of the excess and it is not possible to accept the argument that here was such delivery either contemplated or effected.

(16) Sri Manchanda contended that as on 27-5-1955 the assessed had 4700 shares .with him which he had agreed to sell. On the other hand, he had .agreed to purchase 7600 shares. So- he told the clearing House, as it were, that, instead of delivering to it 4700 shares: and then receiving from them 7600 shares, he would be content to accept delivery of the resultant balance of 2700 shares. But the assumption underlying this argument that the assessed had 4700 shares on hand is without basis. We called upon counsel either to show from the

assessed's books that he had 4700 shares physically which he could have delivered or show, by reference to some bye-law or regulation of the exchange, that he could not have agreed to sell 4700 shares without actually having these shares in his possession. We are not saying that he entered into fictitious transactions for that is prohibited by the bye-laws but he could have lawfully entered into the sale contracts on the strength of the purchase contracts he had entered into. He could also do this without risk because he knows that, under the Regulation, he is not bound to deliver all such shares but is entitled/bound to receive/give delivery only of the surplus transactions on the settlement day. Similar is the position with the other members. The rules also envisage a member agreeing to sell more shares than he purchase in which event he will have to give delivery of the excess of sales over purchases only. It is, Therefore, enough if he has in possession shares to the extent of the difference or he can even purchase from outside and make good at the time for delivery. Thus there is really no guarantee that the purchases or sales registered in the clearing were actually backed by existing securities which could be delivered. So this argument of Sri Manchanda that the assessed must be deemed to have received delivery of 9600 shares, 4700 from himself and 290 from the Clearing House cannot be accepted- In the course of the hearing, we put an illustration to Sri Manchanda. Suppose there are four members of the Exchange A, B, C, D. A agrees to purchase from B 100 shares but agrees to sell D 100 shares. Similarly B agrees to purchase from C 100 shares, and agrees to sell A 100 shares. C agrees to purchase 100 shares from D and to sell 100 shares to B; and, D agrees to purchase 100 shares from A and to sell D 100 shares. Then, under the regulations of the Stock Exchange, no single share need change hands from any one person to any other person because in the hands of each, the purchases and sales square up. Nevertheless, Sri Manchanda would have it that there has been an actual delivery of 800 shares, 200 in the case of each. The argument appears to us to be very unrealistic. In the course of the arguments, another illustration was also posed : Suppose A agrees to sell to B 800 barrels of oil but subsequently agrees to purchase 600 barrels of oil from B and eventually 200 barrels of oil are delivered by A to B, cannot it be said that 800 barrels were delivered of by A to B and simultaneously taken delivery of by A? We are afraid the answer to this question should be in the negative. It will simply be a case where, in view of the counter-contract. A and B agree that it is enough if A delivers (not 800, but only) 200 barrels of oil. We do not think that this illustration helps the assessed's case in any way.

(17) Sri Manchanda then contended that if not actually, at least notionally or constructively, 7600 shares should be taken as delivered to the assesses by the Clearing House and 4700 shares delivered by the assesses to the Clearing House. He relied on the decision in the Duni Chand Rataria Vs. Bhuwarka Brothers Ltd., the Commissioner of Income Tax Vs. Ram Chandra Gupta and Co., Calcutta, and the Raghunath Prasad Poddar, etc. Vs. Commissioner of Income Tax, Calcutta, . But these cases have all been considered by the Supreme Court in the more

recent case of Davenport and Co. Pvt. Ltd. Vs. Commissioner of Income Tax, West Bengal-II, in which the earlier cases have been re- viewed and it has been held, overruling the Raghunath Prasad Poddar, etc. Vs. Commissioner of Income Tax, Calcutta, :

"The words "actual delivery" in Explanation 2 to section 24(1) mean real as opposed to notional delivery. Whether a transaction is speculative in the general sense or under the Contract Act is not relevant for the purpose of this Explanation. The definition of "delivery" in section 2(2) of the Sale of Goods Act which has been held to include both actual and constructive or symbolical delivery has no bearing on the definition of speculative transaction in the Explanation. A transaction which is otherwise speculative would not be a speculative transaction within the meaning of Explanation 2 if actual delivery of the commodity or the scripts has taken place; on the other hand, a transaction which is not otherwise speculative in nature may yet be speculative according to Explanation 2 if there is no actual delivery of the commodity or the scrips. The Explanation does not invalidate speculative transactions which are otherwise legal but gives a special meaning to that expression for purposes of Income Tax only." This contention of Shri Manchanda cannot Therefore be accepted. The facts that the magnitude of transactions on the Stock Exchange are large or that such settlements are permitted by the practice and rules of the Stock Exchange are immaterial. In fact, the practice of delivering puce delivery orders was very widespread in the jute market and it was the commercial method of dealing in jute. Nevertheless the Supreme Court held that delivery of puce delivery orders will not satisfy the requirements of the section. Here there is not even such symbolical or constructive delivery.

