Tax Review/Taxation

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Kind Regards,

Huzaima Bukhari
Editor

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The wrong borrowing mix

by

*Dr. Muhammad Yaqub**

A government that depends heavily on borrowing from the banking system to finance its expenditure is usually taken as an irresponsible government that is creating conditions for high inflation and public sector debt trap. The PPP-led government indulged in reckless borrowing from the banking system and ended up generating a double digit inflation, crowding out of the private sector from the credit market and thereby hurting private investment and slowing economic growth, and excessively loading the commercial banks with government securities on the asset side of their balance sheets with serious consequences for banks.

It was hoped that the PML-N government will learn a lesson from the experience of the previous government and, for the sake of initiating good economic management, will switch from bank borrowing to tax effort and expenditure control as a way to handle the budget. Unfortunately, for the country and its people, the PML-N government has moved on a more dangerous path of borrowing mix while maintaining the high level of borrowing of the previous government, as shown by the monetary data up to November 22, 2013. While resorting to net government borrowing from the banking system in the period July 1, 2013 to November 22, 2013 of Rs383 billions, as compared to Rs416 billion in the corresponding period last year under the PPP-led government, it has made a major switch in borrowing from the commercial banks to borrowing from the State Bank of Pakistan(SBP).

The PML-N government has retired Rs396 billions of its debt to the commercial banks up to November 22, 2013 as compared with new borrowing of Rs496 billions from the commercial banks in the same period by the previous government . At the same time, and during the same period, the PML-N government has borrowed Rs875 billions from the SBP as against retirement of Rs42 billion by the previous government. As a result, while the overall increase in the net domestic assets is only marginally higher than the last year - which of course in itself was excessive - the change in the mix of government borrowing from commercial banks to the SBP will have grave consequences.

In an accounting sense, it would look like a smart move by the ministry of finance because the interest earnings of the SBP will be transferred back to the government as SBP profits, offsetting the corresponding amount of government debt servicing to the SBP, thereby keeping the budgetary situation unchanged in an accounting sense on this particular account. The interest payments on borrowing from commercial banks by the

* The writer is a former governor of the State Bank of Pakistan.

government mainly end up with increased earnings of banks that go to its shareholders, who are mostly in the private sector, and do not offset the government debt servicing payments to banks.

In an economic sense, and particularly for its implications for inflation, exchange rate and foreign exchange reserves of the SBP, it is a disastrous move. What is more intriguing is that it is happening when an operational IMF program is in place without any concern being expressed by the IMF about excessive borrowing of the government from the SBP.

An elementary economics text book will tell you that borrowings from the central bank are more inflationary than borrowings from the commercial banks. The reason is very simple. Government borrowing from the SBP is based on note printing and high-powered money is injected in the system without any dislodging of liquidity in any other sector. The government borrowing from the SBP turns out to be fully inflationary with no offsetting effects from anywhere. On the other hand, commercial banks lend to the government by mobilising deposits from the private sector and by restricting their lending to the private sector and to that extend the impact of government borrowing from commercial banks on liquidity in the system - and on inflation - is partly moderated.

There are other aspects of the monetary survey of the SBP that in an accounting sense would not look abnormal as compared with the corresponding period last year but a professional analysis of the survey would show worsening of the monetary situation.

The net domestic assets of the banking system have grown by about 5 per cent during July 1 to November 22, 2013 which is the same rate as last year. The increase in the last year in the net domestic assets was alarmingly high. The FY2013 ended up with 20 per cent expansion in the net domestic assets, which was excessive. This year the rate of expansion in the net domestic assets so far is the same as last year and if the trend is maintained it would also end up with excessive expansion in the net domestic assets for the year as a whole.

But more significantly, the expansion in the net domestic assets this year is engineered by note printing rather than by government borrowing from commercial banks. It would have much more severe implications for inflation and the balance of payments than the last year. Thus with the same rate of increase in the net domestic assets as last year, the switch in government borrowing from commercial banks to the SBP would end up putting more pressure on prices, reserves and the exchange rate.

