IN THE INCOME TAX APPELLATE TRIBUNAL "L", BENCH MUMBAI

BEFORE SHRI B.RAMAKOTAIAH, AM & SHRI VIJAYPAL RAO, JM

ITA No.3598/Mum/2010

(Assessment Year :2007-2008)

Platinum Investment Management Ltd., A/c Platinum International Fund, C/o. S.B.Millimoria & Co., 264-265, Vaswani Chambers, Dr. Annie Besant Road, Worli, Mumbai-400 018.	Vs.	DDIT(International Taxation)-4(2), Mumbai
PAN No. : AABTP 2973 J		
(Appellant)	..	(**Respondent**)

Assessee by : Mr. F.V.Irani
Revenue by : Mr.Mahesh Kumar

सुनवाई की तारीख / **Date of Hearing : 20th Nov., 2012**
घोषणा की तारीख/**Date of Pronouncement : 5th Dec.,2012**

आदेश / O R D E R

***PER VIJAYPAL RAO (JM)*:**

This appeal by the assessee is directed against the order dated 29-3-2010 of CIT(A)-11, Mumbai for the assessment year 2007-08 on the following grounds :-

"1. Based on the facts and circumstances of the case, the learned Commissioner of Income-tax (Appeal) ['CIT(A)'] erred in upholding the action of the Assessing Officer ('AO') in treating the net loss arising on derivative transaction of Rs.41,42,03,363/- as business loss as against capital loss claimed by your Appellant having failed to appreciate that your Appellant have invested in derivative transactions and so the income arising from derivative transaction is capital gains/loss and not business income/loss.

2. Without prejudice to ground of Appeal No.1 above, the CIT(A) erred in confirming the action of the AO in ignoring the business loss, by suo motu applying the provisions of the Treaty between India and Australia to put the Appellant into a disadvantageous position as compared to the provisions of the Act having failed to appreciate that the

provisions of the treaty are applicable only to the extent that they are more beneficial than the provisions of the Act as per Section 90(2) of the Act.

3. Without prejudice to (1) above, net business loss from derivative transaction be set off against capital gains arising on sale of shares as per section 71 of the Act."

2. The assessee is a sub-account of the Foreign Institutional Investor (in short 'FII') M/s Platinum Investment Management Ltd. registered under the Securities and Exchange Board of India (FII) Regulations, 1995. The only activity in which the assessee is involved is purchase and sale of securities in India and trading in derivatives. The assessee has filed its return of income for the assessment year under consideration on 23-7-2007 declaring 'nil' income and claimed refund. The assessee has shown short term capital gain arising on sale of shares, short term capital gain arising from transactions in derivatives and short term capital loss from transactions in derivatives. The details of the same are as under :-

Particulars	***Rs.***
Short term capital gain arising on sale of listed shares	*274,036,423*
short term capital gain arising from transactions in derivatives	*1,290,480,258*
short term capital loss arising from transactions in derivatives	*(1,704,683,620)*
Net short term capital loss	*(140,166,940)*

3. The Assessing Officer treated the derivatives loss as business loss instead of capital loss claimed by the assessee. Thus, the capital gain on sale of shares and capital gain arising from transactions in derivatives have been accepted as capital gain but the loss on derivatives transactions was treated as business loss and accordingly

by applying the provisions of DTAA, the Assessing Officer held that since the assessee had no PE in India, the loss arising from business is not taken into consideration for determining the total income of the assessee.

4. The assessee challenged the action of the Assessing Officer before the CIT(A) and contended that the assessee is permitted only to invest in the shares and derivatives being an FII as per the SEBI FII Regulations, 1995 and, therefore, the loss arising from transaction in derivatives cannot be treated as business loss. Alternatively, the assessee contended that the Assessing Officer, *suo motu*, cannot apply the provisions of Treaty to put the assessee into disadvantageous position when the assessee had not claimed the benefit under the Treaty. Therefore, the assessee contended before the CIT(A) that even if the loss arising from transactions in derivatives is treated as business loss, the same is liable to be set off against the business income from derivative transactions and balance against the short term capital gain arising from sale of shares under the provisions of Section 7(1) of the Income Tax Act. As far as the profit and loss arising from derivative transactions, the CIT(A) has held that both should be treated as business profit and loss and the loss of derivative transaction should be set off against business profit of the derivative transaction. Therefore, on the issue of treating the capital gain and loss arising from derivative transactions, the CIT(A) has treated both as business profit and loss respectively but concurred with the view of the

Assessing Officer with respect to the application of the provisions of the treaty for ignoring the loss arising from the transactions in derivatives amounting to Rs.14,01,66,940/-.

5. Before us, learned AR of the assessee has advanced two fold arguments. The first leg of argument of the learned AR is regarding the categorization of the income arising on sale of shares and arising from transactions in derivatives. Learned AR has submitted that treating the capital loss arising from derivative transactions as business loss by the Assessing Officer is based on wrong facts as the Assessing Officer has considered as if the derivatives sold in one day whereas the actual fact is that the derivatives were sold on or before the various dates during the month and the same were closed out on the various dates by the subsequent purchase or closed out within the month. Learned AR has referred the details of the transactions of derivatives giving rise to the loss in question at page No.49 and further details as per the statement at page 65 to 69 of the Paper Book and submitted that the Assessing Officer wrongly taken the holding period as 'nil' and treated that the derivatives were sold on the next date whereas the derivatives are settled/closed on the predetermined dates in the month itself. Learned AR of the assessee has submitted that as far as the issue of treating the derivative transaction as business the same is covered by the decision of the coordinate Bench of this Tribunal in the case of **LG Asian Plus Ltd. Vs ADIT(International Transaction)-3(2), reported in (2011) 46 SOT 159** and contended that when the issue is covered

by the decision of the coordinate bench of the Tribunal then the order of the CIT(A) on this issue is not sustainable. Alternatively, the learned AR of the assessee submitted that when the assessee has not claimed the benefit under the DTAA (Treaty) then the revenue authorities cannot thrust upon the provisions of the Treaty to put the assessee into a disadvantageous position as compared with the provisions of the Act which is in violation of the provisions of Section 90(2) of the Act. Learned AR has referred the details of the income of the various years as per the chart placed at page 306 of the paper book and submitted that in the earlier years i.e. Assessment Year 2006-07, though there is no scrutiny assessment but the Assessing Officer has accepted the loss from the transactions of derivatives as capital loss. Similarly, for the Assessment Year 2008-09, the Assessing Officer has accepted the profits from derivatives transaction as capital gain and allowed the setting off of the derivative loss brought forward from the assessment year 2007-08. For the assessment year 2009-10, the Assessing Officer treated the profit on derivative transaction as capital gain though the assessee made an alternative claim as business profit. Similarly, for the assessment year 2011-12 and 2012-13, the profit as well as loss from derivative transaction are treated as capital gain and loss respectively, though there is no scrutiny assessment. Thus, the learned AR has submitted that on the facts of the case, the profit or loss arising from derivative transactions cannot be treated as business profit or loss but the same is to be treated as capital gain or loss.

