

IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD BENCH "B" AHMEDABAD

Before S/Shri Bhavnesh Saini, JM and D.C.Agrawal, AM

ITA No.3361/Ahd/2009
Asst. Year 2006-07

Asstt. CIT, Circle-2, Bhavnagar.	Vs.	Shri Hiren Jaswantrai Shah, Prop. Of Hetal Steel Corporation, 940/B Krishnanagar, Bhavnagar.
(Appellant)	..	(Respondent)

Appellant by :-	Shri Samir Tekriwala, Sr.DR
Respondent by:-	Shri Mehul K. Patel, AR

ORDER

Per D.C. Agrawal, Accountant Member.

This is an appeal filed by the Revenue raising following grounds :-

1. The Ld. CIT(A) Ahmedabad has erred In law and on facts in holding that the derivative transactions are business transactions which cannot be treated as speculative transaction and thereby directing the AO to allow the set off of loss In derivative transactions of Rs,23,62,200/- against the regular business Income. without properly appreciating the facts of the case and the material brought on record by the AO.
- 1.2 In doing so, the Ld. CIT(A) has erred In law and on facts in not appreciating that the assessee could not establish as to how the conditions laid down in Section 43(5) were fulfilled in assessee's case and whether the transactions had been made through the recognized Stock Exchange and whether the same were eligible transactions within the meaning of the provisions of the said section.
2. The only issue involved in the appeal is whether profit arising from derivative transactions at Rs.23,62,290/- should be treated as non-

speculative and accordingly available to be set off against regular business income.

3. The facts relating to the issue are that assessee is engaged in the whole-sale business of iron and steel. He is also carrying out daily transactions in shares. He has made investment in shares, and also trading in shares & securities and money lending. The assessee has shown income from long term capital gains/short term capital gains from shares. During the Asst. Year in question assessee has shown loss from derivative transactions at Rs.23,62,290/- which is sought to be adjusted against normal business income. The AO disallowed the claim on the ground that Government notification for treating income/loss from derivative transactions in shares as regular business income/loss is issued on 25.01.2006 under explanation to section 43(5). Therefore, such loss cannot be treated as from non-speculative transaction. The AO accordingly disallowed the claim of set off.

4. The ld. CIT(A) allowed the claim as under :-

“3.2 During the course of appellate proceedings, the ld. Counsel for the appellant has submitted that no valid cogent, tenable grounds for such treatment/disallowance are shown at all by the AO for treating the loss of Rs.23,62,290/- as speculative loss instead of regular business loss claimed by the assessee. The assessee ought to have been allowed the set off of such loss against his business income in view of decision of the Hon. ITAT in the appellant’s own case for Asst. Year 2005-06 where the similar issue was involved and the Hon. ITAT has allowed the set off of the derivative transactions against the regular business income. The ld.

Counsel has also relied on the decision of Hon. ITAT, Jaipur 'A' Bench in the case of P.S. Kapur vs. ACIT in ITA No.214/Jp/2008 dated 31.07.2008 – (2009) 120 TTJ 422 wherein the similar issue was involved and the appeal of the assessee is allowed. Therefore, the ld. Counsel for the appellant urged to allow the set off of loss in derivative transaction of Rs.23,62,290/- against the regular business income.

3.3 I have carefully considered the contentions of the ld. Counsel for the appellant and have also carefully gone through the assessment order. The case law relied upon by the ld. Counsel for the appellant has also been carefully considered. It is seen in this case that the AO has not come with any adverse findings as regards the loss claimed by the appellant on derivative transactions. It is now very clear that derivative transactions are business transactions and cannot be treated as speculative transactions. In view of the facts and circumstances of the case and in the light of judicial pronouncements cited supra of the Hon. Ahmedabad and Jaipur Tribunals, the AO is directed to allow the set off of loss in derivative transactions of Rs.23,62,290/- against regular business income as the same is to be treated as business loss only.”

5. Before us, the ld. DR submitted that as per clause (ii) of explanation below section 43(5) notification for declaring as to what are the recognized stock exchanges through which assessee can carry out derivative transactions was published on 25.1.2006 and, therefore, the assessee could not carry out derivative transactions through recognized stock exchanges prior to this date as required under that clause (ii) of Explanation to section 43(5) and, therefore, transactions carried out prior to this date would be speculative transactions and accordingly the loss in them cannot be set off against normal business income.