Another noticeable aspect of the monetary survey is that the net foreign assets of the banking system have declined at a faster speed this year so far as compared with the last year. It has knocked out a part of the net domestic assets to show a lower growth in money supply this year so far, as compared to the corresponding period last year (money supply expanded by 2.4 per cent up to November 22 in the current fiscal year as compared with 3.9 per cent in the same period last year). The better monetary outcome reflects one negative development offsetting partly the negative impact of another factor on money supply rather than indicating any favourable developments. The fast depletion of foreign exchange reserves was responsible by neutralising a part of the impact on money supply of the excessive bank borrowing of the government.

The purpose of the above narration is to highlight that while in an accounting sense the present economic management team has made smart moves in financing the budget deficit, in economic sense their budget mismanagement is worse than their predecessors.

If they continue on the path of budget management on accounting principles disregarding the economic implications of their moves, the country will face more severe inflationary and balance of payment problems this year as compared to last year. In that context, the IMF staff would need to do a lot of explaining for deliberately designing an EFF program that allowed the government to do reckless budgetary and monetary management and excessive resort to printing of money in an environment of high inflation, pressure on reserves and depreciating exchange rate.

Austria

Austria's Future Coalition United on Taxation

Marking a significant step closer to a future coalition alliance in Austria, the Social Democrats (SPÖ) and the Austrian People's Party (ÖVP) have united on a raft of tax measures, aimed at consolidating the public finances and at ensuring a structural "zero deficit" in 2016.

The SPÖ and ÖVP have agreed crucially to limit tax breaks for executive remuneration in excess of EUR500,000 (USD686,102). This measure was championed by the SPÖ in their election campaign.

Furthermore, the prospective coalition partners reached a consensus on plans to raise the tax on tobacco and on alcohol. As a result, the cost of a packet of cigarettes is expected to rise by 15 cents a year over a period of three years, and a tax on sparkling wine will increase the cost of a bottle of Champagne by 75 cents. The country's motor vehicle tax is also forecast to rise.

Finally, both parties have agreed to compromise on key tax issues that have so far prevented the formation of an alliance. Chancellor Faymann's Social Democrats have renounced plans to introduce a wealth tax in Austria, while the ÖVP has relinquished its plans to undertake a complete reform of the country's pension system, including plans to increase the age of retirement. The introduction of a bonus-malus system for companies recruiting older workers is currently being considered, however. – *Courtesy tax-news.com*

Switzerland

Swiss SMEs Support Flat Tax

Switzerland's main trade association SGV usam, representing small- and medium-sized enterprises (SMEs) in the Confederation, has welcomed the "clear" decision by the Swiss Council of States to reject the people's initiative calling for an end to the controversial foreigners' flat tax regime, based on the cost of living rather than on the individual's wealth or income.

The Swiss Council of States blocked the proposal by 30 votes to nine, with three abstentions.

Insisting that the levy is a suitable and proven fiscal instrument, of considerable economic importance, SGV usam warned that abolishing the regime would lead to a revenue shortfall for the

Confederation of an estimated CHF700m (USD785m) annually, and would serve to endanger 22,000 jobs. Such a measure would adversely affect Swiss SMEs in particular, especially those located in the mountain regions, the union argued.

Underlining its firm support for the flat tax regime, which currently benefits around 5,600 wealthy foreigners in the Confederation, the body emphasized that the levy yielded a total of around CHF695m last year. The lump sum system has a long tradition in Switzerland, enabling the cantons to compete with fierce international competition, the association ended.

Submitted by the Alternative Left party in October 2012, the initiative "end to tax privileges for millionaires" sought to ban the flat tax regime nationwide.

Although the regime has been abolished in five cantons in Switzerland, and tightened in four, the system still applies for direct federal tax throughout the country. However, to guarantee continued support for the levy, measures aimed at tightening the regime are to apply from 2016.

From then, the tax base for calculating direct federal and cantonal tax will be seven times the cost of living, compared with five times as is currently the case. Further, as regards direct federal tax, a minimal taxable income of CHF400,000 will apply. The Swiss cantons will be required to determine their own minimum taxable amount.

The initiative will now be submitted to the National Council, before subsequently being put to a referendum. – *Courtesy tax-news.com*

Bulgaria

Bulgaria Approves Renewable Energy Profit Tax Hike

Renewable energy producers in Bulgaria have reacted angrily to a new 20 percent tax on revenues, condemning the move as unconstitutional and warning that local and foreign investment will be discouraged.

