

**IN THE INCOME TAX APPELLATE TRIBUNAL
LUCKNOW 'B' BENCH, LUCKNOW**

**BEFORE SH. SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER
AND
SH. NIKHIL CHOUDHARY, ACCOUNTANT MEMBER**

ITA No.122/LKW/2024
A.Y. 2017-18

Pankaj Agarwal, 7/151, Ratan Majestic, Opp. Sony World, Swaroop Nagar, Kanpur-208002	vs.	The Assessing Officer, Special Range, Kanpur-208001
PAN: ABNPA4816E		
(Appellant)		(Respondent)

Assessee by:	Sh. Rakesh Garg, Adv
Revenue by:	Sh. R.R.N. Shukla, Addl CIT DR
Date of hearing:	23.12.2025
Date of pronouncement:	27.02.2026

ORDER

PER NIKHIL CHOUDHARY, A.M.:

This is an appeal filed by the assessee against the order passed by the ld. CIT(A), NFAC dated 9.01.2024 wherein the ld. CIT(A) has dismissed the appeal of the assessee against the orders of the ld. AO, Special Range, Kanpur, passed under section 143(3) on 26.09.2019.

2. It is seen from the record that the appeal is delayed by 2 days. However, since the date of filing is preceded by Saturday and Sunday, wherein the offices of the ITAT were closed, the delay is condoned and the appeal is admitted for hearing. The grounds of appeal are as under: -

"1. Because the CIT(A) has erred on facts and in law in treating the loss of Rs.42,17,895/- being loss on account of trading in derivatives as a capital loss as against business loss claimed by the assessee, which finding of the AO being contrary to facts, bad in law, the addition made be deleted.

2. Because on a proper consideration of facts and circumstances of the case it would be found that the loss incurred in trading in derivatives is not a capital loss but is loss arising in normal course of business, such loss cannot be treated as capital loss but ought to be set off against the other business income, such having not been done the order of CIT(A) being bad in law be quashed.

3. Because on a proper interpretation of the provisions of section 43(5) trading in derivatives being non-speculative, would not be a speculative loss, the same being loss incurred in business ought to be set off against business income, the CIT(A) was not justified in not setting off the loss against the business income.

4. Because the CIT(A) has erred on facts and in law in holding that since the assessee has not maintained separate books of account and has not got the books audited as per section 44AB, the assessee is not eligible, such finding be contrary to facts and in as much as there was no requirement of maintaining of two separate books of account, the books of account as maintained having being audited u/s 44AB, the Auditor's Report attached therein and independent enquiries having been made with the auditor, the CIT(A) has erred in upholding the order of the AO, the disallowance of Rs. 42,17,895/- made be deleted and set off against income from business.

5. Because two separate ledger of accounts having been maintained one for derivatives and other for purchase and investments, the authorities below have erred on facts and in law in holding that separate books of accounts for each business should be maintained such being not the mandate of the Act, the order passed by the Authority below is bad in law and be quashed.

6. Because the CIT(A) has erred in invoking section 74 that being meant for capital loss and capital gains, not applicable to the assessee's case, the provisions of section 72 to be invoked, the CIT(A) was not justified in not setting off the losses incurred in trading in derivatives against other business income, the order of the CIT(A) being erroneous be quashed.

7. Because whenever there has arisen profit on trading in derivatives in assessee's own case both in the past and in the future, the same has been taxed as income from business and not income from capital gains, where as in all years where there is trading loss the same has been gain a differential treatment of trading the same as capital loss and not as business loss, such an act on the part of the revenue is totally contrary to the provisions and spirit of the Act, the loss incurred in trading of derivatives and treated as capital loss be allowed as business loss."

