

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 29.01.2016

CORAM:

THE HONOURABLE **MR.JUSTICE M.JAICHANDREN**

AND

THE HONOURABLE **MRS.JUSTICE S.VIMALA**

T.C.A.No.1077 of 2004

M/s.Rajapalayam Mills Limited,
Post Box No.1,
Samusigapuram,
Rajapalayam – 626 117

... Appellant

.vs.

The Deputy Commissioner of Income Tax,
Special Range-I,
Madurai.

... Respondent

Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961 as against the order dated 20.05.2004 made in I.T.A.No.20(Mds)/1997 on the file of the Income Tax Appellate Tribunal, Chennai 'B' Bench for the assessment year 1990-91.

For Appellant	: Mr.J.Balachander
For Respondent	: Mr.Swaminathan

J U D G M E N T

This Tax Case Appeal has been filed against the order of the Income Tax Appellate Tribunal, 'B' Bench, Chennai, dated 20.05.2004, made in I.T.A.No.20(Mds)/1997.

2. The Appellant Company M/s. Rajapalayam Mills Ltd. is a Company engaged in the manufacture and sale of yarn. For the assessment year 1990-91, the appellant filed return of income on 26.12.1990, admitting total income of Rs.3,69,53,050/-. The assessing officer passed an order under Section 143 (3) of the Income Tax Act, computing the total income at Rs.3,72,70,680/-. The assessee went on appeal and the Commissioner (Appeals), while declining to accept the case of the assessee, quantified the total income at Rs.3,67,68,820/-. Based on the directions of the Commissioner of Appeals, the revised order was passed, by the assessing officer wherein the income was determined at 3,67,68,820/-.

2.1. The assessment was thereafter reopened as the Assessing officer felt that, the transaction in shares is hit by explanation to Section 73 of the Income Tax Act, 1961. Therefore, a notice under Section 148 was issued to the assessee on 07.05.1993. In response to this notice, the assessee had filed a return disclosing the total income, as admitted in the original return. The contention of the assessee,

interalia was that a sum of Rs.25,47,443/-, would have to be considered as short term capital loss. This loss was claimed to be on account of sale of shares of the sister concern, which was held by the assessee. But that contention was not accepted and the finding of the Revenue was that, it was a 'speculation loss' and therefore that must be carried forward and to that extent, income had to be enhanced. Challenging the re-assessment, assessee filed the appeal before the Commissioner of Appeals.

2.2. The Commissioner of Appeals held that the transactions in shares cannot be equated with speculations and the finding was that there was nothing on record to show that the appellant was buying loss, to be set off against the income from its regular business and thus, cancelled the reassessment. Challenging the order of the Commissioner of Income Tax (Appeals), an appeal was filed before Income Tax Appellate Tribunal. The Appellate Tribunal reversed the findings of the Commissioner (Appeals) and restored the findings of the assessing officer. Therefore, the assessee is on appeal raising

the following substantial question of law:

1. Whether on the facts and circumstances of the case, the Appellate Tribunal was right in law in holding that the short term capital loss on sale of shares made by the appellant company is to be treated as a speculative loss by virtue of Explanation to Section 73 of the Act ***when actual delivery and possession has been made in respect of sale of shares?***"

2. Whether on the facts and circumstances of the case, the Appellate Tribunal was right in law in holding that the short term capital loss on sale of shares made by the Appellant Company is deemed to be speculative loss even though the transactions of sale of shares are not covered under Section 43 (5) of the Act?"

3. It is not in dispute that the assessee is a manufacturing Company engaged in the manufacture and sale of yarn. It is also not in dispute that the assessee company is not regularly dealing with the shares, but indulged in purchase and sale of share as an occasional transaction.

3.1. The contention of the assessee is that the regularity of the transaction and the intention behind the transaction are important, while considering the aspect of 'speculation loss' and that as the sale in shares was neither systematic nor

organised course of activity, the transaction cannot be said to be a speculative transaction. It is also contended that the intention of the transaction was towards investing and not towards taking risk and therefore it cannot be construed as a speculative transaction.

