

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 06.05.2013
Pronounced on: 11.07.2013

+ **ITA 94/2013**

THE COMMISSIONER OF INCOME TAX DELHI-IV

..... Appellant

Through: Sh. Sanjeev Sabharwal, Sr.
Standing Counsel with Sh. Puneet Gupta, Jr.
Standing Counsel.

Versus

DLF COMMERCIAL DEVELOPERS LIMITED

..... Respondent

Through: Sh. Ajay Vohra and Ms. Kavita
Jha, Advocates.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE NAJMI WAZIRI

MR. JUSTICE S.RAVINDRA BHAT

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1. This appeal of the revenue impugns an order of the Income Tax Appellate Tribunal (ITAT) dated 30.11.2011 in the assessee's appeal [ITA No. 1446 (Del) of 2011] whereby its contention about inapplicability of Explanation to Section 73 of the Income Tax Act, 1961 in respect of its transactions, and the resulting relief in carry forward of its losses for the previous year, in respect of its

derivative business was upheld. This Court framed the following question of law for consideration, and heard the parties, i.e:

“Did the Income Tax Appellate Tribunal (ITAT) fall into error in not holding that the loss of Rs. 4,92,71,000/- on account of derivative transaction was a speculative loss, and was entitled to the benefit of Section 73, in view of the Explanation to Section 73 of the Income Tax Act;”

2. The brief facts are that the assessee claimed loss of Rs.492.71 lakhs on account of purchase and sale of shares. The assessee argued that the loss in trading of derivatives was not a speculative loss in terms of Section 43(5) of the Income Tax Act and could not be disallowed as speculative loss under any provisions of the Income Tax Act. The Assessing Officer rejected that submission and held that Section 73 applied since it was independent of Section 43(5). Explanation to Section 73 can be applied even if there is delivery based sale purchase of shares and also in situations of trading of derivatives. It was held that the assessee was not engaged in any of the specifically excluded categories of business as to render Explanation to Section 73 inapplicable. The AO held that loss of Rs.492.71 lakhs had to be treated as speculative loss and could not be allowed to be adjusted against business income. The CIT (Appeals) rejected the assessee's contentions. Therefore, a further appeal was preferred to the ITAT, which accepted the contention that Explanation to Section 73 applied, and granted the relief claimed. The revenue is in appeal against that part of the impugned order of the Tribunal.

3. Learned counsel for the Revenue argued that the reliance placed upon an amended Section 43 (4) of the Income Tax Act by the impugned order is erroneous. It is highlighted in this regard that the scheme and structure of Section 73 is clear. Counsel argued that explanation to the provision categorically provides that where any part of the business of the company includes purchase and sale of shares of other company, it shall be deemed to be carrying on speculation business to the extent to which the business consists of that activity. The intention of Section 43, counsel submitted, was to define certain terms in respect of classification of income and for purposes of Sections 28-41. Section 43(5) stated that transactions where contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips, it would not be deemed to be speculative transaction. By the amendment made w.e.f. 01.04.2006, four categories of contracts including the one provided under Section 43(5)(d) i.e. transaction in respect of trading and derivative as defined under Securities Contract (Regulation) Act, 1956 are not to be deemed to be speculative transaction. However, counsel drew strength from the fact that the said provision, i.e., Section 43(5)(d) has restricted application in that it defines speculative transaction and excludes transactions and derivatives only for a limited purpose. On the other hand, Section 73 has wider application and relates to all manner of losses. It deals with a question of under what circumstances can carry forwarding of

such losses be permitted. Learned counsel for the Revenue relied upon the decisions reported as *CIT v. Intermetal Trade Ltd.*, 2006 (285) ITR 536 (M.P.); *CIT v. Arvind Investments Ltd.*, 1991 (192) ITR 365 (Cal) and *Eastern Aviation and Industries Ltd. v. CIT*, 1994 (208) ITR 1023. In this regard, it is submitted that the specific inclusion of the activity of sale and purchase of share of other companies from the otherwise general application of principles underlying Section 73 meant that those transactions could not claim the benefit of the provision. Derivatives of the kind and nature traded by the assessee in the present case were relatable to stocks and shares and what is more were the subject matter of transactions under the National Stock Exchange. In these circumstances, the Tribunal ought not to have permitted the assessee the benefit of Section 73.

