IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI G BENCH, MUMBAI

[Coram : D Manmohan VP and Pramod Kumar AM]

ITA No. 1798/Mum/2010
Assessment year: 2006-07

Gajendra Kumar T Agarwal ***……Appellant***
C/o Shankarlal Jain & Associates
12 Engineers Building
265, Princess Street, Mumbai 400 002
PAN : AABPA7286R

Vs.

Income Tax Officer ***……Respondent***
Ward 11(2)(3), Mumbai 400 020

Appearances:
S L Jain, *for the appellant*
Pavan Vaid, *for the respondent*

O R D E R

Per Pramod Kumar :

1. By way of this appeal, the assessee appellant has called into question correctness of impugned order passed by the learned Commissioner of Income Tax under section 263 of the Income tax Act, 1961, in the matter of assessment under section 143(3) of the Act for the assessment year 2006-07, on the following grounds:

> **1. The learned CIT erred in holding that the assessment order, as originally passed by the assessing officer under section 143(3), is erroneous and prejudicial to the interest of revenue as in the said assessment order the losses incurred by the assessee have not been correctly carried forward without properly appreciating the facts of the case and law applicable thereto.**

2. The learned CIT erred in holding that business income earned by the appellant during the year, in derivatives transactions in shares amouting to Rs 1,91,48,060 be set off against business loss carried forward of Rs 1,95,56,066 for assessment year 2005-06, as against such income being set off against the loss of assessment year 2001-02 incurred by the appellant in derivatives transactions.

3. The learned CIT in not accepting the appellant's claim that loss incurred by the appellant in earlier years, being in derivatives transactions, be entitled to set off against the income earned in derivatives transactions in assessment year 2006-07, without properly appreciating the facts of the case and law applicable thereto.

2. The assessee is a chartered accountant by profession, but if his income details as culled out in the assessment order are anything to go by, he has found greener pastures in the stock markets. In the net profit of Rs 3,07,82,539 disclosed by the assessee, while professional receipts are only at Rs 18,00,000, most of his remaining income consists of profits from trading in derivatives and shares including profits from dealing in derivatives at Rs 1,91,48,060. However, ne has not been as lucky in derivatives dealings in all the preceding assessment years. In the assessment years 2001-02, 2002-03, 2003-04 and 2005-06, he incurred losses in the same activity amounting to Rs 2,89,66,709, Rs 2,34,286, Rs 36,49,488 and Rs 1,95,56,067. There was a profit of Rs 55,31,230 in the assessment year 2004-05, but the same was set off against the loss in the same activity, carried forward from 2001-02, leaving loss of Rs 4,68,75,320. In the relevant assessment year, i.e. assessment year involved in the dispute before us, assessee claimed set off of Rs 1,91,48,060, out of the remaining losses so incurred in dealing in derivatives, against profits from derivatives in the present year. The set off so claimed by the assessee was allowed , and the balance unabsorbed losses of Rs 2,27,27,262 were carried forward.

3. On a perusal of the assessment records, however, learned Commissioner was of the view that the set off so granted by the Assessing Officer rendered the assessment order "erroneous in so far as it is prejudicial to the interest of the revenue to the extent of carry forward of losses". In response to show cause notice

issued by the Commissioner calling upon the assessee to show cause as to why **the set off so granted not be withdrawn, the assessee, inter alia, submitted that "the assessee has carried out derivative transactions and incurred losses in certain years and earned profits in certain other years**" and that since "**nature of transactions, being derivatives trading, profit and loss is mutually adjusted and balance loss has been carried forward in earlier years, being on derivatives transactions, current year's profits, also being in derivatives transactions, is thus entitled to be set off against such carried forward losses**". Learned Commissioner did not accept the plea so advanced by the assessee. He took note of the amendment brought about in section 43(5), with effect from 1st April 2006, by virtue of which eligible transactions of dealing in derivatives were no longer hit by the definition of 'speculative transactions' and, accordingly, were required to be treated as a normal non-speculative business. Learned Commissioner declined the set off of past losses in dealing in derivatives against the profits in dealing in derivatives in the current year "**in view of the above said prospective amendment, which provides that the eligible transaction in respect of a trading in derivatives carried out in a recognized stock exchange shall be not be treated as speculative transaction**…..". It is denial of this set off which is core issue in appeal before us.

4. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

5. In the course of hearing before us, as indeed in the order of the learned Commissioner, a lot of emphasis has been placed on whether or not the transactions in derivatives amounted to 'speculative transactions' under section 43(5) at the relevant points of time, i.e. at the point of time when losses were incurred in preceding assessment years , as also at the point of time when profits are made in the same type of transactions, but, in our humble understanding, that aspect of the matter is still a step away from actual and core controversy involved in this appeal, i.e. whether or not the losses incurred in dealing in derivatives in earlier assessment

years are eligible to set off against the profits from the same activity post amendment to definition of 'speculation transactions' under section 43(5) with effect from 1st April 2006. Undoubtedly, this issue involves examination of impact of amendment in section 43(5), on which so much emphasis has been placed by the parties before us and also before the learned Commissioner, but perhaps at more fundamental and conceptual level, this issue needs to be examined rather holistically in the light of provisions regarding set off and carry forward of losses, and in the light of how those provisions have been interpreted by Hon'ble Courts above.

6. Let us first deal with the nature of transactions in derivatives and the treatment given to these transactions in the Income Tax Act, 1961.

7. As to what is the nature of a derivative transaction, we find useful guidance from Hon'ble Madras High Court's judgment in the case of Rajshree Sugars & Chemicals Ltd. Vs. Axis bank Ltd. reported in (2008) 8 MLJ 261, referred to with approval by Hon'ble Bombay High Court in the case of Bharat S Ruia Vs CIT (2011 TIOL 238 HC), in the following terms:-

> " **What are these derivatives which have gained such a great deal of notoriety ?**
>
> In simple terms, derivatives are financial instruments whose values depend on the value of other underlying financial instruments. The International Accounting Standard (IAS) 39, defines "derivatives" as follows:
>
> " A derivative is a financial instrument
>
> (a) whose value changes in response to the change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or similar variable (sometimes called the 'underlying');
>
> (b) that requires no initial net investment or little initial net investment relative to other types of contracts that have a similar response to changes in market conditions; and
>
> (c) that is settled at a future date. "

Actually, derivatives are assets, whose values are derived from values of underlying assets. These underlying assets can be commodities, metals, energy resources, and financial assets such as shares, bonds and foreign currencies.