6. On the other hand, learned DR has submitted that the FII is permitted to invest in the shares in the recognized stock exchange but not in the derivative transactions. He has referred to the various clauses of the constitution of the Platinum Trust consolidated and submitted that the assessee is allowed for short sale and, therefore, by doing the derivative transactions as hedging against the investment cannot be treated as investment but the very nature of the transaction is speculative and, therefore, the Assessing Officer has rightly treated the same as business and the loss arising from the transaction is to be treated as business loss and not the capital loss. He has relied upon the Ruling of the Authority for Advance Rulings (Income Tax) in the case of **Royal Bank of Canada, dated 22nd March, 2010** and submitted that an identical issue has been decided by the AAR by holding that the income arising from the derivatives would be in the nature of business profit and not capital gain.

7. In rebuttal, learned AR has submitted that as far as the aspect of 'short selling' is concerned, the CIT(A) had dealt with the issue in para 2.51 and 2.54 of the impugned order and held that the transactions carried out by the assessee are not in the nature of short selling, therefore, there is no issue arising from the finding of the CIT(A) on this aspect. As regards, the Ruling of the AAR in case of **Royal Bank of Canada (supra)**, learned AR of the assessee has submitted that the said Ruling is in the case of the bank whereas the assessee is an FII

and, therefore, the decision of the coordinate Bench of this Tribunal is binding and not the Ruling of the AAR.

8. We have considered the rival submissions of the parties as well as relevant material on record. As regards the observation of the Assessing Officer that the derivative were sold on same day, we find that there is a factual error on this point because the derivative were settled/closed on various dates, either by subsequent purchases or on the expiry of period within the month. This fact is clear from the details of page Nos.49 and 65-69 of paper book. On the issue of capital gain or business income, we note that an identical issue has been considered by the coordinate Bench of this Tribunal in the case of **LG Asian Plus Ltd. (supra)**, one of us the Judicial Member is party to the decision. Though the Ruling of the Authority for Advance Ruling has a persuasive value, however, when a direct decision of the coordinate Bench of this Tribunal is on the identical issue then as per the rule of uniformity, the same is binding on us in the absence of any contrary decision of Tribunal or the High Court. The coordinate Bench of this Tribunal has considered and decided the issue after a detail and elaborate discussion of the relevant provisions and aspect relating to the transactions of derivatives by FII. The relevant concluding part of the order from para 8.12 to 11 is as under :-

> *8.11. From the Memorandum explaining the provisions of the Finance Bill, it is palpable that the foreign institutional investors shall be allowed to invest in the country's capital market. Income in respect of securities and income from transfer of securities has been made the subject matter of sec. 115AD. As per this provision, the income arising from the transfer of such securities is to be considered as short-term or long-term capital gain.*

8.12. Thus, on a close scrutiny of the SEBI (FII) Regulations, 1995 together with section 115AD seen in the light of the Memorandum explaining this provisions of the Finance Bill, 1993, it is visible that a FII is allowed to invest only in the `securities' and further the income from securities, either from their retention or from their transfer, is to be taxed as per this section alone. Coming to income arising from the transfer of securities, it has been provided in section 115AD that it shall be charged as short-term or long-term capital gain, which depends upon the period of holding of such securities. A FII is not allowed by the Central Government to do `business' in the `securities'. Once it is noticed that a FII can only `invest' in `securities' and tax on the income from the transfer of such securities is covered by a special provision contained in section 115AD, the natural corollary which follows is that tax should be charged on income arising from transfer of such securities as per the prescription of this section alone, which refers to income by way of short term or long term capital gains.

8.13. The ld. D.R. has relied on sub-section (2) of sec. 115AD for contending that the existence of `Business income' from dealing in securities is also envisaged. We find that sub-sec. (2) of sec. 115AD has two clauses. Clause (a) provides that where the gross total income of a FII consists only of income in respect of security referred to in clause (a) of sub-sec. (1) (i.e. income received in respect of securities, otherwise than from their transfer), then no deduction shall be allowed to it under sections 28 to 44C or section 57 or Chapter VI-A of the Act. It is but natural that when a lower rate of tax has been provided in respect of income earned by a FII from securities, then that rate of tax is final and the assessee cannot claim double benefit, firstly by being taxed at lower rate and secondly by claiming normal deductions etc. against this income. As sec. 115AD(2)(a) refers to income received in respect of securities and not from their transfer, the same would have no application to the instant case. According to clause (b) of sub-sec. (2) of sec. 115AD, where the gross total income includes any income referred to in clause (a) or clause (b) of sub-sec. (1) (i.e. income received in respect of securities by either retaining them or from their transfer), then the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income so reduced is the gross total income of the FII. A plain reading of sub-sec. (2) makes it manifest that the gross total income of a FII may include income other than that received in respect of securities or from the transfer of such securities. The emphasis of the ld. DR is on this part of the provision to bring home the point that a FII may also have `Business income' arising from the transfer of securities. The argument is that a FII may have income from securities as falling under the head `Capital gains', which is covered under section 115AD(1)(b) and also business income, as comes out from sec. 115AD(2)(b). This argument though looks attractive at first flush, but does not stand scrutiny in depth. The rationale behind section 115AD(2)(b) is that the income of a FII, other than that arising from the holding or transfer of securities, should find its place in the total income and the deductions under Chapter VI-A be allowed by considering gross total income net of income received

in respect of securities or arising from the transfer of such securities. It is quite possible that a FII may deposit its surplus funds in banks resulting into interest income. Such interest income, which shall not fall under sub-sec. (1) of sec. 115AD, shall constitute part of the gross total income. It is a simple and plain interpretation of sub-sections (1) and (2) of sec. 115AD. We want to make it clear that the question before us is not to determine whether a FII can have any business income or not. We are confined to determining whether the income from the transfer of securities would fall under sub-section (1) or (2). If it is presumed as a hypothetical case that a FII may also have any business activity, whether legal or illegal, then the income from such activity shall be considered as `Business income' covered under subsection (2)(b). The only embargo against the above presumption is that the business should not be that of dealing in `securities'. Once there is a special provision slicing away the income to a FII from the transfer of `securities' from the other income, it has to find its home only under sub-section (1)(b), irrespective of the fact that the securities are viewed as `Investment' or `Stock in trade'. If the Revenue ventures to make a distinction between such securities as constituting capital asset or stock in trade, which is not contemplated by the Central Government as is evident from SEBI(FII) Regulations and the definition of FII in Explanation (a) to sec. 115AD, then this provision will become otiose. In our considered opinion if a FII receives any income in respect of securities or from the transfer of such securities, the same can be considered under sub-sec. (1) alone and sub-sec. (2)(b) cannot be invoked to construe it as `Business income' .