4. Learned counsel for the Revenue submitted that there is no infirmity with the judgment and order of the Tribunal impugned in the present case. He highlighted the fact that the trade and transactions in derivatives as defined under Section 2 of the Securities Contract (Regulation) Act, 1956, were specifically excluded from the definition of speculative transactions. Even though that definition was in Section 43(5), yet neither the Tribunal nor the Court could ignore it since there was no other definition of derivatives in the Income Tax Act. Counsel sought to highlight that derivative need not be only in respect of stocks and shares but could also pertained to commodities. Such being the case, the Tribunal acted within its jurisdiction and correctly concluded that

the assessee could enjoy the benefit of Section 73 and did not fall within the mischief of its explanation.

5. Counsel submitted that the decision of the Madras High Court in *Rajshree Sugars and Chemicals Ltd. v. Axis Bank Ltd.*, AIR 2011 Mad 144 in support of the submission that derivatives depend on underlying assets which are not confined to stocks and shares but can be commodities, metals, energy resources, bonds and foreign currencies etc. Assessee's counsel also relied upon the decision of the Division of the Bombay High Court reported as *CIT v. Bharat R. Ruia (HUF)*, 2011 (337) ITR 452 (Bom) where especially the discussion relating to the amended position had taken place. The Bombay High Court had considered the pre-amended position and held that derivatives in the light of the then existing position under Section 45 (5) were speculative transactions but the position had changed after 01.04.2006 in view of the clarification by way of the amendment.

6. Before a discussion on the merits of the appeal, it would be essential to extract the relevant provisions of the Income Tax Act. Section 73 (with explanation), to the extent it is relevant, reads as follows:

“Losses in speculation business.

73. (1) Any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business.

(2) Where for any assessment year any loss computed in respect of a speculation business has not been wholly set off under sub-section (1), so much of the loss as is not so set off or the whole loss where the assessee had no income from any other speculation business, shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and—

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

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

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

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

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

Section 43, to the extent it is relevant, reads as follows:

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

(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 recognized stock exchange;]*

Shall not be deemed to be a speculative transaction,

[Explanation – For the purpose 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 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 recognized 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) *“recognized stock exchange” means a recognized 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;]*

7. It is apparent, facially, that the term “speculative transaction” has been defined only in Section 43 (5). At the same time, it is qualified, i.e. that the scope of the definition is restricted in its application to working out the mandate of Sections 28 to 41 of the Act. In terms of the Explanation to Section 73 (4) in the case of a company, business of purchase and sale of shares is deemed to

be speculation business. However, certain companies are excluded from this Explanation which are:

(i) 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'.

(ii) a company, the principal business of which is the business of banking or the granting of loans and advances.

8. Section 43 defines, for the purpose of Sections 28 to 41, certain terms. These latter provisions fall in Chapter IV, in Section D, which deal with computation of business income. The said provisions provide for matters relating to computation of such income, rent taxes, insurance of buildings, repairs of plant and machinery, depreciation, reserves for shipping business, rehabilitation fund, expenditure on certain eligible objects or schemes, deductions, amounts not deductible, profits chargeable to tax, etc. The assessee is no doubt correct in contending that the only definition of derivatives is to be found in Section 43 (5); yet the Court cannot ignore or overlook that the definition – to the extent it excludes such transactions from the mischief of the expression “speculative transactions” is confined in its application. Parliamentary intendment that such transactions are also excluded from the mischief of Explanation to Section 73 (4), however, is not borne out.