6. Derivatives can be used as insurance cover against certain types of business risks such as fluctuations in the rate of foreign exchange, fluctuations in the rate of interest on borrowings, fluctuations in the value of specified assets etc. To take an example, it is common knowledge that the price of gold keeps fluctuating. If a manufacturer of gold jewellery anticipates that he would require a particular quantity of gold at a specified distance of time, he may enter into a contract with the seller of gold bars for the supply of the same at a future date, at the rate specified in the contract. This contract reduces the risk for the buyer, against a possible steep rise in the price of gold. It equally reduces the risk of the seller against a steep fall in the price. Thus the contract acts as an insurance cover. When the transaction goes through without any dispute, the contract is fulfilled. But when the transaction fails and the motive behind the transaction is not necessarily the sale and supply of gold, but the receipt or payment of the difference in the price (difference between the prevailing price and the price fixed in the contract), many eyebrows are raised and many questions are asked. This is the point where the transaction takes a detour from a simple contract of insurance.

7. There are atleast 4 categories of derivatives, commonly in use. Some of them are traded through exchanges and they are known as Exchange-Traded-Derivatives (ETD). Others are traded directly between the parties and they are known as Over-The- Counter (OTC) derivatives. The 4 categories of derivatives are as follows:-

(1) Forwards: A contract between two parties. One party agrees to buy a commodity or financial asset on a date in the future at a fixed price, while the other agrees to deliver that commodity or asset at the predetermined price. These are not traded on exchanges because they are negotiated directly between two parties.

(2) Futures: A contract essentially the same as a forward contract, except that the deal is struck via an organized and regulated exchange. There are three key differences between forwards and futures (i) Futures contract is guaranteed against default (ii) They are standarized and (iii) They are settled on a daily basis.

(3) Swaps: A swap is an agreement made between two parties to exchange payments on regular future dates. Swaps are OTC (Over the counter) products. Swaps are used to manage or hedge risk associated with volatile interest rates, currency exchange rates, commodity prices and share prices. Swaps can be considered as series of forward contracts.

(4) Options: An option gives the holder right to buy or sell an underlying asset at a future date at a predetermined price. A call option is the right to buy. The buyer of a "call option" has the right, but not the obligation to buy an agreed quantity of a particular commodity or financial instrument (underlying instrument), from the seller (or writer) at a certain time (the expiration date) for a certain price (strike price). The buyer pays a premium for this right. In contrast, a put option is the right to sell. The buyer of a "put option" has the right, but not the obligation to sell an agreed quantity of a particular commodity or financial instrument (underlying

instrument), to the seller (or writer) at a certain time (the expiration date) for a certain price (strike price). We have a variety of options such as American and European options, depending upon the time of exercise of the right. Both call option and put option can be combined to achieve "zero cost option."

8. Trading in these markets are regulated internationally by Commodity Futures Trading Commission (CFTC) and International Swaps and Derivatives Association (ISDA) and the National Futures Association (NFA). Experts in the field of economic, finance and investment feel that derivatives are valuable because they provide efficient ways to manage and transfer risk. A business owner who is exposed to changes in market prices can enter into an appropriate derivatives contract and the risk can be assumed by a trader or speculator who is prepared to live with uncertainty in return for the prospect of achieving an attractive return. A large financial institution can withstand more risk than a small corporate and thus may choose to engage in derivatives products for a reasonable compensation. Nobel Laureate Kenneth Arrow predicted that this would increase economic prosperity since people would be more prepared to engage in risk-taking activities. It could also serve to improve the quality of prediction of future events in the world of finance and investments. Derivatives provide a global network for intelligent assessment, management, and distribution of risk on a large scale. "

8. Securities Contracts (Regulations) Act 1956 seeks to regulate the business of dealing in securities, but the definition of expression 'securities', in the said Act, was confined to shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate. Effective 22nd February 2000, definition of the expression 'securities' was extended to include derivatives, and 'derivatives' were defined to include *(a) a security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security (b) a contract which derives its value from the prices, or index of prices of underlying securities.* Section 18A was also inserted in the 1956 Act with effect from 22/2/2000 provides that the contracts in derivative shall be legal and valid if such contracts are traded on a recognized stock exchange and settled on the clearing house of the recognized stock exchange in accordance with the rules and bye laws of such stock exchange. In effect thus, the transactions in derivatives could be legally traded under the 1956 Act with effect from 22nd February 2000, and the transactions in derivatives were to be treated as legal and valid only if they are traded on a recognized stock exchange and cleared on the clearing house of recognized stock

exchange. It was thus practically in the financial year 2000-01, which is relevant to the assessment year 2001-02, that trading in derivatives in India.

9. While trading in derivatives started in India in previous year relevant to the assessment year 2001-02, Income tax Act 1961 did not have any changes corresponding to this new development in securities market. Trading in derivatives was not recognized in its own right, and, as such, profits and losses were treated as profits and losses of speculation business. The underlying principle was this. Every derivative instrument, by definition, derived its value from the underlying asset or security, and delivery of such underlying asset or security was never taken. In effect thus a derivative transaction was treated as a transaction in the underlying asset or securities which never changed hands in physical delivery. Section 43(5) provides that speculative transaction is "**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 actual delivery or transfer of the commodity or scrips**". There are certain exceptions to this rule, as set out in the provisos to this sub section, but these exceptions are not really relevant for the present purposes. A transaction in derivatives was thus characterized as a speculative transaction for the purposes of the Income Tax Act. In view of this definition of speculative transaction, read with Explanation to Section 28 which provides that "**where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as "speculation business") shall be deemed to be distinct and separate from any other business"**, the profits and losses from transactions in derivatives ,which constituted speculation business, were characterized as speculation profits and losses. The rationale behind this characterization of business into speculation business and non-speculation business is that the profits and gains of non-speculation business can not be set off, whether within the assessment year or in subsequent assessment years, against losses of speculation business. This restriction has been placed because non delivery based transactions, as it appears from the stand taken by the Central Board of Direct Taxes, leave substantial "**scope**

for generating fictitious losses through artificial transactions or shifting of incidence of loss from one person to another" (CBDT Circular dated 27th February 2006). The idea in segregating delivery based and non delivery based transaction thus was that the artificial losses generated, or shifted, through speculative transactions should not be adjusted against genuine business profits of the assessee. In effect thus, when a business was classified as 'speculation business', certain restrictions were placed on the losses of such business being set off against profits of other businesses, i.e. non speculative businesses, and, to that extent, assessee was put to disadvantage. Of course, as we note this classification, we are alive to the controversy whether delivery of underlying assets in derivatives trading could have taken place at all, and, whether, because of this impossibility of delivery and because assessee could not do what was impossible anyway, assessee could be placed at a disadvantage of rather disabling provisions of section 43(5). Segregation of speculation and non- speculation business results is not an end in itself, but such a segregation is to restrict the set off of losses incurred a particular type of business activities. One way of looking at Section 43(5) is to hold, as has been held by Hon'ble Bombay High Court in the case of Bharat S Ruia (supra), that "the very object of Section 43(5) is to treat transactions which are settled otherwise than by actual delivery as speculative transactions", though, viewed from a rather academic and conceptual point of view, treating a transaction as speculative transaction is only a modality with the objective of ensuring that there is least possible "scope for generating fictitious losses through artificial transactions or shifting of incidence of loss from one person to another". The line of demarcation being visualized and drawn up between speculative and non-speculative transaction, from this perspective, is not an end but means of achieving the end of minimising tax manoeuvrings. However, these discussions, which are somewhat academic now, must not detain us at this stage. The reason is this. Hon'ble jurisdictional High Court has, in the case of Bharat S Ruia (supra), held that "…….. **Section 43(5) of the Act provides that a transaction for purchase / sale of any commodity would be a speculative transaction if it is settled otherwise than by actual delivery**" and that **"….for the purposes of Section 43(5), it is not**

