

IN THE INCOME TAX APPELLATE TRIBUNAL : SPECIAL BENCH : KOLKATA

[Before Shri G.D.Agrawal, V.P., Shri B.R.Mittal, J.M. & Shri C.D.Rao, A.M.]

I.T.A.No. 1294 (Kol) of 2008
Assessment Year 2004-05

Shree Capital Services Ltd.,
Kolkata.

-Vs-

Asstt. Commissioner of Income-tax,
Circle-5, Kolkata.

[Appellant]

[Respondent]

Appellant by : Sri Manish Sheth

Respondent by : Sri Sushil Kumar (CIT-DR)

ORDER

PER SRI G.D.AGRAWAL, V.P. :

In the above mentioned case, the Hon'ble President, I.T.A.T. constituted a Special Bench u/s. 255(3) of the Income-tax Act, 1961. In this appeal by the assessee, the following grounds are raised :-

"1. That on the facts and in the circumstances of the case, Ld. CIT(Appeals) was not justified and grossly erred in upholding the contention of the A.O. that the loss incurred on account of futures and options are speculative in nature and cannot be regarded as business loss.

2. That on the facts and in the circumstances of the case, Ld. CIT(Appeals) erred in not holding that the derivative transactions entered into by the appellant in the form of futures and options are not covered under the provisions of section 43(5) of the Act hence the said transactions cannot be considered as speculative transactions.

3. That on the facts and in the circumstances of the case, Ld. CIT(Appeals) erred in not holding that the provisions of Section 43(5)(d) are clarificatory in nature and hence are retrospective in operation."

2. The facts of the case are that the assessee is a company which is engaged in the business of financing and investments in shares and securities. During the year under consideration, the assessee suffered the loss amounting to Rs.9,25,065/- on account of futures and options. The A.O. treated the same as speculation loss as

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per section 43(5) of the I.T. Act. On appeal, the C.I.T.(A) confirmed the order of the A.O. on this ground. Hence this appeal by the assessee.

3. At the time of hearing before us, the learned counsel for the assessee argued at length. However, his arguments were basically two folds, viz. -

(i) that the futures and options are a form of derivatives and as per the SEBI Rules applicable at the relevant time, permitting the dealing in derivatives, actual delivery thereof is not possible and, therefore, the same are to be settled in cash. The assessee had no option of either giving or taking delivery of the derivatives. That section 43(5) is applicable when the transaction is for purchase or sale of any commodity including stock and shares. That the derivatives are neither a commodity nor stock and shares. He, therefore, submitted that for a transaction in derivatives, section 43(5) is not applicable at all. In support of his contention, the learned counsel relied upon the following decisions :-

- (a) RBK Securities P. Ltd. vs. ITO - (2008) 118 TTJ 465 (Mum)
- (b) DCIT vs. SSKI Investors Services P.Ltd.-(2008) 113 TTJ 511 (Mum)
- (c) C.Bharath Kumar vs. DCIT - (2005) 4 SOT 593 (Bang)

(ii) That the Finance Act, 2005 has inserted clause (d) in sec. 43(5) providing that trading in derivatives will not be considered as speculative transaction within the meaning of Sec. 43(5). Though this provision is made effective from 1/4/2006, it is only clarificatory and, therefore, should be treated as retrospective. In support of this contention, the learned counsel relied upon the following decisions :-

- (a) Allied Motors (P) Ltd. vs. CIT - 224 LT.R. 677 (SC)
- (b) CIT vs. Podar Cement Pvt. Ltd. - 226 LT.R. 625 (SC)
- (c) CIT vs. Gold Coin Health Food P.Ltd. - 304 LT.R. 308 (SC)
- (d) ITO vs. Daga Capital Management P. Ltd. - 312 ITR (AT) 1 (Mum-SB)

In view of the above, it was submitted by the learned counsel that the A.O. was not justified in holding the loss from dealing in derivatives as speculation loss and the C.I.T.(A) wrongly confirmed the same. He, therefore, submitted that the orders of

the lower authorities should be reversed and the loss may be allowed as a business loss.