8.14. The position has been clarified by way of a Press Note : F No. 5(13)SE/91-FIV dated 24.03.1994 issued by the Ministry of Finance, Department of Economic Affairs (Investment Division) , New Delhi, the relevant part of which is as under :

> *"The taxation of income of Foreign Institutional Investors from securities or capital gains arising from their transfer, for the present, shall be as under:-*
>
> *(i) The income received in respect of securities (other than units of off-shore funds covered by section 115AB of the Income-tax Act) is to be taxed at the rate of 20%;*
>
> *(ii) Income by way long-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 10%;*
>
> *(iii) Income by way of short-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 30%;*
>
> *(iv) The rates of income-tax as aforesaid will apply on the gross income specified above without allowing for any deduction under sections 28 to 44C, 57 and Chapter VI-A of the Incometax Act.*
>
> *2. The expression "Foreign Institutional Investor" has been defined in section 115AD of the Incometax Act to mean such investors as the Central Government may, by notification in the Official Gazette, specify in this behalf. The FIIs as are registered with the Securities*

and Exchange Board of India will be automatically notified by the Central Government for the purpose of section 115AD."

8.15. From the above Press Note, it is abundantly clear that FIIs have been considered as "investors" (and not as traders). Secondly, income from transfer of securities has been viewed as chargeable to tax under the head `capital gains' as long-term or short-term capital gain depending upon the period for which such securities are held.

8.16. In view of the above discussion, it is out-and-out that income arising to a FII from the transfer of `securities' as specified in Explanation (b) to sec. 115AD can only be considered as short-term or long-term capital gain and not as 'business income'. As the `derivatives' have been included in the definition of 'securities' for the purposes of this section, the income from derivatives shall also be considered as short-term or long-term capital gain depending upon the period of holding. If the viewpoint of the Department, to the effect that income from transfer of shares or debentures etc. should be considered as short-term or long-term capital gain (as has been accepted by the AO in the instant case) but that from derivatives should be considered as `Business income' (speculation business), then it would mean considering shares and debenture etc. as distinct from derivatives. Moreover there is nothing on record to demonstrate that the assessee was visited with any consequences as per Regulation 7A for violation of Regulations 15 or 16. It shows that the regulations have been conscientiously followed by the assessee as per which it simply made only Investment in securities and there is nothing of the sort of trading. Although in common parlance, the shares or debentures etc. are distinct from derivatives, and their taxation may also differ in the case of non-FIIs, but such distinction is obliterated in the context of FIIs due to the inclusion of both shares and debentures etc. on one hand and derivatives on the other, in the definition of "securities" for the purpose of sec. 115AD and subsection (1) providing for the income from their transfer to be considered as long term or short term capital gain.

8.17. It is noticed that sec. 115AD falls in Chapter XII which deals with the determination of tax in certain special cases. This Chapter consists of sections 110 to 115BBC. Each section contains special provisions dealing with specific types of incomes for which a specified rate of tax is provided. If a particular item of income is covered in any of these sections, it shall be strictly governed by the prescription of that relevant section alone. We are reminded of the legal maxim `Generalia specialibus non derogant', which means that special provisions override the general provisions. It is a well settled legal position that specific provisions override the general provisions. In other words, if there are two conflicting provisions in an enactment, the special provisions will prevail and the subject matter covered in such a special provision shall stand excluded from the scope of the general provision. The Hon'ble Supreme Court in the case of Britannia Industries Ltd. vs. CIT (2005) 278 ITR 546 (SC) has held that expenditure towards rent, repairs, maintenance of guest house used in connection with business is to be disallowed u/s. 37(4) because this is a special provision overriding the general provision.

9. Coming back to our context, it is seen that income arising from the transfer of securities of the FIIs has been included under sec. 115AD(1)(b) to be categorized as short-term or long-term capital gain depending upon the period of holding. In such a situation, it is impermissible to consider such income as falling under the head "Profits and gains of business or profession". Such income arising from the transfer of securities shall be charged to tax under the head "capital gains" alone. Once inclusion of such income from the transfer of securities is held to be falling only under the head "Capital gains", it cannot be considered as `Business income', whether speculative or non-speculative.

10. The heading of section 43 is : `Definitions of certain terms relevant to income from profits and gains of business or profession'. The opening part of this section is : "In sections 28 to 41 and in this section, unless the context otherwise requires-". Thereafter, six subsections have been given, of which sub-sec. (5) defines "speculative transaction". It is, therefore, clear that sec. 43(5) defining 'speculative transaction' is relevant only in the context of income under the head `Profits and gains of business or profession'. It rules out its application to income under any other head. If that be the position, the picture is clear that sec. 43(5) has no application to FIIs in respect of 'securities' as defined in Explanation to sec. 115AD, income from whose transfer is considered as short term or long term capital gains.

11. We, therefore, hold that the ld. CIT(A) was not justified in holding that income from Index based or non-Index based derivatives be treated as 'business income', whether speculative or nonspeculative. The impugned order is, therefore, set aside by holding that income from derivative transaction resulting into loss of Rs.11.27 crores is to be considered as short-term capital loss on the sale of securities which is eligible for adjustment against short-term capital gains arising from the sale of shares."

9. Respectfully following the decision of the coordinate Bench of this Tribunal, we decide this issue in favour of the assessee and against the revenue. Accordingly, we hold that the income arising from the transaction in derivatives by the assessee, being FII, cannot be treated as business profit or loss but the same has to be capital gain or loss.

10. Since we have decided the nature of transaction and treatment of the same as capital gain or loss in favour of the assessee, then we do not propose to go into the alternative plea of the assessee regarding

thrusting upon the provisions of the Treaty and putting the assessee in disadvantageous position.

11. Resultantly, appeal filed by the assessee is allowed.

Order pronounced in the open court on this 5th day of December,2012.