The tax takes the form of an amendment to the Renewable Energy Sources Act, and affects wind and solar power producers. It was proposed by Volen Siderov, who heads the nationalist Ataka party, and 116 out of 182 Bulgarian MPs backed the measure.

Bulgaria's Ministry of Economy and Energy explained that producers of renewable energy had enjoyed a preferential tax regime due to the risks of investing in new technology, but that their share of the total output was now at 16 percent and so this was no longer necessary.

The Government believes that the tax will raise an extra LEV160m (USD112m).

Workers in the renewable energy industry held protests, at which banners written in English were displayed appealing for the European Union to prevent the tax. However, Finance Minister Petar Chobanov said that examples from other EU countries show that Bulgaria will not be penalized for restricting what he called "excessive profits" in the sector. – *Courtesy tax-news.com*

Implementation, monitoring: FBR given plan to run new tax incentives scheme

Finance Minister Ishaq Dar has given a detailed plan to the Federal Board of Revenue for effective implementation and monitoring of the new tax incentives scheme and established a central monitoring office in the FBR HQ to run the scheme amicably at the national level.

Sources told here on Monday that the Finance Minister has highly appreciated the role played by the FBR team of tax managers for its effective launching of the scheme.

According to Ishaq Dar, "I would like to appreciate the efforts made by the Federal Board of Revenue in formulating the tax incentives scheme, which was announced by Prime Minister Nawaz Sharif on November 28, 2013. Initial reports show that the scheme has received positive public response indicating the appropriateness and effectiveness of the incentives," he said.

The Finance Minister further informed FBR Chairman Tariq Bajwa that the FBR should now put in place an effective implementation and monitoring mechanism so that the scheme can be properly implemented and the public is facilitated in availing various facilities announced. This needs to be done on top priority basis.

Therefore, it has been advised to the FBR that a cell may be created in the FBR to inter alia particularly focus on the following on which the Prime Minister would like to be kept updated on weekly basis:

Firstly, establishment of Prime Minister's tax Incentives' Scheme Counters in every tax office; particularly those of the Deputy Commissioners and above.

Secondly, notification of "focal persons" at the level of Commissioner office with due publication in press and FBR website.

Thirdly, establishment of a web-based portal facilitating new taxpayers in registering them and making online payments. Fourthly, establishment of a Complaint-Registration-and-Redressal system on the website of FBR, with a link on the PMO's website.

Fifthly, advertisement and publicity in print and electronic media.

Sixthly, holding meeting and arranging seminars and Associations/Chambers/Federations to explain the features of the package and answering any queries. Commissioners must ensure that these are arranged and held at the earliest.

Seventhly, establishment of a “Central Monitoring Office” in the FBR Headquarters to ensure that the scheme is administered in an effective manner and that all the above steps are duly taken by the officers concerned in an effective and timely manner. The FBR should monitor the implementation of the scheme and keep Finance Ministry informed through weekly reports, Ishaq Dar added.

Following direction of the Finance Minister, the FBR has established a committee to ensure implementation of the scheme in an effective manner at the level of the Board and field formations.

The committee headed by FBR Member Inland Revenue Policy would comprise the following members: FBR Member IR Operations, Chief Income Tax Policy, Irfan Raza Secretary TPA-I and a tax official would act as a co-ordinator. The committee would address the issues pertaining to the Tax Incentives Scheme, sources said. – *Courtesy Business Recorder*

Afghan transit trade: relevant MCCs to handle all past matters: FBR

The Federal Board of Revenue (FBR) has informed Collectors of Customs that all past matters pertaining to transit trade including adjudication of Afghan Transit Trade (ATT) cases, their appeals and representation at higher appellate fora will be handled by the relevant Model Customs Collectorates (MCC).

In this regard, the FBR has issued instructions to all Model Customs Collectorates here on Monday regarding ‘ISAF container scam- legacy issues, relating to Afghan Transit Trade’.

According to the FBR’s instructions, reference to the Directorate General Transit Trade’s letter dated 18.11.2013 on the subject and to say that Board has already clarified that legacy issues relating to ISAF/Nato containers scam prior to functioning of DGTT, will continue to be dealt with by the relevant Model Customs Collectorates. Now, it is further clarified that all legacy matters including adjudication of Afghan Transit Trade (ATT) cases and their remand, appeals and representation at higher appellate fora will be dealt with by the relevant Model Customs Collectorates, FBR added. – *Courtesy Business Recorder*

About 70 percent drop in revenues feared: government urged to slash 17 percent GST on tractors immediately

With installed capacity of 100,000 units per annum, the country's tractor industry is expected to close the current financial year with less than 30,000 units, which would show about 70 percent drop in revenues from this industry in the FY 2013-14, mainly due to high rate of General Sales Tax (GST).

