IT : Unabsorbed business losses could be adjusted against speculation profit of current year, provided speculation losses for current and earlier years had been first adjusted from speculation profit

• A reading of the sections 71, 72 and 73, Circular and case laws makes it clear that there is no blanket bar as such in adjustment of carry forward non-speculation business loss against current year speculation profit. These provisions provide that loss in speculation business cannot be set against any income under the head "Business or profession" nor against income under any other head, but it can be set off only against profits, if any, of another speculation business. Section 73 effects complete segregation of speculation losses, which stand distinct and separate and can be mixed for set off purpose, only with speculation profits. The circular No. 23-D issued by Board dated 12.09.1960 (which has been held by the Hon'ble High Court to be still holding the field) provide that if speculation losses for earlier years are carried forward and if in the year of account a speculation profit is earned by the assessee, then such speculation profits for the current accounting year should be adjusted against carried forward of speculation losses of the earlier year, before allowing any other losses to be adjusted against those profits. Hence, it is clear that there is no bar in adjustment of unabsorbed business losses from speculation profit of the current year, provided the speculation losses for the year and earlier has been first adjusted from speculation profit.

[2018] 92 taxmann.com 133 (Mumbai - Trib.)

IN THE ITAT MUMBAI BENCH 'D'

Edel Commodities Ltd.

v.

Deputy Commissioner of Income-tax, Circle- 3 (1), Mumbai

SHAMIM YAHYA, ACCOUNTANT MEMBER
AND AMARJIT SINGH, JUDICIAL MEMBER
IT APPEAL NOS. 3426 AND 3576 (MUM.) OF 2016
[ASSESSMENT YEAR 2011-12]
APRIL 6, 2018

Vijay Mehta *for the Appellant.* **Ram Tiwari** *for the Respondent.*

ORDER

Shamim Yahya, Accountant Member - These are cross appeals by the assessee and the Revenue arising out of the order of the ld. Commissioner of Income Tax (Appeals) dated 15.2.2016 and pertain to the assessment year 2011-12.

Assessee's appeal

2. The grounds of appeal read as under:

1. The Hon'ble Commissioner of Income Tax (Appeal) - 8, Mumbai [hereinafter referred as CIT(A}] erred in confirming the action of the AO in not allowing the set off of brought forward non

speculative loss of Rs.1,92,98,587/- against the current years speculative income of Rs.4,77,37,754/-.

The Appellant submits that as per section 72 and 73 of the I.T. Act it has correctly set off the brought forward non-speculative loss against the current years speculative income; hence, the disallowance thereof made by the AO and confirmed by the CIT(A) shall be deleted.

3. The assessee company is engaged in the business of trading in securities, physical commodities and derivative instruments. On perusal of computation of income furnished by the assessee during the course of assessment proceedings the Assessing Officer observed that the assessee company has determined speculative business income of Rs.4,77,37,754/- against this assessee has claimed set off of brought forward loss of Rs.1,92,98,587/- and total income has been determined at Rs.2,84,39,167/-. Thereafter the Assessing Officer noted that in clause 25 the auditor in the report u/s. 44AB have shown details of brought forward losses as under:

25. (*a*) Details of brought forward loss of depreciation allowance in the following manner, to the extent available:

Sr. No.	*Asst. Year*	*Nature of loss/allowance*	*Amount as returned*	*Amount as assessed (give reference)*	*Remarks*
			(in Rs.)	(in Rs.)	
1	2009-10	Business Loss	3,46,493	NA	
2	2010-11	Business Loss	18,932,125	NA	
3	2010-11	Unabsorbed Depreciation	19,969	NA	

4. By examination of the above, the Assessing Officer proceeded to reject the claim of set off for brought forward speculation losses. For this the Assessing Officer held asunder:

4.2 The above chart no-where mentions that the loss is the speculation business loss, meaning thereby assessee has no brought forward speculation loss available. Further exercise was made to peruse the Schedule-CFL of the return of income which provides the details regarding the brought forward losses. As per this schedule of return of income, the brought forward losses to the tune of Rs.1,92,98,587/- are available to the assessee under the head 'loss from business other than loss from speculation business'. This further reinforces the earlier findings that the assessee is not having brought forward speculation business loss. Keeping in tune with this exercise, even assessment records for A.Y.2010-11 was also verified and the statement of income furnished by the assessee during the course of assessment proceedings for A.Y.2010-11 shows same position which has already pin pointed. Thus, this fact further fortifies findings based upon other two evidences mentioned earlier.

