



Deemed Speculation loss

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Deemed Speculation loss..

[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 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 the 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*.]

Observations of Wanchoo Committee

- ✦ Manipulation of profits by **business houses** by trading in shares of **group companies** and incurring losses thereon
- ✦ Consequence: Tax Avoidance
 - Can be checked by treating such loss as speculation loss
 - Relief can be given for investment co.

History

✚ Introduced w.e.f. 1st April, 1977

- Loss in business of purchase or sale of shares by companies, other than *investment, banking or finance companies* or a Company *whose principal business is granting of loans and advances*

✚ Circular no. 204 dt. 24th July, 1976

- Object of this provision is to curb the device sometimes resorted to by *business houses controlling group of companies* to manipulate and reduce the taxable income of companies under their control

Example 1

- ✦ A Investment Ltd. engaged wholly in trading in shares and securities
- ✦ No business other than trading in that yr.
- ✦ Main object as per memorandum also to be a trader in shares and securities
- ✦ Brief summary
 - Loss in share trading (-) 10 lacs
 - Loss from derivative tr. (-) 2 lacs
 - Loss from trading in mutual (-) 5 lacs

Will that loss be allowed to be c/fd as business loss?

Reply to Example 1

✱ *Arvind Inv. Ltd. v. CIT [192 ITR 365 (Cal)]*

✱ It was held that whole includes part.

✱ Derivatives – Amendment by F/Act 2005

✱ Units covered by *Apollo Tyres Ltd [255 ITR 273]*

Implication:

Even if entire business consists in purchase and sale of shares, such business shall be treated as speculation business.

Controversial judgment

✦ Mumbai ITAT

- *Swamini Leasing & Investments Private Limited [ITA no. 2150/Mum/2000 dated 8.3.2004] reported in 39 BCAJ 293*
 - Explanation not applicable when only dealing in shares

Example 2

- E Inv.Ltd engaged in the business of share trading and investments
- Computation for relevant year given on next slide

Whether the said computation is correct or not?

....Computation

<u>Profit from Business: (other than sp.)</u>		
Share Trading Loss	(12.90)	
Interest attributable to share trading loss	(7.95)	(20.85)
Speculation Loss (carried forward)	(8.20)	--
<u>Income from other sources</u>		
Interest income	3.87	3.87
GROSS TOTAL INCOME		(16.98)
Loss Carried forward		
Speculation loss		(8.20)
Business Loss		(16.98)

Reply to Example 2

- ✦ Decided in *Eastern Aviation & Ind. Ltd. v. CIT [208 ITR 1023 (Cal)]*
- ✦ Assessee contended that IOS being positive should be treated as main income.
- ✦ Held:
 - Loss means negative income
 - Quantum of both profit (positive income) and loss (negative income) should be compared
- ✦ Recently, Calcutta HC passed another judgment holding similar view

Recent judgment

✦ *Aryasthan Corporation Ltd v. CIT [253 ITR 401 (Cal)]*

- Facts : IOS 24000/- and loss in share trading 450779/-
- Held : Loss in share trading being a higher figure, has to be treated as main business

IOS – Analyzed...

- **Interest income** – business income or OS
 - Interest income may constitute ‘business income’, if investment yielding int. was done in course of business.
 - ‘business’ - Real, substantial & organised activity
 - *Narain Swadeshi Weaving Mills V. CEPT [26 ITR 765(SC)]*
 - Check
 - Whether deployment of surplus funds
 - Advancing loans is part of regular business activity

IOS – Analyzed...

✦ Dividend income – whether business or OS

- *CIT v. Excellent Commercial Enterprises and Investments Ltd. 282 ITR 423 (Del)*
 - Once it was held that the shares held by the assessee was stock-in-trade, the income, whether directly or incidentally from holding of such shares as stock-in-trade, would be business income
- *Smt Rekha Bharat Chedda vs ACIT 311 ITR 187 (AT)*
 - Dividend should always be treated as exempt

Example 3

- ✦ S Company Ltd. engaged in business of manufacturing activities, share trading and investments
- ✦ Computation for relevant yr on next slide

Whether the said computation is as per law?