4. The Ld. Departmental Representative, on the other hand, referred to the definition of 'Derivatives' as provided under the Securities Contracts (Regulations) Act and also as explained in the Website of Security Exchange Board of India (SEBI). He submitted that as per the Website of SEBI, the derivatives derived its value from the underlying asset. The underlying assets can be securities, commodities, bullion, currency, live stock or anything else. He, therefore, submitted that the derivative gets its colour from the underlying security and the underlying security is either commodity or stock and in either case it will fall within the ambit of Sec. 43(5). In support of his contention, he relied upon the decision of Hon'ble Apex Court in the case of C.I.T. vs. B. Suresh [313 I.T.R. 149 (SC)]. In the said case, the Hon'ble Apex Court has held that the definition of 'goods' is very wide and it includes telecasting right of a film or TV programme. He submitted that the term 'commodity' is even wider and, therefore, the derivatives would fall within the term 'commodity' used in Sec. 43(5). He further submitted that the Legislature inserted clause (d) in Sec. 43(5) providing that the transaction in derivatives would not be treated as speculative transaction w.e.f. 1/4/2006. This establishes that before this amendment, the transactions in derivatives were included in the meaning of sec. 43(5), otherwise there was no purpose of inserting clause (d). If it is held that transaction in derivatives was out of the purview of sec. 43(5), it will render clause (d) of Sec. 43(5) to be redundant. The Legislature will not make an amendment in the Act to insert a redundant clause in the Statute. He also submitted that clause (d) inserted by Finance Act, 2005 w.e.f. 1/4/2006 is prospective and not retrospective. He pointed out that the clause is inserted with a specific date 1/4/2006. When by the same Finance Act the Legislature has made several other amendments with retrospective effect, they could have given the retrospective effect to this clause also, if so intended. He also

referred to the memorandum explaining the insertion of the relevant clause and stated that from the memorandum also it is evident that the clause is inserted prospectively and not retrospectively. In view of the above, it is submitted by the I.d. Departmental Representative that the order of the C.I.T.(A) on this issue should be sustained.

5. We have carefully considered the arguments of both the sides and perused the material placed before us. From the arguments of the parties and the facts of the case, two questions emerge for our adjudication, viz. (i) whether the transaction in derivatives falls within the meaning of speculative transaction as provided u/s. 43(5) ? and (ii) If answer to the above question is in the affirmative, i.e. the transaction in derivatives is held to be speculation transaction u/s. 43(5), whether clause (d) of Sec. 43(5) introduced by Finance Act, 2005 w.e.f. 1.4.2006 is clarificatory in nature and therefore, retrospective in operation ?

5.1. Section 43(5), as it stood during assessment year under consideration, i.e.

A.Y. 2004-05, reads as under :-

"5) "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips:

Provided that for the purposes of this clause--

- (a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or
- (b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or
- (c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member."

From the above it is clear that speculative transaction is a transaction in which contract for purchase and sale of any commodity is settled otherwise than by actual

delivery. It is not in dispute that in the case of transaction in derivatives, the transaction is always settled otherwise than by actual delivery. However, it was contended by the learned counsel that Sec. 43(5) is applicable only in respect of contract for purchase and sale of commodity. His contention was that the derivative is not a commodity and, therefore, Sec. 43(5) would not be applicable at all. The Ld. Departmental Representative has furnished before us the print out taken from the Website of SEBI explaining the term "derivative", which reads as under :-

"The term "Derivative" indicates that it has no independent value, i.e. its value is entirely "derived" from the value of the underlying asset. The underlying asset can be securities, commodities, bullion, currency, live stock or anything else. In other words, Derivative means a forward, future, option or any other hybrid contract of pre-determined fixed duration, linked for the purpose of contract fulfillment to the value of a specified real or financial asset or to an index of securities."

