IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI 'I' BENCH, MUMBAI.

Before Shri B.R. Baskaran (AM) & Shri Sandeep Singh Karhail (JM)

I.T.A. No. 9045/Mum/2004 (A.Y. 1991-92)

Standard Chartered Bank Taxation Department 23-25, M.G. Road 3rd Floor, Fort Mumbai-40 001.	Vs.	DCIT, Special Range 27(International Taxation) Scindia House N.M. Marg Ballard Pier Mumbai-400 038.
(Appellant)		(Respondent)

I.T.A. No. 8937/Mum/2004 (A.Y. 1991-92)

DDIT(IT)-2(1) Room No. 120, 1st Floor Scindia House, N.M. Marg Ballard Estate Mumbai-400 038.	Vs.	Standard Chartered Bank 4th Floor, New Excelsior Building, A.K. Naik Marg Mumbai-400001.
(Appellant)		(Respondent)

Assessee by	Shri Percy Pardiwala, Shri Madhur Agarwal & Shri Fenil Bhat
Department by	Shri Amit Kumar Soni
Date of Hearing	23.12.2022
Date of Pronouncement	08.03.2023

O R D E R

Per B.R.Baskaran (AM) :-

These cross appeals are directed against the order dated 27th September, 2004 passed by Ld CIT(A)-31, Mumbai and they relate to the assessment year 1991-92.

2. The issue urged by the assessee relates to the addition on account of alleged loss in transactions categorized as "Ready forward" transactions.

3. The revenue is challenging the decision of Ld CIT(A) in deleting the disallowances relating to:-

(a) loss of Rs.22,32,707/- relating to CCDS clients

(b) loss of Rs.95,73,750/- relating to transactions categorized as "Read forward transactions."

(c) Computation of interest u/s 234B of the Act.

4. The facts relating to the case are stated in brief. The assessee is a bank incorporated under the Law of England and Wales. It is registered in India under the Companies Act 1956 as foreign body corporate. It carries on the business of banking, financial services and allied activities. The original assessment of the year under consideration was completed u/s 143(3) of the Act on 29-07-1994, wherein several additions were made. In the appellate proceedings, the Ld CIT(A) set aside certain issues to the file of the assessing officer and accordingly the impugned assessment order 31.3.1998 came to be passed. Since the Ld CIT(A) granted partial relief in respect of additions made by the AO in the set aside proceedings, both the parties have filed this appeal before us.

5. The common issue urged by the parties relate to the disallowance of loss arising in transactions categorized as "Ready forward transactions". The facts relating thereto are that the accounts of the assessee were subjected to Special audit. The special auditor categorized certain transactions in purchase and sale of securities as "Ready forward transactions". As per the RBI guidelines, the banks are prohibited from entering into "Ready forward transactions". The special auditor also computed the loss incurred by the assessee in ready forward transactions as under:-

Loss in RF transactions in non-approved securities -Rs.10,01,70,655/-
Loss in RF transactions in approved securities - Rs. 5,85,31,795/-

In the original assessment proceedings, the AO had disallowed above said losses. Before Ld CIT(A), in the first round of proceedings, the assessee raised various contentions about the applicability of RBI directions and hence the Ld CIT(A) restored the issue to the file of AO. The assessing officer, in the impugned order, disallowed loss on RF transactions with nationalized

banks to the tune of Rs.33,45,554/- and with other banks to the tune of Rs.3,21,31,596/-.

6. In the current round, the Ld CIT(A) confirmed the disallowance of Rs.33,45,554/- relating to RF transactions with Nationalised banks. With regard to the RF transactions with other banks, the Ld CIT(A) confirmed disallowance to the extent of Rs.2,25,58,846/- and granted relief to the tune of Rs.95,73,750/-.