necessary that the commodity agreed to be purchased or sold must be capable of actual delivery". Thus, even in the cases of transactions in derivatives trading, in the esteemed views of Their Lordships, as long as delivery of underlying asset does not take place, the transactions must be held to be speculative in nature. The views so stated by Their Lordships are binding on us and we must, therefore, proceed on the basis that even when physical delivery of underlying asset is impossibility, the transactions are to be treated as speculative transaction simply because the transaction is settled otherwise than by delivery.

10. Coming back to the narration of related developments, we find that it was by way of amendments brought about by the Finance Act, 2005 effective from 1st April 2006, that Income Tax Act, 1961 took note of business of dealing in derivatives. Clause (d) was inserted to Section 43(5) and this clause provided that, for the purpose of Section 43(5), following shall not be deemed to be a speculative transaction:

> **(*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;**
>
> ***Explanation.—For the purposes of this clause, 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 the Central Government for this purpose;]

11. As a result of this amendment, broadly speaking, as long as the transactions in derivatives were *bonafide* transactions screen based systems in accordance with the rules regulations and bye laws of the respective governing bodies, evidenced by time stamped contracted note and carried out through a recognized stock exchanges, these transactions could not be held to be 'speculative transactions'. The net result of this amendment was that the losses incurred in such derivatives transactions did not suffer the disabilities as a result of related transactions being termed as 'speculative transactions' and could be freely set off against other non- speculation businesses of the assessee. While introducing this amendment, Hon'be Finance Minister, on the floor of the Lok Sabha, stated that " **As Hon'ble Members are aware, there have been significant developments in the past decade in the capital market including the introduction of trading in financial derivatives. We have also established a transparent system of trading with adequate safeguards for audit trail. Hence, I propose to amend the Income Tax Act to provide that trading in derivatives in specified stock exchanges will not be treated as "speculative transactions" for the purposes of the Income Tax Act.**" It is also interesting to note that only such derivative trading was taken out of the scope of 'speculative transaction' as was on the recognized stock exchanges, and it is to be seen in the light of the treatment given to derivatives trading OTC (Over the Counter), as is clear from the observation made by Hon'ble Finance Minister to the effect, "**Over the counter (OTC) derivatives play a crucial role in mitigating the risks of corporates, banks and other financial entities. There is, however, some ambiguity regarding the legality of OTC derivative contracts which has inhibited their growth. I, therefore, propose to take measures to provide for clear legal validity of such contracts**". The demarcation in derivatives trading was thus between derivatives trading over the counter vis-à-

vis derivatives trading in the recognized stock exchanges. While former were not affected by the legislative amendment, the latter were covered by the legislative amendments. Be that as it may, and in whatever limited way, the amendment was viewed as a measure of relief to the taxpayers. The Hindu Business Line, on 1st March 2005, (www.thehindubusinessline.in/2005/03/01/stories/2005030100642200.htm) commented upon this development as follows:

> **Traders welcome tax amendment for derivatives trading**
> **Our Bureau**
>
> **Mumbai , Feb. 28**
>
> **THE derivatives segment of the equity market received a boost from the Finance Bill in the amendment of the Income Tax Act for derivatives trade.**
>
> **Stockbrokers see it as a positive move.**
>
> **The Finance Minister, Mr P. Chidambaram, in his Budget speech on Monday said trading in derivatives in specified stock exchanges will not be treated as "speculative transactions" for the purposes of the Income Tax Act.**
>
> **It means that profit in the derivatives market can be set-off along with losses in the cash market or vice-versa.**
>
> **Till now, this facility was not available for trades done in the derivatives market. ……..**

12. What clearly emerges from the above is (i) that it was not on account of a some sudden development, which changed the securities market overnight, but to keep pace with, as Hon'ble Finance Minister put it, "**significant developments in the past decade** (*emphasis by underlining supplied by us now*) **in the capital market including the introduction of trading in financial derivatives"**; (ii) that the relief was meant for only such derivatives trading as was done on the recognized stock exchanges; (iii) that it was the first time when Income Tax Act 1961 took note of the derivatives trading ; and (iv) that this measure of amending section 43(5) was a measure to bring relief to the assessee. As a result of the above amendment, losses incurred in derivative trading are held to be eligible for being set off against normal business profits, as derivate trading itself is treated as a non-speculative

business, and losses of any non- speculative businesses can be adjusted profits of any non-speculative business. Ironically, however, this apparently well-intended measure of relief to the taxpayers dealing in derivatives on the stock exchanges – particularly in the manner in which it has been interpreted by the revenue authorities, has resulted in a situation in which some of these taxpayers have been put at a huge disadvantage. What was meant to be a source of relief to the taxpayers has also turned into a cause of unintended difficulties for many taxpayers. The way it has so happened is like this. While, as in this case, the assessee has incurred losses in derivatives trading in earlier assessment years, and he wants such losses to be set off against the profits of the same activity in this assessment year, the assessee has been declined set off on the ground that the losses incurred in past are treated as 'losses of speculation business' and profit earned now is treated as of 'profits of non- speculation business' , and speculation losses can not be set off against the non-speculation profits. Going by this interpretation, which is what the learned Commissioner has followed in the impugned order as well, thus, losses from derivatives trading, in the assessment years prior to 2006-07, stand killed, unless, of course, assessee has some other speculation profits against which the same can be set off.

13. Viewed in this perspective, the fundamental legal issue really is whether this interpretation about the ineligibility of the losses, incurred in past in the activity of dealing in derivatives on stock exchanges and carried forward to the present assessment year, being set off against the profit of the same activity of dealing in derivatives on the stock exchanges, as canvassed by the learned Commissioner, is correct. The impact of amendment in Section 43(5) with effect from 1st April 2006, on characterization of income vis-à-vis speculative or non-speculative, may or may not have some bearing on this core issue but determination of this impact, by itself, is not an answer to the question that we must adjudicate in the present context. In other words, what we must really decide is whether, in a situation like the one

before us, the assessee will be entitled to set off the losses incurred by him in a business, which has been treated as speculation business in the relevant assessment years in which the losses were incurred , against the profits the assessee has earned from the same business in the present assessment year when the said business cannot be treated as speculation business due to legislative amendments in Section 43(5) of the Act.