3. The facts of the case are that the assessee is an individual who has income from Coaching business, house property, capital gains and also income from trading in derivatives. He filed a return of income on 17.10.2017 showing total income of Rs. 3,74,49,060/-. The assessee had debited an amount of Rs. 42,17,895/- from the P&L

account under the head, “derivative loss”. The Id. AO treated the same as capital loss and disallowed the deduction claimed against business income in view of the assessee’s claim that the loss was a business loss. Before the Id. AO, the assessee had maintained that he had two portfolios; one was the investment portfolio and the other was a trading portfolio. As far as the income from investment portfolio was concerned, the same was declared under the head capital gains, either long term or short term as the case may be. As far as trading is concerned, the assessee traded only in derivatives and the profit or loss in derivatives was maintained separately, distinctively and was not part of investments held by the assessee. The AO concluded that the trading in derivatives was also part of the investment portfolio and as such the loss resulting in trading of derivatives, was a capital loss, which could not be set off against the business income. While doing so, the AO quoted from the ICAI guidance note on accounting of future and contracts to demonstrate how the ICAI had laid down the guidelines regarding maintenance of books and preparation of accounts for this trade. He held that since the main purpose of the assessee was investment and he was using the source of the same from his main business of coaching and because he had debited all expenditure relating to investments in the capital account and not in the P&L account therefore, he had claimed the derivative loss wrongly as a business loss when no element of business in the transaction could be proved by him. He had not maintained separate books of accounts and not got the business audited as required under section 44AB of the Act therefore, the loss on derivatives were short term capital loss and was disallowed to be claimed against the business income of the assessee.

4. Aggrieved with this order of the Id. AO, the assessee went before the Id. CIT(A). He noted that in the instant case, the assessee had not maintained separate books of accounts and not got the business audited as required under section 44AB of the Act. He further held that short term capital loss of the current year could only be set off

against short term capital gain during the year and therefore, he upheld the disallowance made by the AO.

5. The assessee has come in appeal before us. Sh. Rakesh Garg, Advocate (hereinafter referred to as the AR) submitted that the issue had been considered at great length by the ITAT in ITA No. 267/LKW/2023 for the A.Y. 2012-13 and there was absolutely no difference in the facts of the case in this assessment year. It was pointed out that upto the year 2009-10, the profits from derivative had been accepted as business income of the assessee. It was only when the trade had resulted in loss that the Department had begun to disallow the said loss in A.Ys. 2010-11 to 2013-14. However, in A.Y. 2012-13, the matter had been considered by the ITAT vide the aforesaid appeal and in their order dated 22.04.2025, the ITAT Lucknow Bench had categorically held that the loss on account of trading in derivatives was a business loss. A copy of the order was attached and it was prayed that in view of the same consequent relief may be granted to the assessee. It was further pointed out that subsequently in the A.Ys. 2014-15 and 2015-16, the Department had again accepted the profits on derivatives as business income and in 2016-17 and 2017-18, when losses had occurred on such trading, the same had been disallowed for set off, holding them to be capital loss. Thus, it was prayed that whenever the assessee earned income from derivative trading, the Department would accept it as business income but whenever the assessee earned a loss, the Department would disallow the same as holding it to be capital loss. It was pointed out that such contradictory stance could not be condoned and therefore, also the losses from derivatives ought to be regarded as business loss in the same manner that profits from derivatives had been regarded as business profits.

6. On the other hand, Shri. R.R.N. Shukla, Id. CIT DR (hereinafter referred to as the DR) representing the Revenue pointed out that the AO had done a detailed analyses of how derivatives were to be accounted for in his assessment order by relying upon the guidance note of the ICAI. While he acknowledged the ITAT order in ITA No.

267/LKW/2023 and admitted that the facts in question were identical, he prayed for reconsideration of the decision in view of these guidance notes that had been quoted in the assessment order.