....Computation

<u>Profit from Business: (other than speculation)</u>		
Share Trading Loss	(25.00)	
Business Profit	27.00	2.00
<u>Income from other sources</u>		
Interest income	5.00	5.00
TOTAL INCOME		7.00

Reply to Example 3

• Similar case in *Rajen Enterprises Limited [41 ITD 469 (Mumbai ITAT)]*

- This section comes in Chapter VI which deals with set off and carry forward of loss
- Chapter VI comes into play only after income or loss computed under five heads of income
- One has to first find out chargeable income under each head & then see applicability of Chp. VI

Recent Calcutta HC judgment – favoring revenue

– **CIT v. Park View Properties Pvt Ltd [(2003) 261 ITR 473(Cal)]**

- Facts : Return of income show Business income of 333670/- and OS of 573701/-. Business loss arrived at after setting off loss in share trading of 898799/-
- Held :
 - Eastern Aviation case will apply
 - Loss in share dealing of to be treated as negative profit

– Similar view held by **Kolkata ITAT in RPG Industries Ltd. vs. ACIT [85 ITD 105]**

Mumbai Special Bench holds different view

✪ **ACIT Vs. Concord Commercials Pvt. Ltd. [94 TTJ 913 (Mum, SB)]**

– Profit from trading in steel, yarn etc.	283.29L
– Loss in share trading	(-)284.26L
– Dividend (from stock)	10.19L

- **HELD**
- GTI consists of mainly of dividend income, chargeable as OS irrespective of shares held as stock
- Deeming provision has to be strictly construed
- Cir. No. 103 dt. 17th Feb, 1973 interpreted the word 'mainly'
- If (IOS+HP+CG) > 50% of GTI, Expl. to S.73 not apply

Example 4

- G Company Ltd. engaged in the business of commission, share trading and granting of loans
- P/L A/c for the relevant year given on the next slide

.....Profit and Loss A/c

<u>INCOME:</u>		
Commission Income	3.35	
Interest Income	1.03	
Loss in Share Trading	(1.77)	2.61
<u>EXPENDITURE:</u>		
Commission Paid	(2.70)	
Administrative and Other Expenses	(1.08)	(3.78)
Loss under the Head Business		(1.17)

Whether the above is as per law?

Reply to Example 4

- Unreported Calcutta ITAT judgment in the case of *G.P.Trading Pvt Ltd [ITA No. 223/Cal/91]*
 - Held that fund was mainly deployed in loans
 - Income criteria is not important to determine principle business
 - Thus '*fund deployment test*' was considered relevant to determine principle business

Principal business..... 'Fund criteria'

Kanoria Investments (P) Ltd [232 ITR 7]

- 'Fund deployment test' – an important criteria to determine 'principal business'

Offshore India Ltd [15 ITD 549(Cal ITAT)]

- Objects in the M/A are not conclusive of the nature of business carried on by the company
- activity which the company actually engages in also determines the nature of its business
- If amt invested in money lending business is more than amt invested in share business, then principal business shall be deemed to be money lending

Principal business... 'Income criteria'

✦ *Melville Finvest Ltd vs. JCIT [89 ITD 528 (Hyd)]*

- Composition of GTI & not percentage of funds held as investments, material for considering applicability of Expl. to s.73.
- Similar view held in *JCIT v. Haldia Inv. Ltd. [85 ITD 212 (Kolkata)]*

“principal business” ??? – analyzed

- ✿ Not defined in the Act
- ✿ Fund Deployment or income criteria ?
- ✿ Current figures or past history?
- ✿ RBI directions for NBFC – Both assets and income pattern are to be considered to determine principal business
- ✿ The issue is still controversial

.....Recent Conflicting Decision

✦ *Kolkata ITAT gave a unique way of determining 'principal business'*

– *DCIT Vs. Venkateshwar Inv. & Finance (P) Ltd. [(2004) 92 TTJ 1129 (Cal)]*

- Loss in share dealings in one particular year – cannot be criteria to determine **principal business**
- Will depend on M/A, past history, current and past year's deployment of funds, break up of income earned, nature of activities etc.

Example 5

- ✦ S Ltd. engaged in trading of various goods
- ✦ Purchased some shares, held as stock-in-trade
- ✦ Loss due to valuation of closing stock
- ✦ Contention of assessee:
 - Deeming provision applies only when *purchase & sale* takes place in same year

Your Views???