14. In order to be able to deal with this question, it will be useful to now refer to, and set out, the provisions of the Act so far as the carry forward and set off of business losses is concerned. These provisions are as follows:

> ***SECTION 72 : CARRY FORWARD AND SET OFF OF BUSINESS LOSSES***
>
> ***(1) Where for any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off or, where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and –***
>
> > ***(i) It shall be set be off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year :***
> >
> > ***Provided that the business or profession for which the loss was originally computed continued to be carried on by him in the previous year relevant for that assessment year; and***
> >
> > ***(ii) If the loss cannot be wholly set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on:***
> >
> > ***Provided that where the whole or any part of such loss is sustained in any such business as is referred to in section 33B which is discontinued in the circumstances specified in that section, and thereafter, at any time before the expiry of the period of three years referred to in that section, such business is re-established, reconstructed or revived by the assessee, so much of the loss as is attributable to such business shall be carried forward to the assessment year relevant to the previous year in which the business is so re-established, reconstructed or revived, and -***

(a) It shall be set off against the profits and gains, if any, of that business or any other business carried on by him and assessable for that assessment year; and

(b) If the loss cannot be wholly so set off, the amount of loss not so set off shall, in case the business so re-established, reconstructed or revived continues to be carried on by the assessee, be carried forward to the following assessment year and so on for seven assessment years immediately succeeding.

(2) Where any allowance or part thereof is, under sub-section (2) of section 32 or sub-section (4) of section 35, to be carried forward, effect shall first be given to provisions of this section.

(3) No loss (other than the loss referred to in the proviso to sub-section (1) of this section) shall be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed

SECTION 73: LOSSES IN SPECULATION BUSINESS

(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 eight 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.

15. As evident from a plain reading of the above statutory provisions, the broad scheme of carry forward and set off of business losses, so far as relevant to the facts before us, is like this. The profits and gains of the business, for the purpose of carry forward and set off of losses, are classified in two baskets – of speculation business and of non-speculation business. These two categories are mutually exclusive and the losses incurred of each category can only be set off against profits of the same category. When an assessee incurs loss, in any of these categories, under the head 'profits and gains from business and profession' in a particular assessment year and cannot set it off against eligible incomes under the other heads, the loss so incurred is carried forward to subsequent year and, subject to certain conditions - which are not relevant in the present context, the assessee can set it off against income of the same business, or any other business, carried on by the assessee assessable for that subsequent year.

16. Interestingly, while section 72(1)(ii)(b) specifically refers to the normal business losses being set off against 'profits and gains, if any, of the same business or any other business carried on by the assesse assessable in that *(subsequent)* year', corresponding provision in section 73, i.e. section 73(2)(i) refers to loss being so carried forward and set off against 'profits and gains, if any, of any speculation business carried on by the assesse assessable in that *(subsequent)* year". However, Hon'ble Calcutta High Court has, in the case of **CIT Vs Soorajmal Baijnath Agencies Pvt Ltd (272 ITR 325)**, observed that "**The word 'any' used in sub-section (2) of section 73 is inclusive"** and that the loss carried forward **"can be set off or adjusted against the income of the same speculation business or against the income of any other speculation business carried on by the**

assessee in the following assessment year". The legal position, as it emerges from the reading of statutory provision read with Hon'ble Calcutta High Court's above observations, thus is that the business loss, speculative or non-speculative, incurred by an assessee in one assessment year can be set off against the business loss against the profits of the same business, speculative or non- speculative, or any other business in the same category.

17. While on the question of eligibility of set off of losses, incurred by the assessee in a particular assessment year, against profits of the same business or any other business in the same category, i.e. speculative or non-speculative, in a subsequent assessment year, it is also useful to make a brief reference to Hon'ble Supreme Court's judgment in the case of **CIT Vs Manmohan Das (59 ITR 699)**. That was a case in which assessee incurred a business loss of Rs 38,027 in the assessment year 1950-51, but the Assessing Officer, while framing assessment order for the said assessment year, held that the loss so incurred by the assessee is not in the nature of business loss, and, accordingly, the same cannot be carried forward. The assessee did not appeal against the stand so taken by the Assessing Officer. However, when assessee was declined set off of the loss of Rs 38,027 against profit of Rs 34,445 in the same pursuit in the subsequent assessment year, i.e. assessment year 1951-52, the assessee carried the matter in appeal. The stand taken by the assessee was that the loss incurred by the assessee in the assessment year was in the nature of business loss and that the same is to be carried forward and set off against the profits of the assessee, from same business, in the subsequent year. These contentions were upheld by a coordinate bench of this Tribunal and the view so taken by the Tribunal was confirmed by Hon'ble Allahabad High Court and by Hon'ble Supreme Court. It was in this backdrop that Hon'ble Supreme Court, inter alia, observed as follows :

> "**Section 24(2)* confers a statutory right (subject to certain conditions which are not material) upon the assessee who sustains a loss of profits in any year in any business, profession or vocation to carry forward the loss as is not set off under sub-section (1) to the following year, and to set it off against his profits and gains, if any, from the same business, profession or vocation for**

that year. Whether the loss of profits or gains in any year may be carried forward to the following year and set off against the profits and gains of the same business, profession or vocation under section 24(2) has to be determined by the Income-tax Officer who deals with the assessment of the subsequent year. It is for the Income-tax Officer dealing with the assessment in the subsequent year to determine whether the loss of the previous year may be set off against the profits of that year. A decision recorded by the Income-tax Officer who computes the loss in the previous year under section 24(3) that the loss cannot be set off against the income of the subsequent year is not binding on the assessee.

(Emphasis by underling supplied by us)

* Section 24(2)(ii) of the Income Tax Act, 1922, is in *pari materia* with section 73(2)(ii) of the Income Tax Act, 1961. Section 24(2) of 1922 Act, inter alia, provided that " where any assessee sustains a loss of profits or gains in any year…… in any business, profession or vocation, and the loss cannot be 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 other head of income shall be carried forward to the following year, …….. (ii) where the loss was sustained by him in any other business, profession or vocation, it shall be set off against the profits and gains, if any, of any business, profession or vocation carried on by him in that year.

18. One of the questions before Their Lordships was as to under which head income of the assessee, from his association with Allahabad Bank as 'treasurer', was to be taxed, and this question was to be determined *qua* the assessment year in which loss had incurred because unless such loss was to be determined under the head 'business income', this loss could not have been carried forward. Dealing with the question as to what was the true nature of assessee's income, i.e. whether it was to be assessed under the head salaries or under the head business profits, Their Lordships further observed as follows :

…….On a careful consideration of the covenants, we are of the view that the treasurer was not a servant of the Allahabad Bank under the terms of the agreement dated January 2, 1931, and the remuneration received by him was not "salaries" within the meaning of section 7 of the Income-tax Act. But that is not sufficient to conclude the matter in favour of the assessee. The benefit of section 24(2) of the Indian Income-tax Act may be availed of by the assessee only if the loss sought to be set off was suffered under the head "Profits and gains ... in any business, profession or vocation". It is difficult to regard the occupation of the treasurer under the agreement as a profession, for a profession involves occupation requiring purely intellectual or manual skill, and the work of the treasurer under the contract cannot be so regarded.