9. In this context, it would be instructive to notice that in *Rajshree Sugars and Chemicals Ltd (supra)*, the Madras High Court noticed, rather dramatically, that “..*'Derivatives are time bombs and financial weapons of mass destruction'* said Warren Buffett, one of the world's greatest investors, who overtook Microsoft Maestro in 2008 to become the richest man in the world and who is known as the 'Sage of Omaha or Oracle of Omaha'. *Derivatives, according to him, can push companies on to a spiral that can lead to a corporate melt down....*” The High Court then, after examining the nature and characteristics of derivatives transactions, observed that:

“5. 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.”

10. It is no doubt, tempting to hold that since the expression “derivatives” is defined only in Section 43 (5) and since it excludes such transactions from the odium of speculative transactions, and further that since that has not been excluded from Section 73, yet, the Court would be doing violence to Parliamentary intendment. This is because a definition enacted for only a restricted purpose or objective should not be applied to achieve other ends or purposes. Doing so would be contrary to the statute. Thus contextual application of a definition or term is stressed; wherever the context and setting of a provision indicates an intention that an expression defined in some other place in the enactment, cannot be applied, that intent prevails, regardless of whether standard exclusionary terms (such as “unless the context otherwise requires”) are used. In *The Vanguard Fire & General Insurance Co. Ltd., Madras v. M/S. Fraser And Ross & Anr* AIR 1960 SC 971 it was held that:

“It is well settled that all statutory definitions or abbreviations must be read subject to the qualification variously expressed in the definition clauses which created them and it may be that even where the definition is exhaustive inasmuch as the word defined is said to mean a certain thing, it is possible for the word to have a somewhat different meaning in different sections of the Act depending upon the subject or the context. That is why all

definitions in statutes generally begin with the qualifying words similar to the words used in the present case, namely, unless there is anything repugnant in the subject or context. Therefore in finding out the meaning of the word " insurer " in various sections of the Act, the meaning to be ordinarily given to it is that given in the definition clause. But this is not inflexible and there may be sections in the Act where the meaning may have to be departed from on account of the subject or context in which the word has been used and that will be giving effect to the opening sentence in the definition section, namely, unless there is anything repugnant in the subject or context. In view of this qualification, the court has not only to look at the words but also to look at the context, the collocation and the object of such words relating to such matter and interpret the meaning intended to be conveyed by the use of the words under the circumstances."

Similarly, in *N.K. Jain and Ors. v C.K. Shah and Ors.* AIR 1991 SC 1289, it was held that:

"4. The subject matter and the context in which a particular word is used are of great importance and it is axiomatic that the object underlying the Act must always be kept in view in construing the context in which a particular word is used....."

11. The stated objective of Section 73- apparent from the tenor of its language is to deny speculative businesses the benefit of carry forward of losses. Explanation to Section 73 (4) has been enacted to clarify beyond any shadow of doubt that share business of certain types or classes of companies are deemed to be speculative. That in another part of the statute, which deals with

computation of business income, derivatives are excluded from the definition of speculative transactions, only underlines that such exclusion is limited for the purpose of those provisions or sections. To borrow the Madras High Court's expression, "*derivatives are assets, whose values are derived from values of underlying assets*"; in the present case, by all accounts the derivatives are based on stocks and shares, which fall squarely within the explanation to Section 73 (4). Therefore, it is idle to contend that derivatives do not fall within that provision, when the underlying asset itself does not qualify for the benefit, as they (derivatives – once removed from it and entirely dependent on stocks and shares, for determination of their value).

12. In the light of the above discussion, it is held that the Tribunal erred in law in holding that the assessee was entitled to carry forward its losses; the question framed is answered in favour of the revenue and against the assessee. The appeal is, therefore, allowed; there shall be no order as to costs.

S. RAVINDRA BHAT
(JUDGE)

NAJMI WAZIRI
(JUDGE)

JULY 11, 2013