In brief, considering the all these documents the undersigned is fully convinced and satisfied that as per assessment records assessee is not having any brought forward speculation loss as claimed by the assessee for the set-off against the speculation business income earned during the year under consideration. As a result, assessee's claim of set-off for brought forward speculation losses stands rejected.

5. Against the above order, the assessee appealed before the ld. Commissioner of Income Tax (Appeals).

6. Considering the assessee's submission, the ld. Commissioner of Income Tax (Appeals) did not find himself in agreement with the submissions of the assessee. He held as under:

5.1.2 In the instant case, the appellant has brought forward non-speculative loss of Rs. 1,92,98,587/- and set it off against speculative income of Rs. 4,77,37,754/-. I have given due consideration to the contention of the appellant above wherein it is essentially argued that section 72 of the Act allows

non-speculation losses to be carried forward and set-off against any source of income which is assessed under the head "profits and gains of business or profession".

5.1.3 I am unaware to except this interpretation of section 72 made by the appellant, ft is established judicial principal of Rule of Harmonious Construction that when there is a conflict between a general provision and a special provision it is the special provision that prevails. This tenant has been established in countless pronouncements of the Apex Court including in a recent decision in the case of COMMERCIAL TAX OFFICER, RAJASTHAN v. BINANI CEMENT LTD. (Civil Appeal No. 336 of 2003) February 19, 2014. Section 72 is specially meant for loss, "not being a loss sustained in a speculation business" whereas section 73 is specialty meant for losses in speculation business". Thus, non-speculative losses have to be set-off under the special provisions of section 72, which means against profits of any source of business or profession except speculation business, for which there is a special section 73. Therefore, in my view, the stand taken by the A.O. was absolutely correct. These grounds of appeal are therefore dismissed.

7. Against the above order, the assessee is in appeal before us.

8. We have heard both the counsel and perused the records. The ld. Counsel of the assessee placed reliance upon the provisions of sections 71 and 72 of the Act relating to the carry forward of losses. He submitted that there is no bar in the Act for adjustment of carry forward non speculation losses from the current year of speculation profit. In this regard, he placed reliance upon the CBDT Circular No. 23D dated 12.09.1960. He further placed reliance upon following case laws in support thereof:

1. Hon'ble Calcutta High Court decision in the case of *CIT* v. *New India Investment Corporation Ltd.* 205 ITR 618 (Cal); and
2. Hon'ble Allahabad High Court decision in the case of *CIT* v. *Ramshree* Steels Pvt. Ltd. 400 ITR 61 (All)

9. Per contra, the ld. Departmental Representative relied upon the orders of the authorities below.

10. Upon careful consideration, we find that issue here is the adjustment of carry forward non speculation business loss against current year speculation profit. Before proceeding further we may gainfully refer to the provisions of sections 71, 72 and 73 of the Act which are relevant here:

[75][**Set off of loss from one head against income from another.**

[76] **71.** (1) Where in respect of any assessment year the net result of the computa tion under any head of income, other than "Capital gains", is a loss and the assessee has no income under the head "Capital gains", he shall, subject to the provisions of this Chapter, be entitled to[77] have the amount of such loss set off against his income, if any, assessable for that assessment year under any other head.

(2) Where in respect of any assessment year, the net result of the computation under any head of income, other than "Capital gains", is a loss and the assessee has income assessable under the head "Capital gains", such loss may, subject to the provisions of this Chapter, be set off against his income, if any, assessable for that assessment year under any head of income including the head "Capital gains" (whether relating to short-term capital assets or any other capital assets).

[78][(2A) Notwithstanding anything contained in sub-section (1) or sub-section (2), where in respect of any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is a loss and the assessee has income assessable under the head "Salaries", the assessee shall not be entitled to have such loss set off against such income.]