> **Occupation of a treasurer is not one of the recognized professions, nor can it be said that it partakes of the character of a business or trade. In performing his duties under the agreement, the assessee exercised his skill and judgment in making proper appointments and made arrangements for supervising the work done by the staff in the cash department of the bank's branches. The remuneration received by him was for due performance of the duties and also for the guarantee against loss arising to the bank out of the acts or omissions of the cash and other staff of the bank. Taking into consideration the nature of the duties performed, and the obligations undertaken, together with the right to remuneration subject to compensation for loss arising to the bank from his own acts and omissions or of the servants introduced by him into the business of the bank, the assessee may be regarded as following a vocation. The remuneration must therefore be computed under section 10 of the Income-tax Act and loss of profit suffered in that vocation in any year may be carried forward to the next year and be set off against the profit of the succeeding year.**

19. Hon'ble Supreme Court's judgment did not specifically reflect whether revenue had taken any objection to re-determination of character of an income, which was earned in an earlier assessment year, and when characterization so assigned had received finality. One could have entertained a little doubt whether Manmohan Das judgment *(supra)* may or may not be viewed as an authority for the proposition that such an objection, when taken, can be rejected, . However, Hon'ble jurisdictional High Court's judgment in the case of **Western India Oil Distributing Ltd Vs CIT (126 ITR 497**), while interpreting the scope of Hon'ble Supreme Court's judgment in the case of Manmohan Das *(supra),* set these doubts at rest, and thus nipped this possible controversy in the bud, by observing as follows :

> **If this decision** *[Hon'ble Supreme Court's judgment in the case of Manmohan Das (supra)]* **be properly analysed, it would seem that <u>the application of the principle of finality, which has been submitted for our acceptance by counsel for the revenue and which found favour with the Tribunal has been rejected by the Supreme Court in a substantially similar set up when it opined that the decision of the ITO in the preceding year that the loss cannot be set off against the income of the subsequent year is not binding on the assessee despite the fact that he has rested content with that decision and not carried further the matter by way of appeal</u>. To put it in other words, in the assessment year 1950-51, the ITO, dealing with the assessee's case, held that there was a net loss but that this could not be carried forward inasmuch as the income received by the assessee was not from the pursuit of any business, profession or vocation. For the suc ceeding year 1951-52, the assessee contended that his income was from pursuit of business, profession or vocation and sought to set**

off the preceding year's loss against the income for the succeeding year. This contention was urged despite the fact that in the preceding year the income had been held to be from a source other than a business, profession or vocation, and on that ground the carrying forward of the loss had not been allowed. It was held by the court that the income of the assessee for both the years must properly be regarded as having arisen from the pursuit of a vocation and, further, that because of this the assessee was liable to have the preceding year's loss set off against the income for the assessment year 1951-52. It brushed aside the argument of the revenue that the preceding year's decision by the ITO had become final and by reason of such finality the assessee in 1951-52 would not be entitled to set off the loss incurred in 1950-51, although the correct legal position was that the income was from the pursuit of a business, profession or vocation and that, if this was so, the assessee was entitled to carry forward the loss.

[These views were approved by Hon'ble Supreme Court in the judgment reported as **CIT Vs Western Oil Distributing Ltd (249 ITR 517)**. However, since Hon'ble Supreme Court's judgment was rather brief and to the point, relevant extracts have been reproduced from Hon'ble High Court's order.]

20. In our humble understanding, Hon'ble Supreme Court's judgment in **Manmohan Das's case** *(supra),* read with Hon'ble Bombay High Court's judgment in the case of **Western Oil Distributing Ltd** *(supra),* is thus authority for three significant propositions. These propositions are summed up as follows:

I. **First, that the call, as to whether a particular business loss, speculative or non-speculative, incurred by the assessee in an earlier year is eligible for set off against business income in a subsequent year, is to be taken in the course of proceedings in the subsequent assessment year, i.e. the assessment year in which set off is claimed. Hon'ble Supreme Court has set out this proposition and this proposition was later clarified, in unambiguous words, by Hon'ble jurisdictional High Court in the case of Western India Oil Distributing Ltd Vs CIT (126 ITR 497), which was approved by Hon'ble Supreme Court in the judgment reported as CIT Vs Western Oil Distributing Ltd (249 ITR 517).**

II. **Second, that section 24(2) of the 1922 Act, which is the same as section 73 (2) in all material respects, confers "a statutory right upon the assessee who sustains a loss of profits in any year in any business, profession or vocation to carry forward the loss as is not set off under sub-section (1) to the following year, and to set it off against his profits and gains, if any, from the same business,**

profession or vocation for that year". The proposition that is set out is infact in the words employed by Their Lordships and it does not need any elaboration. Once this statutory right is recognized, it is a natural corollary of that recognition that when an assessee incurs a loss in a business, speculative or non-speculative, in an year, such loss has to be, subject to fulfilment of other preconditions, is to be set off against the profits of the same business in subsequent year.

III. Third, that in the course of proceedings of the subsequent assessment year, i.e. the assessment year in which set off of loss is claimed, it is open to even decide the true nature and character of loss incurred in the earlier relevant assessment year. In other words, even a finding about the nature of loss, in the assessment year in which loss is incurred, does not bind the assessee, and that aspect of the matter can be decided afresh in the course of proceedings in the assessment year in which set off is claimed. As noted in third paragraph of Hon'ble Supreme Court's judgment itself, "In making his order of assessment for the year 1950-51, the Income-tax Officer declared that the loss computed in that year could not be carried forward to the next year under section 24(2) of the Income-tax Act, as it was not a business loss" and yet, while dealing with the assessment proceedings for the assessment year 1951-52, it was held that loss incurred by the assessee in 1950-51 was 'business loss' in nature. Similarly, as held by Hon'ble Bombay High Court in the case of Western India Oil (supra) and as confirmed by Hon'ble Supreme Court, losses determined under the head 'income from other sources' , which had attained finality, were subsequently treated as 'business losses' – though for the limited purposes of eligibility for set off against profits from same activity in subsequent years.