Agriculturists are of the view that Pakistan currently needs 800,000 more tractors to match India in per hectare tractor population. They said the government needs to immediately slash GST on tractors to bring tractor rates in the reach of small land-holders so as to move forward in farm mechanisation and maximising per acre yield. Despite producing the cheapest tractor in the world, the Pakistani farmers are still not able to afford tractors.

It may be noted that the Pakistan Association of Automotive Parts and Accessories Manufacturers (Paapam) had also sought the help of Lahore Chamber of Commerce and Industry (LCCI) for the revival of dying tractor industry.

LCCI Acting President Mian Tariq Misbah has called for withdrawal of decision to raise rate of GST on tractor industry as increase from existing rate of 10 percent to 17 percent from January 1, 2014 would hit the entire agriculture sector hard besides rendering thousands of skilled workers jobless.

Tariq Misbah said the tractor assemblers and their 300 plus vendors fear a severe drop in sales as a result of massive hike in GST from January 1.

He said that 17 percent GST to be paid by the country's farmers will further curtail their ability to purchase tractors. With no subsidies on tractors in the current federal and provincial budgets, meager loaning by ZTBL in the absence of a Federal Agricultural Ministry (thanks to the 18th amendment) and GST set to go to 17 per cent under IMF pressure, will all add up to massive drop in tractor sales, he added.

The LCCI Acting President said Pakistan lags far behind India in crop yield, crop intensity and number of tractors per hectare. He said that drop in tractor sales means unemployment for thousands of skilled workers who work in hundreds of factories producing tractor parts for the tractor assembly plants.

Employment in rural Pakistan will also be curtailed, as tractor is a major source of employment generation in the form of drivers, mechanics, and spares/lub suppliers etc, he added.

The LCCI Acting President said that an industry that had crossed 70,000 units production for two consecutive years ie, 2009-10, 2010-11, is bracing for below 30,000 units production this year. – *Courtesy Business Recorder*

Smuggling of various goods causes over Rs 22 billion loss to kitty

Pakistan's markets are full of smuggled goods ranging from cosmetic to cigarettes, but a few individuals involved in the business are interested in legalising their business, a survey conducted by revealed. Sale of smuggled petrol and diesel (including LPG) in Balochistan, Sindh, Khyber Pakhtunkhwa and South Punjab has reached its peak, which is causing above Rs 22 billion annual losses to national kitty.

contacted different people and market places well-known for smuggled goods to determine the volume of smuggled goods circulating in the national economy and concluded that an estimated Rs 16 billion smuggled tea is being traded in the country, Rs 18 billion cigarettes, Rs 22 billion petroleum products including smuggled LPG, Rs 25 billion auto-parts as well as vehicles and over Rs 200 billion other products including cosmetics clothing, footwear, medicines, spices, juices, electronics and other items.

The oil, auto parts, cigarettes, tea, electronics and spices smugglers are using Pakistan-Afghan borders and Pak-Iran borders as well as coastal areas of Balochistan as their favoured routes through which their agents market smuggled goods to other parts of the country.

According to Petroleum Ministry officials, as much as Rs 22 billion petroleum products are being smuggled from neighbouring Iran and Afghanistan to Pakistan, which has reached at their peak now-a-days due to high prices of the products in the local market, causing hefty losses to national kitty.

According to an owner of Liquefied Petroleum Gas (LPG) Marketing Company, at present sale of smuggled LPG from Iran to

Pakistan has almost doubled compared to legal business because local LPG is available at Rs 140 per kg while smuggled is available at Rs 100.

Tanvir Khan, an auto parts and vehicles trader based in Quetta, revealed that annually he is selling about 1,000 vehicles, which he brings from Chamman, Pakistan's border city with Afghanistan. He added that an estimated 50,000 different vehicles are being smuggled into the country from Afghanistan per annum.

"We are selling these vehicles at low prices: a Honda Accord car is available at Rs 3.5 million to Rs 4 million in the country while smugglers are providing this car at Rs 0.7 million", Tanvir added.