3.2. The contention of the Revenue is that when the assessee company is neither a company dealing in shares and securities nor a banking company, the explanation to section 73 would come into operation and the purchase of shares which resulted in loss to the Company is to be treated as deemed speculative loss, the finding of which has been rightly upheld by the appellate tribunal.

4. In order to appreciate the contentions raised on both sides, it is necessary (a) to appreciate the meaning of 'speculation' and (b) to look into the relevant provisions relating to speculative transaction, speculative business, and the deeming provisions as dealt with in the Income Tax Act, 1961, (along with explanations).

4.1. Section 2 (13) defining business, Explanation 2 to Section 28 dealing with speculation loss / business, Section 43 dealing with speculative transaction, etc., are relevant provisions to be considered.

4.2. Section 2(13): Business

(13)"business" includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture;

The concept of business, as defined in Section 2(13), includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. These words are of wide import, the underlying idea being of continuous exercise of an activity. The definition, however, is not exhaustive as held in the case of [CIT vs. A.Dharma Reddy, (1969) 73 ITR 751, 755 (SC)].

The Hon 'ble Mr. Justice Venkataraman Aiyar, speaking for the court in Mazagaon Dock Ltd. vs. CIT [(1958) 35 ITR 368, 376 (SC)], explained 'business' as a word of wide import and in fiscal statutes it must be construed in a broad rather than a restricted sense. The definition being inclusive and not exhaustive, is indicative of extension and

expansion and not restriction. The word "business" is one of large and indefinite import and connotes something which occupies the time, attention and labour of a person normally with the object of making profit.

Mere holding of property or investments cannot amount to a business, as held in the case of *East India Prospecting Syndicate v. CEPT*, (1951) 19 ITR 571 (Cal). A person, who merely invests in shares for the purpose of earning dividends, does not carry on business. He may, at any time, convert those shares into his stock-in-trade and carry on business in that commodity [*Bengal & Assam Investors Ltd. vs. CIT*, (1966) 59 ITR 547 (SC)].

In order to constitute an activity as business activity, there are certain essential requirements which must be fulfilled. Firstly, it must be a continuous course of dealing and, secondly, it must be carried on with a profit motive [*Mrs. Kamala Muthia v. CIT*, (2003) 259 ITR 184, 187 (Mad)].

4.3. 28. Profits and gains of business or profession

The following income shall be chargeable to income- tax under the head "Profits and gains of business or profession":-

- (i) the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year;
- (ii) any compensation or other payment due to or received by,-
 - (a) any person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto;
 - (b) any person by whatever name called, managing the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the terms and conditions relating thereto;
 - (c) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto;
 - (d) any person, for or in connection with the vesting in the Government, or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business;]
- (iii) income derived by a trade, professional or similar association from specific services performed for its members;
- (iiia) profits on sale of a licence granted under the

Imports (Control) Order, 1955 , made under the Imports and Exports (Control) Act, 1947 (18 of 1947);]

(iiib) cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India;]

(iiic) any duty of customs or excise re- paid or re- payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971;]

(iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;”

4.4. Explanation 2 to section 28 defines the expression

“speculation business”:-

The basic ingredients of speculative transactions, are as described hereunder, as per the decision reported in the case of CIT v. Ram Chandra Gupta & Co., (1968) 69 ITR 254, 259-260 (Cal) :-

(i) that the contracts are to be periodically or ultimately settled; and

(ii) the settlement would be otherwise than by actual delivery or transfer of commodity or scrips.

In other words, in order that a transaction may fall within the scope of the expression “speculative transaction”, it must be a transaction in which a contract for 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, as held in the case of *Bhandari Rajmal Kushalraj v. CIT*, (1974) 96 ITR 401, 403 (Mys).

