

TAX FLASH NEWS

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Speculative business loss from trading in shares cannot be set-off against profits from the business of futures and options prior to amendment in Section 73 of the Act – Supreme Court

Recently, the Supreme Court in the case of Snowtex Investment Ltd¹ (the taxpayer) dealt with the issue of set-off of loss arising from trading in shares (speculative business loss) against profits from the business of futures and options relating to the period prior to the amendment² in Section 73 of the Income-tax Act, 1961 (the Act). The Supreme Court held that the loss which occurred to the taxpayer 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 held that the amendment introduced [with effect from 1 April 2015] in the Explanation to Section 73 of the Act, with respect to trading in shares, could not be regarded as clarificatory or retrospective in nature.

Facts of the case

The taxpayer was registered as a non-banking financial company (NBFC) under the Reserve Bank of India Act, 1934. The principal business activity of the taxpayer is of trading in shares and securities. During the Assessment Year (AY) 2008-09, the loss from share trading was held as speculation loss. The Finance Act 2005 amended Section 43 of the Act whereby activities pertaining to futures and options could not be treated as speculative transactions. The Assessing Officer (AO) held that in view of the provisions of Section 43(5)(d)³ of the Act,

activities pertaining to futures and options (derivatives) could not be treated as speculative transactions. The AO held that the loss arising from share trading was speculation loss, and such speculation loss cannot be set off against the profits from derivative business. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

The Tribunal held that the claim of the taxpayer for setting off the loss from share trading should be allowed against the profits from transactions in futures and options since the character of the activities was similar. The Tribunal held that the taxpayer which was in the business of share trading had treated the entire activity of the purchase and sale of shares which comprised both of delivery based and non-delivery based trading, as one composite business.

However, the High Court held that the profits which had arisen from trading in futures and options were not profits from speculative business. Hence, the loss on trading in shares could not be set off against the profits arising from the business of futures and options.

Aggrieved, the taxpayer filed an appeal before the Supreme Court.

¹ Snowtex Investment Ltd v. PCIT [2019] 105 taxman.com 282 (SC)

² Section 73 (set-off of speculation losses) of the Act amended with effect from 1 April 2015 to exclude from its purview a company the principal business of which is the business of trading in shares

³ 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 purpose of this clause an eligible transaction in respect of trading in derivatives referred to in the provisions of Securities Contracts Act 1956 carried out in a recognised stock exchange

Supreme Court decision

The provisions of Section 43(5) of the Act were amended by the Finance Act, 2005 and with effect from 1 April 2006, trading in derivatives was by a deeming fiction not regarded as a speculative transaction when it was carried out on a recognised stock exchange. Further, the CBDT Circular dated 27 February 2006 indicated that this amendment was occasioned by the changes which were introduced by Securities and Exchange Board of India (SEBI) both at the legal and technological level for bringing in greater transparency in the market for derivatives.

Prior to the amendment of the Explanation by the Finance (No. 2) Act 2014 in Section 73 (set-off of speculation losses) of the Act with effect from 1 April 2015, the business of trading in shares carried on by a company was not excluded from its purview.

Parliament amended Section 43(5) of the Act with effect from 1 April 2006 as a result of which trading in derivatives on recognised stock exchanges fell outside the purview of the business of speculation. However, amendment to the Explanation to Section 73 in respect of trading in shares was brought in only with effect from 1 April 2015.

While amending the provisions of Section 43(5) of the Act, the Parliament indeed was cognizant of the provisions which were contained in Section 73(4) of the Act. On a perusal to the memorandum⁴ to the Finance Bill 2005, it indicates that the provisions of Section 73(4) were proposed to be amended so as to reduce the period of carry forward of speculation losses from eight assessment years to four assessment years. Having introduced an amendment to Section 73(4), the Parliament would have, if it intended to bring about parity with the provisions of Section 43(5) of the Act introduced a specific amendment. However, Parliament did not do so by the Finance Act 2005. It was only with effect from 1 April 2015 that an amendment was brought about to exclude trading in shares from the deeming provision contained in the Explanation to Section 73 of the Act.

The Supreme Court held that provisions which were amended Explanation to Section 73 of the Act vide Finance Act (No. 2) 2014 cannot be given retrospective effect. The Supreme Court relied on various decisions⁵ in order to support its case that

the provisions introduced in Section 73 with effect from 1 April 2015 could not be regarded as clarificatory in nature since the provision was made with prospective effect. The amendment would not apply to past AYs because the amended provision was brought on the statute book after the AYs in question.

The Parliament amended Section 43(5) of the Act with effect from 1 April 2006 in relation to the business of trading in derivatives. Further, Parliament brought about a specific amendment in the Explanation to Section 73, insofar as trading in shares is concerned, with effect from 1 April 2015. The latter amendment was intended to take effect from the date stipulated by the Parliament, and it cannot be held either that it was clarificatory or that the intent of Parliament was to give it retrospective effect. Consequently, it has been held that in A.Y. 2008-2009, the loss which occurred to the taxpayer 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 taxpayer also contended that Explanation to Section 73 of the Act, as it stood prior to the amendment⁶, excluded from the deeming definition of speculation business, a situation where the principal business of a company was granting of loans and advances. The Supreme Court cannot accept this contention since the taxpayer itself stated before the AO that share trading was its sole business during the AY 2008-09. The Supreme Court observed that Section 73(1) of the Act does not define specifically, the circumstances in which the principal business of a company would be regarded as a business of the specified description.

The High Court, while dealing with the provisions of the Explanation to Section 73 of the Act had observed that income alone cannot be taken into account and where the activity of granting loans and advances 'is on a larger scale than the business of buying and selling shares' that would be an important indicator. In other words, it was held that profit alone could not be made a distinctive factor. Therefore, the principal business of the taxpayer was not of granting loans and advances during the AY. Consequently, the deeming fiction under Section 73 of the Act would be attracted.

⁴ The Memorandum to the Finance Bill 2005 states that an eligible transaction carried out in respect of trading in derivatives in a recognised stock exchange shall not be deemed to be a speculative transaction. The proposed amendment also seeks to notify relevant rules etc. regarding conditions to be fulfilled by recognised exchanges in this regard. Further, it is also proposed to amend sub-section (4) of section 73 so as to reduce the period of carry forward of speculation losses from eight assessment years to four assessment years.

⁵ Allied Motors (P) Ltd. v. CIT [1997] 3 SCC 472, CIT v. Alom Extrusions Ltd. [2010] 1 SCC 489, CIT v. Vatika Township Pvt. Ltd. [2015] 1 SCC 1

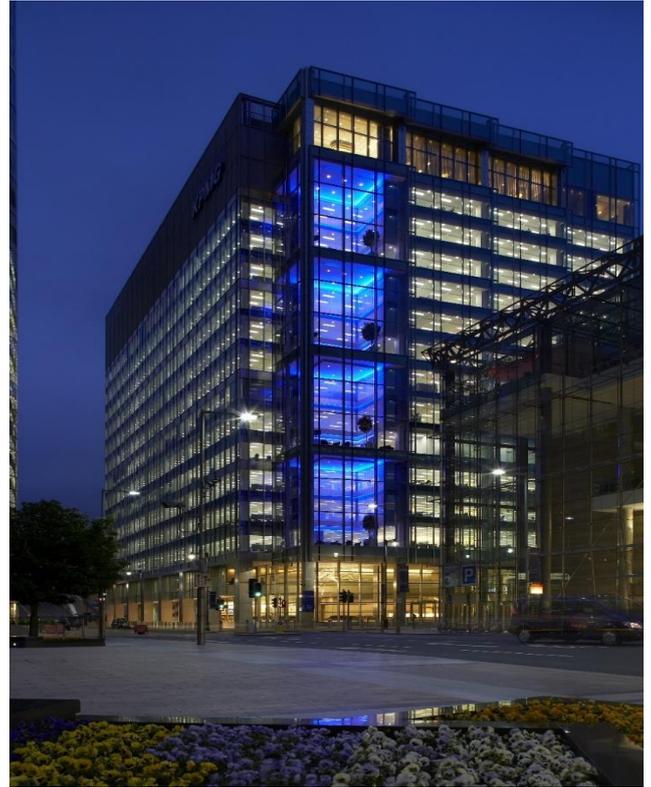
⁶ With effect from 1 April 2015

Our comments

The issue of whether loss from trading in shares (speculative business) can be set-off against profits from the business of futures and options for the period prior to the amendment in Section 73 of the Act has been a matter of debate before the courts.

The Tribunal in some of the cases⁷ has held that the amendment inserted in Explanation to Section 73 by the Finance (No. 2) Act, 2014 with effect from 1 April 2015 is clarificatory in nature and would, therefore, operate retrospectively. However, the Mumbai Tribunal in the case of Arandi Investments Pvt. Ltd.⁸ held that such amendment is prospective in nature.

The Supreme Court put to rest this controversy and held that the amendment introduced in the Explanation to Section 73 of the Act with effect from 1 April 2015, with respect to trading in shares, could not be regarded as clarificatory or retrospective in nature. Thus the loss occurred to the taxpayer as a result 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 from a speculative business.



⁷ Fiduciary Shares & Stock (P.) Ltd. v. ACIT [2016] 159 ITD 554 (Mum),
Jalan Cement Works Ltd. v. CIT [2016] 76 taxmann.com 230 (Kol)

⁸ ITO v. Arandi Investments Pvt. Ltd. (I.T.A. No. 2330/Mum/2016) (Mum)

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