Sd/-	**Sd/-**
(B.RAMAKOTAIAH)	**(VIJAYPAL RAO)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Mumbai; Dated : 5th December, 2012.
प्र.कु.मि/pkm, नि.स/ PS

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A)-X, Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai

IN THE INCOME TAX APPELLATE TRIBUNAL,
MUMBAI BENCH "A",MUMBAI
BEFORE SHRI R.S. SYAL (AM) & SHRI VIJAY PAL RAO (JM)

I.T.A.No.2645/Mum/2008
(A.Y. 2004-05))

M/s. LG Asian Plus Ltd., C/o. S.R. Batliboi & Co., 18th floor, Express Towers, Nariman Point, Mumbai-400 021. PAN: AAACL8243K	Vs.	Asst.Director of Income-tax (International Taxation)-3(2), 1st floor, Scindia House, Ballard Pier, Mumbai-400 038.
Appellant		Respondent

I.T.A.No.2691/Mum/2008
(A.Y. 2004-05)

Asst.Director of Income-tax (International Taxation)-4(1), 133, Scindia House, Ballard Pier, Mumbai-400 038.	Vs.	M/s. LG Asian Plus Ltd., C/o. S.R. Batliboi & Co., 18th floor, Express Towers, Nariman Point, Mumbai-400 021. PAN: AAACL8243K
Appellant		Respondent

Department by		Ms. Usha S. Nair.
Assessee by		Shri Rajan Vora.

O R D E R

PER R.S. SYAL, AM :

These two cross appeals– one by the assessee and the other by the Revenue – arise out of the order passed by the ld. CIT(A) on 29.01.2008 in relation to the asstt. year 2004-05.

2. The Revenue has raised the following effective ground in its appeal :

> *"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing the Assessing Officer to treat the losses incurred by the assessee on futures and options on*

indexes as loss under the head income from business or profession and to re-compute the income and charge tax as per the provisions of Section 115AD of the Act."

3. The assessee is aggrieved against the impugned order on the following two effective grounds :

"1. In treating the short-term capital loss of Rs.112,744,596 arising from exchange traded derivative transactions as a business loss and ignoring the special provisions contained in section 115AD of the Act, applicable to your appellant, being a Foreign Institution Investor ("FII").

2. In treating the short-term capital loss of Rs.18,818,500 arising from non-indexed exchange traded derivative transactions as speculative loss and thereby, disallowing its set-off against short-term capital gains earned on equity shares."

The other grounds taken by the assessee are in support of the main issue contained in ground nos.1 & 2 as reproduced above.

4. Briefly stated, the facts of the case are that the assessee is a company incorporated in Cayman Islands and a tax resident of Cayman Islands. At the material time, there was no Double Taxation Avoidance Agreement between India and Cayman Islands. The assessee is registered with the SEBI as a sub-account of Lloyd George Investment Management (Bermuda) Ltd., which is registered with SEBI as a Foreign Institutional Investor (hereinafter called "FII"). The status of the assessee in the titles of the assessment order has also been given as FII. The assessee showed short-term capital gain of Rs.34.73 crores and short-term capital loss of Rs.25.98 crores. These

two amounts comprised of short-term capital gain/loss on shares to the tune of Rs.31.06 crores and Rs.11.04 crores respectively, thereby leaving the remaining amount of Rs.3.67 crores and 14.94 crores as gain/loss from Derivaties – both under Option contracts and Future contracts. There is no dispute as gain/loss offered by the assessee on sale of shares, which has been accepted as short-term capital gain. The controversy is on the treatment of the loss in derivates to the tune of Rs.11.27 crores (Rs.14.94 crores loss as reduced by Rs.3.67 crores gain on derivates). The amount of loss of Rs.11.27 crores was adjusted by the assessee against the short-term capital gain from the shares as discussed above, as a result of which the taxable short-term capital gain stood reduced to that extent. On being called upon to explain as to why the transactions in Derivatives be not treated as speculative transactions, the assessee submitted its reply through various letters. The AO observed that the Derivatives – Option contracts and Future contracts - were routed through the Stock Exchange without any actual delivery. Considering the provisions of sec. 43(5), he held that before the insertion of proviso (d) by the Finance Act, 2005, transactions in respect of trading in derivates were to be considered as speculative. It was also opined by him that the insertion of proviso (d) by the Finance Act, 2005, commanding that the transactions in respect of trading in derivatives shall not be deemed to be speculative transactions, is prospective and hence could not apply to the year under consideration. In view of the above opinion, the AO held that the loss of Rs.11.27 crores arising on account of derivative transactions was to be assessed as speculation

loss and hence the same was not eligible for set off against the short-term capital gain earned by the assessee from the sale of shares.

5. The assessee went up in appeal before the ld. CIT(A) contending that it was registered as FII as per SEBI Regulations, which entitled it only to make investments in securities. It was, therefore, contended that `Investment' implied purchase and sale of capital assets and not earning of any business income. It was also argued that the assessee was governed by the special provision contained in sec. 115AD and as such the resultant income from the derivatives could be taxed only under the head 'Capital gains'. The ld. CIT(A) noted that the assessee traded in Future contracts based on individual company's shares and also Nifty Indexes. He noticed that the Index Futures were the artificial trade instruments created by Stock Exchanges which could have a lifespan of not more three months and hence it was not possible to have the physical/actual delivery because the underlying Index was not a physical commodity. Once these artificial securities were not capable of delivery from one person to another, he held that the same could not be considered as a commodity and hence the provisions of sec. 43(5) would not apply. As regards loss from the Non-Index based derivatives, that is, where the underlying asset is some specific share, the ld. CIT(A) held that the same would qualify as speculative transaction inasmuch as there was a possibility of delivery of shares underlying such Futures and hence the resultant loss would be speculative loss. He finally held that the loss incurred by the assessee in Non-index based derivatives was

hit by the provisions of section 43(5) and liable to be treated as speculative loss, but the loss from the Index based derivatives would fall under the head `Profits and gains of business or profession' and hence become non-speculation business loss. Both the sides are in appeal before us against their respective stands in terms of the grounds positioned *supra*.

6. We have heard the rival submissions and perused the relevant material on record. It is seen that the assessee claimed net loss of Rs.11.27 crores from derivatives under the head 'Capital gains', whereas the AO held such loss to be speculation business loss u/s. 43(5) of the Act. The ld. CIT(A) bifurcated such loss into two parts viz., non-speculation i.e. normal business loss (from Index based derivatives) and speculation loss (from non-Index based derivatives i.e. based on individual shares). Now the assessee wants that the entire loss should be treated as short term capital loss and the Revenue contends that the entire loss should be held as speculation loss.