The expression “ultimately settled otherwise than by actual delivery or transfer of the commodity or scrips” in the Income-tax Act definition means, by implication, that even at the outset the parties to transaction intended the performance or to claim the difference in price, if ultimately the contract is settled otherwise than by actual delivery or transfer of the commodity or scrips, it is a speculative transaction. The effect of the Income-tax Act definition is two-folds:

(i) where actual delivery of goods, or transfer of the commodity or scrips, takes place, the transaction is not a speculative transaction, however highly speculative it may be in fact; and

(ii) even if the original intention was not to gamble in differences, if in fact the contract is settled by payment of the difference, it is a speculative transaction for the purposes of the Act.

4.5. Section 43, to the extent it is relevant, reads as follows:-

43. In Sections 28 to 41 and in this section, unless the context otherwise requires-

(5) ***Speculative transaction*** means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is

periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips: Provided that for the purposes of this clause –

(a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or

(b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member (or)

(d) ***An eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) carried out in a recognized stock exchange shall not be deemed to be a speculative transaction.***

Explanation – For the purpose of this clause, the expressions –

(i) “eligible transaction” means any transaction –

(A) Carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and exchange Board of India Act, 1992 (15 of 1992) in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 (22 of 1996) and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognized stock exchange; ;and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act;

(ii) "recognized stock exchange" means a recognized stock exchange as referred to in clause (f) of section 2 of the Securities Contracts (Regulation) act, 1956 (42 of 1956) and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose;]

7. It is apparent, facially, that the term "speculative transaction" has been defined only in Section 43 (5). At the same time, it is qualified, i.e. that the scope of the definition is restricted in its application

to working out the mandate of Sections 28 to 41 of the Act. ***In terms of the Explanation to Section 73 (4) in the case of a company, business of purchase and sale of shares is deemed to be speculation business.*** However, certain companies are excluded from this Explanation which are:-

(i) a company whose gross total income consists mainly of income which is chargeable under the heads 'Interest on securities', 'Income from house property', 'Capital gains' and 'Income from other sources'.

(ii) a company, the principal business of which is the business of banking or the granting of loans and advances.

4.6. Section 73 of the Income Tax Act:-

Losses in speculation business: (1) Any loss, computed in respect of a speculation business carried on by the assessee, shall not be set-off except against profits and gains, if any, of another speculation business.

(2) Where for any assessment year any loss computed in respect of a speculation business has not been wholly set-off under sub-section (1), so much of the loss as is not so set-off or the whole loss where the assessee had no income from any other speculation business, shall, subject to the

other provisions of this Chapter, be carried forward to the following assessment year, and-

(i) it shall be set-off against the profits and gains, if any, of any speculation business carried on by him assessable for that assessment year; and

(ii) if the loss cannot be wholly to set-off, the amount of loss not so set-off shall be carried forward to the following assessment year and so on.

(3) In respect of allowance on account of depreciation, or capital expenditure on scientific research, the provisions of sub-section (2) of section 72 shall apply in relation to speculation business as they apply in relation to any other business.

Explanation – Where any part of the business of a company other than a company whose gross total income consists mainly of income which is chargeable under the heads “Interest on securities”, “Income from house property”, “Capital gains” and “Income from other sources”, or a company [the principal business of which is the business of trading in shares or banking or the granting of loans and advances consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be

carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

The Explanation to section 73 creates a deeming fiction that where the assessee is a company and where any part of the business of the company consists of the purchase and sale of shares of other companies, the assessee is for the purposes of section 73 deemed to carry on a speculation business, to the extent to which the business consists of the purchase and sale of shares - [CIT v. Lokmat Newspapers P. Ltd., (2010) 322 ITR 43 (Bom)].

By virtue of the legal fiction created by the Explanation inserted to section 73, even transactions which are not speculative transactions within the meaning of Section 43(5), should be deemed to be speculative if those come within the purview of the Explanation to Section 73 - RPG Industires Ltd. v. CIT, (2011) 338 ITR 313 (Cal).