21. Let us now come back to the facts of the case before us. It is not even in dispute that the assessee has earned profits from the same business in which losses were incurred in the earlier years. Going by the plain words of Hon'ble Supreme Court's judgment, in the case of Manmohan Das (supra), to the effect that section 24(2) of 1922 Act confers "**a statutory right upon the assessee who sustains a loss of profits in any year in any business, profession or vocation to carry forward the loss as is not set off under sub-section (1) to the following year, and to set it off against his profits and gains, if any, from the same business, profession or vocation for that year**", it is clear that section 73(2), which is *pari*

materia with Section 24(2) of the 1922 Act, confers a statutory right upon the assessee to set off such loss against "**his profits and gains, if any, from the same business….for that** *(subsequent)* **year**". Viewed in this perspective, the assessee is entitled to set off the carried forward losses of the earlier assessment years, as long as all other conditions are fulfilled, from the same business, against profits of the business in this assessment year. Undoubtedly, the words employed in Section 73(2)(i) are "profits and gains, if any, of any speculation business carried on by him assessable for that assessment year" but, in the light of law interpreted by **Hon'ble Calcutta High Court** in **Soorajmal Baijnath Agencies'** case (supra), **"the word 'any' used in sub-section (2) of section 73 is inclusive"** and, therefore, **the loss carried forward can thus be set off or adjusted against the income of the same business, or against the income of any other business in that category, i.e. speculation or non-speculation, carried on by the assessee in the following assessment year**. For this short reason alone, in our considered view, the set off of losses incurred by the assessee in the same business in preceding years, if otherwise eligible, must be allowed. In coming to this conclusion, we have taken note of, and relied upon, learned counsel's statement at the bar that there is no change whatsoever in the nature of business dealing of the assessee inasmuch as it was all along on the basis of screen based transactions, evidenced by the same type of date stamped contract notes and on the same stock exchanges. As we hold so, we must also deal with **Hon'ble Bombay High Court**'s judgment in the case of **Bharat S Ruia Vs CIT (2011 TIOL 238 HC)** wherein Hon'ble Bombay High Court had an occasion to deal with the characterization of income from dealing in derivatives prior to and post the amendment in Section 43(5) by the virtue of Finance Act, 2005. Learned Departmental Representative has placed heavy reliance on this decision and contended that once Hon'ble jurisdictional High Court hold that pre 2006-07 losses in derivatives trading were speculation losses, and when admittedly profits of derivatives trading are not profits of speculation business, the set off of these types of business results cannot be given. In Bharat S Ruia's case, the assessee had suffered loss in the assessment year 2003-04, i.e. one of the assessment years prior to assessment year 2006-07, which he claimed is to be carried forward as business

loss, not being in the nature of speculation loss. The only difference in speculation loss and non-speculation loss obviously was the limitation on the profits against which such losses could be set off, but the issue in dispute nevertheless remained confined to the nature of loss carried forward. The Assessing Officer held that it is a loss of speculation business and liable to be carried forward as such. When the matter travelled in appeal before a coordinate bench of this Tribunal, it was held that the loss is a normal business loss, since amendment in section 43(5) is only clarificatory in nature and must relate back to the earlier assessment years as well. However, the stand so taken by the coordinate bench did not find favour with Hon'ble High Court, and Their Lordships reversed the action of the coordinate bench by observing, inter alia, as follows:

> ***33) …… Ordinarily a transaction in a commodity relates to purchase / sale of an asset which is tangible and which is capable of being delivered. However, Section 18A of the 1956 Act inserted with effect from 22/2/2000 provides that notwithstanding anything contained in any other law for the time being in force, contracts in derivative (like futures contracts) shall be legal and valid if such contracts are traded on a recognized stock exchange and settled on the clearing house of a recognized stock exchange in accordance with the rules and bye-laws of such stock exchange. Thus, by operation of law, the transactions in futures are made legal and valid even if the underlying securities permitted to be purchased / sold under the futures contracts are not tangible and incapable of actual delivery, provided such transactions are traded on a recognized stock exchange and settled on the clearing house of a recognized stock exchange. Moreover, Section 43(5) of the Act provides that a transaction for purchase / sale of any commodity would be a speculative transaction if it is settled otherwise than by actual delivery. For the purposes of Section 43(5), it is not necessary that the commodity agreed to be purchased or sold must be capable of actual delivery. Therefore, future contracts for purchase / sale of an underlying security permitted to be traded on the stock exchange and settled otherwise than by actual delivery would be speculative transactions under Section 43(5) of the Act.***
>
> ***34) It is contended that the expression 'commodity' does not include 'stocks & shares', however, for the purposes of Section 43(5), the expression 'commodity' has been expanded to include 'stocks & shares' and since transactions in derivatives are not specifically included in Section 43(5), the same would fall outside the purview of Section 43(5). We see no merit in the above contentions. The expression 'commodity' would cover all articles of trade including stocks & shares. Even under Section 43(5), the expression 'commodity' is not expanded to include 'stocks & shares'. In fact, use of 'comma' in between the word 'commodity' and the words 'including stocks & shares' in Section 43(5) make it***

clear that transactions for purchase of any commodity would include transaction for purchase or sale of stocks & shares. In other words, Section 43(5) does not seek to expand the scope of expression 'commodity' but merely emphasizes that the transaction in commodity includes transactions in stocks & shares. Therefore, transactions in futures contracts like transactions in stocks & shares when settled otherwise than by actual delivery would be speculative transactions under Section 43(5) of the Act.

35) The argument that Section 43(5) refers to contracts which are capable of settlement by actual delivery whereas the transactions in futures are incapable of settlement and therefore, transactions in futures would fall outside the scope of Section 43(5) is also without any merit, because, the very object of Section 43(5) is to treat transactions which are settled otherwise than by actual delivery as speculative transactions. As noted earlier, Section 43(5) refers to contracts for purchase / sale of any commodity and it is not restricted to contracts which are capable of performance by actual delivery. Therefore, the fact that the futures contracts are settled otherwise than actual delivery cannot be a ground to hold that the futures contracts are not speculative transactions under Section 43(5) of the Act.

36) The exceptions enumerated in the proviso to Section 43(5) clearly provide that where speculative transactions are carried out with a view to guard against loss in respect of contracts for actual delivery in cases referred to in clause (a), (b) & (c) of the proviso, then, such speculative transactions shall not be deemed to be speculative transactions. So far as the transactions covered under clause (d) are concerned, they are deemed not to be speculative transactions only with effect from 1/4/2006. Therefore, the transactions covered under clause (d) would not be treated as speculative transactions only with effect from 1/4/2006.

37) The argument advanced on behalf of the assessee that clause (d) inserted to the proviso to Section 43(5) by Finance Act, 1995 with effect from 1/4/2006 is clarificatory and hence retrospective in nature, cannot be accepted, because, firstly, the legislature by Finance Act, 1995 has specifically provided that clause (d) to the proviso to Section 43(5) shall come into operation prospectively with effect from 1/4/2006. Secondly, insertion of clause (d) was not necessitated on account of the fact that the provisions of Section 43(5) were unworkable or interpretation of Section 43(5) resulted in unintended consequences. Thirdly, even after insertion of clause (d), all transactions in derivatives are not taken outside the purview of Section 43(5). It is only those derivative transactions which are covered under clause (d) are taken outside the purview of Section 43(5) and the rest of the transactions in derivatives would continue to be covered under Section 43(5) of the IT Act. In these circumstances, the argument that clause (d) inserted to the proviso to Section 43(5) has retrospective effect cannot be accepted.