(18) It was next argued for the assessed that all the transactions in respect of a particular scrip settled on one clearing day should be taken as one whole. It has been found as a fact by the I.T.O. in the remand report that there was not even a single settlement day on which no delivery at all was given or taken and that on all days some shares were given or taken delivery of. Thus, 2900 shares have been taken delivery on 27-5-1955 and the position was the same on all days. So, it is argued it cannot be said that the transaction was settled otherwise than by actual delivery. We do not see any justification for this sort of approach to the question at all. The Explanation refers to a contract of purchase/sale of goods and its settlement otherwise than by actual delivery. To take up the settlement effected on 27-5-1955, it was a settlement of various contracts entered into by the assessed with various other members of the Stock Exchange on various dates. Actually, as pointed out earlier, the assessed has paid to the Stock Exchange differences in respect of the contracts though, as bound by the rules of the Stock Exchange, he has taken delivery of 2900 shares from somebody. There is no logic or principle on the basis of which all these several transactions of purchase and sale could be taken as a single transaction. Even if so considered, it is difficult to say that it has been settled by delivery, when admittedly delivery is given in respect of a part only of the goods. If this argument is to be accepted

in a case where an assessed enters into a contract for purchase of 100 shares, takes delivery of only one share and settles the rest by payment of differences, the transaction will not be a speculative one. Such an interpretation is not only far-fetched but will also lend itself to wide abuse and frustrate the very object and purpose of the Explanation. We are, Therefore, unable to accept this contention of Sri Manchanda.

(19) Sri Manchanda then addressed certain subsidiary arguments in which we do not find much substance and we shall briefly deal with them.

(a) He drew our attention to the observations in the orders of the I.T.O. and A.A.C. that the assessed had maintained regular, correct and complete books of account. We do not see how these observations help us in deciding the nature of the transactions in the Difference account. (b) He then contended that two accounts were kept only for the sake of convenience, that the resultant position would have been the same even if there only had been one and that the assessed should not be penalised for recording his transactions more fully and precisely. This argument proceeds on a misapprehension. No one is thinking of penalising the assessed for maintaining separate books. Even if all the transactions had been recorded in a single set of books, the I.T.O. was bound to have investigated the question as to which of them were settled by delivery and which not. The maintenance of the two sets of accounts by the assesses only facilitates the work of the I.T.O. and nothing more. (c) He then placed great reliance on the findings of the Appellate Assistant Commissioner. But, as pointed out by us earlier, even the Appellate Assistant Commissioner has given a clear basic finding that only the excess of purchases or sales were actually delivered and this finding, in our opinion, goes against the assessed. (d) He then submitted that both types of transactions are an integral part of the assessed's business as a stock broker and dealer in shares and laid stress on the finding of the A.A.C. that all the transactions formed part and parcel of a single business. Unfortunately, however, both Sri Manchanda and the A.A.C. have overlooked the provisions of Explanation I to Section 24 which deem speculative transactions in the nature of a business to be a separate and distinct business. Thus even where such transactions form part of a business in shares, there is a statutory dichotomy. In fact, the said Explanation was intended to get over arguments and contentions that had been raised earlier in reported decisions (See cases collected at p. 623 of Vol. 1 of Kanga & Palkiwala 7th Ed) that where the speculative transactions formed an integral part of a regular business in a commodity, the loss or profit of the business should be ascertained of the business, a whole and that the speculative transactions could not be segregated for differential treatment. (e) He then pointed out that in the last twenty five years since the Explanation was added no case had come up to the High Courts or even up to the stage of the Tribunal. This may be so but we cannot infer from this, as Sri Manchanda asks us to do, that this is because the Department has conceded, and rightly, that such losses are not losses in speculative transactions.

(20) We have discussed the matter at some length because the question has not come up for consideration earlier but is likely to recur and Sri Manchanda argued the matter elaborately. But it seems to us that the basic question is a simple one and, in view of the concurrent findings and, indeed, admission that delivery on each of the settlement dates was taken or given only in respect of a part of the purchases or sales settled on that date, we really do not see how it can be said that there was any delivery of shares except to that extent. We may also add that it can also perhaps be contended that in the Explanation, the word "delivery" goes with the word "commodity" and the word "transfer" with the word "scrips" but even on that interpretation the result in the present case will be no different.

(21) For the reasons above mentioned, we answer the question referred to us in the affirmative and against the assessed. We, however, make no order as to costs.