In order to fall within the net of section 73, there need be a "business" of speculative transactions and it must be "carried on". Whether a number of transactions are or are not part of assessee's business was examined in Juvvi

Subbaramaiah & Co. v. CIT (1964) 51 ITR 742 (AP).

The loss on account of sale of units of the UTI within one month of their purchase was not a speculative loss. It was so held in the case of CIT v. Lakshmi Mills Co. Ltd, (2007) 290 ITR 663 (Mad).

The scope of section 73 read with section 28 Explanation 2 is to deal with the situation where loss in speculative transaction is sought to be set off against other business income. Section 73 provides that such loss can be set off only against income from speculative business. The object of the Explanation is to explain the scheme in the main provision to situations where part of business is from speculative transactions. To that extent the assessee will be deemed to be carrying on speculative business - Aravali Engineers P. Ltd. v. CIT, (2011) 335 ITR 508 (Punj).

5. The learned counsel for the assessee has relied upon the following decisions in order to support the contention that the assessee is neither doing any business in shares and securities nor speculative business and therefore the income of the assessee should be computed only under the head of short

term capital loss:

(i) Mysore Rolling Mills Pvt. Ltd. vs. Commissioner of Income Tax (195 I.T.R. 404 (Kar HC)):-

"What is required for speculation business is that the course of speculative transactions carried on by an assessee is of such a nature as to constitute a business. ***It is, therefore, necessary in each case to examine and find out whether the speculative transactions carried on by an assessee are of such a nature as to constitute a business.*** It may be that, in a given case, a single speculative transaction, on application of proper tests, may be found to constitute 'speculation business'. It may equally be true that a plurality of speculative transactions, on application of proper tests, constitute 'speculation business'. It would depend upon the facts of each case. It is not possible to accept the submission of learned standing counsel for the Revenue that no recognised tests are applicable for the purpose of determining whether an assessee is carrying on speculation business by reference to the nature of the speculative transaction carried on by him."

"The Explanation is attracted only when

part of the business of the assessee-company consisted of the purchase and sale of shares of other companies; it is only in such a situation that such dealing in shares is deemed to be carrying on a speculation business. According to Mr.Chandrakumar, learned counsel for the Revenue, the definition of "business" is quite wide and any particular venture will fall within the definition of "business". Learned counsel referred to the definition in section 2(13) wherein "business" includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. ***It is to be noticed that any kind of venture will not fall within this inclusive definition. The venture or the adventure will have to be in the nature of trade, commerce or manufacture.*** Basically, the concept of business involves a frequent activity of a particular nature. An isolated activity is opposed to the concept of business. As observed by an English court (extracted from p. 114 of Kanga and Palkhivala's The Law and Practice of Income Tax - Vol. 1, 7th edition).

"A single plunge may be enough provided it is shown to the satisfaction of the court that the

plunge is made in the waters of trade; but the sale of a piece of property - if that is all that is involved in the plunge - may easily fall short of anything in the nature of trade. Transaction of sale are characteristic of trade, but they are not necessarily distinctive of it; ***much depends on the circumstances.***"

(ii) Commissioner of Income Tax vs. Lakshmi Mills Co. Ltd. (2007 290 ITR 663 (Mad)):-

In the decision of the Supreme Court in Apollo Tyres Ltd. vs. Commissioner of Income Tax (2002) 255 ITR 273, wherein it is held as under (head-note):

"Even though section 32(3) of the Unit Trust of India Act, 1963, creates a fiction to make the UTI a deemed company and distribution of income received by the unit holder a deemed dividend for the purposes of the Income-tax Act, by virtue of those provisions it cannot be said that the section also makes the unit of the UTI a deemed share. The deeming provision in section 32(3) should be confined only to deeming the UTI a company and the income from units a dividend. In the absence of any specific deeming provision in regard to the units as shares it would be erroneous to extend the

provisions of section 32(3) for the purpose of holding the unit a share.