(3) Where in respect of any assessment year, the net result of the computation under the head

"Capital gains" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to have such loss set off against income under the other head.]

Following sub-section (3A) shall be inserted after sub-section (3) of section 71 by the Finance Act, 2017, w.e.f. 1-4-2018 :

(3A) Notwithstanding anything contained in sub-section (1) or sub-section (2), where in respect of any assessment year, the net result of the computation under the head "Income from house property" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to set off such loss, to the extent the amount of the loss exceeds two lakh rupees, against income under the other head.

[79][(4) Where the net result of the computation under the head "Income from house property" is a loss, in respect of the assessment years commencing on the 1st day of April, 1995 and the 1st day of April, 1996, such loss shall be first set off under sub-sections (1) and (2) and thereafter the loss referred to in section 71A shall be set off in the relevant assessment year in accordance with the provisions of that section.]

Carry forward and set off of business losses.

[82] **72.** [83][(1) Where for any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off or, [84][* * *] where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and—

(*i*) it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year ; [85][* * *]

(*ii*) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on :]

[86][**Provided** that where the whole or any part of such loss is sustained in any such business as is referred to in section 33B which is discontinued in the circumstances specified in that section, and, thereafter, at any time before the expiry of the period of three years referred to in that section, such business is re established, reconstructed or revived by the assessee, so much of the loss as is attributable to such business shall be carried forward to the assessment year relevant to the previous year in which the business is so re-established, reconstructed or revived, and—

(*a*) it shall be set off against the profits and gains, if any, of that business or any other business carried on by him and assessable for that assessment year; and

(*b*) if the loss cannot be wholly so set off, the amount of loss not so set off shall, in case the business so re-established, reconstructed or revived continues to be carried on by the assessee, be carried forward to the following assessment year and so on for seven assessment years immediately succeeding.]

(2) Where any allowance or part thereof is, under sub-section (2) of section 32 or sub-section (4) of section 35, to be carried forward, effect shall first be given to the provisions of this section.

(3) No loss [86][(other than the loss referred to in the proviso to sub-section (1) of this section)] shall

be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Losses in speculation business.

[4] **73.** (1) Any loss, computed in respect of a speculation business carried on[5] by the assessee, shall not be set off except against profits and gains, if any, of another speculation business.

(2) Where for any[5] assessment year any loss computed in respect of a speculation business has not been wholly set off under sub-section (1), so much of the loss as is not so set off or the whole loss where the assessee had no income from any other speculation business, shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and—

(*i*) it shall be set off against the profits and gains, if any, of any speculation business carried on by him assessable for that assessment year; and

(*ii*) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

(3) In respect of allowance on account of depreciation or capital expenditure on scientific research, the provisions of sub-section (2) of section 72 shall apply in relation to speculation business as they apply in relation to any other business.

(4) No loss shall be carried forward under this section for more than [6][four] assessment years immediately succeeding the assessment year for which the loss was first computed.

[7][*Explanation.*—Where any part of the business of a company ([8][other than a company whose gross total income consists mainly of income which is chargeable[9] under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources"], or a company [10][the principal business of which is the business of trading in shares or banking] or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section[9], be deemed to be carrying on a speculation business[9] to the extent to which the business consists of the purchase and sale of such shares.]

11. In this regard, we note that Circular No. 23-D issued by the Board dated 12.09.1960 *inter alia* mentioned as under:

POINT (v) - **Speculation loss if any, carried forward from the earlier years or the speculation loss, if any, in a year should first be adjusted against speculation profits of the particular year before allowing any other loss to be adjusted against those profits.**

BOARD'S DECISION - The suggestion is acceptable. For the purpose of set-off under section 10 (of the 1922 Act) and section 24(1) the speculation loss of any year should first be set-off against the speculation profits of that year and the remaining amount of speculation profits, if any, should then be utilised for setting-off of any loss of that year from other sources. For the purposes of section 24(2), the ITO may allow the assessee—

(*i*) either to first set-off the speculation losses carried forward from an earlier year against the speculation profits of the current year and then to set-off the current year's losses from other sources against the remaining part, if any, of the current year's speculation profits,

(*ii*) or to first set-off the current year's losses from non-speculation business and other sources against the current year's speculation profits and then to set-off the carried forward speculation losses of the earlier year against the

remaining part, if any, of the current year's speculation profits, whichever is advantageous to the assessee.