Salman Ahmad, a Lahore-based businessman, told on telephone that he has invested Rs15 million rupees in the 'informal' business. He said he brings cosmetics, jewellery, and medicines from India and supplies these items to wholesalers in Anarkali market.

Elaborating on the route, he said that items from India are first brought to Dubai, then Afghanistan and finally via Torkhum reach Bara Market in Peshawar.

"Almost 50,000 rupees are given to Afghan and Pakistani officials as a bribe in a single consignment," he said. Some of the medicines he brings from India include Aspirin, Amoxilin, Ampicillin, Cemetidine, Lexotanil, Co- Trimaxazole, Famotidine, Ciprofloxine, and Rentidin.

Talking about the government scheme of investment, he said that he along with his two other partners are planning to invest in business of drugs to whiten their money. "We are not going to leave our business of bringing things from India, but will definitely invest in Pakistan in the legal business," he said.

Ahmad said that investment through the scheme will provide him with two benefits: legal business and whitening of money.

Kamran Khan, an Islamabad based businessman, said that the government's scheme is neither lucrative nor beneficial to businessmen like him. Khan is involved in illegal business of import of garments from Bangladesh and China. "There is neither electricity nor gas in Pakistan. How can one invest in these terrible conditions?" he asked.

Khan termed the government's investment scheme 'a drama,' saying if the government is serious about luring businessmen for investment, it should announce a long term investment policy.

"The informal business is easy and more reliable than legal business in Pakistan," he said. – *Courtesy Business Recorder*

FBR recalling senior officers on deputation

The Federal Board of Revenue has decided to recall all officers (BS-17 to BS-20) to their parent organisation, who are serving on deputation in other government departments/ organizations for a period of more than three years. Sources told here on Monday that the FBR has issued instructions to the field formations on 'FBR-officers on deputation-decision.'

According to the FBR, due to acute shortage of officers in BS-17 to BS-20 in FBR (HQ) and its field formations, it has been decided that the officers who are serving on deputation in other government departments/organisations for a period of more than three years will be recalled to their parent organisation.

The officers who have already completed five years of deputation in other departments, as a rule, are required to report back immediately to their parent departments. As for officers having completed initial period of three years, the FBR for the aforementioned reason shall not extend the period of deputation beyond three years. All the officers of BS-17 to BS-20 may be informed about this policy decision.

Respective Chief Commiss-ioners/Director Generals/Chief Collectors/ Collectors are also requested not to recommend any officer for deputation for the reason mentioned above, the FBR added. – *Courtesy Business Recorder*

No.CCIR/RTO-II/SO-VII/2013-14 Islamabad, the 4th December, 2013

<u>ORDER</u>

Notification No. 27.– In pursuance of the Board's Order F.No.1(32)Jurisdiction/2013/158224-R dated 26.11.2013, and in exercise of powers conferred by Proviso to Sub-Section (1) of Section 209 of the Income Tax Ordinance, 2001, Sub-Section (2) of Section 30 of the Sales Tax Act, 1990 and Sub-Section (1A) of Section 29 of the Federal Excise Act, 2005, the jurisdiction over the case of M/s. Gulf Mineral FZE Pvt. Ltd. STRN: 17-00-2859-845-14 NTN: 2859845-8 is hereby assign to Commissioner Inland Revenue, Zone-I, RTO-II, Karachi.

2013 TRI 1989 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "L" BENCH, MUMBAI

B.R. Mittal, Judicial Member and N.K. Billaiya, Accountant Member

FACTS/HELD

Section 115AD: High Court verdict in Bharat Ruia 337 ITR 452 (Bom) on taxation of derivatives as speculation income/ loss is not applicable to FIIs

1. The assessee, a Foreign Institutional Investor ("FII"), suffered a loss of Rs. 172.18 crore on account of derivative transactions which was claimed as a short-term capital loss. The AO held that the said loss constituted a business/ speculation loss and could not be set-off against the short-term capital gains. Though in the assessee's own case (Platinum Investment Management Ltd vs. DDIT (ITAT Mumbai)) it had been held that all income arising to a FII, including from dealings in derivatives, has to be assessed as capital gains, the department argued that this view was no longer good law in view of CIT vs. Bharat R. Ruia (HUF) 337 ITR 452 (Bom) where it was held that as transactions in derivatives are entered into and settled without taking any delivery of the shares, the same constitutes a speculative transaction. HELD by the Tribunal rejecting the department's case:

   > The judgement of the Bombay High Court in Bharat Ruia is not applicable to assessees which are FIIs duly registered with SEBI. FIIs are allowed to only invest in the Capital Market and the income arising from transfer of security is to be considered as short term capital gain or long term capital gain as per s. 115AD of the Act. FIIs are not allowed to do business in the security market. Also, derivative is a security as per the clause (ia) to sub-section (h) of section 2 of The Securities Contracts (Regulation) Act, 1956 with effect from 22.2.2000. The co-ordinate Bench of the Tribunal has considered this aspect as well in the earlier order dated 5.12.2012 in

which the earlier decision in LG Asian Plus Ltd v/s ADIT 46 SOT 159 was also considered.

Appeals allowed partly.

ITA Nos. 2787 & 2788/M/2012 (Assessment Year : 2006-07).

Heard on: 27th November, 2013.

Decided on: 4th December, 2013.

Present at hearing: F.V. Irani, for Appellant. Narendra Kumar, for Respondent.

JUDGMENT

Per B.R. Mittal:– (Judicial Member)

These appeals are filed by assessee against orders of ld. CIT(A), both dated 2.1.2012 relating to assessment year 2006-07.

2. The assessee is a sub-account of the Foreign Institutional Investor (in short 'FII') registered in Australia and operating in India, Registered with Securities and Exchange Board of India (SEBI). The activity of assessee involved in purchase and sale of securities in India and trading in derivatives. Both assessee(s) have filed return (s) of income as under:

a) the assessee, sub-account Platinum Asia Fund (ITA No.2787/Mum/2012) declaring total income of Rs.NIL and claimed a refund of Rs.1,45,96,129/-. The said assessee also claimed carried forward short term capital loss of Rs.78,91,43,597/-. However, AO completed the assessment vide order dated 24.12.2010 u/s 143(3) r.w. section 147 of the Income Tax Act, 1961 (the Act) at an income of Rs.93,26,84,307/- after holding that the net loss of Rs.1,72,18,27,904/- arising from index derivative transactions as business loss and assessable under the head income from business or profession as against the claim of assessee as capital loss. Ld. CIT(A) also confirmed the findings of the AO;

b) similarly, in respect of sub-account Platinum International Brands Fund, (ITA No.2788/Mum/2012) the return of income was filed on 25.7.2006 declaring total income at Rs.NIL and claimed refund of Rs.16,02,881/-. It also claimed short term capital loss of Rs.5,42,36,870/-. However, the AO completed the assessment vide order dated 24.12.2010 passed u/s 143(3) r.w.s.147 of the Act at an income of Rs.17,62,78,618/- by treating net loss of Rs.23,05,15,488/- arising from index derivative transaction as business loss assessable under the head business or profession as against capital loss claimed by assessee. The ld. CIT(A) also confirmed the action of AO.

Hence, both assessees who are sub-account of FII M/s Platinum Asset Management Ltd, are in appeals before the Tribunal taking the following Grounds:

3. <u>I.T.A.No.2787/M/2012</u>

> "1. On facts and in circumstances of the case and in law, the Commissioner of Income-tax (Appeals) -11, Mumbai, (hereinafter referred to as 'the CIT(A)') erred in confirming the re-opening of the case under section 147 of the Income Tax Act, 1961(the 'Act') by the Assessing Officer having failed to appreciate that there was no income which has escaped assessment.
>
> Your Appellant submits that the re-assessment proceedings being bad in law should be quashed.
>
> 2. On facts and in circumstances of the case and in law, the learned CIT (A), Mumbai, erred in upholding the action of the Assessing Officer (AO) in treating the net loss of Rs 1,721,827,904/- arising from index derivative transactions as business loss as against capital loss, and assessable under the head 'Income from Business or Profession', having failed to appreciate that the derivatives are securities and so in case of your Appellant being a Foreign Institutional Investor, the derivatives are capital asset and not business / trading asset.
>
> The CIT (A) ought to have held that the loss Rs. 1,721,827,904/- arising from index derivative transactions are short-term capital loss and so should be allowed set off against short-term capital gains arising on transfer of shares as per Section 70 of the Act and carry forward unabsorbed short-term capital loss on derivative transactions as per Section 74 of the Act.
>
> 3. Without prejudice to the above, on facts and in circumstances of the case and in law, the learned CIT(A) erred in holding that in absence of business connection in India or in absence of permanent establishment in India as per India Australia Double Taxation Avoidance Agreement, the business loss of Rs. 1,721,827,904 arising on transfer of derivatives cannot be determined and so the same is not allowable as set-off against the capital gains arising on sale of shares in India having failed to appreciate that the loss is arising through the transfer of capital asset situated in India and / or the loss is arising through or from source of income in India and so the loss arising on transfer of derivatives is determinable in India.
>
> The CIT(A) ought to have held the business loss of Rs 1,721,827,904 arising on sale of derivatives can be determined and should be set off against short-term capital gains of Rs. 921,955,751 and long-term capital gains of Rs 10,728,556 and