Held accordingly, that buying and selling of units by the assessee company could not be treated as a speculative business. The Explanation to Section 73 of the Income-tax Act did not apply. Loss in buying and selling of units of the UTI was business loss not speculation loss”.

(iii) Commissioner of Income Tax vs. Kamani Tubes

Ltd. (207 ITR 298 (Bom)):-

“So far as the legal proposition advanced by Mr. Jetly is concerned, we do not find any difficulty in accepting the same in view of section 43(5) of the Act which defines "speculative transaction" to mean 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. The meaning and scope of this expression is no more res integra in view of the decision of the Supreme Court in CIT v. Shantilal P. Ltd. [1983] 144 ITR 57. In that case, the Supreme Court explained the distinction between "a settlement of the contract otherwise than by actual

delivery of the goods" and "breach of contract". It was observed (at page 60) :

".... A contract can be said to be settled if instead of effecting the delivery or transfer of the commodity envisaged by the contract the promise, in terms of section 63 of the Contract Act, accepts, instead of it, any satisfaction which he thinks fit. It is quite another matter where instead of such acceptance the parties raise a dispute and no agreement can be reached for a discharge of the contract. There is a breach of the contract and by virtue of section 73 of the Contract Act the party suffering by such breach becomes entitled to receive from the party who broke the contract compensation for any loss or damage caused to him thereby. There is no reason why the sense conveyed by the law relating to contracts should not be imported into the definition of 'speculative transaction'. The award of damages for the breach of a contract is not the same thing as a party to the contract accepting satisfaction of the contract otherwise than in accordance with the original terms thereof. It may be that in a general sense the lay man would understand that the contract must be regarded as settled when damages are paid by way

of compensation for its breach. What is really settled by the award of such damages and their acceptance by the aggrieved party is the dispute between the parties. The law, however, speaks of a settlement of the contract, and a contract is settled when it is either performed or the promise dispenses with or remits, wholly or in part, the performance of the promise made to him or accepts instead of it any satisfaction which he thinks fit. We are concerned with the sense of law, and it is that sense which must prevail in sub-section (5) of section 43. Accordingly, we hold that a transaction cannot be described as a 'speculative transaction' within the meaning of sub-section (5) of section 43, Income-tax Act, 1961, where there is a breach of the contract and on a dispute between the parties damages are awarded as compensation...."

The above observation makes it abundantly clear that a transaction cannot be described as a "speculative transaction" within the meaning of section 43(5) of the Act where there is a breach of the contract and on a dispute between the parties damages are awarded as compensation.

(iv) Commissioner of Income Tax vs. Pangal Vittal Nayak and Co P.Ltd. (74 ITR 754 (SC))

"... the receipt of commission was a receipt from the business of the assessee as a broker and was not a receipt of income from the business of speculation and therefore the commission should not be assessed under the head "speculation business". In our opinion, the argument put forward on behalf of the appellant is well-founded and must be accepted as correct. The reason is that there is no element of speculation whatever, in the commission income received by the assessee. The commission was earned and received by the assessee independently of any fluctuation in the market and no risk was involved in the earning of the commission and so it must be treated as profit from the other business of the assessee and not as profit from speculation business"

(v) Commissioner of Income Tax vs. Hotz Hotel Ltd. (260 ITR 132 (DEL)):-

".... Clause (5) of Section 43 of the Income-Tax Act, 1961, defines speculative transaction to mean a transaction in which a contract for the purchase or sale of any commodity, which may

include stocks and shares, is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scripts. However, certain exceptions to the definition of "speculative transaction" are provided in a proviso to section 43(5). Clauses (a), (b) and (c) of the proviso enumerate the contracts which are not deemed to be speculative transactions. Clause (b) provides that a contract in respect of stocks and shares entered into by a dealer or investor to guard against loss in his holdings of stocks and shares through price fluctuations shall not be deemed to be a speculative transaction. Proviso (b) contemplates a transaction which is entered into to safeguard the fall in price of the holding of stocks or shares. It is a hedging contract to protect oneself against loss on account of adverse price fluctuations. The pre-requisites for being classed as a hedging contract and to fall within the ambit of the said proviso are : (i) a contract in respect of stocks or shares, and (ii) entered into guard against loss in the holdings of stocks and shares through future price fluctuations. The question about the existence of the contract and the intention to enter into such a contract, on which the answer to the question whether a

transaction is a hedging transaction or not rests, is primarily one of fact, necessarily to be determined on appreciation of facts surrounding the transaction."