From the above it is clear that the derivatives derive its value from the underlying asset. The underlying asset can be securities, commodities, bullion, currency etc. Sec. 2(ac) of the Securities Contracts (Regulation) Act, 1956 also defines the term "derivative" as under :-

"(ac) "derivative" includes -

- (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;"

5.2. In the appeal under consideration before us, it was fairly admitted by the assessee's counsel that the underlying assets in the derivatives dealt with by the assessee were shares of certain companies. Before interpreting the term "commodity", it would be useful to refer to the decision of Hon'ble Apex Court in the case of C.I.T. vs. B. Suresh (supra) relied upon by the Ld. Departmental Representative, which gives an important guideline for interpreting the words keeping in view the technical advancement. In the case of B. Suresh (supra), the

assessee claimed deduction u/s. 80HHC in respect of foreign exchange earned by him by transfer of feature film rights for exploitation outside India. The transfer of right was by way of lease. The same was denied by the department on the ground that there was no sale of any goods or merchandise. The Appellate Tribunal and the High Court held that the assessee was entitled to deduction u/s. 80HHC. On appeal by the department, their Lordships of Hon'ble Apex Court held as under at pages 153 & 154 of the Report :-

"Findings : Two questions arise for determination, namely, whether foreign exchange earned by transfer of feature film rights for exploitation outside India, in the form of lease, is entitled to the benefit of section 80HHC deduction. The same is denied by the Department on the ground that there is no "sale". The other question is whether such "rights" are goods/merchandise.

The basic requirement of section 80HHC is earning in foreign exchange and retention of profits for export business. Profits are embedded in the "income" earned. Today the difference between the two is getting blurred with globalization and cross-border transaction. Today with technological advancement one has to change our thinking regarding concepts like goods, merchandise and articles. In the case of B Suresh, the assessee had bought rights of various decoders and had recorded movies on beta-cam-tapes which were transferred as telecasting rights to Star T.V. for five years (it has a limited life). Hence, such "rights" would certainly fall in the category of articles of trade and commerce, hence merchandise.

On the question as to whether transfer of the said rights by way of lease would attract section 80HHC, we find merit in the contention that under rule 9A and rule 9B, the word "lease" is included in the meaning of the word "sale".

Lastly, we find no infirmity in the judgment of the Bombay High Court in the case of Abdulgafar A. Nadiadwala [2004] 267 ITR 488." [Emphasis supplied]

Thus, their Lordships have held that due to technological advancement, one has to change his thinking about various concepts like goods, merchandise and articles. The above observation would be squarely applicable while interpreting the word "commodity". In Sec. 43(5), the term "commodity" has been given a wide meaning because it is mentioned that any commodity includes stocks and shares. Therefore, even if in common parlance the term "commodity" may not include any stocks and shares, but the legislature for the purpose of sec. 43(5) provided that the term "commodity" would include stocks and shares. This makes the intention of

the legislature clear that they used the term "commodity" in a very wide manner. Sec. 43(5) was brought on the Statute decades back when there was no concept of trading in derivatives. Therefore, naturally the Legislature will not mention the word 'derivatives' in Sec. 43(5). However, it has been provided that the term 'commodity' would include stock and shares. Thus the securities represented by stock and shares are included in the term 'commodity'. The derivatives are also securities. Derivative derives its value from the underlying assets. In other words, the underlying assets are represented by derivatives. When the underlying asset of any derivative is share and stock for all practical purposes, the treatment given to such derivatives should be similar to stock and securities. In the case under appeal before us, it is admitted that the underlying asset is shares. Therefore, in our opinion, derivatives will also fall within the meaning of 'commodity' used in Sec. 43(5). We may also mention that Finance Act, 2005 has provided that certain transactions in respect of trading in derivatives shall not be deemed to be speculative transactions within the meaning of Sec. 43(5). If the transaction in derivatives does not fall within the definition of 'speculation transaction' w/s. 43(5), then there was no question of exempting certain type of transaction in derivatives from the scope of speculative transaction w/s. 43(5). If it is held that the transaction in derivatives does not fall in Sec.43(5), it will make clause (d) and Explanation thereto below Sec. 43(5) introduced by Finance Act, 2005 to be redundant. In furtherance to the above Explanation, the Central Govt. has also framed Rules, i.e. Rules 6DDA and Rule 6DDB. It cannot be presumed that the Government has introduced a clause, i.e. clause (d) as well as Explanation thereto, which was redundant and infructuous.