[Emphasis supplied by us]

12. We further note that the Hon'ble Allahabad High Court decision in the case of *Ramshree* Steels Pvt. Ltd. (*supra*) have held that loss of current year and carry forward losses of earlier year from non speculation business can be set off against the profit of speculation business of current year. Furthermore, we note that the Hon'ble Calcutta High Court in the case of *New India Investment Corporation Ltd.* (supra) while referring to the Hon'ble Bombay High Court decision in the case of *Navnitlal Ambalal vs. CIT* [1976] 105 ITR 735 (Bom.) and also by referring to the afore-said CBDT Circular have held as under:

It is thus clear from this circular that if speculation losses for the earlier years are carried forward and if in the year of account a speculation profit is earned by the assessee then the circular provides that such speculation profits for the accounting year should be adjusted against the carried forward speculation loss of the previous year before allowing any other loss to be adjusted against those profits.

13. The Hon'ble Bombay High Court in the case of *Navnitlal Ambalal* (*supra*) has held as under:

That it was unnecessary to construe the provisions of section 24 read with the provisions of section 6 and 10 of the Act, because the Board of Revenue has stated in one of its circulars that if speculation losses for earlier years are carried forward and if in the year of account a speculation profit is earned by the assessee, then such speculative profits for the accounting year should be adjusted against the carried forward speculation loss of the previous year before allowing any other loss to be adjusted against those profits.

14. A reading of the above sections 71, 72 and 73, Circular and case laws makes it clear that there is no blanket bar as such in adjustment of carry forward non speculation business loss against current year speculation profit. These provisions provide that loss in speculation business cannot be set against any income under the head "Business or profession" nor against income under any other head, but it can be set off only against profits, if any, of another speculation business. Section 73 effects complete segregation of speculation losses, which stand distinct and separate and can be mixed for set off purpose, only with speculation profits. The said circular of the Board (which has been held by the Hon'ble High Court to be still holding the field) provide that if speculation losses for earlier years are carried forward and if in the year of account a speculation profit is earned by the assessee, then such speculation profits for the current accounting year should be adjusted against carried forward of speculation losses of the earlier year, before allowing any other losses to be adjusted against those profits. Hence, it is clear that there is no bar in adjustment of unabsorbed business losses from speculation profit of the current year, provided the speculation losses for the year and earlier has been first adjusted from speculation profit. In the present case, no case has been made out by the Revenue that the current or earlier speculation losses have not been adjusted from the speculation profit. Hence, in view of the aforesaid case laws including that from the Hon'ble jurisdictional High Court and CBDT Circular mentioned hereinabove, we set aside the order of the authorities below and decide the issue in favour of the assessee.

Revenue's appeal:

15. The grounds of appeal read as under:

1. "On the facts and circumstances of the case and in law, the Ld.CIT(A) erred in deleting the addition made on account of mismatch of AIR data with income offered by the assessee without appreciating the fact that the

assessee had claimed the TDS on the same and had not offered the income for taxation."

2. "On the facts and circumstances of the case and in law, the Ld.CIT(A) erred in deleting the addition of Rs.5,24,53,455/- made by Assessing Officer on account of mark to market loss claimed by the assessee in derivative transactions without appreciating the fact that the loss claimed on the basis of value of derivative as on 31st March is merely a notional loss and the actual loss or the profit in respect of such derivative transactions would get crystallized only at the time of settlement of such transaction,"

3. "The appellant prays that the order of CIT (A) on the above ground be set aside and that of Assessing Officer be restored."

Apropos ground no. 1:

16. On this issue, the Assessing Officer noted that there were discrepancies between AIR data and 26AS information. The assessee was asked to provide the reconciliation between the same. The assessee furnished the reconciliation statement and stated that the payments of interest of Rs.3,50,236/- and rent of Rs.1,00,188/- made by one of the party appearing the AIR data, i.e., Divya Strips & Profile Pvt. Ltd. did not pertain to them. The assessee after making enquiries on its own has further submitted that the aforesaid party has inadvertently credited the TDS against their pan while filing the Quarterly TDS returns u/s.206 of the I.T. Act.

