

## Loss from derivative is a normal business loss and not a speculation loss

**Summary – The High Court of Calcutta in a recent case of Asian Financial Services Ltd., (the Assessee) held that Loss incurred on account of derivatives would be deemed business loss under proviso to section 43(5) and not speculation loss and, hence, Explanation to section 73 could not be applied; as such, loss would be set off against income from business**

### Facts

- The assessee-company was dealing in settlement of future and option/derivatives and suffered loss.
- The Assessing Officer treated the same as speculation loss and could not allowed set off of the said loss against business income he also applied *Explanation* to section 73.
- On appeal, Commissioner (Appeals) however, allowed the assessee's claim.
- The Tribunal applying *Explanation* to section 73 held that the loss was incurred in eligible transaction within the meaning of proviso to section 43(5) not involving any purchase or sale of shares as such was speculation loss.
- On assessee's appeal, it was contended that the loss incurred by the assessee to the tune of Rs. 3,24,76,184 was on account of settlement of future and option. This loss had to be treated as a business loss under the proviso to section 43(5). Once it was deemed to be business loss on the basis of the proviso appended to section 43(5), the question of applying section 73 or the *Explanation* thereto for the purpose of refusing the loss to be set off against the business income would be palpably wrong.
- The revenue contended that a company dealing in purchase and sale of shares amongst others, which does not come within the exceptions carved out in the *Explanation* itself is hit by the mischief of the aforesaid *Explanation*. It was also contended that when the business consisting of purchase and sale of shares of other companies amounts to a speculation business, it cannot be said that business in derivatives, which depend upon the value of the underlying shares, is anything other than a speculation business. Thus, the question was to be answered against the assessee.

### Held

- It cannot be said that sub-section (5) of section 43 is a general provision and the provision contained in section 73 is specific in nature. On the contrary, the object of sub-section (5) of section 43 is to define 'speculative business'. Group-D of Chapter-IV of the Income-tax Act consists of sections 28 to 44DB. When the statute talks of profit, it also talks of losses because loss has been construed as a negative profit. Sections in Group-D of Chapter-IV evidently deal with profits and losses of business or profession.
- From a plain reading of the *Explanation 2* to section 28 the following deductions can be made—

- (a) Speculative transactions carried on by an assessee may be of such a nature as to constitute a business;
- (b) Such speculation business carried on by an assessee shall be deemed to be distinct and separate from any other business.
- Thus, a conclusion can be arrived that speculation transaction may partake the character of deemed business where statute so provides. Definition of 'speculative transaction' has been provided in sub-section (5) of section 43.
  - The activities appearing in clauses (a) to (e) of proviso to section 43(5) are not to be deemed to be speculative transactions. Therefore, this comes within the category of deemed business which is however distinct and separate from any other business. Now, the question is, whether loss arising out of such deemed business can be set off against the profit arising out of other business or businesses which may for clarity be called proper business. Under section 70, the assessee is entitled to have the loss set off against his income from any other source under the same head unless otherwise provided. Therefore, answer to the question is that the assessee is entitled to have the loss arising out of deemed business set off against the income arising out of business proper unless otherwise provided. The question however remains whether the *Explanation* to sub-section (4) of section 73 relied upon by revenue provides otherwise. A plain reading of the *Explanation 2* cannot be said to have provided otherwise. In that case the irresistible conclusion is that the assessee is entitled to set off such loss arising out of deemed business against the income arising out of business proper.
  - The Tribunal has supported the contention of the revenue relying upon the judgment of the Delhi High Court. The views expressed by the Delhi High Court are contained in a part of the sentence, which is as that, by all accounts, the derivatives are based on stocks and shares, which fall squarely within the *Explanation* to section 73(4). The clause of the sentence 'which fall squarely', qualifies the word 'shares' and not the word 'derivatives'. The view of the Delhi High Court that shares fall squarely within the *Explanation* to section 73(4) is to be accepted. Derivatives cannot be treated at par with the shares because the Legislature has treated them differently.
  - The appeal is, thus disposed of.