7. All these transactions relate to purchase and sale of securities. It was submitted that the assessee would purchase securities in the first instance and would selling it subsequently. The profit/loss arising on sale is accounted for in the books of accounts. Subsequently, the assessee may purchase the very same security and it would be recorded as fresh purchase of security in the books of accounts. These types of transactions of purchase and sale of same securities are done by banking companies in the regular course. The assessee is following "First in First Out" (FIFO) method in determining the profit/loss arising in sale of securities. Accordingly, it was contended that these transactions cannot be categorized as "Ready forward"(RF) transactions.

8. Thus, the main contention of the assessee is that it has not entered into RF transactions at all. According to the assessee, there is no definition of "RF" transactions given in the Act. It is only the Special auditors, who have classified the regular transactions of purchase and sale of securities as RF transaction by applying certain criteria determined by them, which is not in accordance with the standard meaning assigned to the same. The ingredients of RF transaction were explained as under by the assessee before the AO:-

(a) RF transaction is not a simple transaction of purchase or sale. It is a transaction of purchase or sale with a commitment for resale or repurchase (in a predetermined future date)

(b) It must be between the same parties, in respect of same stock of securities of the same face value.

(c) It must have been entered into at the same time or approximately the same time and is one composite contract.

(d) The consideration for a RF transaction is not what is paid in the first leg but the consideration for such a contract is the profit or the interest component which is to be earned on the reverse leg.

(e) Purchase in the first leg has been entered into not for the sake of purchase of securities but for sake of profit which would be made at the time when the second respondent purchased the securities.

(f) A motive for profit is an important ingredient. Thus, if in the second leg, the purchaser sells at a lower rate, it cannot be termed as an RF transaction.

Explaining further, the Ld A.R submitted that the RF transactions are one in which, at the time of entering into first leg (ready leg) of transactions, the terms and conditions of second leg (forward leg) is determined. It is the contention of the assessee that the Special auditors could not prove or show that the terms and conditions of second leg were determined at the time of entering into first leg itself. Accordingly, it was contended that there was no reason to categorise the regular transactions of purchase and sale of securities entered in the normal course of business as RF transactions.

9. The Ld A.R also submitted that the impugned loss computed by the Special auditor is fictitious loss, i.e., the said loss has not been claimed by the assessee as deduction at all. The Ld A.R explained the same with the following example:-

Purchase of security "A"	-	Rs.100
Sale of above security	-	Rs.105
Profit on above sale	-	Rs. 5
Repurchase of above security	-	Rs.108

The assessee has declared actual profit of Rs.5/- and accounted the repurchased security amounting to Rs.108/- as fresh purchase. However, the special auditor has determined loss of Rs.3.00 (Rs.108/- less Rs.105/-)

on account of repurchase of security. It was submitted that the assessee did not incur any loss as computed by the Special auditor and hence there is no question of claiming the same as deduction. The assessee would be accounting for the profit or loss arising on sale of the repurchased security at the time of its actual sales. Accordingly, it was contended that the loss determined by the special auditor is a notional loss and hence there is no question of disallowing the same, since the said alleged loss has not been claimed by the assessee.

10. The Ld A.R further contended that even if the above said transactions are considered to be RF transactions, the same cannot be considered to be illegal. The Ld A.R submitted that the RF contracts are severable into two parts, viz., the ready leg and forward leg. The ready leg of the transactions, having been completed, is not illegal. The illegality is attached to forward leg transactions only and the same has to be ignored. In this regard, the Ld A.R placed reliance on the decision rendered by Hon'ble Supreme Court in the case of BOI Finance Ltd vs. The Custodian & Ors dated 19th March 1997, wherein it was held that the ready leg (which has already been performed) are legal and valid. Further, it was held that the illegality of the forward leg contained in the agreement cannot affect the transfers which have already taken place in the ready leg.