22. In the light of the views so expressed by Hon'ble jurisdictional High Court, we must proceed on the basis that the losses incurred in the assessment years prior to

2006-07, in dealing in derivatives, must be held to be losses of speculation business. To that extent, the issue is covered against the assessee. However, the question whether such losses of dealing in derivatives, which have been treated as losses of speculation business, can be set of against the profits of the same business activity in the assessment year 2006-07, did not really come up for adjudication before Hon'ble jurisdictional High Court, and Their Lordships did not also have any occasion to examine the scope of statutory provisions regarding carry forward and set off of business losses and the manner in which Hon'ble Courts have interpreted the same. In our humble understanding, therefore, this decision can not be viewed as an authority for the proposition that losses incurred in dealing in derivatives, prior to the assessment year 2006-07, cannot be set off against the profits of the same business in the assessment year 2006-07 or later assessment years. That aspect of the matter did not come up for consideration before Their Lordships. Similarly, the scope of provisions for set off and carry forward of losses did not come up for consideration before a coordinate bench of this Tribunal in the case of **ACIT Vs Shreegopal Purohit (33 SOT 1)**. The coordinate bench apparently proceeded on the assumption that if a loss is characterized as speculation loss, in assessment proceedings for the assessment year in which loss was incurred, and profits from the same business in a subsequent year is characterized as non-speculation business profit, the former cannot be set off against the latter – an assumption, as we have seen earlier in this decision, is contrary to the law laid down by Hon'ble Supreme Courts in Manmohan Das's case (supra). None of these decisions thus deal with the issue which has come up for our consideration.

23. In view of the above discussions, though subject to certain conditions – which are not relevant for the present purposes, the assessee was indeed entitled to set off the loss incurred, in the assessment years prior to the assessment year 2006-07, in the business of dealing in derivatives, against the profits earned in the assessment year 2006-07 and later assessment years.

24. It is also important to bear in mind that whether the business in the assessment years in which loss had incurred was speculative or non-speculative, this aspect of the matter is also, in view of Hon'ble Supreme Court's judgment in Manmohan Das's case *(supra)*, to be decided in the course of these proceedings, and the views of the Assessing Officer in the assessment year in which loss had incurred are of no significance. In our humble understanding, whatever be the status of finality of characterization of income in the assessment, which stands on a different fitting anyway, the norms applied in determination of character of income, for the purpose of eligibility of set off, in the assessment year in which loss is incurred and in the assessment year in which set off is claimed, must be the same. It is more so for the reason that as a result of this characterization of income, and as held in the case of Western Oil Distributing Ltd (supra), only the set off is to be determined and the characterization in assessment, which has attained finality anyway, remains unchanged. When we go by the theory of a vested right being conferred on the assessee, by the virtue of section 73(2) and for setting off the losses incurred by the assessee in one year against the profits of subsequent year, which, as we have seen in the foregoing discussions, has the sanction of Hon'ble Supreme Court, this question is a wholly academic question. However, when we are examining whether a business is a speculative business or not and this examination is with respect of the nature of the business, rather than modality of taxability of business in a particular assessment year, normally we cannot have different norms for different years. It is a peculiar situation in which the law governing definition of speculative transaction itself has undergone a change within the relevant period, and, therefore, there cannot be a uniform view in respect of the entire period of business. Having said that, if at all a uniform finding on the nature of business is needed to be given, as we believe is warranted on the facts of this case, the nature of the business must be held to be non-speculative business in nature, since, in view of the law as it stands now, the business cannot be said to be speculative business in nature. This finding, in view of our understanding of law laid down by Hon'ble Bombay High Court in the case of Western Oil Distributing Ltd (supra), is relevant only for the purpose of the set off in the present assessment year and it will have no bearing on

the earlier assessments which have received finality. This may somewhat incongruous at the first sight, but then this is how Hon'ble Courts has interpreted the legal position and, to our limited understanding, this seems to be the only way to iron out the wrinkles of complexities, and alleviate genuine hardship, caused due to change in definition of 'speculative transaction' without visualizing, and providing for, all the corollaries of this legislative amendment. As we say so, we are alive to the fact that whatever be the nature of hardship faced by the assessee, it is not open to us, or for that purpose any judicial body, to supply any *casus omissus*, but then all that we are doing is to give a harmonious interpretation to the law, even though judge made law to a large extent, as it exists. While loss incurred by the assessee in preceding assessment years is certainly speculation business loss for the purposes of assessment in the relevant assessment years, incongruous as it sound, it is still required to be treated as non-speculation business loss for the limited purposes of set off of carried forward of losses against current year's profits.

25. Let us also not lose sight of the fact that the only purpose of segregating losses of speculation and non-speculation business is to ensure that the losses incurred by the assessee in speculation business, which lack sufficient transparency, and leave the scope for generating fictitious losses through artificial transactions or shifting of incidence of loss from one person to another, are not allowed to be set off against profits of another business other than a similar business. This aspect of the matter also become clear from the observations in CBDT circular dated 27th February 2006, explaining the amendments made to Section 43(5) vide Finance Act 2005, as follows:

> **Existing provisions of clause (5) of section 43 define 'speculative transaction' to mean a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is settled otherwise than by the actual delivery or transfer of the commodity or scrips. The proviso to section 43(5) lists out certain transactions which are not deemed to be speculative transactions.**
>
> **Systemic and technological changes introduced by SEBI have resulted in sufficient transparency in the stock markets and have to a large extent curbed**

> **the scope for generating fictitious losses through artificial transactions or shifting of incidence of loss from one person to another. The screen based computerized trading provides for audit trail. In the wake of these developments, the present distinction between speculative and non-speculative transactions, in respect of trading in derivatives of securities is losing relevance.**
>
> **The Finance Act, 2005 has, accordingly, amended section 43(5) to provide that an eligible transaction in respect of trading in derivatives of securities carried out on a recognised stock exchange shall not be deemed as speculative transaction……..**

26. As we have pointed out earlier, the 'systemic and technological changes' brought about by the SEBI (Securities and Exchange Board of India) which, as per CBDT's own stand, lead to derivatives dealings being specifically taken out of the ambit of 'speculative transactions' were not overnight changes but the changes which were brought about, as Hon'ble Finance Minister noted in the relevant budget speech referred to earlier in this order, by 'significant developments over the past decade'. The screen based trading, with audit trail, was as much in existence in 2001-02 as it was in 2006-07. The nature of business thus was the same in every significant manner, and there was no other earlier occasion when 'derivatives trading' was taken note of the Income Tax Act, 1961. A school of thought was thus indeed possible, at least until a Special Bench of this Tribunal and until Hon'ble jurisdictional High Court ruled to the contrary, that amendment in Section 43(5) was no more than clarificatory in nature. Several coordinate benches of this Tribunal, such as in the case of P.S. Kapur Vs.ACIT (120 TTJ 422), held so. As these decisions were available at the point of time when Assessing Officer allowed set off in the assessment order, and no contrary binding decision was available at that point of time, the view adopted by the Assessing Officer was at least a possible view of the matter and it could not be substituted by another possible view, as taken in the impugned order, by the Commissioner. **Hon'ble Supreme Court's judgment**, in the case of **CIT Vs G M Stainless Steel Ltd (263 ITR 255**), supports the proposition that correctness of an assessment order, in the context of Section 263, is to be examined in the light of interpretation of law as was available as at the point of time when assessment order was passed. That was a case in which Hon'ble Supreme

