

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 20.02.2018

CORAM:

THE HONOURABLE MR.JUSTICE S.MANIKUMAR
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

T.C.A.No.853 of 2017

Commissioner of Income-tax,
Chennai.

.. Appellant

Vs.

M/s.Sri Vasavi Gold & Bullion Pvt. Ltd.,
137, NSC Bose Road Sowcarpet,
Chennai - 600 079.

... Respondent

Prayer: Tax Case Appeal is filed under Section 260A of Income Tax Act, 1961, against the order dated 15.09.2016, made in ITA No.659/mds/2016, on the file of the Income Tax Appellate Tribunal Madras "A" Bench. Preferred against the order dated 16.12.2015 in ITA.No.64/CIT(A)-15/14-15 passed by the Commissioner of Income Tax (Appeal), 15, Nungambakkam, Chennai-600 034. the Assessment order dated 26.03.2014 passed by the Income Tax Officer Company Ward No.VI(1)Chennai, for the Assessment year 2011-2012.

For Appellant : Mr.TR.Senthilkumar
for Mr.J.Narayanaswamy

For Respondent : Mr.MP.Senthilkumar

J U D G E M E N T

(Judgement of this Court was made by S.MANIKUMAR, J.)

Tax Case Appeal is filed against the order, dated 15.09.2016, made in ITA No.659/mds/2016, on the file of the Income Tax Appellate Tribunal Madras "A" Bench.

2. Short facts leading to filing of the instant Tax Case Appeal are that, the Assessing Officer, while completing the assessment found that the assessee had claimed an amount of Rs.60,66,466/- as loss in open market trading. Assessee was carrying on commodity trading through M/s.HRIM Comtrade. The

Assessing Officer rejected the assessee's claim to set off the loss against the normal business income, on the ground that the assessee failed to prove that transactions were done through a recognised stock exchange viz., MCX stock exchange and was not supported by proper time stamped contract notes and that the transaction did not qualify as an eligible transaction. Thus, the Assessing Officer rejected the assessee's claim. Alternatively, the Assessing Officer also held that even if the transaction has to be treated as eligible speculative transaction, the assessee will not be entitled for the claim, in view of Explanation to Section 73, as per which, the company had to be treated as in the speculative business to the extent of which the income was derived from speculative transaction.

3. Aggrieved by the assessment order, assessee filed appeal before the Commissioner of Income Tax (Appeal), Chennai. The Commissioner of Income Tax (Appeals), stated that the transaction in F&O / derivative segments were to be entered into, with the support of contracts notices having unique client identity number, and that the transaction were to be carried out through recognised stock exchange, and therefore the transaction is an eligible transaction, under Section 43(5). The Commissioner of Income Tax (Appeal), Chennai, held that the derivatives cannot be treated as share and therefore the transaction is excluded from the Explanation to Section 73(4). Thereby, the Commissioner of Income Tax (Appeal), Chennai, has directed the Assessing Officer to delete the above disallowance.

4. Aggrieved by the above said order, the Revenue preferred an appeal in ITA.No.659/Mds/2016, before the Income Tax Appellate Tribunal 'A' Bench, Chennai. Submissions made by the Revenue, before the Income Tax Appellate Tribunal, Chennai, are as follows:-

"2. Shri Shiva Srinivas, the learned Departmental Representative, submitted that, the only issue arises, for consideration is with regard to addition of Rs.60,66,466/-. According to the learned departmental representative, the assessee claimed the sum of Rs.60,66,466/- as loss in open market trading. According to the Ld. D.R., the assessee traded in Multi Commodity Exchange. The assessee claimed that the transaction is only a business transaction. Referring to Section 43(5) of the Income-tax Act, 1961 (in short 'the Act'), the Ld. D.R. submitted that the assessee could not produce necessary material, before the Assessing Officer, to prove that the transaction was carried out through Multi Commodity Stock Exchange. No

proper stamped voucher or contract note was produced before the Assessing Officer. Even assuming for a moment that the transaction was carried out through Multi Commodity Stock Exchange, the business was carried out by the assessee only for three months, therefore, it has to be considered as speculative business, hence, the same cannot be set off against the other income of the assessee."