7. We have duly considered the facts and circumstances of the case. We note that in ITA No. 267/LKW/2023 for the A.Y. 2012-13 vide our order dated 22.04.2025, we have already adjudicated on all the issues that arise for consideration in this appeal also. In the said order, we have held as under:-

“We have duly considered the facts and circumstances of the case and the arguments advanced by both parties. We observe that the presumption of the AO, that because the assessee was running a coaching institute, he could not be a trader but must necessarily be an investor, is not based on any sound reasoning. It is entirely possible that an assessee may have a main business and also do a side business. We note that the assessee has been dealing in shares and derivatives for many years. It is therefore unreasonable to hold that he had no understanding of how to do trades in derivatives, only because he ran a coaching institute, without any empirical evidence to back up this assumption. We also note that the assessee has taken the help of at least four broking houses and clearing agents to perform these trades. It is not unreasonable to hold that he could do trades with professional assistance, even if he himself was not accomplished in all the nuances of derivative trading and therefore this is no reason to hold that his foray into derivative trading was in the nature of investment. We note that the CBDT in the circular no 4/2007 dated 15.06.2007 has pointed out that it is possible for a taxpayer to have two separate portfolios, one for investment and the other for trading and quoted from judgments to show that the test for determining which security falls into the category of investment and which security falls into the category of stock in trade, depends on various factors such as the magnitude of purchase and sale, the ratio between purchase and sale and also the holding period. The assessee has consistently submitted that the transactions into derivatives ran into crores of rupees, they are marked by frequent sale and purchase without taking delivery and that the holding periods of these derivatives is extremely short and therefore these are demonstrative of the fact that the trading in derivatives were not for investment purposes but rather for making of profit. The Assessing Officer has not refuted these assertions with any empirical evidence that the derivatives traded by the assessee were in the nature of LEAPS (Long Term Equity Anticipation Securities) or even that the average holding period of the derivatives were sufficient to justify their reclassification as capital assets rather than business assets. She has also not highlighted any instance showing that the derivatives were used strategically as hedging tools against investments in listed securities, allowing the assessee to mitigate risk without

abandoning his investment positions. In the circumstances there is simply no evidence brought on record by the Ld. AO, to justify reclassification of derivatives as capital assets liable to be assessed under the head of capital gains. The Assessee has also submitted that the "Investments" referred to in his balance sheet and audit report are shares and mutual funds of which delivery had been taken, that were purchased either with a view of earning dividend or selling them on appreciation and that these had been offered for tax under the head Capital gains. The AO has not been able to refute, with any empirical evidence that the premium paid for derivatives or the expected gains in open positioned trades on balance sheet date have also been included under the head, "investments" in the balance sheet. In the circumstances, her observation that the derivatives had been certified as investments in the audited accounts of the assessee remain unsubstantiated. In fact, we note, that even while the AO has held that the assessee did not maintain a separate trading portfolio, by accepting the profits on commodity (derivative) transactions as business income, the Ld. AO has contradicted her own findings that all the trades done by the assessee were in the nature of investment or that the assessee was not capable of trading in derivatives as a business. This contradictory stand of treating income from commodity transactions as business income and losses from derivatives in security as short-term capital loss, without any investigation into the volume of trades, the ratio between sale and purchase or the holding period or even whether the derivative trading had been done with a view to hedging against risk to the investment portfolio, cannot therefore be justified. We further note that the assessee has submitted that he had always been showing derivative trading as a separate business income in his returns filed over the previous and subsequent years. We further note the submission that the assessment in AY 2010-11 was done under section 143(3) and no adverse inference was taken on this point and that in the assessment year 2015-16, where notice under section 148 was issued, the notice was dropped without making any such addition. Therefore, the stand of the Ld AO in this assessment year would also appear to be at variance with the principle of consistency.