6. On the other hand, the ld. AR submitted that this notification is clarificatory in nature. Recognized stock exchanges are already in

existence even prior to 25.1.2006. He relied on the decision of Special Bench of the Tribunal, Kolkata, in the case of Shree Capital Services Ltd. vs. ACIT (2009) 318 ITR (AT) 01, ITAT, Kolkata (SB) wherein it is held that clause (d) of section 43(5), defining special transactions in derivatives, would be prospective in nature and would be effective from 1st April, 2006.

7. We have heard the rival arguments and perused the material on record. The only issue involved in this appeal is whether by virtue of notification from CBDT dated 25.1.2006 in S.O.(89E) recognizing National Stock Exchange and Bombay Stock Exchange for the purpose of derivative transactions would make the application of clause (d) of section 43(5) effective only from 25.1.2006 or this provision will remain in effect from 1st April, 2006 when the clause (d) of sub-section (5) was brought into statute. For the sake of convenience we reproduce section 43(5), (which includes clause (d) also which was introduced by the Finance Act, 2005 w.e.f. 1.4.2006) 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 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 (aa) 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, 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.

In derivative transactions there is no purchase or sale directly. These instruments, however, depend upon original assets and derive their value from them. Such derivatives are in the form of future and options. Before the amendment brought in by the IT Act w.e.f. 1.4.2006 in section 43(5), all the transactions in derivatives were treated as speculative in nature and, therefore, losses arising therein could not be allowed to be set off against other business income. However, w.e.f. 1.4.2006 amendments were made in section 43(5) and the transactions involved in derivatives were taken out of definition of speculative transactions. For this purpose

clause(d) was inserted in section 43(5). This amendment was held prospective in nature and applicable from Asst. Year 2006-07 as held by the Special Bench in Shree Capital Services Ltd. vs.ACIT (supra) as under :-

“The 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 section 43(5). If the transaction in derivatives did not fall within the definition of "speculation transaction" under section 43(5), there was no question of exempting certain types of transaction in derivatives from the scope of speculative transaction under section 43(5) and clause (d) and Explanation thereto below section 43(5) introduced by the Finance Act, 2005 would be redundant. The term "derivatives" in which the underlying asset is shares, will fall within the meaning of "commodity" used in section 43(5) of the Act. Clause (d) of section 43(5) cannot be said to be clarificatory in nature. Clause (d) of section 43(5) is prospective in nature and will be effective from the date on which the Legislature made it effective, i.e., April 1,2006 and will be applicable to the assessment year 2006-07 onwards.”

8. This view was upheld by Hon. Bombay High Court in the case of CIT –IV, Mumbai vs. Shri Bharat R. Ruia (HUF) (2011) 10 taxmann.co, 265 (Bom) pronounced on April 18,2011 while interpreting clause (d) to the proviso to section 43(5) (that it is effective from 1.4.2006) as under:-

Plain reading of clause (d) to the proviso to section 43(5) makes it clear that with effect from 1-4-2006, only those eligible transaction in derivatives referred to under section 2(ac) of the 1956 Act, which are carried out in a recognized stock exchange, shall not be deemed to be a speculative transaction. It is only because the transactions in derivatives referred to under section 2(ac) of the 1956 Act carried out in a recognized stock exchange were covered under section 43(5), the Legislature could exclude those transactions from the

purview of section 43(5) with effect from 1-4-2006. In other words, unless the transactions referred in clause (d) were not covered under section 43(5), there would be no question of excluding those transactions from the purview of section 43(5). [Para 23]

9. Explanation to section 43(5) was also inserted by Finance Act, 2005 w.e.f. 1.4.2006. The conditions that a stock exchange is required to fulfill for being notified as recognized stock exchange for the purposes of clause (d) to section 43(5) were inserted by Income-tax 20th amendment Rules 2005 w.e.f. 1.7.2005. These conditions as per Rule 6DDA of I.T. Rules, 1962 at the relevant time were as under :-