3. The Id. Departmental Representative further submitted that the assessee's main business is retail gold jewellery. Therefore, Explanation to Section 73(4) would come into operation. Hence, the transaction of purchase and sale of derivatives has to be construed as speculative transaction. Therefore, the loss suffered by the assessee cannot be set off against the other income of the assessee. Referring to the order of the CIT(Appeals), the Id. D.R. submitted that the CIT(Appeals) by referring to the Notification dated 22.05.2009, found that the derivative is a financial instrument whose value depends upon the value of other underlying financial instrument which requires no initial net investment or little initial net investment that would be settled at a future date, therefore, Explanation to Section 73(4) of the Act would come into operation. The CIT (Appeals) has also found that derivatives are not shares, therefore, they are excluded from the ambit of Section 73(4) of the Act. According to the Id. D.R., the CIT(Appeals) is not correct in allowing the claim of the assessee.

5. Before the Tribunal, the learned counsel for the assessee, made the following submissions:

"4. On the contrary, Shri M.P. Senthil Kumar, the Learned counsel for the assessee, submitted that admittedly, the assessee is engaged in the business of jewellery. The assessee traded in derivatives in the Multi Commodity Stock Exchange. Referring to proviso to Section 43(5) of the Act, the Learned counsel submitted that when trading was made in derivatives through a recognized Stock Exchange, the same cannot be deemed to

be a speculative transaction. Therefore, according to the Learned counsel, provisions of Section 73(4) is not applicable at all."

6. After considering the rival submissions and on the facts and circumstances of the case, the Income Tax Appellate Tribunal 'A' Bench, Chennai, vide order dated 15.09.2016, made in ITA No.659/mds/2016, dismissed the Revenue appeal.

7. Aggrieved by the same, the present Tax Case Appeal has been filed by the Commissioner of Income Tax, Chennai, on the following substantial questions of law:

"1. Whether on the facts and in the circumstances of the case and in law, Tribunal was right in not appreciating the fact that the assessee had traded the commodity through Multi Commodity Stock Exchange an un recognised exchange which is a different entity from the MCX Stock Exchange which is a recognised exchange ?

2. Whether on the facts and in the circumstances of the case and in law, Tribunal was right in holding that transactions in commodity derivatives done through Multi Commodity Stock Exchange cannot be treated as speculative transaction as per Section 43(5) ?

3. Whether on the facts and circumstances of the case and in law, Tribunal was right in perversely holding that transaction in derivatives done by assessee cannot be treated as speculative transaction under Section 43(5) when assessee did not comply with any of the conditions stipulated under Section 43(5)(d) by producing any evidence to satisfy the conditions ?"

8. Supporting of the above substantial questions of law, the grounds raised in the instant appeal are that:

(i) The Tribunal has erred in not appreciating the fact that the assessee had traded the commodity through Multi-Commodity Stock Exchange an un recognised exchange which is a different entity from the MCX Stock Exchange which is a recognised exchange.

(ii) The Tribunal ought to have appreciated the Multi-Commodity Stock Exchange is not a recognised stock exchange and had mistook the said exchange as MCX Stock Exchange which is a recognised exchange.

(iii) Tribunal has erred in holding that the transaction in derivative by the assessee cannot be treated as speculative transaction under Section 43(5) even though the assessee had not complied with the condition stipulated in Section 43(5)(d).

(iv) The Tribunal ought to have appreciated that the open market trading done by the assessee is not an eligible transaction as per Section 43(5)(d).

(v) The Tribunal ought to have appreciated that the normal business of the assessee is only a jewellery business and the assessee had not transacted for the purpose of the investment but had indulged in F&O commodity trading.

(vi) The Tribunal ought to have appreciated that the loss incurred by the assessee is a speculative loss and same cannot be set off against normal business loss of the assessee.

(vii) The Tribunal has also erred in not considering the grounds raised by the Revenue with respect to the Explanation to Section 73 while deciding the issue.