(vi) Commissioner of Income Tax vs. H.Hollock Larsen (160 ITR 67 (SC)):-

"Held, (i) that *the* question whether the transactions of sale and purchase of shares were ***trading transactions or were in the nature of investment*** was a mixed question of law and fact.

In order to determine whether one was a dealer in shares or an investor, the real question was not whether the transaction of buying and selling the shares lacks the element of trading, but whether the later stages of the whole operation show that the first step – the purchase of the shares – was not taken as, or in the course of, a trading transaction. The ***totality of all the facts will have to be borne in mind*** and the correct legal principles applied to these."

"... Investors face an unknown and uncertain future and try to diversify the investments. As a general law, it was emphasised at page 603 of the book, growth of capital was a desirable objective of

portfolio management. This did not mean that every investor must invest in growth stocks; this would be inconsistent with many investor's needs. A fund can be built up from reinvested income as well as through the purchase of growth shares. A large fund does provide more income for the investor than a small fund. Many investors have increased the capital value of their funds through reinvested dividends and interest income. Some wanted income, some capital gains and some a combination of both. In spite of these variations, several objectives should be considered as a basis to a well-executed investment programme. The guiding principles establish the indifference curve of risk versus return for the investor."

6. Contending that, even a single transaction on share would amount to speculative business and therefore, the assessee is not entitled to set-off the loss as against its business income the following decisions are relied upon by the learned counsel for the respondent:-

(i) **R.P.G. Industries Ltd. v. CIT and another (2011) 338 ITR 313 (Cal.):-**

" In the case of **S.Sundaram Pillai v.**

V.R.Pattabiraman, AIR 1985 SC 582, the Supreme Court laid down the general rule of 'interpretation of an explanation' in the following way:-

"It is now well settled that an Explanation added to a statutory provision is not a substantive provision in any sense of the term but as the plain meaning of the word itself shows it is merely meant to explain or clarify certain ambiguities which may have crept in the statutory provision. Sarathi in 'Interpretation of Statutes' while dwelling on the various aspects of an Explanation observes as follows:

"(a) The object of an explanation is to understand the Act in the light of the explanation.

(b) It does not ordinarily enlarge the scope of the original A section which it explains, but only makes the meaning clear beyond dispute."

Swarup in 'Legislation and Interpretation' very aptly sums up the scope and effect of an Explanation thus:

"Sometimes an explanation is appended to stress upon a particular thing which ordinarily would not appear clearly from the provisions of the section. The proper function of an explanation is to make plain or elucidate what is enacted in the substantive provision and not to add or subtract from it. Thus an explanation does not either restrict or extend the enacting part; it

does not enlarge or narrow down the scope of the original section that it is supposed to explain .. The Explanation must be interpreted according to its own tenor; that it is meant to explain and not vice versa."

(P.P. 297-298.) Bindra in 'Interpretation of Statutes' (5th Edn.) at page 67 states thus:

"An explanation does not enlarge the scope of the original section that it is supposed to explain. It is axiomatic that an explanation only explains and does not expand or add to the scope of the original section.. The purpose of an explanation is, however, not to limit the scope o the main provision.. The construction of the explanation must depend upon its terms, and no theory of its purpose can be entertained unless it is to be inferred from the language used. An 'explanation' must be interpreted according to its own tenor ."

....

