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## Loss arising to a company on non-speculative transactions of the purchase and sale of shares held to be speculative loss

### In brief

In a recent ruling, the Calcutta High Court (“the Court”), in the case of Paharpur Cooling Towers Ltd. (“the Assessee”)<sup>1</sup>, held that in the case of companies, the Explanation to section 73 of the Income-tax Act, 1961 (“the Act”), which has been enacted for special purposes, overrides the other provisions of the Act. Hence, loss on the purchase and sale of shares held as stock-in-trade would be treated as loss arising from speculation business within the meaning of Explanation to section 73

of the Act, though the transaction would not be otherwise treated as a speculative transaction within the meaning of section 43(5) of the Act.

### Facts

The assessee, a public limited company, was engaged in the manufacturing of Cooling Towers and in the business of selling and purchasing shares.

For the assessment year 1994-95, the assessee had filed its return showing net income under the head ‘Profits and Gains of business or profession’ after adjusting a loss arising from the purchase and sale of shares held as stock-in-trade.

<sup>1</sup> Paharpur Cooling Towers Ltd. v. CIT [ITA No. 256 of 2002]

The assessing officer (“AO”) did not allow the loss to be set off against the profits from business, but treated the loss as loss arising from speculation business in terms of the provisions of Explanation to section 73 of the Act.

The Commissioner of Income-tax (Appeals) (“CIT(A)”) and the Income-tax Appellate Tribunal (“the Tribunal”) upheld the decision of the AO, which resulted in the current appeal before the Court.

### Issue

Whether, in relation to transactions of the purchase and sale of shares which are not covered by the provisions of section 43(5) of the Act, which defines speculative transactions, loss arising from the purchase and sale of shares can be treated as loss from speculation business by application of the Explanation to section 73 of the Act.

### Assessee’s contentions

The assessee contended as follows:

- There was no finding that the purchase and sale of shares was not affected by the physical and actual delivery of shares, and hence, the transactions carried out by the assessee were not ‘speculative transactions’ in terms of the provisions of section 43(5)<sup>2</sup> of the Act.
- Explanation 2 to section 28 of the Act provides that where speculative transactions carried on by an assessee are of such a nature as to constitute a

business, the business shall be deemed to be distinct and separate from any other business.

- Section 73(1) of the Act provides that, in respect of a speculation business carried out by the assessee, any loss shall not be set off except against the profits and gains, if any, of another speculation business. Accordingly, the scheme of events would be that if the speculative transactions, which constitute a business, are to be treated as a speculation business, then the losses arising therefrom shall be allowed to be set off only against the profit and gains of an another speculation business.
- The object of introducing section 73 to the Act was specifically to unearth black money and prevent its proliferation and to fight and curb tax evasion to check avoidance of tax through various legal devices.
- The object of introducing the Explanation was not to treat all the transactions of the purchase and sale of shares and loss arising therefrom as speculative loss. This amendment is not applicable to all assessees. It is only in the case of companies, even though the purchase and sale of shares effected by the physical delivery of shares are treated as speculative business.
- The Court has to interpret the section in the light of its object. The literal interpretation may give rise to unintended results. Hence, the Court has to interpret the Explanation in the light of the object of the clause.
- The Explanation to section 73 of the Act creates a fiction which is to be applied only for the purpose, and the object, of that section and cannot be extended to include the purchase and sale of shares which are *bona fide* entered into by physical delivery of shares for a consideration.

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<sup>2</sup> Section 43(5) defines a speculative transaction as ‘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’.

- Hence, the assessee prayed before the Court to allow set-off of the losses arising on the purchase and sale of shares held as stock-in-trade under section 72 of the Act as normal business losses.

### Revenue's contentions

The Revenue's contentions were as follows:

- Explanation 2 to section 73 of the Act applies to company assessee only. Certain categories of companies are expressly excluded from the purview of this Explanation which creates a legal fiction and must be applied in its context.
- Furthermore, section 43(5) and Explanation 2 to section 28 of the Act are general provisions and definitions which define the terms 'speculative transaction' and 'speculative business', whereas section 73 of the Act is a specific provision for the purpose of speculative losses. Hence, there is no conflict between the Explanation to section 73 on the one hand and section 43(5) and the second Explanation to section 28 of the Act on the other.
- The phraseology used in section 73(1) of the Act and the Explanation thereof are clear, unambiguous and admit no dispute. Hence, purposeful construction of the mischief rule as laid down by the Supreme Court in the case of *S. Sundaram Pillai*<sup>3</sup> shall not apply.
- Based on the above, the Revenue argued that even in a case where the entire business of the assessee is the purchase and sale of shares, the Explanation to section 73 would apply.

### Court's Observations and Ruling

The Court observed as follows:

- On reading section 72 of the Act it appears that in order to get the benefit of carry forward and setting-off of business losses, the nature of the business must not be a speculative one. Section 73 of the Act is specifically for dealing with losses in speculative business.
- The Explanation to section 73 of the Act creates a fiction and it is well settled by several judgments of the Supreme Court that a fiction cannot be read or explained for any purpose other than the one for which it is created.
- Keeping in view the aforesaid proposition of the law, a reasonable interpretation of section 73 of the Act with the Explanation does not abridge or extend the purpose incorporated in section 73 of the Act, taking away the real object and purport of section 73 of the Act.
- The expression 'assessee' in sub-section (1) of section 73 of the Act covers all types of assesses, and includes a company. The Explanation to section 73 of the Act mentions that not all companies are included within the expression 'assessee' for the purpose of section 73 of the Act. The Explanation restricts the meaning of the expression 'assessee' for the purpose of section 73 of the Act and renders it applicable to companies only and not to any other assessee.
- Explanation 2 to section 28 of the Act provides that the 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

<sup>3</sup> *S. Sundaram Pillai and Others v. V R. Pattabiraman and Others* [1985] 72 AIR 582 (SC)

transaction takes place as a part of the business activity of the assessee. Speculative business can be one of the businesses of the assessee and must be distinct and separate from any other business. In this case, the assessee was carrying on the business of the purchase and sale of shares and also other business.

- To apply the fiction of section 73, read with Explanation, the business of the assessee must be speculative business which, in its turn, must be a speculative transaction. All speculative businesses would amount to speculative transactions but not vice versa.
- Also, the Explanation to section 73 of the Act contains a deeming clause, that the definition of speculation business includes not only settlement on paper, but also actual delivery of scrips.
- On a clear and plain reading, if it appears that the provisions of the statute can be applied without any difficulty or without any aid whatsoever, then the object and reasons need not be looked into by the Court.

## **Conclusion**

Explanation to section 73 of the Act is clear and unambiguous and is for a set of assessee companies. Section 43(5), read with Explanation (2) to section 28 of the Act, does not render transactions undertaken by companies covered by the Explanation to section 73 of the Act to be non-speculative.

Based on the above findings, the Court concluded that the Explanation to section 73 of the Act does not bring about any non-conformity with the object and purpose for which section 73 of the Act was enacted. It was further held that the provisions of section 73 and of the Explanation thereto override the other provisions of the Act.

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