17. The Assessing Officer did not accept this contention. He held that though, the assessee has contended that M/s. Divya Strips & Profile Pvt. Ltd. has inadvertently credited the TDS against their PAN in the online system of Income Tax, it has not carried out the necessary rectification as required to correct the mistake occurred on its part. Further, the assessee company, even not having nexus with the party has claimed the credit for the corresponding TDS. Therefore, the Assessing Officer has held that the assessee's contention for not considering the corresponding amount for taxation cannot be accepted. Hence, he opined that interest of Rs.3,50,236/- and rent of Rs.1,00,188/- both are required to bring to tax as income of the assessee. He further concluded that a sum of Rs.4,50,424/- being interest of Rs.3,50,236/- plus rent income of Rs.1,00,188/-, is hereby brought to tax subject to the rectification as and when TDS credit appearing against the PAN of the assessee gets rectified in the online TDS accounting system of income tax.

Warehouse Charges

18. From the reconciliation statement submitted by the assessee, it was further observed that there was discrepancy amounting to Rs.23,31,761/- on account of 'warehouse charges' as offered by the assessee for taxation vis-a-vis AIR/26AS data. The assessee was therefore, requested to explain the discrepancy so noticed. The Assessing Officer noted that in reply the assessee has not offered any plausible explanation. That the assessee has merely stated that the aforesaid amount pertains to its one of the sister concerns wrongly credited assessee's account. He observed that the assessee was requested to carry out the necessary rectification in Online Accounting System of Income Tax so as to correct the effect of income wrongly shown against its PAN. That the assessee has not carried out the rectification as required. Hence, the Assessing Officer held that an amount of Rs.23,31,761/- being discrepancy in income offered by assessee vis-a-vis AIR is hereby brought to tax as income of the assessee subject to rectification as and when same gets rectified in the online TDS accounting system of income tax.

19. Before the ld. Commissioner of Income Tax (Appeals) the assessee made the following submissions as under:

During the course of assessment proceeding, the Appellant was given AIR to reconcile the entries

therein with the books of accounts of the Appellant. The Appellant reconciled all the entries except following three entries tabulated as under:

Sr. No.	*Name of parties*	*Nature of income*	*Amount as per AIR (A)*	*Amount as per books (B)*	*Difference (A-B)*
1	Edelvalue Partners	Warehouse charges	2,68,70,965/-	2,45,39,204/-	23,31,761
2	Divya Strips and Profile Pvt Ltd.	Interest	3,50,236/-		3,50,236/-
3	Divya Strips and Profile Pvt. Ltd.	Rent	1,00,188/-	-	-1,00,0188/-
Total			2,73,21,389/-	2,45,39,204/-	27,82,185/-

During the assessment proceeding, the Appellant submitted that it has not earned any amount in excess of what is recorded in its books of account. The discrepancy/variation is due to error in TDS return filed by the parties wrongly mentioning the Appellants PAN in TDS return resulting into appearance of the entries in the Appellant's AIR. However, the AO made the addition of Rs.27,82,185/- in the hand of the Appellant stating that the Appellant has not carried necessary rectification in Online Accounting System of Income Tax.

20. Upon the assessee's appeal, the ld. Commissioner of Income Tax (Appeals) held as under:

5.2.1 These grounds are against addition of Rs. 27,82,185/-due to variation in AIR and books of account of the appellant. The appellant was unable to reconcile three entries totalling to the impugned amount. It is contended that the discrepancy/variation is due to error in TDS return of one of the three parties of Edelvalue Partners. The same has now been rectified. It has been contended that the appellant has not entered into any transaction with DSPPL.

5.2.2 The Assessing Officer is directed to verify the revised Form 26 AS in respect of Edelvalue Partners. As regards amounts in respect of DSPPL, in view of the decisions of Hon'ble ITAT, Mumbai cited and relied upon by the appellant, the Assessing Officer is directed to delete the additions of Rs.3,50,236/- and Rs. 1,00,188/-. This ground of appeal is allowed.