Court noted that while the law, as it was finally laid down by Hon'ble Supreme Court itself and which must, therefore, be treated to be correct position of law always, was contrary to the view adopted in the assessment order, the assessment order could not be said to be erroneous because the same was in accordance with the judicial precedents available to the Assessing Officer as at the time of assessment. Viewed thus, at the minimum, the view adopted by the Assessing Officer could not be subjected to revision proceedings under section 263. The assessee appellant must succeed for this reason as well.

27. As a result of the amendment in Section 43(5) with effect from 1st April 2006, losses incurred in derivative trading are held to be eligible for being set off against normal business profits, as derivate trading itself is treated as a non-speculative business, and losses of any non- speculative businesses can be adjusted profits of any non-speculative business. Ironically, however, this apparently well-intended measure of relief to the assessee has resulted in an absurd situation in which past losses of derivatives trading cannot be set off against profits of derivatives trading itself. What was meant to be a source of relief has turned into a cause of misery. That is clearly an absurdity. As to what should be done in susch a situation, we find guidance from the observations made by **Hon'ble Supreme Court**, in the case **CIT vs Hindustan Bulk Carriers Ltd (259 ITR 449)**, as follows:

> **A construction which reduces the statute to a futility has to be avoided. A statute or any enacting provision therein must be so construed as to make it effective and operative on the principle expressed in maxim *ut res magis valeat quam pereat i.e.,* a liberal construction should be put upon written instruments, so as to uphold them, if possible, and carry into effect the intention of the parties. [*See* Broom's *Legal Maxims* (10th Edition), page 361, Craies on *Statutes* (7th Edition) page 95 and Maxwell on *Statutes* (11th Edition) page 221.]**
>
> **A statute is designed to be workable and the interpretation thereof by a Court should be to secure that object unless crucial omission or clear direction makes that end unattainable - *Whitney* v. *Commissioner of Inland Revenue* [1926] AC 37 p. 52 referred to in *CIT* v. *S. Teja Singh* AIR 1959 SC 352, *Gursahai Saigal* v. *CIT* AIR 1963 SC 1062.**

The Courts will have to reject that construction which will defeat the plain intention of the Legislature even though there may be some inexactitude in the language used - *Salmon* v. *Duncombe* [1886] 11 AC 627 p. 634 (PC), *Curtis* v. *Stovin* [1889] 22 CBD 513 referred to in *S. Teja Singh's* case (*supra*).

If the choice is between two interpretations, the narrower of which would fail to achieve the manifest purpose of the legislation we should avoid.

Whenever it is possible to do so, it must be done to construe the provisions which appear to conflict so that they harmonise. It should not be lightly assumed that Parliament had given with one hand what it took away with the other.

28. Hon'ble Supreme Court, in the case of **K.P. Varghese v. ITO (131 ITR 597)**, has further held that the task of interpretation is not a mechanical task and, quoted with approval, Justice Hand's observation that "**it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning**". Their Lordships, *inter alia*, observed as follows:

". . . The task of interpretation of a statutory enactment is not a mechanical task. It is more than a mere reading of mathematical formulae because few words possess the precision of mathematical symbols. It is an attempt to discover the intent of the Legislature from the language used by it and it must always be remembered that language is at best an imperfect instrument for the expression of human thought and, as pointed out by Lord Denning, it would be idle to expect every statutory provision to be "drafted with divine prescience and perfect clarity". We can do no better than repeat the famous words of judge Learned Hand when he said :

'. . . it is true that the words used, even in their literal sense, are the primary and ordinarily the most reliable source of interpreting the meaning of any writing : be it a statute, a contract or anything else. But it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.'

We must not adopt a strictly literal interpretation of . . . but we must construe its language having regard to the object and purpose which the Legislature had in view in enacting that provision and in the context of the setting in which it occurs. We cannot ignore the context and the collection of the provisions in which . . ., appears, because, as pointed out by judge Learned Hand in the most felicitous

language : interpret '. . . the meaning of sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create. . . .'"

29. In view of the guidance so given by Their Lordships, we have to proceed on the basis that despite 'inexactitude in the language used', as was the expression approved by Hon'ble Supreme Court, the provisions of carry forward and set off are to be construed in a manner so as not to defeat the plain and unambiguous intention of the legislature. In our considered view, this amendment was to provide relief to the taxpayers and is to be viewed as beneficial provisions, as such, and one cannot possibly proceed on the basis that the object of making amendment in Section 43(5) was to kill the brought forward losses of dealing in derivatives or make them ineligible for being set off against the profits of the same business in subsequent years. Whatever may be characterization of income for the purpose of intra assessment year set off in the relevant assessment year, and irrespective of the fact that such a characterization has achieved finality in assessment, the losses and profits from dealing in derivatives must be characterized on a uniform basis in the assessment year in which set off is claimed. Viewed in this perspective also, the classification of business for the limited purpose of set off of past losses, into speculative and non-speculative, is to be done on a uniform basis, and, whichever way one looks at it, the losses incurred in the same business in earlier assessment years are to be treated as eligible for set off against profits of the same business, subject to fulfilment of other conditions, in the subsequent assessment years. For this reason also, the assessee deserves to be granted set off of brought forward losses from business of dealing in derivatives, incurred in assessment years prior to assessment year 2006-07 against profits of the same business in assessment years 2006-07 and subsequent assessment years.

30. For the reasons set out above, we are of the considered view that the assessee was indeed eligible for setting of losses of business of dealing in derivatives, incurred in the assessment years prior to the assessment year 2006-07, against the profits of

the same business in assessment year 2006-07. There was no infirmity in the Assessing Officer granting the said set off. The assessment order, subjected to impugned revision proceedings, thus could not be held to be erroneous .and prejudicial to the interest of the revenue. Accordingly, we quash the impugned revision proceedings, and set aside learned Commissioner's order in challenge before us.

31. In the result, the appeal is allowed. Pronounced in the open court today on __31st day of May, 2011.

Sd/- sd/-

(D Manmohan) **(Pramod Kumar)**
Vice President Accountant Member
*Mumbai; **31st** day of **May** , **2011**.*

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2. *The respondent*
3. *Commissioner -1 , Mumbai*
4. *Departmental Representative, 'G' bench, Mumbai*
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By Order etc.

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai