IN THE INCOME TAX APPELLATE TRIBUNAL,
MUMBAI BENCH "J", MUMBAI

BEFORE SHRI G.S. PANNU, ACCOUNTANT MEMBER AND
SHRI SANJAY GARG, JUDICIAL MEMBER

ITA No.3654/M/2014
Assessment Year: 2009-10

M/s. J.M. Financial Services Ltd., (Formerly JM Financial Services Pvt. Ltd.), 7th Floor, Cnergy, Appasaheb Marathe Marg, Prabhadevi, Mumbai – 400 025 **PAN: AAACJ5977A**	Vs.	The Joint Commissioner of Income-tax (OSD)-4(3), Room No.635, Aayakar Bhavan, M.K. Road, Mumbai - 400020
(Appellant)		(Respondent)

ITA No.3660/M/2014
Assessment Year: 2009-10

Dy. Commissioner of Income-tax-4(3), 6th Fl., R. No.649, Aayakar Bhavan, Mumbai - 20	Vs.	M/s. J.M. Financial Services Ltd., (Formerly JM Financial Services Pvt. Ltd.), 7th Floor, Cnergy, Appasaheb Marathe Marg, Prabhadevi, Mumbai – 400 025 **PAN: AAACJ5977A**
(Appellant)		(Respondent)

Present for:
Assessee by : Shri K. Shivaram, A.R.
Revenue by : Shri Alok Johri, D.R.

Date of Hearing : 13.06.2016
Date of Pronouncement : 28.12.2016

O R D E R

Per Sanjay Garg, Judicial Member:

The above titled appeals, one by the assessee and the other by the Revenue, have been preferred against the order dated 27.03.2014 of the

Commissioner of Income Tax (Appeals) [hereinafter referred to as the CIT(A)] relevant to assessment year 2009-10.

2. The assessee has taken the following grounds of appeal:

"A) The learned Commissioner of Income Tax (Appeals) - 8. Mumbai [CIT(A)] erred on facts and in law in directing the Joint Commissioner of Income Tax (OSD) —4(3), Mumbai (AO) to allow the claim of depreciation on intangible assets and at the same time disallow the depreciation on other intangible assets without appreciating that in A.Y. 2008 09 there was a specific direction to allow depreciation on intangible assets on Rs.4.25 crores and disallow the claim of depreciation on Rs.1.75 crores of the value of other intangible assets.

B) **<u>Disallowance of lease rentals paid on motor vehicles - Rs. 32,54,995/-</u>**

2) The learned CIT(A) erred on facts and in law in upholding the order of the AO making a disallowance of lease rentals paid on motor vehicles taken on lease amounting to Rs.32,54,995/- by holding that the lease rentals paid by the assesseewere not the liability of the assesseebut that of their employees and also holding that there is no genuine lease between the lessor and lessee.

3) The appellant prays that the disallowance of lease rentals paid on motor vehicles taken of lease amounting to Rs.32,54,995/- as made by the AO and as confirmed by the CIT(A) may be deleted.

4) Without prejudice to the above, the learned CIT(A) erred in not allowing depreciation on leased assets amounting to Rs.12,61,373/- and finance charges amounting to Rs.9,14,252/- included in the lease rent.

5) The appellant prays that if lease rentals are not allowed as a deduction, depreciation on leased assets and finance charges included in the lease rentals may be allowed as a deduction.

C) **<u>Additional disallowance u/s. 14A - Rs. 21,48,928/-</u>**

6) The learned CIT(A) erred on facts and in law in upholding the order of the AO making an additional disallowance u/s. 14A read with Rule 8D of Rs.21,48,928/- without recording a finding as to why the appellant's contention is to be rejected having regard to the accounts.

7) The learned CIT(A) erred in not appreciating that the disallowance u/s. 14A could not be made unless a satisfaction was reached by the AO that the appellant's claim could not he accepted having regard to the accounts. No such satisfaction having been recorded by the AO or CIT(A), the additional disallowance of Rs.21,48,928/- tinder section 14A read with Rule 8D is liable to be deleted.

8) The appellant prays that the additional disallowance of Rs.21,48,928/- u/s. 14A made by the AO and as upheld by the CIT(A) may be deleted.

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D) **General**

9) The above grounds of appeal are without prejudice to one another and the appellant craves leave to add alter, amend, delete or modify any of the above grounds of appeal."

Ground A : Disallowance of depreciation on intangibles – Rs.16,76,266/-

3. Assessee had claimed depreciation of Rs. 16,76,266/- on intangible assets comprising of Goodwill, BSE Card and NSE membership rights and other assets. AO disallowed the claim based on earlier years.

Before CIT(A), it was submitted that depreciation claim was allowed in earlier years. However, with respect to other intangible assets, depreciation was allowed on Rs.4.25 crores out of the total intangible assets of Rs.6 crores. CIT(A) accordingly directed the AO to allow depreciation on intangible assets as in past on Rs.4.25 crors. Aggrieved by the order of the CIT(A) in not allowing depreciation on BSE and NSE membership rights, assessee is in appeal before us.

4. The Ld. AR of the assessee has submitted that as the CIT(A) has directed the AO to allow depreciation on other intangible assets amounting to Rs.4.25 crores, which the AO has already allowed while giving effect to order of CIT(A), hence no directions or order is required with respect to Rs.7,97,774/-. As depreciation has been allowed by ITAT on BSE and NSE Membership rights in A.Y. 2007 - 08 and 2008 – 09. It has however been submitted that depreciation on BSE and NSE cards has been allowed by the tribunal in the to AY- 2007-08 and AY 2008-09. It has therefore been requested that depreciation of Rs. 2,68, 428/- on BSE membership rights and of Rs.2,61,528/- on NSE membership rights be directed to be allowed.

5. We have gone through the order 28.2.2014 of the ITAT in the own case of the assessee for AY 2008-09. We notice that the Tribunal has allowed the similar claim of the assessee for depreciation on BSE/ NSE cards following the decision of the Hon'ble Supreme Court in the case of 'Tecno Shares and Stock ltd'. reported in 327 ITR 323(SC) . Respectfully following the decision of the

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Co- ordinate bench of the Tribunal in the own case of the assessee, we allow this issue in favour of the assessee.

Ground B: Disallowance of lease rentals paid on motor vehicles

During the year under consideration, the assessee had paid lease rentals to M/s. Orix Infrastructure Services Private Limited for cars taken on lease from them. The assessee had capitalized the value of vehicles in the books of accounts in accordance with the requirements of Accounting Standards 'AS-19' issued by the Institute of Chartered Accountants of India. Accordingly, the finance charges on the leased vehicles amounting to Rs.9,14,252/- and depreciation on leased vehicles were disallowed by the assessee. The assessee reduced the lease rentals amounting to Rs.32,54,995/- from the income for income tax purposes. The assessee claimed that the entire lease rentals incurred were revenue expenditure in nature and were incurred in the normal course of business of the assessee and hence, the same ought to be allowed. Without prejudice, the assessee also submitted that if the AO was inclined to disallow the lease rentals then the assessee should be allowed depreciation and finance charges with respect to the leased vehicles.

The AO, however, disallowed the lease rentals claimed by the assessee following the order for Assessment Year 2008 - 09. The AO also did not accept the alternate claim of the assessee for depreciation and finance charges on the leased assets. In this regard, the AO relied on the decision of the Hon'ble Supreme Court in the case of Goetze (India) (2006) 284 ITR 323 (SC).

6. The ld. CIT(A) following his own decision in earlier year, confirmed disallowance so made by the AO. Aggrieved by the said order, the assessee is in appeal before us.

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7. The Ld. AR of the assessee, before us, has submitted that the Tribunal in appeal relating to A.Y. 2007 – 08 vide order dated 28.06 2013 has restored the matter back to the file of the AO directing it to be decided in the light of the decision of the Hon'ble Supreme Court in the case of "ICDS v. CIT" (2013) 350 ITR 527 (SC) . Following the same line, the tribunal in assessee's appeal relating to AY -2008-09 vide order dated 28.2.2014 has again restored the matter to the file of the AO with direction to decide the same as per the directions given by the Tribunal in order dated 28. 06 2013 for AY 2007-08. Since the issue involved and the material facts relevant thereto are identical in nature, hence this issue accordingly with same directions as given by the Tribunal for AY 2007-08, is restored to the file of the AO for decision a fresh.

Ground (C) Additional disallowance u/s. 14A - Rs. 21,48,928/-

8. During the year under consideration, assessee had earned dividend income of Rs.3,46,00,697/-, which was exempt from tax. Assessee had suo moto made a disallowance u/s. 14A of Rs.7,92,939. The AO however, computed the disallowance as per Rule 8D of the I.T. Rules at Rs.29,41,867/-. As assessee had already disallowed Rs.7,92,939/-, hence, the AO made additional disallowance of Rs.21,48,928/-.

9. In appeal, the Ld. CIT(A) confirmed the said disallowance following the order of his predecessor in A.Y. 2008 - 09. Aggrieved by said order, assessee is in appeal before us.

10. Before us, the Ld. AR of the assessee has submitted that the working of disallowance suo- moto made by assessee was duly explained to the AO that the 50% of time of employees was devoted in this respect and accordingly, 50% of their salary was disallowed. Assessee also attributed indirect expenses of Rs.2,74,998/- towards this activity. Accordingly, total disallowance of Rs.7,92,939/ was made. It has been contended that no satisfaction was

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recorded by the AO before discarding disallowance suo- moto made by assessee. The Ld. AR in this respect has placed reliance on the decision of the Hon'ble Bombay High Court in the case of 'Godrej & Boyce Mfg. Co. Ltd. v. DCIT' 328 ITR 81 (Bom). He has further submitted that similar disallowance made in Assessment Year 2007 - 08 was deleted by ITAT on the ground that AO and CIT(A) had not pointed out any defect in calculation of disallowance furnished by assessee and neither of them had pointed out any specific expenditure incurred for earning dividend income. It has been further submitted that in Assessment Year 2008 - 09, AO, however, had recorded his dissatisfaction regarding the amount disallowed by the assessee; it was in such circumstances that the disallowance was confirmed by the ITAT for the said assessment year. However as there is no such dissatisfaction recorded by AO for the year under consideration and as CIT(A) has blindly followed the order for A.Y. 2008 – 09. It has been contended that so far the facts for the year under consideration are concerned, rule 8D could not be invoked. The Ld. AR in this regard has also placed on the following decisions:

a) CIT v. Taikisha Engg. India Ltd. (2015) 370 ITR 275 (Del)
b) I. P. Support Services India (P.) Ltd. (2015) 378 ITR 240 (Del)
c) ACIT v. Magarpatta Township Development & Construction Co Ltd. (2015) 152 ITD 469/(2014) 46 taxmann.com 284 (Pune - Trib.).
d) AFL P. Ltd. v. ACIT (2013) 28 ITR (Trib.) *263* (Mumbai)

11. The Ld. DR on the other hand has relied upon the findings of the lower authorities.

12. We have considered the rival contentions and gone through record. It may be observed that in the case of 'Godrej & Boyce Manufacturing Co. Ltd.' 328 ITR 81, the Hon'ble Bombay High Court has held that under section 14A of the Act, resort can be made to Rule 8D of the Income Tax Rules for determining the amount of expenditure in relation to exempt income, if, the AO is not

satisfied with the correctness of the claim made by the assessee in respect of such expenditure. The satisfaction of the Assessing Officer has to be arrived at, having regard to the accounts of the assessee. Sub section (2) does not ipso facto enable the Assessing Officer to apply the method prescribed by the rules straightaway without considering whether the claim made by the assessee in respect such expenditure is correct. The satisfaction of the Assessing Officer must be arrived at on an objective basis. In a situation where the accounts of the assessee furnish an objective basis for the Assessing Officer to arrive at a satisfaction in regard to the correctness of the claim of the assessee, there would be no warrant for taking recourse to the method prescribed by the rules. An objective satisfaction contemplates a notice to the assessee, an opportunity to the assessee to place on record all the relevant facts including his accounts and recording of reasons by the Assessing Officer in the event that he comes to the conclusion that he is not satisfied with the claim of the assessee. We may further observe that the Hon'ble Delhi High Court in a recent decision has further given a similar view in the case of "CIT vs. Taikisha engineering India Ltd." (supra) has held that the AO having regard to the accounts of the assessee is required to record his satisfaction that the self or voluntarily expenditure offered by the assessee or claim that no expenditure has been incurred by the assessee in relation to earning of exempt income was not correct or the same was unsatisfactory on examination of the accounts of the assessee. Without recording such a satisfaction he cannot proceed to apply Rule 8D for the computation of disallowance under section 14A.

13. However, a perusal of the assessment order in the case in hand reveals that the AO has not followed the guidelines of objective satisfaction as laid down by the Hon'ble Bombay high Court in the case of Godrej & Boyce (supra) while making the disallowance. He without recording any reasoning for his dissatisfaction with regard to the working/claim of the assessee, straightway applied Rule 8D against the mandate of the provisions of section

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14A of the Income Tax Act. The ld. CIT(A) also ignored the mandate of the provisions of section 14 A, while confirming the disallowance. Hence, in the light of the above referred to judicial pronouncements and respectfully following the decision of the Tribunal in the own case of the assessee for AY 2007-08, the disallowance u/s 14A for the year under consideration is restricted to that has been suo- moto offered by the assessee in the return of income. This issue is accordingly decided in favour of the assessee.

Now coming to the appeal of the revenue:

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14. The Revenue has taken the following grounds of appeal:

> "1. Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) is right in directing the AO to delete the addition of deemed speculation loss of Rs.25,96,01,368/- made by the AO under explanation to section 73 of IT Act as the assessee has wrongly set off a speculative loss against a non-speculative income.
>
> 2. The appellant craves leave to amend or alter any ground or add a new ground which may be necessary".

15. The brief facts relevant to the issue are that during the year under consideration, the assessee had carried out cash future arbitrage and earned a profit from the said activity. During course of assessment proceedings, AO asked assessee to give break up of Cash and Future arbitrage, which was duly furnished by the assessee. AO thereafter sought an explanation as to why the loss from cash segment should not be disallowed as per Explanation to section 73. Assessee vide letter dated 19th December. 2011 submitted that the activity of buying and selling of shares in cash segment and future segment was a composite activity carried out by the assessee. The transactions are so managed that if there will be loss in one segment, there will be profit in the other segment, however, after netting off of the corresponding losses and profits from both the segments, the resultant figure will be a positive figure i.e. in the end, the assessee will get profits only. The assessee also filed 20 samples of cash & future arbitrage with the AO. However the AO was of the view that

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futures and option transactions were non-speculative as per section 43(5). However, loss on purchase and sale of shares was to be considered as speculative loss as per Explanation to section 73 of the Act. He accordingly considered the loss in purchase and sale of shares as speculative loss as per Explanation to section 73. After considering direct expenses incurred for the said activity, AO held the loss of Rs. 25,96,01,368/- as speculation loss. Being aggrieved by the above order of the AO, the assessee filed appeal before the CIT(A).

16. Before the ld. CIT(A), assessee also filed additional evidences under Rule 46A showing that in respect of the sale in derivative segment, an equal number of shares were purchased in cash segment. The assessee also filed details of corresponding sale in cash segment and purchase in derivative segment. The Ld. CIT(A) vide letter dated 9/10/2012 called for Remand Report from AO asking him to verify whether on the basis of the details submitted by the assessee, the transactions constituted arbitrage transactions and whether the transactions were correct or not ?

The AO vide letter dated 16/1/2013 submitted Remand Report and informed CIT(A) that transactions cannot be considered to be arbitrage transactions as "arbitrage" means buying or selling in the same commodity in different markets to take advantage of price difference. But in cash segment and F& O segment, scrip of same company will have different character. One is delivery based and another is non-delivery based. However the Ld. CIT(A) further asked AO to specify correctness of transactions.

In response, the AO vide letter dated 12/3/2014 stated that there were many instances wherein the purchase and sale were not squared off on the same date. The assessee vide letter dated 24th March, 2014 submitted that there were instances when scrip was purchased in cash segment but said quantity was not available on future segment or vice versa. In such circumstances, the purchase was squared off to match the purchase in cash segment against sale in future

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segment. It was also submitted that at times, purchase of huge quantity may not be available either in cash segment or future segment on same day. Accordingly, purchase/sale had to be done in installments carried on to the next day/days.

17. The Ld. CIT(A) after considering submissions of assessee held that the arbitrage transactions were excluded from the definition of speculation as per clause (d) of section 43(5). That the said clause did not refer to delivery or non delivery based transactions. He further observed that the AO had applied the proviso (d) to section 43(5) only to a part of jobbing/arbitrage activity i.e. 'F & O' segment and that such selective application was not permissible. That the assessee had entered in business of arbitrage to take advantage of price difference between the cash and F & O segment. That there was a complete matching of purchase in cash segment along with simultaneous sale in derivative segment of the same or similar quantity. That the transactions were so managed that the final position in arbitrage would always be a profit. Considering only loss in cash segment but not considering simultaneous profit in the derivatives segment or vice a- - versa would result in a view contrary to principles of arbitrage/jobbing business. The relevant part of the order of the CIT(A) is reproduced as under:

> "2.2.8. Considering the facts of the case, remand report of the AO, rejoinder of the appellant, supplementary remand report & rejoinder thereof and submissions made by the appellant, the additional evidences submitted under Rule 46A of the I.T. Rules, 1962 are admitted in order to impart justice in the present case.
>
> 2.3.1 I have carefully considered the facts of the case and the submission offered by the appellant. On going through the remand report, I find that the remand report essentially reiterate the findings given in the assessment order. When appellant purchases a share in cash market and sells the same scrip in F&O market, then one leg of the transaction, i.e. purchase in the cash market is accompanied by delivery and in case of sale in cash market & purchase in F & 0, the sale is accompanied by delivery. Hence one leg of the transaction is delivery based and as a result, it automatically falls out of the ambit of Section 43(5). Arbitrage simply means buying and selling of the same commodity in different market to take advantage of price difference but

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in Cash segment and F&O segment scrip of the same company will have different character. One is delivery based and another is non-delivery based. This position has been accepted by the AO in his remand report. The assessee contended that the AO has accepted the fact and agreed with the appellant's submission that the arbitrage activity carried out by it is one consolidated activity, out of which one leg of the transaction is in Cash segment and the other is in F&O segment.

2.3.2 I find that Ld. AO has completely overlooked and missed out the provisions of Proviso (c) to section 43 (5), which clearly mentioned that a transaction in the nature of arbitrage entered into by a member of stock exchange in the ordinary course of his business to guard against loss is not to be regarded as "speculative transaction". It is significant to note that this clause does not even refer to delivery/no delivery and, as such, that aspect is not relevant. When the Legislature wanted to have delivery as a criteria in this regard, it has specifically provided so in clause (a). The Ld. AO has only applied proviso (d) to section 43(5) and that too only on a part of the entire jobbing / arbitrage activity, i.e. on the F & 0 segment in order to hold that it is a non-speculative activity. Such selective application of the provisions of the Act and that too only to one part of the entire activity is not permissible.

2.3.3 I find that the case of the appellant is that it is a member of stock exchange and is entered in the business of arbitrage to protect its loss as arbitrage simply means buying or selling of the same commodity in different market to take advantage of price difference. This is exactly the case of the appellant. After observing this, I find that the Ld. AO has no rationale to hold that the Cash Segment and F&O Segment have to be treated separately as they have different characters. Now, neither as per the BSE / NSF rules and regulation nor under the commercial parlance nor even as per the provisions of the Act, this can be the criteria for deciding whether a transaction is arbitrage transaction or not.

2.3.4 I find that Ld. AO has not analysed the transaction of the appellant properly, if analysed it revealed that appellant has bought a position in a scrip in Cash segment and within fraction of time it is simultaneously takes sell position in the same scrip contract in the derivatives segment (F & O) for the same or similar (subject to the Lot Size) quantity. There is a difference in price of a security in Cash segment and Derivatives segment which starts reducing towards the expiry of the contract in F&O Segment which is the last Thursday of every month. On the expiry day, the closing price is taken and the position in Cash and Derivatives segment is squared off on notional basis.

2.3.5 The arbitrageur loses in one segment and gains in the other due to exactly opposite positions in both the segments. The basic feature of arbitrage is to hedge the buy position in cash segment with a sell position in Derivatives segment in the same security and to earn the

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differential in the prices in both the segments which starts reducing towards expiry. It is purely hedge position and not any kind of investment. While a jobber takes a position in liquid scrips with good price movement in anticipation of profit and encashes the profit or loss immediately within a very less time gap in small price difference to earn profits. He takes generally quantitative positions in scrips and the buy-sell price margin is not much.

2.3.6 It is submitted that considering only the loss in the cash segment, but not considering the simultaneous profit incurred in the derivates segment or vice-a-versa would result in a view that is absolutely divorced from the facts and contrary to the Principles of Arbitrage/ Jobbing Business. The Appellant being in Arbitrage business, purchases shares in one segment and simultaneously sell the same shares in the other segment and when the price parity reduces, the transactions is reversed in both the segments which is a normal hedging practice. All the four legs of the transaction have to be consolidated and then only the profit / loss can be derived which is the essential ingredient of the Arbitrage/Jobbing transactions.

2.3.7 In the instant case, the appellant on May 15, 2008 i.e. around 15 days prior to the ex-date for issue of bonus shares of Reliance Power Limited sensed an arbitrage opportunity in the shares of Reliance Power Limited. Based on the workings/calculations of the arbitrage opportunity which is attached herewith the arbitrage opportunity of Rs.132.26 per share was worked out. Based on the said opportunity different scenarios of the expected profit from doing the arbitrage were worked out. Based on the above, the company started buying equity shares of Reliance Power from May 20, 2008.After allotment of the bonus shares the average cost price of the company's shares stood at Rs.255.94 which is around the ex-bonus price at shareholder level of Rs.260/-. Based on the estimated price of Rs.392.26 which was likely to be opened after the allotment of bonus shares, the actual price opened was around Rs. 200 (on the last day of Book Closure i.e. June 5, 2008) which was much less than the ex-bonus price at shareholder level. Since then the price never recovered and the company eventually sold out majority of its holdings in October, 2010. The overall loss made by the company from these shares of Reliance Power is Rs. 2,98,91,923/-.

2.3.8 A very important and peculiar feature is that the final ultimate position is generally in profit i.e. loss if any in cash segment is always less than the profit in derivatives segment or vice and versa. Therefore, considering only the loss on the cash segment, but not considering the simultaneous profit incurred in the derivatives segment or vice-a-versa would result in a view contrary to the Principles of Arbitrage/ Jobbing Business. The Appellant being in Arbitrage business, purchases shares in one segment and simultaneously sell the same shares in the other segment and when the price parity reduces, the transactions is reversed in both the segments which is a normal hedging practice. All the four

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legs of the transaction have to be consolidated and then only the profit / loss can be derived which is the essential Ingredient of the Arbitrage/Jobbing transactions. It is a matter of fact and record that the AO has considered only one leg of the arbitrage transaction i.e. the Transaction of the Cash segment ignoring that the Derivative Segment (F & O) i.e. the other side of the Transaction.

2.3.9 During the course of carrying on its business of proprietary trading in shares and securities, as a measure of risk mitigation, the appellant executes transactions in cash segment for purchase/sale of share and also entered into transactions in derivative segment. Both the activities are interlinked and part of the same business activity of trading in securities. The appellant during the remand proceedings has explained the nature of these transactions to the assessing officer and also submitted few annexures before assessing officer. As per the submission given by the appellant, it was engaged in arbitrage activities wherein the position in cash segment in particular scrip is taken on a particular date and at the same time the reverse position is taken in the same scrip in F&O segment. Arbitrage activity envisage that an assessee who is engaged in the security trading will try to protect himself by carrying out trade in cash segment as well as in F&O segment in such a manner that the adverse impact of price movement in one segment will be offset by the benefit in the other segment. In arbitrage transaction, generally, a position is taken of purchase or sale in a particular segment and at the same time in the same scrip the reverse position is taken in F&O segment so that the loss, if any, suffered in one segment then the same is offset by the profit in the other segment. In arbitrage, it also happens that during the course of the day, the assessee changes his view on particular scrip and if he has purchased the scrip in a cash segment and sold in the F&O segment, he may sell the same scrip in the cash segment and purchase in the F&O segment. Ultimately, at the end of the day, he may square off all the transactions entered into cash segment as well as in the F&O segment. There could also be instances, where the arbitrage transactions is initiated in 1 segment and after buying/selling in 1 segment, due to price fluctuations or liquidity the same quantity is not available in other segment and thus the arbitrager has to unwind the transaction, to minimize/cut off the loss. In the situation, in certain instances, it may be found that the transactions in 1 segment only, may it be cash/F&O or partly executed. However, in these case also almost all the net open positions remain at Nil. The appellant enclosed in the submission to assessing officer, the summary as well as day-wise position showing the scrip wise quantities purchased and sold in cash segment and quantities sold and purchased in F&O segment. There were approx. 13,000 line items data showing the date-wise and scrip wise transactions. The appellant by submitting these details showed that it has undertaken the business activity in the cash segment and F&O segment as part of one single business activity. The transactions in cash segment and F&O segment are inextricably linked with each other and are so interwoven that it is not possible to divorce

these transactions and decide the nature of its income/loss. The assessee submitted that both the activities should be treated as one and only one activity and the net result of the same should be treated as business income/loss. The appellant respectfully submitted that the loss suffered in a cash segment, being an integrated part of the total arbitrage activities, should be allowed to be set off against income from derivative segment.

2.3.10 Dimensions of arbitrage / jobbing business can be summarized as under-.-

> "Sometimes the price of a stock in the cash market is lower or higher than it should be, in comparison to its price in the derivatives market. Arbitrageurs exploit these imperfections and inefficiencies to their advantage Arbitrage trade low risk trade where-simultaneous purchase of securities is done in one market and a corresponding sale is carried out in another market. These are clone when the same securities are being quoted at different prices in two markets. To understand this proposition, let us have an example of XYZ Ltd., suppose the cash market price is Rs 1000 per share, it may be quoting at Rs 1010 in the futures market. An arbitrageur would purchase 100 shares of XYZ Ltd. at Rs 1000 in the cash market and simultaneously, sell 100 shares at Rs 1010 per share in the futures market, thereby gaining Rs.10 per share, on the day that the futures contract expires this is because in the Indian markets, there is no delivery of shares in order to settle positions in the derivatives segment; as you will see later, the cash and future prices converge on the expiry day, and a trader merely pays or receives the difference between his purchase price and the price prevailing in the cash market on the day the contract expires. For now, all one needs to know is that by holding the position i.e. purchase of 100 shares in the cash market at Rs 100 and selling 100 shares in the futures market at Rs 110) until a specific date in the near future (expiry date of the futures contract), one can make a risk free return of Rs 10 per share that have been bought and sold, a net profit of Rs1000 for taking no risk at all".

2.3.11 It may be mentioned here that activity of arbitration/jobbing is carried on in the following manner:

> *"i. The arbitrageur takes a position i.e. buy position in a scrip in Cash segment for say 'x' quantity and within fraction of time he simultaneously takes sell position in the same scrip contract in Derivatives segment (F & O) for the same or similar (subject to the Lot Size) 'x' quantity.*
> *ii. There is a difference in price of a security in Cash segment and Derivatives segment which starts reducing towards the expiry of the contract in F&O Segment which is the last Thursday of every month.*
> *iii. On the expiry day, the closing price is taken and the*

position in Cash and Derivatives segment is squared off on notional basis.

Iv The arbitrageur loses in one segment and gains in the other due to exactly opposite positions in both the segments.

v. The basic feature of arbitrage is to hedge the buy position in cash segment with a sell position in Derivatives segment in the same security and to earn the differential in the prices in both the segments which starts reducing towards expiry. It is purely hedge position and not any kind of investment.

vi. The jobber takes a position in liquid scrips with good price movement in anticipation of profit and encashes the profit or loss immediately within a very less time gap in small price difference to earn profits. He takes generally quantitative positions in scrips and the buy-sell price margin is not much.

vii. While Arbitrage is concerned with working with the difference in prices of same shares or other financial instruments/products within two segments of exchanges such as It may be BSE cash to NSE cash/NSE F&O It is also done on Call & Put.

11. The benefits of carrying out the arbitrage can be Listed as follows:

i. It is an attempt to profit by exploiting price differences of identical or similar financial instruments, on different markets or in different forms which results in risk less business.

ii. Profiting from differences in prices or yields in different markets, 'Arbitrageurs' buy a commodity, currency, security or any other financial instrument in one place and immediately sell it at a higher price to a ready buyer at another place completing both ends of the transaction usually within a time span. Arbitrage is a risk-free transaction because it involves dealings where returns and prices are definite, fixed, and known.

iii. The simultaneous purchase and sale of an asset in order to profit from a difference in the price. It is a trade that profits by exploiting price differences of identical or similar financial instruments, on different markets or in different forms.

iv. Arbitrage refers to the opportunity of taking advantage between the price difference between two different markets for that same stock or commodity

A very important and peculiar feature is that the final ultimate position is generally in profit. i.e. loss if any in cash segment is always less than the profit in Derivatives segment or vice and versa.

If the loss on cash segment is considered without considering the simultaneous profit incurred in derivatives segment or vice versa would result in a view that is absolutely, divorced from the facts and contrary to the principles of arbitrage/jobbing

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business. The appellant who is in arbitrage business **purchases shares in one segment and simultaneously sell the same shares in the other segment and when the price parity reduces, the transactions is reversed in both the segments which is a normal hedging practice. All the four legs of the transaction have to be consolidated arid then only the profit / loss can be derived which is the essential ingredient of the Arbitrage/Jobbing transactions.**

2.3.12 "Arbitrage" is an activity, whereby arbitrageur's enters into transaction to make profit from price differentials exiting in two markets by simultaneously operating the two different markets. Arbitrageur makes riskless profit by exploiting the price differentials, on the same instrument or on the similar assets by trading on different exchanges. He buys from one market when price is lower and sells in another market when the price is higher. At times opportunities exist where he can buy in derivative market and sell in cash market or vice versa. The appellant has provided all the details of arbitrage transactions submitted which clearly shows the transactions in cash segment and F&O segment carried out by the appellant company comprises off Arbitrage activity. Looking to all these transactions, your goodself will find that all the transactions are carried out in 2 segments i.e., cash and F&O and at all point of time, the transactions and position is hedged against corresponding reverse position of buy/sell. Once the sale/purchase order are placed in different segment which are hedged against each other, the appellant finds opportunity of earning any profit in any of the segment due to price fluctuation at that particular point of time. The appellant further makes the transaction in that segment for the same quantity, number of times, keeping reverse position intact hedged in other segment. Due to this, the total quantity traded in cash and F&O segment varies. However, at all point of time, the transactions are hedged and the net open position is kept at Nil. There are instances, where the arbitrage transactions is initiated in 1 segment and after buying/selling in 1 segment, due to price fluctuations or liquidity, the same quantity is not available in other segment and thus the arbitrager has to unwind the transaction, to minimize/cut off the loss. In the situation, in certain instances, the transactions in 1 segment only, may it be cash/F & O or partly executed. However, in this case also, in almost all, the net open positions remain at Nil. It is to be borne in mind that no arbitrage is absolutely perfect as it is not possible to complete each and every leg of a transaction at one instance. Many a times, it so happens that the execution of a complete arbitrage trade does not take place fully and within that short period of time, the arbitrageur has to take a decision on whether to complete the arbitrage trade anyhow regardless of price or square-up the position initiated till now of such incomplete arbitrage trade. Various reasons such as constant changing of prices, high competition, lack of depth, etc. are responsible for such an eventuality. Due to the same, the arbitrage transaction initiated

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might have to be squared-up mid-way and sometimes loss may result from such trades. The arbitrage trading is continuous process and sometimes, it so happens that the trade is executed at the very fag end of the market. Before the complete simultaneous trade is executed, markets may close for trading and the uncovered position might have to be carried-forward to next day. This happens rarely but still, is a possibility which might result in undue profit/loss as well as mismatch in positions. Apart from the abovementioned few reasons of mismatch in quantities due to "execution risk" in arbitrage trade, there are also other reasons for mismatches/difference in quantities.

2.3.13 It is noticed that the AO in his remand report dated 12/3/2014 has observed the transactions at macro level and that in many events it could not be justifiable that the shares purchased on cash segment with a simultaneous sale in derivatives/futures segment and vice versa. The appellant, on the other hand contended that they are in the business of arbitrage operations. Accordingly, in the first leg, the appellant purchase the shares and correspondingly sell the shares in the derivatives/futures segment. There may be a few occasions where the corresponding sale/purchase in futures segment or cash segment may not materialize. In such an event, the appellant carry out the reverse transaction. However, this is also part of the arbitrage operations and it is only on account of corresponding quantities not being available in the opposite segment, the appellant are forced to carry out the reverse transaction. In fact, this clearly shows that the appellant's intention was always to take positions in different markets. It is seen that the in the second leg of the transaction, the appellant sell the shares in the cash segment and correspondingly buy the shares in the derivative/futures segment. The net effect of the purchase/sale in cash segment and derivative/futures segment is assessee's gain from arbitrage operations. The AO has also made a reference to the fact that the purchase and sale of shares are not squared off on the same day. It is seen that when the appellant takes positions, purchase in cash segment is countered by corresponding sale in derivatives/futures segment. These transactions are always simultaneous, which fact can be ascertained from the detailed paper book filed before me. Further, this position is maintained till expiry or such time as the appellant consider appropriate. In the second leg, as explained above, the appellant sell the shares in the cash segment and an equal number of futures are bought in the derivatives/futures segment. It is seen that this sale and corresponding purchase in the derivatives/futures segment is also done simultaneously. Accordingly, the purchase and corresponding sale of shares in the cash segment is usually not on the same day. Similarly, the purchase and corresponding sale of futures in the derivatives/futures segment is also not on the same day. The AO has also commented that the appellant has purchased shares on various

dates and clubbed them together and has sold it on a single day, which clearly certifies that the purchase and sale of the scripts are not done simultaneously. In this respect, the appellant stated that on numerous occasions, it is not possible to execute the order on the same day. For example, if the appellant want to purchase 10,00,000 shares of Tata Steel, the entire purchase may not be executed on the same day on account of the non availability of the stock in the market. Accordingly, the purchases may be carried out over a period of few days. However, the moot point is that for a purchase of 10,00,000 shares of Tata Steel in the cash segment, there would be a corresponding sale of 10,00,000 futures in the derivatives/futures segment. The price difference in the cash segment vis-a-vis the derivatives/future segment leads to an arbitrage profit. Accordingly, merely because the appellant may not have been in a position to purchase the entire lot of shares on the same day, it does not imply that the transaction is not an arbitrage transaction as the corresponding sale in derivatives/future segment is taken simultaneously. However, it may be possible to sell the entire lot if an institutional buyer or a mutual fund would like to buy those shares in bulk in which case the corresponding positions in the derivatives/futures segment will also be closed simultaneously. The mere fact that the purchases may have been made in lots and the sale might have been made on a single day does not change the character of an otherwise arbitrage transaction. The AO has stated that on the basis of her remarks, the transactions may be considered to be speculation transactions. However, the appellant stated that the AO has in the remand report accepted that for every purchase of shares in the cash segment, there is corresponding sale in the derivative/future segment. If that be the case, it cannot be id that the appellant's transactions are in the nature of speculation transactions. It is seen from the remand report, the AO held that there was a one to one correspondence between the purchase and sale in the cash and derivative/future segment and one to one correspondence between the sale and purchase in cash and derivative/future segment. In this regard, the relevant extracts from the remand report dated 16/1/2013 are reproduced hereunder for reference:

> From page 2 of Remand report :-
>
> " It is submitted that the AO had never disputed over the transactions done by the Assessee in purchase of shares on the cash segment with a simultaneous sale in derivative/future segments,"
>
> From page 3 of Remand report:-
>
> .....The AO never had a dispute over the Assessee's transactions of purchase in cash segment with simultaneous sale in future segment."

2.3.14 A bare perusal of the explanation to section 73 revealed that the said Explanation is for the purpose of section 73 of the Act and applies to those company whose business consists of purchase and sale of shares subject to conditions specified therein then only, it shall be deemed to be speculation business to the extent to which the business consists of the purchase and sale of shares. The appellant has earned profit in one segment and incurred loss in the other segment but overall considering all the aspects, the net is normally always in profit. Considering the figure of only one segment without offsetting the result of the transactions on the other segment would result in absurdity. If so, the opposite segment transaction should also be considered as a speculation. A script wise summary data for both the segments reflecting profit in one segment vis-à-vis loss in another segment in the same scripts which is a typical phenomenon of arbitrage has been placed on record and verified by the undersigned revealed the exact nature of assessee business. The appellant in this case has earned profit in one segment and incurred loss in the other segment but considering the overall picture, i.e. all the aspects of the Arbitrage Activity, the net is normally always in profit. Considering the figure of only one segment without offsetting the result of the transactions in the other segment would result in absurdity.

2.3.15 As is evident from the extant provisions of the section 43(5) of the Act, that none of the transactions are speculative in nature and that they are all hedge transactions between the two segments. If at all one segment of the transaction is to be considered as speculative then, the opposite segment transaction should also be considered as a speculative, here again the loss in the cash segment need to be allowed as a set off against the derivative profit considering both are speculative in nature. From the foregoing discussion it is clear that the arbitrage activity cannot be broken up and one limb of the said activity i.e., purchase and sale of shares in the cash segment be considered to be speculation as per explanation and the other limb i.e. sale and purchase of stock futures in the F & C segment be considered to be normal business activity, especially when the appellant company are not indulging in trading activity but are engaged in the business of arbitrage operations. Further my findings are supported by the following judicial decisions;

a. In case of Arion Commercial Pvt. Ltd. ITA No, 1010/Kol/2011, it is held that “trading of shares which is done by delivery transactions are not hit by Section 43(5) as speculation. Similarly, derivative transaction in shares profit/loss is also not hit by Section 43(5) of the Income Tax Act, which deals about speculation transaction. As such, both profit floss from all the share delivery transactions &

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derivative transactions are having the same meaning, so far as, section 43(5) of the Income Tax Act is concerned. It is further held that, once the transactions done by delivery as well as the transactions of derivatives are not hit by Section 43(5) of the Act, the aggregation of the share trading loss and profit from derivative transactions should he done before the application of explanation to section 73 of the Income Tax Act is applicable.

b. In case of Shree Capital Services Ltd. Vs. ACIT, ITA No.1294 (Kol) of 2008, the Hon. ITAT, Kolkata, has held that F&O shall be treated in same line with cash and vice versa.

c. In case of DCIT vs. Loknath Saraf Securities Ltd., ITA No.695/Kol/2008, the Hon. ITAT has held that different treatment of transactions in a composite business, cannot be said to be different business.

d. In case of Chirag Tanna Vs ACIT, ITA No. 4227/Mum/2010, the Hon. ITAT has held that, derivatives transactions entered into by the assessee at the recognized stock exchanges are to be treated as covered by the exclusion clause set out in Sec. 43(5)(d) of the act and also the arbitrage / jobbing transactions carried out by the assessee are not speculative transactions.

e. In case of ITO Vs Arena textiles & Industries Ltd, ITA No. 1019/Kol/2011 the Hon. Kolkata ITAT has held that, trading of a share which is done by delivery transactions are not hit by sec. 43(5) as speculation. Also, derivatives transactions in shares profit /loss is also not hit by sec. 43(5), which deals about speculative transactions. The transactions done by delivery as well as the transactions of derivatives are not hit by sec. 43(5), it is considered that the aggregation of share trading loss and profit from derivatives should be done before the application of Explanation of Sec. 73 of the I T Act is applicable.

Thus, from the above it is evident that arbitrage/jobbing transactions are non- speculative transactions and sec. 73 is not applicable to the case of the appellant.

2.3.16 Further, I find that Explanation to section 73 was inserted by the Taxation Laws (Amendment) Act, 1975 effective from 1st April, 1977. The objective of the explanation, as explained in the Memorandum explaining the provisions of the amending bill was to curb the manipulation by the business house controlling the group companies of reducing the taxable income of the companies under their

control. It was also explained by the Board through its circular 204 dated 24th July, 1976 as follows:

> *"19.2 The object of this provision is to curb the device sometimes resorted to by business houses controlling groups of companies to manipulate and reduce the taxable income of the companies under their control."*

The main purpose of the Explanation k to plug the device adopted for hooking losses and thereby reduce the taxable income. It is settled law that for interpreting the provision, the objective is relevant. From the Explanation it is clear that:

- It applies only to a company;
- It applies where any part of the business of the company consists of the sale and purchase of shares of other companies;
- If so, such business is deemed as speculative business; and
- The fiction is limited for the purpose of the section, that is, section 73 governing losses in speculation business.

Accordingly, for the purpose of application of the Explanation, inter alia, it is necessary to find out whether any part of the business of the company consists of the sale and purchase of shares of other companies. If the business does not consist of the sale and purchase of shares of other companies, obviously, the Explanation cannot apply. The appellant is in the business of arbitrage operations and not in the business of purchase and sale of shares. The arbitrage operations include not only the purchase of a particular script in one segment and but its simultaneous sale in the other segment. Both these activities form part of the common transaction i.e. arbitrage operations. One cannot divide the two activities which form part of one composite transaction. In pure trading operations, one can suffer an overall loss, however, in arbitrage operations, one cannot suffer an overall loss as the operation is carried out with a view to gain from the price differences in the two segments or markets i.e. cash and future segments. Accordingly, there would always be a profit in arbitrage operations. Accordingly, the business of arbitrage operations cannot be considered to be the business of purchase and sale of shares as envisaged in Explanation to section 73 of the Income Tax Act.

2.3.17 Further, the transaction of selling in the futures segment is carried out by the assessee to hedge against the price movement of the share in the cash segment. Accordingly, the simultaneous sale of shares in the futures segment would have to be excluded from the definition of "speculative transaction". The same principle would equally apply in the context of Explanation to section 73. This view finds support from the decision of the Hon'ble Bangalore Tribunal in the case of JSW Steel Ltd. v. ACIT (2010) 5 ITR (Trib) 31 (Bang.). In the said case, the assessee had taken a foreign currency loan for purchase of plant and machinery. In order to

hedge against the fluctuation in foreign exchange, the assessee had entered into foreign exchange forward contracts. Assessee had claimed that the loss incurred on account of settlement of foreign exchange forward contracts be adjusted to the cost of asset u/s. 43A: The AO disallowed the said loss. The Hon'ble Tribunal held that as the loss was in order to safeguard against foreign exchange fluctuation for purchase of plant and machinery, the said loss was to be added to the cost of plant and machinery as per the provisions of section 43A of the Income tax Act. The Hon'ble Tribunal has considered the entire transaction as a composite transaction to safeguard the loss which may arise on account of foreign exchange fluctuation on repayment of foreign exchange loan taken for the purpose of purchase of plant and machinery and allowed the loss to be adjusted to the cost of asset u/s. 43A of the Act. As in the present case, the activity of purchase and sale of shares is only one of the parts of the overall activity of arbitrage operations, the said activity cannot be looked upon independently. It is the total profit or loss from the entire operation i.e. arbitrage operations, which have to be looked at as a whole. When it comes to the taxation of a composite transaction, it is the net income or loss from such composite transaction which should determine the Head of Income and the basis of taxation. A single indivisible transaction must be assessed as such and not as two distinct unrelated transactions. The character of the income should depend upon the nature of the business transaction and the intention of the Appellant while entering into the transaction. The purchase and sale in the cash segment and the future & options segment in this case, were not a standalone transactions but only an arbitrage transaction. Hence, both the transactions should be viewed as an integral transaction.

2.3.18 The proviso "c" to section 43(5) itself shows that in case of composite transactions in arbitrage, the character of individual legs comprised in the said transaction would not decide the character of the entire transaction taken as a whole, i.e. even the non-delivery based leg in an arbitrage transaction will not be treated as a speculative transaction if undertaken to guard against loss in ordinary course of business as a member of a forward market or a stock exchange. For the proposition that it is only the net or combined result of all activities/transactions in an integrated business such as arbitrage business, which has to be looked at, to determine the character and the head of income, reliance is placed on the following decisions:

- Miss Dhun Dadabhoy Kapadia v CIT [1967] 63 ITR 651 (SC)
- CIT v UP State Industrial Development Corporation [1997) 225 ITR 703 (SC)

- CIT v Nirmal Kumar & Co. [1986] 161 ITR 413 (Cal)
- Dr. Rajesh M. Parikh v ITO [2006] 8 SOT 61 (Mum ITAT)
- ChiragTanna v ACIT (ITA No 4227 and 5027/Mum/2010)

In view of the above the loss on purchase and sale of shares independently but to consider it is an integral part of the arbitrage operations. As there in no loss from arbitrage operations, the question of applying section 43(5) or Explanation to section 73 does not arise.

2.3.19 Without prejudice to the above, as observed supra in the case of CIT v. DLF Commercial Developers Ltd wherein it was held that for the purposes of Explanation to section 73, derivatives would be considered to be shares. If derivatives are considered to be shares for the purposes of Explanation to section 73, the loss from purchase and sale of shares has to be set off against the profit from derivative transactions and only the net loss can be disallowed under Explanation to section 73. In this regard, reliance is also placed on the decision of the Hon'ble Bombay High Court in the case of CIT v. Lokmat Newspapers (P.) Ltd. (2010) 322 ITR 43 (Born) where in it has been held that the Explanation applied whether there is a profit or loss. The Ld. AO, therefore, erred on facts and in law in considering a part of the arbitrage transaction as deemed speculation loss as per Expin. to Sec.73. In view of the facts as explained above it is held that the appellant carries on arbitrage business and accordingly the loss on purchase and sale of shares cannot be looked in isolation and the treatment given by the AO of treating the loss on sale of shares as speculation loss as per Explanation to section 73 is incorrect.

2.3.20 Without prejudice to my above stated findings that arbitrage/jobbing transactions are non-speculative transactions and Sec. 73 is not applicable to the case of the appellant as well as provisions of Explanation to section 73 are not applicable to the appellant case in view of findings of the Hon'ble jurisdictional High Court in the case of Darshan Securities(Supra) Leven if it is held that the transaction are speculative than also profit of the F&O transaction are to be adjusted against the losses of cash transactions in view of decision of Anon Commercial Pvt Ltd. (supra) wherein it was held that trading of shares which is done by delivery transactions are not hit by Section 43(5) as speculation. Similarly, derivative transaction in shares profit/loss is also not hit by Section 43(5) of the Income Tax Act, which deals about speculation transaction. As such, both

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profit/loss from all the share delivery transactions & derivative transactions are having the same meaning, so far as, section 43(5) of the Income Tax Act is concerned. It is further held that, once the transactions done by delivery as well as the transactions of derivatives are not hit by Section 43(5) of the Act, the aggregation of the share trading loss and profit from derivative transactions should be done before the application of explanation to section 73 of the Income Tax Act is applicable. As is evident from the extant provisions of the section 43(5) of the Act, that none of the transactions are speculative in nature and that they are all hedge transactions between the two segments. If at all one segment of the transaction is to be considered as speculative then, the opposite segment transaction should also be considered as a speculative, here again the loss in the cash segment need to be allowed as a set off against the derivative profit considering both are speculative in nature. Similar issue was also involved in the case of M/s. Arena Textiles & Industries Ltd., Kolkata in ITA No.1019/Kol/2011 for A.Y.2008-09 before the Hon'ble ITAT, Kolkata. The grounds of appeal raised by the Revenue were as under :-

1. Whether on the facts and circumstances of the case and settled legal position, the Ld. CIT(A) is justified in holding that transactions in derivatives are not hit by section 43(5) of the I.T.Act.

2. Whether on the facts and circumstances of the case and settled legal position, the Ld. CIT(A) was justified on facts and in law in deleting the disallowance and addition of Rs.28,95,42,845/- treated as deemed speculation loss by the AO.

3. Whether on the facts and circumstances of the case and settled legal position, the Ld. CIT(A) is justified in holding that delivery-based share transactions does not fall in the ambit of Explanation to section 73 of the I.T. Act.

The Tribunal after considering rival submissions has observed as under:

"• After hearing the rival submissions and on careful perusal of materials available on record, we are of the view that trading of shares which is done by delivery transactions are not hit by Section 43(5) as speculation. Similarly, derivative transaction in 9 shares profit/loss is also not hit by Sec. 43(5) of the I. T.Act, which deals about speculation transaction. As such, both profit/loss from all the share delivery transactions and derivative transactions are having the same meaning, so far as Sec.43(5) of the I.T. Act is

concerned.

• When once we held that the transactions done by delivery as well as the transactions of derivatives are not hit by Sec. 43(5) of the Act it is in our considered view that the aggregation of the share trading loss and profit from derivative transactions should be done before the application of the Explanation to Sec. 73 of the I. T. Act is applicable."

Thus, Hon'ble ITAT in this case has held that aggregation of share trading loss and profit from derivative transaction should be done before the application of Explanation to Section 73 of the I.T. Act is applicable.

This position is further supported by the Hon'ble Delhi High Court's Judgment in the case of CIT v/s DLF Commercial Developers Ltd. [ITA No. 94/2013 vide order dated 11 .07.2013] wherein it has been held that Derivatives which derive their value from the underlying shares & securities cannot be exempted from the underlying shares & securities cannot be exempted from the mischief of Explanation to Section 73 and are therefore to be considered as Speculative in nature. The Hon'ble Delhi High Court has held as under:

> "9. In this context, it would be instructive to notice that in Rajashree 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 derivate 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. MIS. 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

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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.."

Therefore, the Hon'ble Delhi High Court has categorically observed that the provisions of Section 73 of the Act would be applicable even in the case of derivatives to the extent they are backed by stock and shares. The Hon'ble Bombay High Court in the case of CIT vs. Lokmat Newspapers (P.) Ltd. (2010) 322 ITR 43 (Born) has held that the Explanation applied whether there is a profit or loss in cash segment. In view of this decision of Hon'ble Delhi High Court and Mumbai High Court, the provisions of section 73 are applied to both profit and loss from derivative and cash segments. Therefore, if the AO invoked the provision of the explanation of Sec. 73, the entire transaction of the assessee become speculative for this purpose as per Delhi High Court and Mumbai High Court, the assessee is entitled for the set off which will make the addition

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nullified as made by the AO.

2.3.21. In view of the foregoing discussion wherein in both circumstances of treating the transactions as speculative or non speculative, the set off has to be allowed, the addition made by the Ld. AO cannot be sustained both on facts and circumstances of the appellant's case, the same are accordingly deleted. This ground of appeal is **allowed**.

2.3.22 As regards allocation expenditure towards speculation loss, in this regard, I have carefully considered the arguments of the AO, submissions of the appellant. Since I have held that the transactions of sale and purchase in cash segment and transactions in F & 0 are not speculative in nature and need to be set off before invoking the provision of Sec. 73 of the Act, this ground of appeal is to be held in favour of the appellant. However, in case, the AO found that the resultant figure is a loss after such set off, then such figure may be taken for proportionate disallowance of expenses. With these observations, this ground of appeal is disposed of."

18. Aggrieved by said order of the CIT(A), Revenue has come in appeal before us.

19. We have heard the Ld. Representatives of the parties. The Ld. D.R. has submitted that under the provisions of the Income Tax Act the speculative business is deemed to be a distinct and separate business than the normal business or profession as defined under section 28 of the Act. The Ld. D.R. has further submitted that as per the provisions of section 43(5) of the Income Tax Act some transactions, though, are otherwise speculative transactions but have been deemed not to be speculative transactions and therefore the profit and loss arising out of such transaction is to be computed/set off as that of a normal business. He has further contended that however, the transactions which are not specifically excluded under the provisions of section 43 of the Act, those transactions result into speculative profit or loss which cannot be adjusted or set off from the profit and loss of normal business transactions. He has further invited our attention to section 73 of the Act and has submitted that though as per the provisions of section 43(5), the delivery based transaction in shares are not deemed to be speculative transactions; however, the section 73

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carves an exception to it wherein subject to certain exceptions, the profit or loss from business of purchase and sale of shares by the companies is to be treated as speculative profit or loss which cannot be set off or carried forward towards the loss from other/normal business. The Ld. D.R. has further has further invited our attention to the provisions of section 43(5) of the Income Tax Act, 1961 to submit that certain transactions in derivatives of commodities and securities, though otherwise are speculative transactions, but because of the provisions of section 43(5) of the Act are to be treated as normal business transactions. He has therefore submitted that certain transactions such as hedging transactions, jobbing and arbitrage in commodities and securities are excluded from the preview of speculative transactions for the purpose of section 43(5) of the Act. However, explanation to section 73 covers the share transactions done by a company, subject to certain exceptions, as speculative transactions. He, therefore, has contended that the assessee's profit or loss from future arbitrage in derivatives are to be computed separately as normal business transactions, whereas, the transaction done by the assessee in cash segment in shares are to be treated as speculative transactions. Therefore, the loss or profit earned in derivative/future arbitrage cannot be adjusted or set off against the profit and loss arrived out of delivery based share transactions. He, in this respect, has strongly relied upon the decision of the Hon'ble Kolkata High Court in the case of "Paharpur Cooling Towers Ltd. vs. CIT" (2011) 338 ITR 295 (Cal) to contend that when any purchase or sale of shares by certain companies would be speculative transaction for the purpose of section 73, the loss arising there from cannot be set off or carried forward by treating the same as non-speculative as section 43(5) of the Act excludes the delivery based share transactions from the preview of speculative business. He has further contended the Hon'ble Kolkata High Court, has held that the explanation added to section 73 is for the special purposes and for that section only and that the provision of section 73 with the Explanation overrides the provisions of section section 43(5).