Thus, from a conspectus of the authorities referred to above, it is manifest that the object of an Explanation to a statutory provision is-

- (a) to explain the meaning and intendment of the Act itself,
- (b) where there is any obscurity or vagueness in the main enactment, to clarify the same so a- to make it consistent with the dominant object which it seems to

subserve, (1) [1967]1 S.C.R. 848.

(2) [1977]2 S.C.R. 790.

(c) to provide an additional support to the dominant object of the Act in order to make it meaningful and purposeful,

(d) an Explanation cannot in any way interfere with or change the enactment or any part thereof but where some gap is left which is relevant for the purpose of the Explanation, in order to suppress the mischief and advance the object of the Act it can help or assist the Court in interpreting the true purport and intendment of the enactment, and

(e) it cannot, however, take away a statutory right with which any person under a statute has been clothed or set at naught the working of an Act by becoming an hindrance in the interpretation of the same.

(ii) CIT v. DLF Commercial Developers Ltd., (2013)

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"8. [Section 43](#) defines, for the purpose of [Sections 28 to 41](#), certain terms. These latter provisions fall in Chapter IV, in Section D, which deal with computation of business income. The said provisions provide for matters relating to computation of such income, rent taxes, insurance of buildings, repairs of plant and machinery, depreciation, reserves for shipping business,

rehabilitation fund, expenditure on certain eligible objects or schemes, deductions, amounts not deductible, profits chargeable to tax, etc. The assessee is no doubt correct in contending that the only definition of derivatives is to be found in [Section 43](#) (5); yet the Court cannot ignore or overlook that the definition - to the extent it excludes such transactions from the mischief of the expression "speculative transactions" is confined in its application. Parliamentary intendment that such transactions are also excluded from the mischief of Explanation to [Section 73](#) (4), however, is not borne out.

9. In this context, it would be instructive to notice that in *Rajshree 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 derivative 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.

ITA 94/2013 Page 10 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."

(iii) Eastern Aviation and Industries v. CIT, 208 ITR

1023:-

"6. The expression "investment company" has been defined in [Section 109\(ii\)](#) of the said Act as under :

'investment company' means a company whose gross total income consists mainly of income which is chargeable under the heads 'Interest on securities', 'Income from house property', 'Capital gains' and 'Income from other sources'."

....

8. It is by now well-settled that the words "income" or "profits and gains" should be understood as including losses also so that in one sense "profits and gains" represent "positive income" whereas "losses" represent "negative income". In other words, "loss" is "negative profit". Both positive and negative profits are of revenue character. Both must enter into computation, wherever it becomes material, in the same mode of the taxable income of the assessee. Reference, in this context, may be made to the decision of the Supreme Court in [CIT v. Harprasad and Co. P. Ltd.](#) [1975] 99 ITR 118. The Supreme Court in the case of [CIT v. J.H. Gotla](#) [1985] 156 ITR 323, in construing the word "income" in [Section 16\(3\)](#) of the Indian Income-tax Act, 1922, held that the word "income" would include loss."

(iv) Paharpur Cooling Towers v. CIT (2011) 338 ITR

295 (Cal):-

"The Explanation to any section cannot be read to extend or stretch the applicability of that section. The Explanation creates a fiction and that fiction cannot be

read or explained for any purpose other than that for

which it is created. The fiction created in the Explanation does not take away the real object and purport of section 73 of the Income-tax Act, 1961. Section 73 generally provides that any loss arising out of speculation business can be set off only against another speculation business of the assessee. The word "assessee" in sub-section (1) covers all types of assessees as mentioned in section 2(7) of the Act which includes individuals and companies. Sub-section (2) of section provides that where the loss arising out of speculation business which cannot be set off in a particular assessment year fully the balance may be carried forward for the next assessment year and so on not exceeding eight assessment years immediately after succeeding year as provided in sub-section (4). Under the Explanation, all companies are not included within the word "assessee" as mentioned in Section 73. Companies other than those whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities" "Income from house property", "Capital gains" and "Income from other sources" or a company the principal business of which is the business of banking or granting of loan and advances consists in purchase and sale of shares of other companies, shall be for the purpose of this