the balance loss of Rs.789,143,597 should be allowed to be carried forward to subsequent assessment years.

4. Without prejudice to the above, on the facts and in the circumstances of the case, the CIT(A) erred in not allowing set off of business loss of Rs. 1,721,827,904 arising on derivative transactions against capital gains arising on sale of shares under section 71 of the Act and carry forward of balance unabsorbed business loss as per section 72 of the Act in view of the provisions of section 90(2) of the Act

5. The CIT(A) ought to have held the business loss of Rs 1,721,827,904 arising on sale of derivatives should be set off against short-term capital gains of Rs. 921,955,751 and long-term capital gains of Rs 10,728,556 and the balance loss of Rs. 789,143,597 should be allowed to be carried forward to subsequent assessment years.

Your Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing of the appeal, so as to enable the Hon'ble Tribunal to decide this appeal according to law."

I.T.A.No.2788/M/2012

"1. On facts and in circumstances of the case and in law, the Commissioner of Income-tax (Appeals) -11, Mumbai, (hereinafter referred to as 'the CIT(A)') erred in confirming the re-opening of the case under section 147 of the Income Tax Act, 1961(the 'Act') by the Assessing Officer having failed to appreciate that there was no income which has escaped assessment.

Your Appellant submits that the re-assessment proceedings being bad in law should be quashed.

2. On facts and in circumstances of the case and in law, the learned CIT (A), Mumbai, erred in upholding the action of the Assessing Officer (AO) in treating the net loss of Rs 230,515,488/- arising from index derivative transactions as business loss as against capital loss, and assessable under the head 'Income from Business or Profession', having failed to appreciate that the derivatives are securities and so in case of your Appellant being a Foreign Institutional Investor, the derivatives are capital asset and not business / trading asset.

The CIT (A) ought to have held that the loss Rs.230,515,488/- arising from index derivative transactions are short-term capital loss and so should be allowed set off against short-term capital gains arising on transfer of shares as per Section 70 of the Act and carry forward unabsorbed short-term capital loss on derivative transactions as per Section 74 of the Act.

3. Without prejudice to the above, on facts and in circumstances of the case and in law, the learned CIT(A) erred in holding that in absence of business loss of Rs. 230,515,488/- arising on transfer of derivatives cannot be determined and so the same is not allowable as set-off against the capital gains arising on sale of shares in India having failed to appreciate that the loss is arising through the transfer of capital asset situated in India and / or the loss is arising through or from source of income in India and so the loss arising on transfer of derivatives is determinable in India.

The CIT(A) ought to have held the business loss of Rs 230,515,488 arising on sale of derivatives can be determined and should be set off against short-term capital gains of Rs. 165,781,163 and long-term capital gains of Rs 10,497,455 and the balance loss of Rs.54,236,870/- should be allowed to be carried forward to subsequent assessment years.

4. Without prejudice to the above, on the facts and in the circumstances of the case, the CIT(A) erred in not allowing set off of business loss of Rs. 230,515,488/- arising on derivative transactions against capital gains arising on sale of shares under section 71 of the Act and carry forward of balance unabsorbed business loss as per section 72 of the Act in view of the provisions of section 90(2) of the Act The CIT(A) ought to have held the business loss of Rs 230,515,488 arising on sale of derivatives should be set off against short-term capital gains of Rs. 165,781,163 and long- term capital gains of Rs 10,497,455 and the balance loss of Rs. 54,236,870/- should be allowed to be carried forward to subsequent assessment years.