I. TRANSACTIONS IN DERIVATIVES – SEC. 43(5)

7. Section 43(5) 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*". Such a transaction is deemed to be speculative transaction unless a case falls under any of the specific clauses of the

proviso to this sub-section. Here, it is important to mention that up to assessment year 2005-06, there were three clauses, (a) to (c) to this proviso. However, by the Finance Act, 2005, w.e.f. 01-04-2006, the following clause (d) has been inserted, which reads as under :

> *"(d) an eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulations) Act, 1956 (42 of 1956) carried out in a recognized Stock Exchange".*

7.2. The effect of this insertion from the assessment year 2006-07 is that transactions in respect of trading in derivates are not to be deemed as speculative transactions, as a result of which the gain or loss from such transactions shall not be considered as gain or loss from speculation business. The Special Bench of the Tribunal in Shree Capital Services Ltd. vs. ACIT (2009) 28 DTR 1 (Kol.) (SB) (Trib.) has held that the `derivative' in which underlying asset is a share, falls under the expression `commodity' u/s 43(5) and thus loss on account of transactions in futures and options derivates with the underlying assets as shares is speculative loss up to assessment year 2005-06. It has further been held in this case that the insertion of clause (d) of proviso to sec. 43(5), taking such transactions outside the purview of the speculative transactions, is prospective in operation and applies only from assessment year 2006-07. Thus the Special Bench of the tribunal in the aforenoted case held that the transactions in derivatives with the underlying assets as non index are speculative transactions upto A.Y. 2005-06. It is further noticed that the Hon'ble jurisdictional High Court in CIT vs. Shri Bharat R. Ruia (HUF) vide its recent unreported judgment dated 18-04-2011 has held that

transactions in Exchange traded finance derivatives are speculative transactions as defined in sec. 43(5) and further clause (d) inserted to the proviso to sec. 43(5) w.e.f. 01-04-2006 is prospective. In view of the judgment of the Hon'ble jurisdictional High Court and also the Special Bench Tribunal order, it becomes apparent that the transactions in the Exchange traded finance derivatives are to be considered as speculative transactions within the meaning of sec. 43(5) in relation to the asst. year 2004-05 under consideration.

7.3 It is noticed that the ld. CIT(A) has drawn a distinction between the transactions in Index based derivates and individual shares based derivatives by holding the former as business transactions and later as speculative transactions. The reasoning given by him in support of such a distinction is that there is a possibility of delivery of shares in the non-Index based derivatives because the underlying asset on which the value is derived is the share of the company. As regards loss from the Index based Exchange traded derivative transactions, the ld. CIT(A) held it to be `Business loss' on the ground that no physical delivery is possible because the underlying asset on which the value is derived is an Index which is not a physical commodity. In our considered opinion, the ld. CIT(A) was not justified in drawing such a line of demarcation between the two sets of transactions. It is for the reason that the derivates are finance instruments whose value depend on the value of the other underlying finance instruments. The underlying asset may be a particular share or the Index such as BSE Index and Nifty Index. In other words, the Index based derivatives

are not based on the value of a particular share in the Futures but on the Index as a whole, which comprises of a number of shares included in such Index. Derivative, in itself, cannot be compared with the underlying share or Index. In fact, these are Futures contracts in both Index as well as Stocks which can be purchased or sold through recognized Stock Exchange. It has been noticed by the Hon'ble jurisdictional High Court in the above noted case in para 31 that "Futures contracts expire on the last Thursday of the expiry month. All futures contracts are settled in cash either on a daily basis or at the expiry of the respective contracts as the case may be. Clients/Trading members are not required to hold any stock of the underlying for dealing in the Futures Market." It is still further noticed that in the case of Shree Capital Services Ltd. (supra), the Special Bench dealt with derivatives in which the underlying assets were shares, and such transactions have been eventually held to be a speculative transactions. From the above discussion, it is clear that the transactions in derivates, whether having underlying assets as shares or Index, are speculative transactions within the meaning of sec. 43(5). As such, we hold that the ld. CIT(A) was not justified in coming to the conclusion that the Index based derivative transactions be treated as normal business or non-speculative transactions. We, therefore, overturn the impugned order to the extent of holding that the loss in Option trading in Index Futures be considered as non-speculative. The net result is that in a normal case, the loss in Option trading on individual shares or Index has to be held as speculative loss.

II. SECTION 115AD AND INCOME FROM DERIVATIVES BY F.I.Is.

8. Having held that transactions in derivatives, both Index based and individual shares based, are to be considered as speculative transactions u/s.43(5) in a normal case, their nature needs to be examined in the hands of FIIs. The ld. A.R. contended that sec. 115AD deals with taxation on income of FIIs from securities or capital gains arising from their transfer and that being a special provision would override the general provisions including sec. 43(5). While referring to sub-sec. (1) of sec. 115AD, the ld. A.R. pointed out that income from transfer of derivatives is to be considered as capital gain alone, depending upon the period for which such derivatives are held so as to further classify them as short-term or long-term capital gain. He submitted that sub-section (1) of sec. 115AD alone governs the taxability of income by way of short-term or long-term capital gains arising from the transfer of such securities and it was wrong on the part of the authorities below to consider such income under the head "Profits and gains of business or profession", whether as speculation or non-speculation. He also referred to the definition of "Foreign Institutional Investors" given under Securities and Exchange Board of India (Foreign Institutional Investors) Regulation, 1995, to mean an institution which proposes to make investment in India in securities. It was contended that the permission to carry on activities in India is subject to the terms and conditions stipulated in such Regulations, as

per which the FIIs can only make investment in securities and not undertake trade in them.

8.2 In the opposition, the ld. D.R. relied on the impugned order to contend that sec. 115AD(2) envisages the existence of business income, distinct from capital gains *qua* the dealings in securities. It was submitted that the argument advanced on behalf of the assessee that there can be no business income from the transactions in derivatives, was devoid of any force.

8.3 In order to appreciate the rival contentions, it would be apposite to consider the marginal note as well as the provisions of sec. 115AD, as under:

> **"Tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer**
>
> *115AD. (1) Where the total income of a Foreign Institutional Investor includes—*
>
> *(a) income other than income by way of dividends referred to in section 115-O received in respect of securities (other than units referred to in section 115AB); or*
> *(b) income by way of short-term or long-term capital gains arising from the transfer of such securities,*
>
> *the income-tax payable shall be the aggregate of—*
>
> *(i) the amount of income-tax calculated on the income in respect of the securities referred to in clause (a), if any, included in the total income, at the rate of twenty per cent;*
> *(ii) the amount of income-tax calculated on the income by way of short-term capital gains referred to in*

clause (b), if any, included in the total income, at the rate of thirty per cent;

***Provided** that the amount of income-tax calculated on the income by way of short-term capital gains referred to in section 111A shall be at the rate of fifteen per cent;*

(iii) the amount of income-tax calculated on the income by way of long-term capital gains referred to in clause (b), if any, included in the total income, at the rate of ten per cent; and
(iv) the amount of income-tax with which the Foreign Institutional Investor would have been chargeable had its total income been reduced by the amount of income referred to in clause (a) and clause (b).