Reply to Example 5

✦ Decided in *Sun Distributors & Mining Co. Ltd. v. CIT* [68 Taxman 223 (Cal)]

✦ Held

- “*Purchase and sale of shares*” not necessarily means that same should take place in same yr.
- What is important is that there needs to be a business of purchase and sale of shares

Mumbai ITAT holds different view

– Trade Team P. Ltd v. DCIT [54 ITD 306(Mumbai)]

- Held that a solitary transaction cannot be regarded as business activity unless proved otherwise by the Dept.
 - Kruti Marketing P Ltd's [118 Taxman 194]*
 - Modella Woollens Mills [101 TTJ 1009(Mum)]*

Calcutta ITAT – Recent judgment

Paharpur Cooling Towers Limited 85 ITD 745 *(Kol)*

- Even if loss is on account of valuation, it is loss from business and hence Explanation would apply

Purchase whether includes allotment..

- *Ginni Finance (P) Ltd. v. ITO (ITA No. 2827 of 2001 - Cal)* – unreported
 - Purchase does not include shares acquired by way of application and consequent allotment
 - Similar view held in *Naseeb Holding Pvt. Ltd. vs. ITO in ITA no. 2824 (Cal) of 1997*
- Special Bench' order favoring Dept
 - *AMP Spinning & Weaving Mills Ltd V. ITO [100 ITD 142 (Ahd)]*
 - Purchase includes shares acquired by way of allotment

Example 6

- ✘ A.T. Ltd. engaged in manufacturing business
- ✘ Purchased some units of UTI before dividend date and sold it after some days
- ✘ Loss on such sale - dividend was exempt
- ✘ Company not doing any financial activities
- ✘ Issue :
 - *Whether explanation will apply on this co.?*

Reply to Example 6

✦ Decided in *Apollo Tyres Ltd. v. CIT [255 ITR 273 (SC)]*

✦ Held:

- Units of mutual fund are not shares
- Hence Explanation to Section 73 will not apply

Example 7

- ✦ W. Ltd. engaged in investment in shares – no other business
- ✦ Suffer losses shown under the head 'Loss under the head Capital Gains'
- ✦ Issue :
 - *Whether explanation will apply on this company?*

Reply to Example 7

Decided in *Western Metal Caps Limited [(1999) 110 Taxman 237]*

- Held : Explanation does not apply on '*investments*' hence loss will be carried forward as short term capital loss

Relevance of legitative intent

• *Whether Explanation apply where loss not in a business house?*

– Favouring assessee

• ***Aman Portfolio (P) Ltd v. DCIT [92 TTJ 351(Del)]***

- No material to show that assessee was a company controlled by a business house
- No evidence to prove that transactions were done to reduce taxable income

Held

- loss could not be treated as speculative

Relevance of legislative intent

✦ *Whether Explanation apply where loss not in a business house?*

– Favouring Revenue

- ***DCIT Vs. Frontline Capital Securities Ltd 96 TTJ 201(Del ITAT)***
- ***Rohini Capital Services Ltd 92 ITD 317 (Del)***
- ***Arvind Investments Ltd***
- ***Circular Para 19.1***

• Alternative judgment

- ***SC in Gwalior Rayon Silk Mfg. Co. Ltd 196 ITR 149*** held that when the language used in the section is unambiguous, there is no basis to look at the objective or intention.

Hyderabad ITAT innovates....

– *Godavari Capital Ltd. Vs. DCIT [273 ITR 10 (Hyd)]*

- Net loss of 9.61 L from non-speculative and profit of 6.61 L from speculative
- Commission income of 2.30 L & OS of 4.87L
- Held
 - Speculative – there is no loss
 - Explanation is only for purposes of s.73 & where section doesn't apply, Explan. cannot be invoked.

Share Brokers.....

✿ Whether Explanation to section 73 apply to share brokers?

- *SRJ Securities Ltd. Vs. ACIT [86 ITD 583(Delhi)]*
 - Expl. to section 73 will also apply on stock brokers.
 - Similar view - in *Merfin (India) Ltd [80 ITD 399(Hyd)]*
- However, in *GDB Share & Stock Broking Services Ltd [(2004) 3 SOT 569 (Kol)]*, in case of sharebroker, loss in carrying transactions on behalf of clients not treated as speculative.

Explanation to S.73 – Summing up

- ✦ Applies only to corporate assessee
- ✦ Applicable only on share transactions – Not on mutual fund units
- ✦ Not applicable on loss arising on sale of investments
- ✦ Deeming provision to be applied strictly within four corners of law
- ✦ Certain exceptional categories
 - GTI *'mainly'* consists of income from HP, CG, and OS
 - *Principal business* is banking or granting of loans