

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

Summary – The Ahmedabad ITAT in a recent case of Magic Share Traders 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 applicable; and such loss would be set off against income from business

Disallowance under section 14A could not exceed exempt dividend income itself

Facts

- The assessee-company was engaged in the trading and investment in shares and securities, mutual funds and future & options, *i.e.*, F & O trading in shares and securities. During the year, the assessee had carried out transactions in shares in cash segment as well as in derivative segment. The assessee had incurred losses of certain amount from F & O business, *i.e.*, in derivative business and earned profits of certain amount from share trading in cash segment. Thus, while the assessee incurred losses in derivative segment, it had earned profits in cash segment, *i.e.*, on account of ordinary action of purchase and sale of shares simplicitor. The assessee claimed set off losses arising from derivatives against business income.
- On these facts, the Assessing Officer invoked the Explanation to section 73 and held that losses arising from derivative transactions were in the nature of speculative loss and, thus, not allowed to be set off against other streams of income reported in the return of income except income arising in cash segment of speculative nature.
- On appeal, the Commissioner (Appeals) also sustained the action of the Assessing Officer towards denial of set off of losses arising in derivative segment from income arising in other streams of business except speculative income arising in cash segment.
- On second appeal:

Held

- The substantive question that arises for adjudication is whether loss incurred in eligible transactions *i.e.* derivative transactions within the meaning of proviso (d) to section 43(5) not involving any purchase or sale of shares *per se* can be regarded as speculative loss for the purposes of set off in view of Explanation to section 73 or not. The controversy involved in the present case is thus essentially legal in nature.
- In the present appeal, the assessee seeks set-off of losses arising from derivative losses as non-speculative business loss. In contrast, the revenue has labelled the loss arising from derivative transactions as 'speculative loss' and has consequently denied set off of such losses from regular income of non-speculative nature etc. by applying Explanation to section 73.

- One shall first advert to the pivotal contention on behalf of the assessee that Explanation to section 73 cannot apply to loss arising from derivative transactions which are categorically excluded from being regarded as speculative business as defined under section 43(5) read with proviso (d) thereto. Identical issue arose before the Calcutta High Court in the case of *Asian Financial Services Ltd. v. CIT* [2016] 70 taxmann.com 9/240 Taxman 192 relied upon. The Calcutta High Court held that once it is deemed to be a normal business loss on the basis of proviso appended to section 43(5), a question of applying section 73 or the Explanation thereto for the purposes of refusing loss to be set off against business income is wholly incorrect. The Calcutta High Court took a stand that derivatives cannot be treated at par with shares for the purposes of Explanation to section 73 because the legislature has treated it differently. Thus, in view of the aforesaid position enunciated by the High Court in *Asian Financial Services (supra)*, it is good deal of force in the case of assessee. The claim of the assessee thus requires to be allowed on this ground alone.
- In view of the resounding conclusion drawn in favour of the assessee on the aforesaid legal position, one does not consider it necessary to advert to other alternative contentions raised on behalf of the assessee.