(2) Where the gross total income of the Foreign Institutional Investor--
(a) consists only of income in respect of securities referred to in clause (a) of sub-section (1), no deduction shall be allowed to it under sections 28 to 44C or clause (i) or clause (iii) of section 57 or under Chapter VI-A;

(b) includes any income referred to in clause (a) or clause (b) of sub-section (1), the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income as so reduced, were the gross total income of the Foreign Institutional Investor.

(3) Nothing contained in the first and second provisos to section 48 shall apply for the computation of capital gains arising out of the transfer of securities referred to in clause (b) of sub-section (1).

Explanation.—For the purposes of this section, --

(a) the expression "Foreign Institutional Investor' means such investor as the Central Government may, by notification in the official Gazette, specify in this behalf;

> *(b) the expression "securities" shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956)."*

8.4 From Explanation (a) above, two things are noticeable. Firstly, the FII is an `Investor' and secondly, it can transact only when the Central Government notifies in the Official Gazette. It is further noticed that the FIIs are monitored through the regulations specifically made by the SEBI for FIIs, which are known as the Securities and Exchange Board of India (Foreign Institutional Investors) Regulation, 1995. Regulation 2(f) defines "Foreign Institutional Investors" to mean *"an institution established or incorporated outside India which proposes to make an **investment** in India in securities"*. It is imperative to observe that the SEBI has allowed the FIIs to operate in a limited field. The restrictions on the making of Investment by the FIIs are contained in Regulation 15(1) which reads as under :

> "15. (1) A Foreign Institutional Investor may **invest only** in the following:-
>
> (a) securities in the primary and secondary markets including shares, debentures and warrants of companies unlisted, listed or to be listed on a recognised stock exchange in India; and
>
> (b) units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on a recognised stock exchange or not,units of scheme floated by a Collective Investment Scheme.
>
> (c) dated Government Securities;

(d) derivatives traded on a recognised stock exchange;

(e) commercial paper;

(f) security receipts;"

8.5 From the prescription of Regulation 15(1), it can be viewed that there are restrictions on a FII in making investments, which can only be in the specified securities which, inter alia, include shares, debentures and derivatives traded on a recognized Stock Exchange. It is further essential to note that the regulations, apart from providing that a FII can invest only in the specified securities, also provides for certain additional conditions, which have been laid down in Regulation 15(3), the relevant part of which is as under :

"(3) In respect of investments in the secondary market, the following additional conditions shall apply:-(a) a foreign institutional investor or sub-account shall transact in the Indian securities market only on the basis of taking and giving delivery of securities purchased or sold:

Provided that nothing contained in this clause shall apply to any transactions in derivatives on a recognised stock exchange:

Provided further that a foreign institutional investor or sub-account may enter into short selling transactions only in accordance with the framework specified by the Board in this regard;]

(b) no transaction on the stock exchange shall be carried forward; and

> (c) the transaction of business in securities shall be only through stock brokers who has been granted a certificate by the Board under sub section (1) of section 12 of the securities and Exchange Board of India Act,1992:
>
> ……."

8.6 It is further relevant to note that even after the grant of initial registration by the Central Government, a FII has to adhere to the regulations of the SEBI. Its activities are monitored on day to day basis, as can be seen from Regulation 16, which spells out certain obligations and responsibilities of the FIIs. It is worthwhile to take notice of Regulation 16(2), which is as under :-

> "The Foreign Institutional Investor shall ensure that the domestic custodian takes steps for –
>
> (a) monitoring of investments of the Foreign Institutional Investor in India;
>
> (b) reporting to the Board on a daily basis the transactions entered into by the Foreign Institutional Investor;
>
> (c) preservation for five years of records relating to his activities as a Foreign Institutional Investor; and
>
> (d) furnishing such information to the Board as may be called for by the Board with regard to the activities of the Foreign Institutional Investor and as may be relevant for the purpose of this regulation."

8.7 The consequences which follow from non-compliance of the relevant regulations by a FII have been provided for in Regulation 7A.

When we view Regulation 15(1) in juxtaposition to Regulation 15(3), it becomes abundantly clear that a FII is eligible to make only investments (not trading) in the specified securities and secondly,

investment in the secondary market can be only on the basis of taking and giving delivery of securities purchases or sold. The restriction regarding taking and giving delivery of securities purchased or sold does not apply to any transaction in derivates provided these are routed through recognized Stock Exchange.

Section 2(h) of the Securities Contracts (Regulation) Act defines "securities" to include—

> *(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;*
> *(ia) derivative;*
> *(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;*
> *(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;*
> *(id) units or any other such instrument issued to the investors under any mutual fund scheme;*
>
> *(ii) Government securities;*
> *(iia) such other instruments as may be declared by the Central Government to be securities; and*
>
> *(iii) rights or interest in securities;*

From the above definition of `securities', it is discernible that derivatives and shares etc. have been kept on a single platform.

8.8 Having taken insight into the Regulations governing FIIs, we return to section 115AD. Explanation (a) defines the expression "Foreign Institutional Investor' to mean such an investor as the Central Government may, by notification in the official Gazette, specify in this behalf. On a conjoint reading of Regulation 15 with Expl. (a) to sec. 115AD, it is easily perceptible that a FII can only `Invest' but

not trade in the specified securities. Further Expl. (b) to section 115AD defines the expression `securities' to "have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).", which refer to derivatives and shares etc.

8.9. In the light of the above background, we will examine sec. 115AD which is a special provision enshrined in the Act for charging tax on the income of FIIs from securities or capital gains arising from their transfer. Sub-sec. (1) provides through clause (a) that the income, other than from the units of a Mutual Fund specified under sec. 10(23D) or of the United Trust of India, received in respect of securities except the income by way of dividend from domestic companies, shall be charged to tax @ 20%. Clause (b) of sec. 115AD(1) deals with income by way of short-term or long-term capital gains arising from the transfer of securities. Separate rates of tax have been provided in respect of long-term and short-term capital gains arising from the transfer of securities. Explanation (b) defines the expression "securities" to have the meaning assigned to it in sec. 2(h) of the Securities Contracts (Regulation) Act, 1956, which has been noted above. From such definition of "securities", that has been bodily lifted in sec. 115AD, it is explicitly obvious that it includes shares and also derivatives. Further when we examine Regulation 15, it can be seen that a FII is entitled to invest in the `specified securities', which also, include shares and derivatives. Thus, it is patent that for the purposes of section 115AD, both the derivatives and shares have been categorized as `securities' to be treated alike,

notwithstanding the different tax treatment in the hands of non-FIIs to the income from the transfer of shares, which may vary from `Business income' to `Capital gains' depending upon the facts and circumstances of each case and from the transfer of derivatives which shall be speculative income up to the A.Y.2005-06.