5.3. In view of above, we hold that the term 'derivatives' in which underlying asset is shares, will fall within the meaning of 'commodity' used in Sec. 43(5) of the Act.

6. Now we come to next question whether clause (d) of Sec. 43(5) introduced by Finance Act, 2005 w.e.f. 1.4.2006 is clarificatory and, therefore, retrospective in

nature. Clause (d) as well as Explanation thereto reads as under :-

"(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;

shall not be deemed to be a speculative transaction

[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 by the Central Government for this purpose;"

6.1. In the memorandum explaining the provisions in the Finance Bill, 2005, which introduced clause (d) [273 ITR (St.) 207], the purpose of introduction of clause (d) has been explained, which reads as under :-

"MEASURES TO RATIONALISE THE TAX TREATMENT OF DERIVATIVE TRANSACTION

Under the existing provisions [clause (5) of section 43] a transaction for the purchase and sale of any commodity including stocks and shares is deemed to be a "speculative transaction", if it is settled otherwise than by actual delivery. However, certain categories of transactions are excluded from the purview of the said provision. Further, the unabsorbed speculation losses are allowed to be carried forward for eight years for set-off against speculation profits in subsequent years. These restrictions were essentially designed as an anti-evasion measure to prevent claims of artificially generated losses in the absence of an appropriate institutional infrastructure.

Recent systemic and technological changes introduced by stock markets have resulted in sufficient transparency to prevent generating fictitious losses through artificial transactions or shifting of incidence of loss from one person to another. The screen based computerized trading provides for an excellent audit trail. Therefore, the

present distinction between speculative and non-speculative transactions, particularly relating to derivatives is no more required.

The proposed amendment, therefore, seeks to provide that an eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange shall not be deemed to be a speculative transaction. The proposed amendment also seeks to notify relevant rules etc. regarding conditions to be fulfilled by recognised exchanges in this regard. Further it is also proposed to amend sub-section (4) of section 73 so as to reduce the period of carry forward of speculation losses from eight assessment years to four assessment years.

These amendments will take effect from 1st April, 2006 and will, accordingly, apply in relation to assessment year 2006-07 and subsequent years." [Emphasis supplied]

From the above it is evident that the transaction in derivatives is exempted from the purview of speculative transaction u/s. 43(5) because of recent systemic and technological changes introduced by stock exchange. The above intention of the Legislature is also clear from the fact that all the transactions in derivatives have not been exempted from the ambit of speculative transaction u/s. 43(5) but only the eligible transactions of trading in derivatives carried out in a recognised stock exchange are exempt. By way of explanation, the Legislature has also defined the term 'eligible transaction' and "recognized stock exchange". The Legislature has also provided the Rules, i.e. Rule 6DDA and Rule 6DDB prescribing the conditions which a stock exchange is required to fulfill to get notified as a recognized stock exchange for the purpose of clause (d) of proviso to Sec. 43(5). This rule is inserted w.e.f. 01/7/2005. From the above it is abundantly clear that clause (d) of Sec.43(5) cannot be said to be clarificatory in nature. The learned counsel for the assessee has relied upon several decisions to buttress his claim that clause (d) of Sec. 43(5) is clarificatory in nature. However, the facts in all those cases were altogether different than the facts relating to Sec.43(5).

6.2. In the case of Allied Motors (P) Ltd. (supra) relied upon by the assessee's learned counsel, it has been held by Hon'ble Apex Court as under :-

"Section 43B(a), the first proviso to section 43B and Explanation 2 have to be read together as giving effect to the true intention of section 43B. Explanation 2 being retrospective, the first proviso has also to be so construed. Without the first proviso.

Explanation 2 would not obviate the hardship or the unintended consequences of section 43B. The proviso supplies an obvious omission. But for this proviso the ambit of section 43B becomes unduly wide bringing within its scope those payments which were not intended to be prohibited from the category of permissible deductions. The first proviso to section 43B, therefore, has to be treated as retrospective.