9. Heard the learned counsel appearing for the parties and perused all the materials available on record.

10. Main issue on which arguments were advanced before this Court is with regard to addition of Rs.60,66,466/- (loss on open market trading) made by the Assessing Officer to the income of the assessee. Assessment order dated 26.03.2014, reads as follows:

"The assessee company has not substantiated that the transactions were supported by Contract Notes and were carried on in a recognised stock exchange i.e., in MCX which is the recognised stock exchange as per SO 1327 (E) dated 22.05.2009. Thus the transactions cannot be considered as 'eligible transactions' as per section 43(5)(d).

In view of explanation to section 73, the assessee will not be eligible for set off and carry forward of the loss of Rs.60,66,466/- irrespective of the fact whether the transactions are covered by the definition of 'eligible transaction'.

Penalty proceedings under Section 271(1)(c) are initiated for furnishing inaccurate particulars of income.

The assessed income is computed as under:

Income from business as admitted	: Rs.22,65,469/-
Add: Loss on open market trading	: Rs.60,66,466/-
Assessed income	: Rs.83,31,935/-

Tax as per computation sheet and demand notice enclosed should be paid."

11. According to the Assessing Officer (i) as per Section 45 (5) (d) of the Income Tax Act, the transaction carried out by the assessee cannot be considered as 'eligible transaction' and the same has to be treated as 'speculative transaction' and (ii) irrespective of the fact whether the transactions are covered by the definition of 'eligible transaction' and the assessee will not be eligible for set off and carry forward of the loss of Rs.60,66,466/- in view of Explanation to Section 73 of the Income Tax Act.

12. For better understanding of the relevant provisions relied on by the Assessing Officer, viz., Section 43(5) (d) and Explanation to Section 73 are extracted hereunder:

"Definitions of certain terms relevant to income from profits and gains of business or profession.

43. In sections 28 to 41 and in this section, unless the context otherwise requires—

- (1) "actual cost" means
- (2) "paid" means
- (3) "plant" includes
- (4) (i) "scientific research" means
- (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 merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or

(b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member; or

(d) an eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) carried out in a recognised stock exchange; or

(e) an eligible transaction in respect of trading in commodity derivatives carried out in a recognised association, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013 (17 of 2013),

shall not be deemed to be a speculative transaction.

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

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

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) in accordance with the provisions of the Securities

Contracts (Regulation) Act, 1956 (42 of 1956) or the Securities and Exchange Board of India Act, 1992 (15 of 1992) or the Depositories Act, 1996 (22 of 1996) and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and

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

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

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"Section 73: Losses in speculative 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 four assessment years immediately succeeding the assessment year for which the loss was first computed.

Explanation.— Where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of trading in shares or 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." (emphasis is ours)

13. Keeping the above provisions in mind, first let us consider whether Section 43(5) of the I.T. Act will apply to the facts and circumstances of the case. Section 43(5) deals with 'speculative transaction' and any income derived from the same will be computed under the head "income from profits and gains of business or profession". Proviso (d) to Section 43(5) gives exemption to an eligible transaction in respect of trading in derivatives carried out in a recognised exchange.

14. Now, let us consider the kind of transaction, the assessee carried out in the instant case. The assessee's main business is in retail gold jewellery and for a short period of time viz., three months i.e., from 08.08.2010 to 25.10.2010, the assessee was also trading in derivatives through recognised Multi Commodity Stock Exchange and suffered loss to a tune of

Rs.60,66,466/-. The said transactions were carried out by the assessee electronically on screen based systems and through approved stock broker and that the same is supported by Time Stamped Contract Note, issued by the stock broker indicating the unique identification number and PAN number in the contract note. The Authorised Representative of the assessee has explained and furnished the above details during assessment proceedings. However, an adverse assessment order has been preferred.

