



**Derivatives transactions having underlying asset as shares are covered under section 43(5) prior to the amendment (effective from AY 2006-07) exempting derivatives from the definition of ‘speculative transaction’**

Recently, the Special Bench of the Kolkata Income-tax Appellate Tribunal (the Tribunal) in the case of Shree Capital Services Ltd.<sup>1</sup> while dealing with a case prior to the amendment to section 43(5) of the Income-tax Act, 1961 (the Act) exempting derivative transaction as speculative in nature, held that the derivative transactions will be considered as speculative transaction under section 43(5) of the Act. Further, it was also held that the above referred amendment to section 43(5) of the Act is perspective in nature and comes into effect from Assessment Year (AY) 2006-07.

**Facts of the case**

- The taxpayer company was engaged in business of financing and investments in shares and securities. During the year the taxpayer suffered the loss amounting to INR 925,065 on account of futures and options. The Assessing Officer (AO) treated the same as speculation loss as per section 43(5) of the Act.

**Contentions of the taxpayer**

- The derivative transactions entered into in the form of futures and options were not covered under the provisions of section 43(5) of the Act. Hence, the said transactions cannot be considered as speculative transactions.
- The amendment to section 43(5) of the Act was clarificatory in nature and hence is retrospective in operation.

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<sup>1</sup> Shree Capital Services Ltd. v. ACIT (2009-TIOL-542-ITAT-KOL-SB)

### **Contentions of the tax department**

- As per the meaning given on the website of Security Exchange Board of India (SEBI) the 'Derivatives' gets its colour from the underlying security and the underlying security can be either commodity or stock and in either case it will fall within the ambit of section 43(5) of the Act.
- The term 'commodity' is wider and, therefore, the derivatives would fall within the term 'commodity' used in section 43(5) of the Act.
- Clause (d) in section 43(5) of the Act was introduced with effect from 1 April 2006, providing that the derivatives transaction would not be treated as speculative transaction. Accordingly, transactions in derivatives before this amendment would be covered under section 43(5) of the Act.
- It was evident from the memorandum explaining the insertion of the relevant clause in the Finance Act that the insertion of clause (d) under section 43(5) of the Act was prospectively and not retrospectively.

### **Issues before the Tribunal**

- Whether the derivative transaction falls within the meaning of speculative transaction under section 43(5) of the Act?
- Whether clause (d) of section 43(5), introduced by Finance Act, 2005 with effect from 1 April 2006 was clarificatory in nature and therefore, applies retrospectively?

### **Ruling of the Special Bench**

*Whether Derivatives falls within the ambit of section 43(5) of the Act prior to the amendment*

- The term 'commodity' has been given a wide meaning and it has been mentioned that any commodity includes stocks and shares. Thus, the securities represented by stock and shares were also included in the term 'commodity'. The derivatives are also securities which derives its value from the underlying assets.
- In other words, the underlying assets were represented by derivatives and since in the current case it was not disputed that the underlying asset was shares, the Special Bench held that the derivatives will also fall within the meaning of 'commodity' used in section 43(5) of the Act.

*Applicability of the amendment to section 43(5) of the Act*

- The Finance Act 2005 had amended provisions of section 43(5) of the Act to provide that certain transactions in respect of trading in derivatives shall not be deemed to be speculative transactions.

- The Special Bench also observed that if it was held that the transaction in derivatives does not fall in section 43(5) of the Act, it will make clause (d) and explanation thereto below section 43(5) as introduced by the Finance Act, 2005 to be redundant. It cannot be presumed that the Government has introduced a clause as well as explanation thereto, which was redundant and infructuous.
- Further it was observed that the Legislature had made the amendment to section 43(5) 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 in nature.
- Accordingly, it was held that clause (d) of Section 43(5) was prospective in nature and will be applicable from assessment year 2006-07 onwards.

### **Our Comments**

The controversy with respect to derivative transaction to be treated as a speculative in nature, prior to the amendment to section 43(5) of the Act, exempting the derivatives from the speculative transactions, has been decided by the Special Bench of the Kolkata Tribunal in favour of the tax department. The Special Bench has clarified that the above discussed amendment to section 43(5) of the Act applies prospectively from AY 2006-07.

The Special Bench has disregarded the decision of the Mumbai Tribunal in the case of SSKI Investors Services Pvt. Ltd.<sup>2</sup> where it was held that the loss occurred to the taxpayer in the course of dealing in derivatives cannot be treated as a speculation loss. The Special Bench has disregarded this decision on the ground that facts of the cases were different.

It is pertinent to note the decision of the Kolkata High Court in the case of *CIT v. Nirmal Trading Co.*<sup>3</sup> wherein renunciation letters which enabled right of allotment of shares in a company, which were being bought and sold in the exchange, were held to be not in the nature of “commodities” and therefore not treated as speculative in nature.

It is likely that the taxpayer may file an appeal against this decision and refer the matter to the High Court.

### **Disclaimer**

*The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is*

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<sup>2</sup> DCIT v. SSKI Investors Services Pvt. Ltd. [2008] 113 TTJ 511 (Mum)

<sup>3</sup> CIT v. Nirmal Trading Co [1971] 82 ITR 782 (Cal)

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