11. The Ld A.R also put forth one more contention, viz., even if the RF transactions are treated as illegal, the loss arising there from is allowable as deduction under the provisions of the Act. In this regard, the Ld A.R placed his reliance on the decision rendered by the co-ordinate bench in the case of Bank of America vs. DCIT (2009)(27 SOT 97)(Mum), wherein it was held that even though the assessee has executed security transactions which are in violation of the provisions of section 15 of the Securities Contract (Regulation) Act, 1956, loss arising from the said illegal transaction is allowable as deduction under the provisions of the Act. The Ld A.R submitted that the Tribunal has followed the decision rendered by Hon'ble

Supreme Court in the case of Dr. T.A. Quereshi vs. CIT (2006)(287 ITR 547). Accordingly, the Ld A.R submitted that the disallowance of loss relating to RF transactions should be deleted.

12. The Ld D.R, on the contrary, strongly relied upon the order passed by the assessing officer. He also submitted that the Ld CIT(A) was not justified in granting relief to the assessee to the extent of Rs.95,73,750/-.

13. We heard the parties on this issue and perused the record. The assessee has explained the nature of RF transactions. The main ingredient noticed is that there are two transactions, viz., sale of security and repurchase of security and the terms and conditions governing both the transactions are determined at the same time or approximately same time. Thus, it is a composite contract and the terms and conditions relating to second transaction are also determined prior hand. In the instant case, we notice that the Special auditors have not brought on record to prove that the above said condition was satisfied in this case, i.e., there was a composite contract and the terms and conditions of second transaction are determined in the first instance itself.

14. Be that as it may, it is stated that the assessee has not claimed any loss from RF transaction. It was stated by giving an illustration that the assessee has treated each transaction of purchase and sale of security as separate one. The profit from sale of security has been determined under FIFO method. When the assessee has not claimed any loss as deduction while computing book profit, the question of making any disallowance does not arise.

15. Thus, we notice that the main condition that there existed a composite contract for purchase and resale or Sale and repurchase was not satisfied in this case by the Special Auditors. We noticed that the Special auditors have identified certain transaction of purchase and sale of securities as RF transaction by making certain assumptions, which in our view, cannot

conclusively establish that they are RF transactions. We noticed that the assessee has not treated the sale of transactions and subsequent repurchase as composite transactions, i.e., the repurchase was treated as a separate transaction. The profit was computed by the assessee at the time of sale of security by following FIFO method, which is the accounting method regularly followed by the assessee. Hence the repurchase of security at a price higher than the earlier sale price was not claimed as loss, as presumed by the Special auditors. When the assessee has not claimed any loss, the question of making any disallowance of non-existence loss does not arise.

16. In the alternative, the Ld A.R submitted that the transactions of purchase and sale and repurchase are considered to be illegal for a moment, still the loss arising in such transactions is allowable as deduction. In this regard, he placed his reliance on the decision rendered by co-ordinate bench in the case of Bank of America vs. DCIT (2009)(27 SOT 97)(Mum). The relevant portion of the decision rendered by the co-ordinate bench in the above said case is extracted below:-

> "10. Other related issue refers to allowing the set-off of the said loss against the profits of the illegal transactions. Factually, this is the case where the BOA is engaged in executing the normal transactions as well as the transactions attracting the provisions of section 15 of the SCR Act, 1956. The later type yielded both 'loss' as well as 'gains'. Assessee's prayer before us is to allow the set-off of such loss against such gains. This issue has to be examined in the light of the entries in the books of account as well as the judgment in force. It is undisputed that the said transactions is recorded transactions and borne out of the books of account of the assessee. Thus, all these transactions, which yielded the losses, form part of the business of the assessee. In such circumstances, the issue for adjudication by us trickles down to whether the loss emanating from the security transactions in violation of section 15, constitute an allowable business losses. In this regard, we find that the Jaipur Bench of the Tribunal in the case of Ashok Kumar Karola v. Asstt. CIT [2008] 305 ITR (AT) 202 held that the loss arising out of the transactions by infraction of law is not an allowable business loss and in these circumstances, the judgment of the Apex Court in the case of CIT v. Piara Singh [1980] 124 ITR 40 should have no application. However, the Supreme Court held in another case of Dr. T.A. Quereshi v. CIT [2006] 287 ITR 547 held that illegal losses are allowable losses. In that case, where the assessee reflected the banned substances in the stock-in-trade, when such stock is seized, the loss on account of such stock is held as an allowable business

loss despite the infraction of law. Relevant paras 14 and 16 from the said judgment is as under.

