



2024:KER:90772

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT

THE HONOURABLE DR. JUSTICE A.K.JAYASANKARAN NAMBIAR

&

THE HONOURABLE MR. JUSTICE EASWARAN S.

MONDAY, THE 2ND DAY OF DECEMBER 2024/11TH AGRAHAYANA, 1946

I.T.A.NO.82 OF 2018

AGAINST THE ORDER DATED 19.03.2018 IN I.T.A.NO.219 OF 2014
OF I.T.A.TRIBUNAL, COCHIN BENCH

APPELLANT/RESPONDENT:

THE PRINCIPAL COMMISSIONER OF INCOME TAX
KOCHI-1.

BY SRI.JOSE JOSEPH, STANDING COUNSEL FOR INCOME TAX

RESPONDENT/APPELLANT:

M/S.DEWA PROJECTS PVT. LTD.,
S.S. KOVIL RTOD, THAMPANOR, TRIVANDRUM.

BY ADV.SRI.SHIYAS K.R.
BY ADV.SRI.P.P.FAISAL(K/1340/1998)
BY ADV.SMT.D.REETHA(K/1069/2003)

THIS INCOME TAX APPEAL HAVING COME UP FOR ADMISSION
ON 02.12.2024, THE COURT ON THE SAME DAY DELIVERED THE
FOLLOWING:



J U D G M E N T

Dr. A.K. Jayasankaran Nambiar, J.

This I.T. Appeal is preferred by the Revenue against the order dated 19.03.2018 of the Income Tax Appellate Tribunal, Cochin Bench in I.T.A.No.219/Coch/2014 pertaining to the assessment year 2007-08 under the Income Tax Act [hereinafter referred to as the "I.T. Act"].

2. The brief facts necessary for the disposal of the I.T. Appeal are as follows:

The respondent/assessee is a company engaged in property development and is currently under liquidation. During the previous year relevant to the assessment year 2007-08, the assessee had returned business income in connection with its property business but had also netted off a loss of Rs.803.03 lakhs, which was the carried forward loss from previous years in relation to its business of trading in derivatives. The Assessing Officer treated the loss of Rs.803.03 lakhs as speculative loss and, going by the provisions of Section 73 of the I.T. Act, found that the speculative loss could not be set off against other business income of the assessee. The assessment was completed



accordingly by cancelling the set off and adding the amount of Rs.803.03 lakhs to the business income for the said year.

3. Aggrieved by the order of the Assessing Officer, the assessee carried the matter in appeal before the First Appellate Authority, where the assessee *inter alia* argued that only an amount of Rs.283 lakhs represented the carry forward loss from trading in shares whereas an amount of Rs.591 lakhs represented the carry forward loss from dealing in derivatives. The First Appellate Authority, however, rejected the contention of the assessee *in toto* and affirmed the order of the Assessing Authority.

4. In the further appeal preferred by the assessee before the Appellate Tribunal, the Tribunal placed reliance on a judgment of the Calcutta High Court in **M/s. Balji Securities Pvt. Ltd. - [88 CCH 313]** to find that inasmuch as Section 43 of the I.T. Act had been amended with effect from 01.04.2006, and had clarified that delivery based transactions and derivative transactions would not attract the definition of "speculative transaction" for the purposes envisaged under Section 43, the authorities below had erred in treating the carried forward loss from derivative business as 'speculative loss' for the purposes of Section 73 of the I.T. Act. In holding so, the Tribunal also distinguished the judgment of the Delhi High Court in **Commissioner**