21. Against the above order, the Revenue is in appeal before us.

22. We have both the counsel and perused the records. We find that as regards the issue relating to reconciliation for the sum of Rs.27,82,185/-, we find that the ld. Commissioner of Income Tax (Appeals) has directed the Assessing Officer to verify the revised Form 26AS in respect of Edelvalue Partners. We find that the ld. Commissioner of Income Tax (Appeals) has not directed the Assessing Officer to delete the addition; rather he has directed him to verify the revised form to verify the claim that the same has been rectified in Form 26AS and that the assessee has not entered into any transaction with Edelvalue Partners. Hence, in our considered opinion, there is no infirmity in the direction of the ld. Commissioner of Income Tax (Appeals) in this regard.

23. As regards the ld. Commissioner of Income Tax (Appeals)'s direction to delete the addition of Rs.3,50,236/- and Rs.1,00,188/-, we find that the same is not appropriate. He has referred to the ITAT decision, where it was held that when the assessee contradicts the AIR information, the Assessing Officer should verify the same. Here we find that though the assessee is contradicting the AIR information by stating that these transactions do not relate to it, the assessee has duly taken credit of the concerned TDS. Thus, the assessee cannot blow hot and cold and shift the onus to the Revenue. The assessee having taken credit of the TDS has to prove that the transaction did not belong to him if it claims that the relevant income do not relate to it. Hence, we remit this issue also to the file of the Assessing Officer. The Assessing Officer is directed to give the assessee an opportunity to prove that the credit for the said TDS has been wrongly taken and these incomes do not belong to it. Needless to add,

the assessee should be granted adequate opportunity of being heard.

Apropos ground no.2:

24. On this issue, the Assessing Officer observed that the assessee was also carrying trading activities in stock and commodities. From the assessee's details, the Assessing Officer observed that it has recognized the unrealistic loss of Rs.5,24,53,455/- by debiting to loss on trading in currency derivative instruments (net) and profit in trading commodity derivative instrument (net) under the income head 'income from treasury operation' as per Schedule XVII of the profit and loss account. The assessee gave detailed submissions in this regard. After elaborating and discussing the issue, the Assessing Officer held that mark to market losses account cannot constitute deductible expenditure for the purpose of income tax act, simply because they have to be provided for in the accounting as per the accounting standard. He held that the assessee had made provision for such losses which cannot be allowed at all as they are contingent in nature. Hence, the Assessing Officer concluded that the assessee's claim for provision for losses future/options (market to market losses) of Rs.5,24,53,455/- on commodities cannot be allowed and, therefore, sum was added back to the total income of the assessee.

25. Upon the assessee's appeal, the ld. Commissioner of Income Tax (Appeals) found the issue in favour of the assessee by several decisions of the ITAT in assessee's own group companies. The ld. Commissioner of Income Tax (Appeals) held as under:

> I find that this is a covered issue in favour of the appellant in jurisdictional Mumbai ITAT in the following cases relied upon by the appellant:
>
> *Edelweiss Capital Limited* v. *ITO* [ITA 5324/Mum/2007
>
> *Edelweiss Securities Limited* v. *Addll. CIT* [ITA 2193/Mum/2009]
>
> *DCIT* v. *ECL Finance Limited* [ITA 7656/Mum/2011]
>
> *DCIT* v. *Edelweiss Securities Limited* [ITA 7792/Mum/2012]
>
> *DCIT* v. *Kotak Mahindra Investment Limited* [ITA 1502/Mum/2012]
>
> *Shri Ramesh Kumar Damani* v. *Addll. CIT* [ITA 1443/Mum/2009]
>
> *M/s. Ekansha Enterprises P. Ltd* v. *DCIT* [ITA 809/M/2012]
>
> *ACIT* v. *Suryakant D. Nissar* [ITA 2750/Mum/2010]
>
> *DCIT* v. *Edelweiss Securities Limited* [ITA 5939/Mum/2011]
>
> 5.3.2 In view of direct decisions on the issue from jurisdictional ITAT, the disallowance of Rs. 5,24,53,455/- made on this account is deleted. These grounds of appeal are allowed

26. Against the above order, the Revenue is in appeal before us.

27. We have heard both the counsel and perused the records. The ld. Departmental Representative relied upon the orders of the Assessing Officer. He further contended that there is a specific CBDT Circular No. 3/2010 dated 23.3.2010 in which the CBDT has categorically directed that mark to market losses are notional, and they cannot be allowed to be set off against the taxable income, that the same therefore should be added back for computing the taxable income of the assessee.