6DDA. Conditions that a stock exchange is required to fulfil to be notified as a recognised stock exchange for the purposes of clause (d) of proviso to clause (5) of section 43.—For the purposes of clause (d) of proviso to clause (5) of section 43, a stock exchange shall fulfil the following conditions in respect of trading in derivatives, namely :—

(i) the stock exchange shall have the approval of the Securities and Exchange Board of India established under the Securities and Exchange Board of India Act, 1992 (15 of 1992) in respect of trading in derivatives and shall function in accordance with the guidelines or conditions laid down by the Securities and Exchange Board of India ;

(ii) the stock exchange shall ensure that the particulars of the client (including unique client identity number and PAN) are duly recorded and stored in its databases ;

(iii) the stock exchange shall maintain a complete audit trail of all transactions (in respect of cash and derivative market) for a period of seven years on its system ;

(iv) the stock exchange shall ensure that transactions once registered in the system cannot be erased or modified.

**I.T. (20th Amend.) Rules, 2005, wef. 1-7-2005.*

Rule 6DDB provides the procedure for notification as required under explanation (ii) to section 43(5). This procedure is laid down as under :-

**6DDB. Notification of a recognised stock exchange for the purposes of clause (d) of proviso to clause (5) of section 43.—(1) An application for notification of a stock exchange as a recognised stock exchange for the purposes of clause (d) of proviso to clause (5) of section 43 may be made to the Member (L), Central Board of Direct Taxes, North Block, New Delhi-110 001.*

(2) The application referred to in sub-rule (1) shall be accompanied with the following documents, namely :—

- (i) approval granted by Securities and Exchange Board of India for trading in derivatives ;
- (ii) up-to-date rules, bye-laws and trading regulations of the stock exchange ;
- (iii) confirmation regarding fulfilling the conditions referred to in clause (ii) to clause (iv) of rule 6DDA ;
- (iv) such other information as the stock exchange may like to place before the Central Government.

(3) The Central Government may call for such other information from the applicant as it deems necessary for taking a decision on the application.

(4) The Central Government, after examining the information furnished by the stock exchange under sub-rule (2) or sub-rule (3), shall notify the stock exchange as a recognised stock exchange for the purposes of clause (d) of proviso to clause (5) of section 43 or issue an order rejecting the application before the expiry of four months from the end of the month in which the application is received.

(5) The notification referred to in sub-rule (4) shall be effective until the approval granted by the Securities and Exchange Board of India is withdrawn or expired, or the notification is rescinded by the Central Government.”

*I.T. (20th Amend.) Rules, 2005, w.e.f.1-7-2005.

A combined reading of the provision of clause (d) to proviso to section 43(5) and the explanation (ii) to section 43(5) and above rules 6DDA and 6DDB indicate that a stock exchange whether newly created or already existing should satisfy above conditions as per Rule 6DDA and such stock exchange should be approved by the Stock Exchange Board of India (SEBI) under the SEBI Act, 1992 for recognition of a stock exchange should keep record of particulars of the clients, complete audit trail of all transactions are maintained for seven years and that such transactions are not erased or modified. On an application filed with CBDT along with particulars as given in rule 6DDB, the stock exchange will be notified as recognized stock exchange for the purpose of clause (d) to proviso to subsection (5) of section 43. In our considered view rule

6DDA has come into effect from 1.7.2005 and will accordingly be effective from date only. In other words, a stock exchange can file an application with CBDT for recognition within the meaning of clause (d) of proviso to section 43(5) after this date. The main provision i.e. clause (d) of proviso to section 43(5) has come into effect from 1.4.2006. It means that the Government has prescribed the conditions and made effective in advance so that stock exchanges can take steps to file application for recognition for derivative transactions much in advance. However, Rule 6DDB is only a procedural law as it prescribes the method how to apply for necessary recognition and consequent notification. The issue is whether notification issued on 25.1.2006 can curtail the applicability of clause (d) of proviso to section 43(5) so as to make transactions in derivatives done prior to 25.1.2006 as speculative and transactions after 25.1.2006 as non-speculative as argued by the Revenue.