15. After considering the rival submissions, in the appeal filed by the assessee, the Commissioner of Income Tax (Appeals), vide order dated 16.12.2015, held as follows:

"5.1.6. For the transactions in F & O segments to qualify for being non-speculative transactions as per the definitions in Section 43(5) the transactions have to be eligible transactions and the transactions have to be carried out through recognised MCX stock exchange. The appellant has entered into transactions which are supported by contract notes having a unique client identity number. Such transactions were carried out through a stock broker on a screen based system. These transactions are eligible transactions. The transactions were carried out in a recognised stock exchange. The AO has held that the appellant failed to prove that the transactions were carried out through MCX Stock Exchange Ltd. which got notified by Notification No.46/2009 dated 22.05.2009. In terms of Explanation to Section 73(4) in the case of a company, business of purchase and sale of shares is deemed to be speculative business. A derivative is a financial instrument whose value depends on the value of other underlying financial instruments which requires no initial net investment or little initial net investment that is settled at a future date. Explanation to Sec.73(4) has been enacted to clarify beyond any doubt that share business of certain type or classes of companies are deemed to be speculative. Since derivatives are not shares, they are excluded from the ambit of explanation to Sec.73(4). Therefore, the transactions entered into by the appellant are eligible transactions and the AO is directed to delete

the addition of Rs.60,66,466/-. These grounds of appeal are allowed."

16. Adverting to the submissions of the parties, extracted supra, Income Tax Appellate Tribunal, vide order dated 15.09.2016, held as follows:

"5. We have considered the rival submissions on either side and perused the relevant material available on record. In this case, the assessee is trading in derivatives in the Multi Commodity Stock Exchange, which was recognized. Therefore, the same cannot be treated as speculative transaction within the meaning of Section 43 (5) of the Act. In other words, the transaction made in derivatives through Multi Commodities Stock Exchange was exempted under proviso (d) to Section 43(5) of the Act. Therefore, this Tribunal do not find any reason to interfere with the order of the lower authority and accordingly the same is confirmed.

6. In the result, the appeal filed by the Revenue is dismissed."

17. On the facts and circumstances of this case, the transaction done by the assessee is not a speculative transaction but it only comes under provios (d) to Section 43(5) of the Act thereby it is only a non speculative transaction and thus exempt from tax.

18. Section 73 of the I.T. Act deals with "losses in speculation business". Explanation to Section 73 categorically states that in the case of a company, business of purchase and sale of shares is deemed to be speculative business. Here, in the instant case, the assessee had suffered loss in trading of derivatives carried through Multi Commodity Stock Exchange. As derivative transactions being separate from trading in shares, provisions of Explanation to Section 73 will not be applicable to such transactions and hence, the loss incurred by the assessee in derivative transactions through recognised stock exchange has to be set off against other business income as per provisions of the Act.

19. In the light of the above discussions, we are of the view that the transaction carried out by the assessee is a non speculative transaction and thus Section 43(5) is not attracted to the facts of the instant case and likewise the assessee was

trading in derivatives and not in shares, so the loss suffered by the assessee in trading in derivatives is excluded from the ambit of Explanation to Section 73.

20. Therefore, we concur with the decision taken by the Appellate Tribunal as well as the Commissioner of Income Tax (Appeals) in rejecting the view taken by the Assessing Officer to add Rs.60,66,466/- as loss, on open market trading to the income of the assessee.

21. Accordingly, substantial questions of law are answered against the Revenue and instant Tax Appeal is dismissed. No costs.

Sd/-

Assistant Registrar(CS VI)

//True Copy//

Sub Assistant Registrar

dm/kk

To

1. The Income Tax Appellate Tribunal,
Madras "A" Bench,
Chennai.
2. The Commissioner of Income Tax,
Chennai.
3. The Commissioner of Income Tax,
(Appeals)-15,
121, Mahatma Gandhi Road,
Nungambakkam, Chennai-600 034.
4. The Income Tax Officer,
Company Ward VI (1)
7th Floor, New Block,
Room No.704, 212, MG Road,
Chennai 600 034

+1cc to Mr.TR.Senthilkumar, Advocate, S.R.No.

+1cc to Mr.Philip George, Advocate, S.R.No.

T.C.A.No.853 of 2017

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