To stress his point, the Ld. D.R. has further relied upon the following case laws to stress upon the point that section 73 overrides the provisions of section 43(5) and what is considered as speculative in nature under section 73, section 43(5) cannot be applied to exclude those transactions from the preview of speculative transactions. He finally has stressed that since the transactions in derivatives is non-speculative because of the exclusion given under section 43(5) of the Act whereas the assessee's business in shares is to be treated as speculative as per the provisions of section 73 of the Act. That the explanation to section 73 does not cover the transactions in derivatives and therefore the provisions of section 43(5) will come into operation and therefore the income from derivatives is to be treated as normal business income and can not be adjusted or setoff against income from speculative transactions.

"1. CIT vs. Lokmat Newspaper (P) Ltd. – (2010) 322 ITR 43
2. CIT vs. Arvind Investments Ltd. – (1991) 192 ITR 365
3. Araksa Diamond Pvt. Ltd. vs. ACIT 5(1), Mumbai – ITA No.5631/M/12 for A.Y. 2009-10 (ITAT-Mumbai)
4. ACIT vs. Sucham Finance & Investment – (2007) 290 ITR 379 (ITAT Mum.)
5. Shree Capital Services Ltd. vs. ACIT (2009) 121 ITD 498 (Kol. ITAT) (SB)
6. C. Bharath Kumar vs. DCIT (2005) 4 SOT 593 (Bang.) (ITAT)
7. DCIT vs. Sski Investors Services (P) Ltd. – (2008) 113 TTJ 511 (ITAT)(Mum)
8. Apollo Tyres Ltd. vs. CIT (2002) 255 ITR 273 (SC)"

20. The Ld. Counsel for the assessee, on the other hand, has submitted that the assessee is in the business of cash future arbitrage. The assessee takes benefit in the price difference in the two different market/segments. The assessee in his business buys a particular scrip in the cash segment and simultaneously sells the same scrip in the future segment. Though, while purchasing the scrip in cash segment, the assessee has to pay the price and take delivery of the shares; however, on simultaneously selling the scrip in future segment at a higher rate, the assessee on the stipulated date of conclusion of

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contract is not required to receive any payment towards the price of the shares but receive the margin between the price difference as on the date of entering into the contract and date of maturity of the contract. The assessee at a later date would sell the shares purchased in the cash segment and buy the shares in the future market. The difference in the price of the cash and future segment is the profit of the assessee. The Ld. Counsel by way of an example has explained that the assessee so manages these transactions that when the profit and loss from both the transactions is taken together and set off against each other, the resultant figure will always be a positive figure. In other words both the transactions are taken as a composite business where the loss in one segment will result into profit in another segment and vice -a-versa and ultimate the net result will be a profit. Therefore, the action of the AO in treating the business having composite transactions in cash segment and future segment as under different heads and thereby not allowing the set off of profit and loss from one segment against another segment is not justified. The Ld. Counsel, in this respect, has relied upon various case laws which are detailed as under:

1) J.G.A. Shah Share Brokers P. Ltd. [ITA No.4053/Mum/2013]
2) ITO v. M/s. Arion Commercial Ltd. [ITA No.1010/Kol/2011]
3) ITO v. M/s. Arena Textiles & Industries Ltd. [ITA No.1019/Kol/2011]
4) ITO v. M/s. Rajanigandha Properties Ltd. [ITA No.1011/Kol/2011]
5) DCIT v. Baljit Securities Pvt. Ltd. [ITA No.1183/Kol/2012]
6) CIT v. Lokmat Newspapers (P.) Ltd. (2010) 322 ITR 43 (Bom)
7) DLF Commercial Developers Ltd. (2013) 261 CTR 127 (Del)

21. We have considered the rival contentions. In this case, the peculiarity of the business of the assessee is that the assessee so manages his transactions of sale and purchase in shares in cash segment and in future segment that the final outcome will be a profit. The transactions of the assessee, therefore, cannot be segregated to arrive at profit and loss in both these transactions independently or separately. The nature of the business of the assessee is such that the

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transactions of the assessee in both segments are part of composite business of the assessee and the transactions are so managed that the resultant figure will be a profit. We, therefore, do not find any justification on the part of the lower authorities to interpret the provisions of the Income Tax Act to the disadvantage of the assessee and to segregate the transactions in cash and future segment which, in our view, will be against the spirit of the taxation laws. Even otherwise the case of the assessee is squarely covered by the decision of the Hon'ble Delhi High Court in the case of "CIT vs. DLF Commercial Developers' (supra) wherein the Hon'ble Delhi High Court has categorically held that in terms of explanation to section 73, by all accounts, derivatives are based on stocks and shares which fall squarely within explanation to section 73 and therefore loss from sale-purchase of such derivatives would be speculative loss. The Hon'ble Delhi High Court has, thus, held that though under provisions of section 43(5), the transactions in derivatives at certain stock exchanges are deemed to be non-speculative, however, as per the explanation to section 73 for the purpose of computation of business loss the derivative transactions squarely fall within the scope of explanation to section 73. Under the circumstances, both the transactions i.e. the transactions in the derivative and transactions in the cash segment can be treated as speculative transactions as per explanation to section 73 and hence the profit or loss against both the segments can be adjusted or set off against each other.

22. Even otherwise as discussed above, the peculiarity of the business of the assessee is such that the transactions carried out by the assessee in cash segment and in future segment cannot be segregated. The business of the assessee survives on the ultimate resultant figure arrived at after setting off/adjusting of the profit and loss from each segment. It cannot be said that the transactions in each segment done by the assessee are independent of each other. Before parting we would like to further add that certain exceptions have

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been carved out under section 43(5) vide which certain transactions in derivative named as 'eligible transactions,' done on a recognized stock exchange, subject to fulfillment of certain requirements, are deemed to be non-speculative. The said provisions have been inserted in the Act for the benefit of the assessees keeping in view the fact that in such type transactions on recognized stock exchange, the chance of manipulating and thereby adjusting the business profits towards speculative losses by the assessee is negligible because such transactions are done on recognized stock exchange and there are less chances of manipulation of figures of profits and losses. These provisions have been inserted for the benefit of the assessee so that the assessee may be able to set off and adjust his profit and losses from derivatives in commodities against the normal business losses. These provisions are intended to ease out the assessee from the difficulties faced due to the stringent provisions separating the speculative transactions from the normal transactions. However, these exclusions given to the assessee cannot be allowed to be so interpreted to the disadvantage of an assessee so as to give it a different meaning and thereby denying the assessee the set off of otherwise eligible business loss from one segment as against the other segment, especially when the activity done by the assessee is a composite activity and profit and loss in one segment not only depends but the very transaction is done taking into consideration not 'expected' but certain future profit or loss in other segment.

23. In view of the above, we do not find any merit in the appeal of the Revenue and the same is accordingly dismissed. However, in view of our findings given above, the appeal of the assessee is treated as partly allowed.

Order pronounced in the open court on 28.12.2016.

Sd/- **(G.S. Pannu)** **ACCOUNTANT MEMBER**	**Sd/-** **(Sanjay Garg)** **JUDICIAL MEMBER**

Mumbai, Dated: 28.12.2016.

* Kishore, Sr. P.S.

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Copy to: The Appellant
The Respondent
The CIT, Concerned, Mumbai
The CIT (A) Concerned, Mumbai
The DR Concerned Bench

//True Copy//

By Order

Dy/Asstt. Registrar, ITAT, Mumbai.

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