10. We do not, however, agree with the view advanced by the Revenue that notification dated 25.1.2006 is prospective in effect. It is undisputed that Rule 6DDB is only procedural in nature. When a Rule or provision does not affect or empower any right or create an obligation or only relates to procedures, then it is deemed to be retrospective unless such inference is likely to lead absurdity. Thus if an amendment is made in procedure it will apply to all proceedings pending or to be initiated. In the

context of Rule 1BB Hon. Rajasthan High Court in CWT vs. Man Bahadur Singh (1994) 208 ITR 658 held that such procedural amendment in rule would be retrospective. Therefore, in our considered view if transactions are carried out through stock exchanges from 1.4.2005 to 25.1.2006 which are recognized by notification issued by CBDT on 25.1.2006 would be eligible for being treated as non-speculative within the meaning of clause (d) of proviso to section 43(5). The notification issued under rule 6DDB does not empower any right or create obligation but only recognizes what is already in existence. It is not a case that NSE or BSE were created after 25.1.2006 and, therefore, transactions could not have been carried out through them and, therefore, transactions carried out prior to this date would not be covered for being treated as non-speculative. In other words if transactions are derivatives and are carried out through stock exchange which are already in existence during Asst. Year 2006-07 i.e. FY 1.4.05 & 31-3-06 onwards and which are subsequently recognized under rule 6DDB and there is no allegation that such transactions or the stock exchanges have violated any condition prescribed under rule 6DDB then such recognition to stock exchanges by CBDT for the purpose of clause (d) of proviso to section 43(5) would be retrospective effect from 1.4.2006.

11. Our view that notification dated 25.1.2006 would be effective from 1.4.2005 i.e. it would be applicable to entire Asst. Year 2006-07 is also

supported by a recent decision of ITAT, Mumbai in ACIT vs. Parimal D. Nathwani (2011) 9 taxmann.com 284 (Mum-ITAT) pronounced on January 21,2011 wherein following decision of the ITAT Delhi Bench in the case of G.K. Anand Bros.Buildwell (P) Ltd. vs. ITO (2009) 34 SOT 439 (Delhi) held that notification dated 24.1.2006 is only a subordinate legislation and cannot over ride the principal legislation enacted by the Parliament. ITAT Mumbai Bench in that case held as under:-

11. It is the contention of the Revenue that the notification was issued on 24.01.2006 and accordingly the transactions effected prior to 24.1.2006 are to be considered as speculative transactions and the transactions after that date can be considered as non-speculative, in view of the notification issued by the Board. The Coordinate Bench in the case of *G.K. Anand Bros. Buildwell (P.) Ltd. v. ITO* 234 SOT 439 (Delhi) has considered the issue and held that notification dated 24.1.2006 is by way of a subordinated legislation but cannot override the principal legislation enacted by the Parliament. Therefore the loss in question was to be treated as business loss and not as speculative loss in the above said case. The facts and reasons for holding as such are as under :—

"The assessee is carrying on business as builder, developer and contractor. During the year it has also done trading in shares by way of future and option transactions. This resulted into a loss of Rs. 20,36,328, The AO was of the opinion that loss in future and option segment is to be considered as speculation loss in terms of section 43(5) r/ w Explanation to section 73. The assessee submitted that the transactions are carried on through a broker M/s March Securities (P.) Ltd. who is a registered member of National Stock Exchange. The speculative transaction is defined in section 43(5) . Clause (d) of the proviso to section 43(5) provides, "an eligible transaction in respect of trading in derivatives referred to in Securities Contracts (Regulation) Act, 1956 carried out in a recognized stock exchange, shall not be deemed to be a speculative transaction". The phrases "eligible transaction" as also "recognized stock exchange" is defined in Explanation below the proviso to section 43(5). It was also noted that cl. (d) is inserted in the proviso by Finance Act, 2005 w.e.f. 1st April, 2006. Accordingly, for asst. yr. 2006-07 the transaction in the derivatives in the form of future and option cannot be considered as speculative transaction and hence loss in such transaction cannot be classified as loss in speculation business.