of Income Tax v. DLF Commercial Developers Ltd. - [(2013) 261 CTR (Del) 127], wherein it was held that determination of stock derivatives value is dependent on shares and hence, the provisions of Section 73 of the I.T. Act would be applicable to the derivative business, and accordingly, the loss on account of derivative transactions would not be allowed to be carried forward and set off against non-speculative business income. The Tribunal thereafter remitted the issue to the file of the Assessing Officer to bifurcate the speculative loss and normal business loss. The Tribunal also disallowed 2% of the exempt income as expenditure incurred for the purposes of earning exempt income. This was in relation to an amount of Rs.8,40,000/- which the Assessing Officer had disallowed under Section 14A of the I.T. Act as the assessee had earned exempt income of Rs.8.97 lakhs. Since the disallowance by the Assessing Officer was in terms of Rule 8D that was inserted into the Income Tax Rules [hereinafter referred to as the "I.T. Rules"] with effect from 24.03.2008, the Tribunal found that the provisions of Rule 8D could not be applied for the assessment year 2007-08 since there was no retrospective operation envisaged for the Rules. It was, therefore, and after recognising that there would be some expenditure incurred for the purposes of earning exempt income that it directed the Assessing Officer to disallow 2% of the exempt income towards expenditure incurred for the purposes of earning the exempt income.



5. The Revenue is before us through this I.T. Appeal raising the following substantial questions of law:

1. Whether, on the facts and in the circumstances of the case, does the case call for/require bifurcation of loss and is the ITAT right in law in bifurcation in remitting back the issue to Assessing Officer to bifurcate speculative loss and normal business loss ?
2. Whether, on the facts and in the circumstances of the case is the Hon'ble ITAT right in law in directing the Assessing Officer to disallow 2% of the exempt income as expenditure incurred for the purpose of earning exempt income ?
3. The Tribunal is right in law in its conclusion and does the case warrant a direction as issued ?

6. At the outset, it is submitted by Sri.Jose Joseph, the learned Standing Counsel for the Income Tax Department that the Revenue does not press question No.(2) above since it has since become well-settled that the amendment effected to the I.T. Rules with effect from 2008 would not apply for the prior assessment years. We, therefore, answer the said question against the Revenue and in favour of the assessee.

7. In relation to question Nos.(1) and (3), Sri.Jose Joseph would rely on the judgment of the Delhi High Court in *DLF (supra)* to contend that the definition of "speculative transaction" in Section 43 of the I.T. Act has to be seen as limited for the purposes of determining the income from profits and gains of business or profession and not for the



purposes of Section 73 of the I.T. Act that deal with the circumstances under which the losses in speculation business can be carried forward.

8. Per contra, we have been shown the judgment of the Calcutta High Court in *M/s. Balji (supra)* and a later judgment of the Supreme Court in **Snowtex Investment Limited v. Principal Commissioner of Income-Tax - [(2019) 414 ITR 227 (SC)]**. In *Snowtex (supra)*, the issue that came up for consideration was whether, under the provisions of the I.T. Act, profit from trading in futures and options can be seen as speculation profit and set off against speculation loss originated from trading of shares of other companies ? The Calcutta High Court had decided that the loss which occurred to the assessee as a result of its activity of trading in shares [a loss arising from the business of speculation] was not capable of being set off against the profits which it had earned against the business of futures and options since the latter did not constitute profits and gains of a speculative business. The Supreme Court concurred with the said finding and dismissed the appeal preferred by the Revenue.

9. The interplay between the provisions of Section 43 and Section 73 of the I.T. Act, to the extent they are relevant for deciding the issue before us, has been discussed by the Supreme Court in *Snowtex (supra)* as follows:



“14. The provisions of section 43(5) were amended by the Finance Act, 2005. Prior to the amendment, section 43(5) defined a ‘speculative transaction’ to mean a transaction in which a contract for the purchase or the sale of any commodity including stocks and shares is settled otherwise than by the actual delivery or transfer of the commodity or scrips. The impact of the amendment by the Finance Act, 2005 was that an eligible transaction on a recognised stock exchange in respect of trading in derivatives was deemed not to be a speculative transaction. With effect from April 1, 2006, trading in derivatives was by a deeming fiction not regarded as a speculative transaction when it was carried out on a recognized stock exchange.