> "14. . . . .We fully agree with the High Court that the assessee was committing a highly immoral act in illegally manufacturing and selling heroin. However, cases are to be decided by the court on legal principles and not on one's own moral views. Law is different from morality, as the positivist jurists, Bentham and Austin pointed out.
>
> 16. The Explanation to section 37 has really nothing to do with the present case as it is not a case of a business expenditure, but of business loss. Business losses are allowable on ordinary commercial principles in computing profits. Once it is found that the heroin seized formed part of the stock-in-trade of the assessee, it follows that the seizure and confiscation of such stock in trade has to be allowed as a business loss. Loss of stock in trade has to be considered as a trading loss...."
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> **11.** Thus, the Apex Court distinguished the relevance of the principles of the morality from the principles of the legality as pointed out by the Bentham and Austin. In the light of the above, we have examined the instant case, where the assessee executed the security transaction, may be in violation of the provisions of section 15 of the SCR Act, and the loss generated out of the said transaction, when undisputedly borne out of the books of the assessee, is an allowable loss. Therefore, the said loss is eligible for set off as claimed by the assessee. Accordingly, the ground 1 of the assessee is allowed."

17. In view of the foregoing discussions, we are of the view that there is no legal or valid reason to add the alleged loss arising from alleged Ready Forward transactions. Accordingly, we direct the AO to delete the entire addition of Rs.3.54 crores (Rs.3,21,31,596/- + Rs.33,45,554/-). In this process, the relief granted by Ld CIT(A) would get confirmed.

18. The revenue is contesting one more issue relating to relief granted in respect of disallowance of loss of Rs.22,32,707/- in respect of CCDS. The facts are that the assessee had collected funds under "Corporate Cash Deployment Scheme" (CCDS) and deployed the same in purchase and sale of approved securities. The special auditors reported that a sum of Rs.38,61,036/- comprising of loss in approved securities of Rs.22,32,707/- and non-approved securities of Rs.16,28,329/- are required to be disallowed. The reason given is that the funds collected under CCDS scheme are in fact

short term deposits collected by the assessee and it constituted assessee's own funds. In the first round, the AO disallowed entire amount of Rs.38,16,036/-. The Ld CIT(A), in the first round granted relief of Rs.16,28,329/- in respect of loss from non-approved securities. In the second round, the AO sustained the addition of Rs.22,32,707/- relating to approved securities.

19. Before Ld CIT(A), in the second round, the assessee contended that it has not claimed loss of Rs.22,32,707/- computed by the special auditors stating the same to be with CCDS clients. The Ld CIT(A) was convinced with the said contentions of the assessee. He noticed that the above said loss was related to two securities, viz., (a) 8% GOI 1991 and 11.50% GOI 2010. He also noticed that the Special auditors have computed loss from the above said securities on the basis of data generated by applying a query called "Security Status Query" (SSQ). However, the Ld CIT(A) noticed that the sale of securities shown in the above said SSQ are not related to CCDS clients. Accordingly, the Ld CIT(A) held that there was no requirement of making any disallowance of this loss, since the assessee has not claimed the said loss. For the sake of convenience, we extract below the decision rendered by Ld CIT(A) on this issue:-