8.10. We again slip back to sub-sec. (1) of sec. 115AD, clause (a) of which refers to income in respect of securities and clause (b) refers to income way of short-term or long-term capital gain arising from the transfer of such securities. Thus, the scope of clause (a) encompasses the income earned by retaining the `securities' other than from transfer of such `securities' and clause (b) specifically deals with income arising from the transfer of such `securities'. Therefore, it is manifest that the income earned by a FII either by way of retention or by way of transfer of securities (including derivates) is subject matter of sub-sec. (1) of sec. 115AD.

8.11. Before we proceed further, it would be apt to note that sec.115AD was inserted by the Finance Act, 1993. The Memorandum explaining the provisions of the Finance Bill, 1993 reported at 200 ITR (St) 152 provides as under :

"MEASURE TO PROMOTE CAPITAL MARKET
Tax incentive for Foreign Institutional Investors
Investing in securities

While presenting the Budget for 1992-93, the Finance Minister had stated that ways would be considered of allowing reputable ***foreign investors to invest*** *in the country's capital markets. In pursuance of this announcement, guidelines have been issued through a Press Note dated 14th September, 1992,* ***for such investment*** *by Foreign Institutional Investors.* ***Income***

> ***from such investment*** *is to be taxed at concessional rates. Accordingly, the Bill seeks to insert a new section 115AD in the Income-tax Act relating to* ***tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer****.*
>
> *The income received in respect of securities (other than units referred to in section 115AB) listed in a recognized stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956, is proposed to be taxed at the rate of twenty per cent. Income by way of long-term capital gains arising from the transfer of the said securities is proposed to be taxed at the rate of ten per cent. Income way of short-term capital gains arising from the transfer of the said securities is proposed to be taxed at the rate of thirty per cent. However, these rates of tax will apply on the gross income of the nature specified above without allowing for any deduction under sections 28 to 44C and Chapter VI-A. The first and second provisos of section 48 relating to computation of capital gains will not apply in the case of transfer of the aforesaid securities by the Foreign Institutional Investors.*
>
> *The expression "Foreign Institutional Investor" is proposed to be defined to mean* ***such investor*** *as the Central Government may, by notification in the Official Gazette, specify in this behalf. The expression "securities" is proposed to have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.*
>
> *This amendment will take effect from 1st April, 1993 and will, accordingly, apply in relation to the assessment year 1993-94 and subsequent years".*
>
> (Emphasis supplied by us)

8.12. From the Memorandum explaining the provisions of the Finance Bill, it is palpable that the foreign institutional investors shall be allowed to invest in the country's capital market. Income in respect of securities and income from transfer of securities has been made the subject matter of sec. 115AD. As per this provision, the income arising from the transfer of such securities is to be considered as short-term or long-term capital gain.

8.13. Thus, on a close scrutiny of the SEBI (FII) Regulations, 1995 together with section 115AD seen in the light of the Memorandum explaining this provisions of the Finance Bill, 1993, it is visible that a FII is allowed to invest only in the `securities' and further the income from securities, either from their retention or from their transfer, is to be taxed as per this section alone. Coming to income arising from the transfer of securities, it has been provided in section 115AD that it shall be charged as short-term or long-term capital gain, which depends upon the period of holding of such securities. A FII is not allowed by the Central Government to do `business' in the `securities'. Once it is noticed that a FII can only `invest' in `securities' and tax on the income from the transfer of such securities is covered by a special provision contained in section 115AD, the natural corollary which follows is that tax should be charged on income arising from transfer of such securities as per the prescription of this section alone, which refers to income by way of short term or long term capital gains.

8.14. The ld. D.R. has relied on sub-section (2) of sec. 115AD for contending that the existence of `Business income' from dealing in securities is also envisaged. We find that sub-sec. (2) of sec. 115AD has two clauses. Clause (a) provides that where the gross total income of a FII consists only of income in respect of security referred to in clause (a) of sub-sec. (1) (i.e. income received in respect of securities, otherwise than from their transfer), then no deduction

shall be allowed to it under sections 28 to 44C or section 57 or Chapter VI-A of the Act. It is but natural that when a lower rate of tax has been provided in respect of income earned by a FII from securities, then that rate of tax is final and the assessee cannot claim double benefit, firstly by being taxed at lower rate and secondly by claiming normal deductions etc. against this income. As sec. 115AD(2)(a) refers to income received in respect of securities and not from their transfer, the same would have no application to the instant case. According to clause (b) of sub-sec. (2) of sec. 115AD, where the gross total income includes any income referred to in clause (a) or clause (b) of sub-sec. (1) (i.e. income received in respect of securities by either retaining them or from their transfer), then the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income so reduced is the gross total income of the FII. A plain reading of sub-sec. (2) makes it manifest that the gross total income of a FII may include income other than that received in respect of securities or from the transfer of such securities. The emphasis of the ld. DR is on this part of the provision to bring home the point that a FII may also have `Business income' arising from the transfer of securities. The argument is that a FII may have income from securities as falling under the head `Capital gains', which is covered under section 115AD(1)(b) and also business income, as comes out from sec. 115AD(2)(b). This argument though looks attractive at first flush, but does not stand scrutiny in depth. The rationale behind section 115AD(2)(b) is that the income of a FII, other than that arising from

the holding or transfer of securities, should find its place in the total income and the deductions under Chapter VI-A be allowed by considering gross total income net of income received in respect of securities or arising from the transfer of such securities. It is quite possible that a FII may deposit its surplus funds in banks resulting into interest income. Such interest income, which shall not fall under sub-sec. (1) of sec. 115AD, shall constitute part of the gross total income. It is a simple and plain interpretation of sub-sections (1) and (2) of sec. 115AD. We want to make it clear that the question before us is not to determine whether a FII can have any business income or not. We are confined to determining whether the income from the transfer of securities would fall under sub-section (1) or (2). If it is presumed as a hypothetical case that a FII may also have any business activity, whether legal or illegal, then the income from such activity shall be considered as `Business income' covered under sub-section (2)(b). The only embargo against the above presumption is that the business should not be that of dealing in `securities'. Once there is a special provision slicing away the income to a FII from the transfer of `securities' from the other income, it has to find its home only under sub-section (1)(b), irrespective of the fact that the securities are viewed as `Investment' or `Stock in trade'. If the Revenue ventures to make a distinction between such securities as constituting capital asset or stock in trade, which is not contemplated by the Central Government as is evident from SEBI(FII) Regulations and the definition of FII in Explanation (a) to sec. 115AD, then this provision will become otiose. In our considered opinion if a FII

receives any income in respect of securities or from the transfer of such securities, the same can be considered under sub-sec. (1) alone and sub-sec. (2)(b) cannot be invoked to construe it as `Business income' .