The rule of reasonable construction must be applied while construing a statute."

From the above it is evident that Explanation 2 to Sec. 43B itself being retrospective, the first proviso to that section is also to be considered as retrospective because the proviso supplies an obvious omission. But in the case of the assessee before us, as we have already mentioned above that in the memorandum explaining the provisions in the Finance Bill, 2005, which introduced clause (d), the purpose of introduction of clause (d) has been clearly explained. The Legislature by way of Explanation to clause (d) to Sec. 43(5) has clarified the term 'eligible transaction' and 'recognised stock exchange' and in Rules 61DDA & 61DDB the Legislature has also prescribed the conditions which a stock exchange is required to fulfill to get notified as a recognized stock exchange for the purpose of clause (b) of proviso to Sec. 43(5). Therefore, the ratio of decision of Hon'ble Apex Court in the case of Allied Motors (P) Ltd. (supra) would not be applicable while considering clause (d) of sec. 43(5).

6.3. In the case of Podar Cement Pvt. Ltd. (supra), their Lordships of Hon'ble Apex Court on the meaning of 'owner' and interpretation of taxing statutes observed as under :-

"From the memorandum explaining the Finance Bill, 1987, it is clear that the amendment to section 27 of the Act 1961 Act was intended to supply an obvious omission or to clear up doubts as to meaning of the word 'owner' in section 22. The amendment introduced by the Finance Bill, 1987, was declaratory/clarificatory in nature so far as it related to section 27(iii), (iiia) and (iiib). Consequently, these provisions are retrospective in operation."

From the above decision it is evident that their Lordships was of the opinion that amendment to Sec. 22 was intended to clear up the obvious omission and doubts as to the meaning of the word 'owner' in that section and hence the amendment was

ificatory in nature. As we have already found that the purpose of introduction clause (d) of Sec. 43(5) was not to clear any obvious omission, but the legislature found that due to recent systemic and technological changes introduced by stock markets there is sufficient transparency in the transactions and, therefore, the Legislature decided to exempt the trading in derivatives which otherwise under certain conditions, i.e. eligible transactions in trading in derivatives in recognized stock exchange, were exempt from the purview of speculative transaction u/s. 43(5). The procedure has also been prescribed by way of Rule 6DDA and Rule 6DDB how a stock exchange can become a recognized stock exchange. From these facts it is evident that clause (d) of sec. 43(5) cannot be held to be retrospective.

6.4. In the case of CIT vs. Gold Coin Health Food P.Ltd. (supra), their Lordships of Hon'ble Apex Court while dealing with the issue of penalty on concealment of income, held that Explanation 4 to sec. 271(1)(c)(iii) is clarificatory in nature and not substantive by observing as under :-

"The circumstances under which an amendment was brought into existence and the consequences of the amendment will have to be taken care of while deciding whether the amendment was clarificatory or substantive in nature and whether it will have retrospective effect or it was not so."

From the above it is clear that if it is a necessary implication from the language employed that the Legislature intended a particular section to have retrospective operation, the court will give it such an operation. But in the case before us, as stated above, the Legislature made the amendment because of the technological advancement introduced by the stock markets resulting in more transparency in the dealings. Therefore, the circumstances under which amendment was brought into existence do not lead to the inference that it was retrospective. Therefore, the ratio of the aforesaid decision is not applicable to the case of the assessee.

7. In view of the above, we hold that clause (d) of Sec. 43(5) is prospective in nature and will be effective from the date from which the Legislature made it effective, i.e. 1/4/2006 and will be applicable to assessment year 2006-07 onwards.

In view of the above, we find no merit in the assessee's appeal. The same is dismissed.

8. In the result, the assessee's appeal is dismissed.

The order is pronounced in the Court on 31.7.09.

Sd/-
(C.D. Rao)
ACCOUNTANT MEMBER

Sd/-
(B.R.Mittal)
JUDICIAL MEMBER

Sd/-
(G.D.Agrawal)
VICE-PRESIDENT

Dated : 31-07-2009.