Your Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing of the appeal, so as to enable the Hon'ble Tribunal to decide this appeal according to law."

3. At the time of hearing, the ld. AR of the assessee submitted that Ground No.1 of both the appeals is not pressed for. Hence, Ground No.1 of both appeals is rejected as not pressed.

4. The ld. AR of the assessee submitted that Ground No.2 in both the appeals is covered by the decision of Platinum Investment Management Ltd., A/c Platinum International Fund V/s DDIT(International Taxation) in ITA No.3598/Mum/2010 (AY-2007-08)order dated 5.12.2012 in favour of the assessee. He filed a copy of the said order to substantiate his submissions.

5. On the other hand, ld. DR relied on the order of ld. CIT(A). He further submitted that the Hon'ble Jurisdictional High Court in the case of *CIT vs. Bharat R. Ruia* (HUF) 337 ITR 452 (Bom) has held that the transaction in derivative are entered into without taking any delivery of stock and shares or commodity and periodically or ultimately settled. Hence, Transactions in respect of derivative is a speculative transaction. He submitted that prior to amendment made by Finance Act, 2005 in section 43(5) trading in derivative was a speculative transaction and after insertion of clause (d) to sub-section 43(5) by Finance Act, 2005 w.e.f. 1.4.2006, the transaction in respect of derivative at a recognized Stock Exchange is a business transaction and cannot be considered as an investment.

6. In rejoinder, the ld. AR submitted that the said case of Hon'ble Bombay High Court viz Bharat Ruia (supra) is not applicable to the facts and the issue involve as the assessees are FII duly registered with SEBI. He further submitted that the assessee is allowed to invest in Indian Capital Market and the income arising from transfer of security is to be considered as short term capital gain or long term capital gain as per section 115AD of the Act. He further submitted that assessee, FII is not allowed to do business in the security market. He further submitted that derivative is a security as per the clause (ia) to sub-section (h) of section 2 of The Securities Contracts (Regulation) Act, 1956 with effect from 22.2.2000. The said fact is not disputed by ld. DR that derivative " is a security" under The Securities Contracts (Regulation) Act, 1956. The ld. AR submitted that the Co-ordinate Bench of the Tribunal, has considered this aspect as well vide its earlier order dated 5.12.2012 (supra) in which the earlier decision of co-ordinate Bench in the case of *LG Asian Plus Ltd vs ADIT* (International Taxation) (2011) 46 SOT 159 was also considered.

7. We have carefully considered the submissions of the ld. Representatives of the parties and the orders of authorities below. We have also considered the earlier orders of the Tribunal, (supra) relied upon by ld. AR and also the decision of Hon'ble Jurisdictional High Court in the case of Bharat Ruia(supra). We agree with ld. AR that the decision relied upon by ld.DR is not relevant to the facts of the fact of the case before us. Further, the issue is squarely covered by the decision of the Tribunal, order dated 5.12.2012 which has been decided by considering the earlier order of coordinate Bench in the case of LG Asian Plus Ltd (supra). We consider it prudent to reproduce paragraph 8 of the said order of the Tribunal dated 5.12.2012 which read as under :

> "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 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." 8.15. 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 nonspeculative.

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 subsec. (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."

In view of above order and respectfully following the decision of Co-ordinate Bench of the Tribunal (supra), we decide Ground No.2 of the appeal in favour of assessee. Accordingly, we hold that the income arising from transaction in derivative by assessee(s), being sub-account FII cannot be treated as business profit or loss.

8. Hence, Ground No.2 is decided in favour of assessee in both the appeals.

9. At the time of hearing, it was submitted that if ground No.2 is decided in favour of assessee, the ground Nos.3 to 5 in appeal No.2787/Mum/2012 and Ground Nos.3 and 4 in appeal No.2788/Mum/2012 become infructuous and no need to be adjudicated. Since, we have decided the nature of transaction as an investment and profit and loss has to be considered as capital profit or loss, Ground Nos 3 to 5 of Appeal No.2787/Mum/2012 and Ground Nos. 3 and 4 in Appeal No.2788/Mum/2012 have become infructuous.

10. In the result, both the appeals of assessee are allowed in part.

Order pronounced in the open court on 4th day of December 2013