15. The circular of the Central Board of Direct Taxes dated February 27, 2006 indicated that this amendment was occasioned by the changes which were introduced by SEBI both at the legal and technological level for bringing in greater transparency in the market for derivatives. Explaining the reason for the amendment, the Circular states:

“3.10 Excluding ‘trading in derivatives’ on recognised stock exchanges from the ambit of ‘speculative transactions’

The 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. The notification prescribing the rules and the conditions to be fulfilled by a stock exchange to be recognized by the Central Government for the purposes of section 43(5) [i.e., Rules 6DDA and 6DDB of the Income-tax Rules, 1962] has been published in the Official Gazette on 1st July, 2005 vide S. O. No. 932(E).

Applicability : From the assessment year 2006-07 onwards.”

16. Section 73 deals with losses from speculation business. Under sub-section (1) of section 73, a loss computed in relation to speculation business carried on by an assessee can only be set off against the profits and gains of another speculation business. The *Explanation* to section 73 contains a deeming fiction where certain businesses shall, for the purposes of the section, be deemed to be speculation businesses. The *Explanation* also carves out an exception in respect of certain specified businesses which shall lie outside the fold of the deeming fiction. Prior to the amendment of the *Explanation* by the Finance (No.2) Act 2014 with effect from April 1, 2015,



the business of trading in shares carried on by a company was not excluded from its purview. However, by the amendment which was brought into force from April 1, 2015, the *Explanation* to section 73 reads as follows:

“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.”

17. While on the one hand, Parliament amended section 43(5) with effect from April 1, 2006 as a result of which trading in derivatives on recognised stock exchanges fell outside the purview of the business of speculation, a corresponding amendment to the *Explanation* to section 73 in respect of trading in shares was brought in only with effect from April 1, 2015.”

It will thus be seen that once the provisions of Section 43(5), as amended, came to treat a trade in derivatives as not a speculative transaction when it was carried out on a recognised stock exchange, then the effect of that amendment was to treat the transaction in derivatives as merely a business transaction. A loss in the derivative business would consequently be a business loss for the purposes of Section 72, and a set off of such business loss would have to be permitted against profits and gains of business as computed in terms of the I.T. Act. In other words, this was not a case where Section 73 was attracted at all since Section 73 deals specifically with losses in speculation business. As rightly found by the Tribunal in the instant case, since the transaction in derivatives was not a speculative transaction, the disallowance of the set off by the Assessing Officer was clearly illegal. We find, therefore, that the impugned order of the



Tribunal, inasmuch as it relates to the questions raised in the present appeal, does not require any interference. Question nos.(1) to (3) are thus answered against the Revenue and in favour of the assessee.

The I.T. Appeal is thus dismissed by answering the questions of law raised against the Revenue and in favour of the assessee.

Sd/-
DR. A.K.JAYASANKARAN NAMBIAR
JUDGE

Sd/-
EASWARAN S.
JUDGE



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APPENDIX OF I.T.A.NO.82/2018

PETITIONER'S ANNEXURES:

ANNEXURE A	COPY OF THE ASSESSMENT ORDER U/S. 143 (3) DATED 28/12/2009 FOR A.Y 2007-08
ANNEXURE B	COPY OF CIT (APPEALS, ORDER IN ITA NO. 143/R-1/E/CIT(A) II/09-10 DATED 18/12/2013 FOR A.Y 2007-08
ANNEXURE C	COPY OF ASSESSMENT ORDER U/S. 143 (3) R.W.S 147 DATED 25/10/2011 FOR A.Y 2007-08.
ANNEXURE D	COPY OF CIT (APPEALS) ORDER IN ITA-53/R-1/E/CIT(A) II/2011-12 DATED 18/12/2013.
ANNEXURE E	COPY OF ITAT'S ORDER IN ITA NO.150 & 151/COCH/2014 AND ITA NO.219/COCH/ 2014 DATED 19/03/2018 FOR A.Y 2007-08

RESPONDENT'S ANNEXURES:

ANNEXURE - R1	A COPY OF THE ORDER OF LIQUIDATION.
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P.S. TO JUDGE