> "4.6 I have considered the facts of the case and the submissions of the appellant. The addition of Rs.22,32,707/- has been made by the A.O. on the grounds that (1) the transactions have been reported by the Special Auditors as with CCDS clients, and (ii) in the assessment under section 143(3) it was held that the funds collected under CCDS are appellant's own funds and there cannot be a loss in dealing with one's own funds. He therefore, disallowed the loss of Rs.22,32,707/- stated to be with CCDS clients. In the reassessment as well as in the Remand Report called from the A.O., the A.O. has accepted the fact after due verification of records that the sale/redemption transactions in the two securities under consideration were not with CCDS clients. However, he preferred to sustain the addition only because the auditors had reported the transactions to be with CCDS clients. Coming to the Special Audit report, there is merit in appellant's contention that the Special Auditors erred in reporting the sale transaction in the two securities under consideration as with CCDS clients. The security 4% GOI 1991 had matured and redeemed on 04.02.1991, whereas the Special Auditors erred in reporting the same as sale to CCDS clients. Similarly, the SSQ indicates that the balance

stock of Rs.29.50 crores in 11.5% GOI 2010 was sold on 02.01.1991 to Andhra Bank. The list of deals done on 04.02.1991 and 29.12.1990 also does not indicate any sale of 8% GOI 1991 on 04.02.1991 and sale of 11.5% GOI 2010 on 29.12.1990. Further, the Special Auditors have linked the sale of the said two securities to deal number 9999 dated 9/9/99. The deal number and date also appears to be non-existent since we are dealing with the previous year ended 31.3.1991 whereas the sale deals are stated to have been undertaken on 9/9/99. No explanation could be found in the report of the Special Auditors for such sale deals. The loss computed by the auditors is Rs.22,32,707/- whereas actual profit/loss booked on redemption/sale of the said securities was different as stated earlier.

4.7 Despite specific direction by the CIT(A)-XIII to verify whether the loss of Rs.22,32,707/- has been debited to P&L A/c. or any other account by which the income of the appellant has been reduced, the A.O. has not given any finding in this regard in the subject assessment le framed under section 143(3) r.w.s. 250 of the Act. The CIT(A)-XIII had specifically observed that if the loss of Rs.22,32,707/- has not been reduced out of any income from any source and such loss has not been debited to the P&L A/C. then there may be no disallowance of loss because the loss has not been reduced from any income and it may be artificial loss. Further, despite again asking specific reply to this question by me in remand report, the AO has not given any reply to this part. The AR, on the other hand has refuted the A.0.% contention and submitted that the appellant has neither debited the said loss of Rs.22,32,707/- computed by the Special Auditors to the Profit & Loss Account nor made a separate claim for the said amount of Rs.22,32,707/- In the Return of Income. The appellant has further provided the details of profit/loss made on the redemption/sale of the said two securities as mentioned earlier.

4.8 Taking all the above factors into consideration, I am of the view that the addition of Rs.22,32,707/- made by the AO was not warranted since the transactions in the first place were not with CCDS clients and secondly, the Special Auditors have erroneously reported these transactions with CCD clients. Thirdly, the appellant has not debited the said loss of Rs.22,32,707 to the P&L A/c. and has also not made any claim in the Return. The pro loss booked by the appellant in respect of the said two securities was in t regular course of banking business and therefore, taxable/allowable as such. This ground of appeal is, accordingly, allowed and the addition of Rs. 22,32,707/- is directed to be deleted."

20. We notice that the Ld CIT(A) has given his decision on the basis of his finding on the facts relating to the issue under consideration. The said finding of fact given by Ld CIT(A) could not be controverted by the revenue. Accordingly, we confirm the order passed by Ld CIT(A) on this issue.

21. The last issue urged by the revenue relates to the computation of interest u/s 234B of the Act. Charging of interest is consequential and we restore this issue to the file of the AO for computing interest u/s 234B of the Act in accordance with law.

22. In the result, the appeal filed by the assessee is allowed and the appeal of the revenue is dismissed.

Pronounced in the open court on 08.03.2023.

Sd/-	Sd/-
(SANDEEP SINGH KARHAIL)	(B.R. BASAKARAN)
Judicial Member	Accountant Member

Mumbai; Dated : 08/03/2023

Copy of the Order forwarded to :

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

BY ORDER,

//True Copy//

(Assistant Registrar)

PS ITAT, Mumbai