10. We would now turn our attention to some of the alleged lacunae pointed out by the Ld. AO and the replies submitted by the assessee with regard to them. The AO has pointed out that the assessee has not maintained separate books of accounts or got them audited, therefore the trading in derivatives cannot be recognized as a separate business. We note the submission of the assessee that a separate ledger accounts have been maintained for trading activities of both securities and commodities and that the assessee is an individual whose books of accounts have been audited under section 44AB. To our mind that satisfies the condition that separate books should be maintained and audited. The second alleged lacuna that has pointed out by the Ld. AO is that the Assessee has pledged shares on which he earns dividends, with trading members instead of depositing cash as initial margin in derivative contracts and this shows an intimate link between the securities held as capital assets and the derivatives. We note that pledging of shares as security to safeguard against default in a derivative contract

is nothing more than pledging of an asset as security and does not confer the derivative with the identity of a capital asset. That is something that has to be established by an analysis of the concerned derivative, which the Ld. AO has not done. We also note that the AO has quoted from certain ICAI guidelines regarding accounting of derivatives, but there is no discussion in the order, with reference to the assessee's accounts, as to how these guidelines have been violated by the assessee. It is not clear from the assessment order as to whether any study was undertaken of the assessee's accounts with reference to these guidelines, or whether the assessee was asked to show how compliance had been made. Rather the guidelines appear to have been reproduced, in an effort to show that derivatives can be considered to be a capital asset attracting short term capital gains or losses. To our mind, the issue in the present case is not whether derivatives could be regarded to be a short-term capital asset but whether, in the present case, they are so and as we have already observed, this has not been demonstrated with reference to any of the tests which have been laid down for determining whether an asset was a capital asset or a stock in trade. In fact, we observe that the AO has conceded in her order that the assessee had to square up his derivative position every three months and take up fresh position and also pay mark to market on a daily basis. These would indicate the derivative trading carried on by the assessee were in the nature of business transactions rather than investments. We also observe that any shortcoming in the accounting of the assessee with reference to the ICAI guidelines may have their own tax implications but would not justify re-classification of derivatives as "investments" without the evidence to demonstrate that they were so.

11. In parting with this issue, we note that prior to F.Y. 2005-06, transactions in derivatives were considered as speculative transactions for the purposes of determination of tax liability under the Income Tax Act. Finance Act 2005 amended section 43(5) so as to exclude transactions in derivatives on "recognized stock exchanges" from the purview of speculative income or loss. Thus, losses on derivative transactions that meet the exception criteria in clauses (d) and (e) of section 43(5) can now be set off against any other income of the year and also carried forward for set off against any other income of the subsequent year. The two case laws relied upon by the Ld AR essentially reaffirm this principle. Thus, we note that in the given facts and circumstances of the case, the decision of the Ld AO to reclassify the business loss on derivatives as short-term capital loss was unjustified. We also note that the Ld CIT(A) has chosen to merely rely upon the findings of the AO and not independently applied his mind to the arguments made and evidences placed before him. Thus, we are not in agreement with his decision to sustain the disallowance. Accordingly, we quash the disallowance of business loss from derivative trading in securities of Rs 2,47,02,865/- and direct that the assessee be permitted to set it off against commodity transactions of Rs 60,13,263.98, which in turn have already been accepted as business income by the Ld AO. Ground nos 1 to 4 are accordingly allowed. Ground no 5, being rendered

infructuous on account of our decision with regard to Ground nos. 1 to 4, is dismissed as such."

8. Accordingly, following our orders in ITA No. 267/LKW/2023 and for the same reasons stated therein, we hold that the decision of the AO to treat the loss in derivatives as short term capital loss and his refusal to allow the same to be set off against regular business profits are not justified as the same are clearly business losses in view of the fact of the case. Accordingly, the addition made in this regard is deleted and the appeal of the assessee is held to be allowed.

9. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 27.02.2026.

Sd/-

**[SUDHANSHU SRIVASTAVA]
JUDICIAL MEMBER**

DATED: 27/02/2026

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Copy forwarded to:

1. Appellant -
2. Respondent -
3. CIT DR, ITAT,
4. CIT,
5. The CIT(A)

Sd/-

**[NIKHIL CHOUDHARY]
ACCOUNTANT MEMBER**

By order
Sr. P.S.