28. Per contra, the ld. Counsel of the assessee submitted that in the assessee's own group case, the ITAT has decided the issue in favour of the assessee. Furthermore, the ld. Counsel of the assessee submitted that the assessee has incurred losses on account of valuation of closing stock in commodities/derivative.

He submitted that as per the accounting norms, the assessee had valued the stock and accounted for the loss upon valuation in terms of market position. He further placed reliance upon the Hon'ble Apex Court decision in the case of *CIT vs. Woodward* Governor 294 ITR 451 (SC).

29. Upon careful consideration, before proceeding further we note that the ITAT in the case of *Edelweiss Capital Limited* v. *ITO* (in ITA 5324/Mum/2007 vide order dated 10.11.2010) has considered this issue and held as under:

> "7. We have considered the facts and the rival contentions. In the Schedule annexed to and forming part of the Balance Sheet and Profit & Loss Account for the year under appeal (page 13 of the Paper Book), the assessee has made the following Note: -
>
> "H. Equity Futures — Index / Stock
>
> (*a*) "Initial Margin-Equity Derivative Instruments", representing initial margin paid, and "Margin Deposits", representing additional margin over and above initial margin, for entering into contracts for Equity Index / Stock Futures, which are released on final settlement / squaring-up of underlying contracts, are disclosed under Loans and Advances.
>
> (*b*) Equity Index / Stock Futures are marked-to-market on a daily basis. Debit or credit balance disclosed under Loans and Advances or Current Liabilities, respectively, in the Mark-to- Market Margin -Equity Index / Stock Futures Account', represents the net amount paid or received on the basis of movement in the prices of Index / Stock Futures till the Balance Sheet date. Amount paid to brokers in addition to Mark-to-Market Margins is disclosed as "Margin Deposits' under Loans and Advances.
>
> (*c*) As on the Balance Sheet date, profit/loss on open positions in Index / Stock Futures are accounted for as follows:
>
> Credit balance in the "Mark-to Market Margin — Equity Index / Stock Futures Account, being anticipated profit, is ignored and no credit for the same is taken in the Profit and Loss Account
>
> Debit balance in the "Mark-to-Market Margin — Equity Index / Stock Futures Account', being anticipated loss, is adjusted in the Profit and Loss Account.
>
> (*d*) On final settlement or squaring-up of contracts for Equity Index / Stock Futures, the profit or loss is calculated as the difference between settlement / squaring-up price and contract price. Accordingly, debit or credit balance pertaining to the settled / squared-up contract in "Mark-to-Market Margin -Equity Index / Stock Futures Account" is recognized in the Profit and Loss Account."
>
> The aforesaid Note gives a fair picture of the nature of the provision. The provision in substance has been made to cover the anticipated loss in the derivates trading. There is no dispute that the assessees holds derivatives as its stock-in-trade and there is also no dispute that it follows the principle "cost or market price, whichever is lower" in valuing the derivatives. When the derivatives are held as stock-in-trade then whatever rules apply to the valuation of stock-in-trade will have to be necessarily apply to their valuation also. It is a well settled position in law that 'while anticipated loss is taken into account in valuing the closing stock, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account, as no prudent trader would care to show increased profit before its realization. This is the theory underlying the rule that the closing stock is