8.15. The position has been clarified by way of a Press Note : F No. 5(13)SE/91-FIV dated 24.03.1994 issued by the Ministry of Finance, Department of Economic Affairs (Investment Division) , New Delhi, the relevant part of which is as under :

> *"The taxation of income of Foreign Institutional Investors from securities or capital gains arising from their transfer, for the present, shall be as under:-*
>
> > *(i) The income received in respect of securities (other than units of off-shore funds covered by section 115AB of the Income-tax Act) is to be taxed at the rate of 20%;*
> >
> > *(ii) Income by way long-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 10%;*
> >
> > *(iii) Income by way of short-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 30%;*
> >
> > *(iv) The rates of income-tax as aforesaid will apply on the gross income specified above without allowing for any deduction under sections 28 to 44C, 57 and Chapter VI-A of the Income-tax Act.*
>
> *2. The expression "Foreign Institutional Investor" has been defined in section 115AD of the Income-tax Act to mean such investors as the Central Government may, by notification in the Official Gazette, specify in this behalf. The FIIs as are registered with the Securities and Exchange Board of India will be automatically notified by the Central Government for the purpose of section 115AD."*

8.16. From the above Press Note, it is abundantly clear that FIIs have been considered as "investors" (and not as traders). Secondly, income from transfer of securities has been viewed as chargeable to tax under the head `capital gains' as long-term or short-term capital gain depending upon the period for which such securities are held.

8.17. In view of the above discussion, it is out-and-out that income arising to a FII from the transfer of `securities' as specified in Explanation (b) to sec. 115AD can only be considered as short-term or long-term capital gain and not as 'business income'. As the `derivatives' have been included in the definition of 'securities' for the purposes of this section, the income from derivatives shall also be considered as short-term or long-term capital gain depending upon the period of holding. If the viewpoint of the Department, to the effect that income from transfer of shares or debentures etc. should be considered as short-term or long-term capital gain (as has been accepted by the AO in the instant case) but that from derivatives should be considered as `Business income' (speculation business), then it would mean considering shares and debenture etc. as distinct from derivatives. Moreover there is nothing on record to demonstrate that the assessee was visited with any consequences as per Regulation 7A for violation of Regulations 15 or 16. It shows that the regulations have been conscientiously followed by the assessee as per which it simply made only Investment in securities and there is nothing of the sort of trading. Although in common parlance, the shares or debentures etc. are distinct from derivatives, and their

taxation may also differ in the case of non-FIIs, but such distinction is obliterated in the context of FIIs due to the inclusion of both shares and debentures etc. on one hand and derivatives on the other, in the definition of "securities" for the purpose of sec. 115AD and sub-section (1) providing for the income from their transfer to be considered as long term or short term capital gain.

8.18. It is noticed that sec. 115AD falls in Chapter XII which deals with the determination of tax in certain special cases. This Chapter consists of sections 110 to 115BBC. Each section contains special provisions dealing with specific types of incomes for which a specified rate of tax is provided. If a particular item of income is covered in any of these sections, it shall be strictly governed by the prescription of that relevant section alone. We are reminded of the legal maxim `*Generalia specialibus non derogant*', which means that special provisions override the general provisions. It is a well settled legal position that specific provisions override the general provisions. In other words, if there are two conflicting provisions in an enactment, the special provisions will prevail and the subject matter covered in such a special provision shall stand excluded from the scope of the general provision. The Hon'ble Supreme Court in the case of *Britannia Industries Ltd. vs. CIT (2005) 278 ITR 546 (SC)* has held that expenditure towards rent, repairs, maintenance of guest house used in connection with business is to be disallowed u/s. 37(4) because this is a special provision overriding the general provision.

9. Coming back to our context, it is seen that income arising from the transfer of securities of the FIIs has been included under sec. 115AD(1)(b) to be categorized as short-term or long-term capital gain depending upon the period of holding. In such a situation, it is impermissible to consider such income as falling under the head "Profits and gains of business or profession". Such income arising from the transfer of securities shall be charged to tax under the head "capital gains" alone. Once inclusion of such income from the transfer of securities is held to be falling only under the head "Capital gains", it cannot be considered as `Business income', whether speculative or non-speculative.

10. The heading of section 43 is : `Definitions of certain terms relevant to income from profits and gains of business or profession'. The opening part of this section is : "In sections 28 to 41 and in this section, unless the context otherwise requires-". Thereafter, six sub-sections have been given, of which sub-sec. (5) defines "speculative transaction". It is, therefore, clear that sec. 43(5) defining 'speculative transaction' is relevant only in the context of income under the head `Profits and gains of business or profession'. It rules out its application to income under any other head. If that be the position, the picture is clear that sec. 43(5) has no application to FIIs in respect of 'securities' as defined in Explanation to sec. 115AD, income from whose transfer is considered as short term or long term capital gains.

11. We, therefore, hold that the ld. CIT(A) was not justified in holding that income from Index based or non-Index based derivatives be treated as 'business income', whether speculative or non-speculative. The impugned order is, therefore, set aside by holding that income from derivative transaction resulting into loss of Rs.11.27 crores is to be considered as short-term capital loss on the sale of securities which is eligible for adjustment against short-term capital gains arising from the sale of shares.

12. In the result, the appeal of the assessee is allowed and that of the Revenue is dismissed.

Order pronounced on the 27th day of May, 2011.

Sd/-	**Sd/-**
(VIJAY PAL RAO) **JUDICIAL MEMBER**	**(R.S. SYAL)** **ACCOUNTANT MEMBER**

Mumbai: 27th May , 2011.

NG:

Copy to :

1. Department.
2.Assessee.
3 CIT(A)-XXVII,,Mumbai.
4 CIT,City-3,Mumbai.
5.DR,"B" Bench,Mumbai.
6.Master file.
(TRUE COPY)

BY ORDER,

Asst.Registrar, ITAT, Mumbai.

	Details	Date	Initials	Designation
1.	Draft dictated on	19-05-11		Sr.PS/
2.	Draft Placed before author	23-05-11		Sr.PS/
3.	Draft proposed & placed before the Second Member			JM/AM
4.	Draft discussed/approved by Second Member			JM/AM
5.	Approved Draft comes to the Sr.PS/PS			Sr.PS/
6.	Kept for pronouncement on			Sr.PS/
7.	File sent to the Bench Clerk			Sr.PS/
8.	Date on which the file goes to the Head clerk			
9.	Date on which file goes to the AR			
10.	Date of dispatch of order			

*