section, be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of shares. Thus, the Explanation has really employed a restricted meaning of the word "assessee" as mentioned in Section 73. The Departmental Circular cannot be treated as a guide for interpretation of the section when the same with Explanation is very clear and free from any ambiguity. By virtue of Explanation 2 to section 28 of the Act business of speculative transaction must be distinct and separate from any other business. Thus, any speculative transaction cannot be treated as speculative unless such a transaction takes place as a part of business activity of the assessee concerned. It is not necessary that the assessee must carry on speculative business exclusively – it can be one of the businesses but this must be distinct and separate from any other business. The definition of speculative transaction in section 43(5) demands that there must be actual delivery or transfer of the commodity or scrip. Only if it is by way of a paper transaction it can be said to be a speculative transaction. The Explanation to section 73 will be applicable in respect of companies and companies alone and not any other assessee, namely, individuals or other assessees. However, part of the business of a company other than a few category of companies as mentioned therein, shall be treated as

speculation business, if such part consists of the purchase and sale of shares, not other category of speculative dealings. If on a clear and plain reading the statute can be applied without any difficulty or without any aid whatsoever, then the objects and reasons need not be looked into.”

6.1. The decisions relied upon by the learned counsel for the respondent are not applicable to the facts of the case.

7. As held in the decisions relied upon by the learned counsel for the assessee, the facts and circumstances of each case is relevant to find out, whether the transaction alleged would amount to speculative transaction or not.

8. In order to decide that, the nature of the transaction alleged is important, it has been stated the order of Commissioner of Appeals that the appellant has not purchased the shares as a dealer; shares were purchased because of certain financial problems of the sister company viz., Madras Cements Limited. Subsequently, when the shares were sold the market had not been favourable to the assessee and that is how he sustained loss. There is no intention to speculate

and to benefit out of the speculation as there was a clause in the Memorandum of Association to invest surplus funds in shares, the appellant has chosen to invest fund in shares. Moreover, the transaction is not periodic. It was also not settled otherwise than by actual delivery. Only when there is settlement otherwise than by delivery speculative transaction can be thought of. In the present case, it is not so. As the main activity is only in manufacture and sale of yarn, the purchase of shares, having not been regular, should be construed only as an investment. When there is no systematic or organised course of activity and when there is no regularity in the transaction and as the purchase is infact an one time activity it cannot be construed as a speculative transaction. When the purchase of shares cannot come within the definition of business, under Section 2(13) of the Income Tax Act, 1961, there is no point in contending that the assessee is engaged in the business muchless in a speculative business. Therefore, the Assessing Officer ought to have allowed the loss, as short term capital loss and set off against the other business income of

the appellant Company. As the appellant Company had properly delivered the shares at the time of selling, the transaction would not come under the provisions of Section 43 (5) of the Income Tax Act, 1961. When the provisions of Section 43 (5) is not applicable to the facts of this case, the contention that the case of the assessee would be covered under explanation to Section 73 of the Income Tax Act, 1961, cannot be accepted. As the genuineness of the transaction is not doubted the contention of the Revenue that it is a case of avoidance of tax liability by dubious means also cannot be accepted.

9. In the result, the appeal filed by the Assessee is allowed. The order passed by the Income Tax Appellate Tribunal in I.T.A.No.20/mds/1997 is set aside. No costs.

(M.J.J.) (S.V.J.)
29.01.2016

Internet : Yes/No
Index : Yes/No
arr/srk

M.JAICHANDREN, J.
and
S.VIMALA, J.

arr/srk

To

1. The Deputy Commissioner of Income Tax,
Special Range-I,
Madurai.
2. The Income Tax Appellate Tribunal, Chennai 'B' Bench,
Chennai.

T.C.A.No.1077 of 2004

29.01.2016