The AO held, that the transactions are carried on at National Stock Exchange and Bombay Stock Exchange. Bombay Stock Exchange Ltd. and National Stock Exchange of India Ltd. are recognized stock exchanges as per notification dt. 25th Jan., 2006. Therefore the transactions in F&O segment prior to 25th Jan., 2006 are regarded as speculative loss.

Section 43(5) defined ' speculative transaction ' means a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodical or ultimately settled otherwise than by the actual delivery or the transfer of commodity or scrips. Proviso below section 43(5) carves out exceptions to section 43(5) . As per cl. (d) of the said proviso "an eligible transaction in respect of trading in derivatives referred in Securities Contracts (Regulation) Act, 1956 carried out in a recognized stock exchange shall not be deemed to be a speculative transaction". Clause (d) in the proviso was inserted by Finance Act, 2005 w.e.f. 1st April, 2006. Therefore, if a transaction falls within cl. (d) of the proviso will not be deemed to be a speculative transaction in respect of transaction pertaining to asst. yr. 2006-07. Under cl. (d) of the proviso, a transaction is not a speculative transaction provided it is an eligible transaction within the meaning of cl. (i) of Explanation and it is carried on at recognized stock exchange as explained in cl. (ii) of the said Explanation below proviso to section 43(5)(d). The recognized stock exchange means a recognized stock exchange as notified by the Central Government for this purpose. Therefore, even if the notification is from a particular date, as per cl. (d) inserted, the same will apply to all the transactions in relation to asst. yr. 2006-07 and onwards. Clause (d) does not mention that unless the recognized stock exchange is notified, the transaction will not be deemed to be a speculative transaction. The power to notify the stock exchange is granted under the statute and hence once the recognized stock exchange is notified, the same will apply in respect of all eligible transactions carried out in relation to financial year relevant to asst. yr. 2006-07 and onwards. The Special Bench of Tribunal in the case of Shree Capital Services Ltd. (supra) in para 7 held that "cl. (d) of section 43(5) is prospective in nature and will be effective from the date from which the legislature made it effective, i.e., 1st April, 2006 and will be applicable to asst. yr. 2006-07 onwards". The notification is by way of a subordinated legislation but cannot override the principal legislation enacted by the Parliament. It only clarifies but will not override unless statutorily so prescribed. Since there is no dispute to the fact that the transactions in the present case in F&O segment are the eligible transactions carried out in a recognized stock exchange, loss in such transactions cannot be deemed to be transaction in

speculation business. The same being considered as regular business transaction, loss incurred in the same is to be treated as business loss and not loss in speculation business."

12. In view of this, respectfully following the same we are of the opinion that there is no merit in ground No. 2 raised by the Revenue. Accordingly ground No. 2 is rejected and A.O. is directed to treat the profit/loss on derivatives as non-speculative business profits as per the provisions of the Act effective from 1.4.2006.

12. In view of above, we do not find any reasons to take a different view than what is taken by Id. CIT(A). As a result, appeal filed by the Revenue is dismissed.

13. In the result, the appeal filed by the Revenue is dismissed.

Order was pronounced in open Court on 17.06.2011.

Sd/-
(Bhavnes Saini)
Judicial Member

Sd/-
(D.C. Agrawal)
Accountant Member

Ahmedabad,

Dated : 17/06/2011.

Fit for publication.

Mahata/-

(JM)

(AM)

Copy of the Order forwarded to:-

1. The Assessee.
2. The Revenue.
3. The CIT(Appeals)-
4. The CIT concerns.
5. The DR, ITAT, Ahmedabad
6. Guard File.

BY ORDER,

Deputy/Asstt.Registrar
ITAT, Ahmedabad

- 1.Date of dictation 2/6/2011
- 2.Date on which the typed draft is placed before the Dictating Member.....Other Member..... 7/6/2011
- 3.Date on which the approved draft comes to the Sr.P.S./P.S.....
- 4.Date on which the fair order is placed before the Dictating Member for pronouncement.....
- 5.Date on which the fair order comes back to the Sr.P.S./P.S.....
- 6.Date on which the file goes to the Bench Clerk.....
- 7.Date on which the file goes to the Head Clerk.....
- 8.The date on which the file goes to the Asstt. Registrar for signature on the order.....
- 9.Date of Despatch of the Order.....