to be valued at cost or market price whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy". This is what the Supreme Court held in the case of Chainrup Sampatram vs. Commissioner of Income Tax, West Bengal (1953) 24 ITR 481 (SC), speaking through Hon'ble Justice Patanjali Sastri, the then Chief Justice of India (page 485 — 486 of the Report). At page 486 the Supreme Court further observed that "loss due to a fall in price below cost is allowed even if such loss has not been actually realized". Quoting from the case of *Whimster & Co*. v. *Commissioners of Inland Revenue* [1926] 12 Tax Cases 813, the Supreme Court observed that the profits that are chargeable to tax are those realized in the year and that an exception is recognized where a trader purchased and still holds goods which are fallen in value in which case though no loss has been realized nor it has occurred, nevertheless at the close of the year he is permitted to treat these goods as of their market value. This decision of the Supreme Court governs the facts of the present case. It is to the assessee's strength that the Institute of Chartered Accountants of India in its guidelines have also approved of the rule of prudence which really means that while anticipated losses can be taken note of while valuing the closing stock, anticipated profits cannot be recognized. The anticipated loss, in the light of the judgment of the Supreme Court cited above, cannot be treated as a contingent liability.

8. The learned DR pointed out that the assessee has valued each scrip of the derivatives as at the end of the year. We do not see how this can make any difference to the legal principle. If the derivatives have been treated as stock-in-trade then there is nothing unusual in the assessee valuing each derivative by applying the rule cost or market whichever is lower.

9. We, therefore, direct the Assessing Officer to allow the provision as reflecting in substance the loss arising on account of valuation of the closing stock. The ground is allowed."

30. From the above, we note that the ITAT had carefully examined the issue and had come to the decision that the provision is being made to cover the anticipated loss in the derivates trading. There was no dispute that the assessee's hold derivatives as its stock-in-trade and there is also no dispute that it follows the principle "cost or market price, whichever is lower" in valuing the derivatives. Thereafter, the Tribunal had opined that when the derivatives are held as stock-in-trade then whatever rules apply to the valuation of stock-in-trade will have to be necessarily applied to their valuation also. In this regard, the tribunal had referred to the Hon'ble Apex Court decisions referred hereinabove. The tribunal in coming to the aforesaid decision has also held that the decision of the Hon'ble Supreme Court covered the facts of the present case and it was to the assessee's strength that the Institute of Chartered Accountants of India in its guidelines have also approved of the rule of prudence which really means that while anticipated losses can be taken note of while valuing the closing stock, anticipated profits cannot be recognized. The tribunal had held that in the light of the judgment of the Supreme Court cited above, the anticipated losses cannot be treated as a contingent liability.

31. Now we examine the present case on the touch stone of the above said decision. We find that the facts are identical. Thus, the same are held to be as stock-in-trade by the assessee and the Revenue does not dispute that. It is also not disputed that these have been valued on the principle of cost or market value, whichever is less. In such scenario, the Revenue's only ground is that the CBDT vide its Instruction No. 3/2014 as noted above has directed that these losses should not be allowed. We agree with the ITAT wherein the ITAT in assessee's group cases in ITA No. 6612/Mum/2012 vide order dated 30.01.2013 had opined that the CBDT Instructions though may be binding upon the Revenue authority but are not binding upon the appellate authority. We find ourselves in agreement with the co-ordinate Bench that these instructions are not binding in light of the ratios emanating from the Hon'ble Apex Court decision on the issue of the valuation of stock.

32. When it is held that these derivatives held are stock-in-trade then there cannot be any reservation in

valuation thereof as per the well settled practice of valuation of closing stock at market value or cost whichever is lower. No case has been made out by the Revenue that the valuation done is not correct or not properly explained. In these situations, the decisions of the Hon'ble Apex Court relied upon hereinabove in the case of *Chainrup Sampatram* v. *Commissioner of Income Tax, West Bengal* [1953] 24 ITR 481 (SC), is quite germane. Furthermore, we find the Assessing Officer has totally erred in placing reliance upon the decision of the Hon'ble Apex Court in the case of *M/S. Sanjeev Woolen Mills* v. *Commissioner Of Income-Tax* (in Civil Appeal No. 6735-6736/2003 vide order dated 24.11.2005). In the said decision, the Hon'ble Apex Court has analyzed the entire gamut of decisions on the issue of valuation of the stock. It has categorically held that recognized and settled accounting practice of accounting for the closing stock in the accounts is that it has to be valued on the cost basis or at the market value basis if the market value of the stock is less than the cost value. It was also expounded that the established and well settled practice in this regard should not be disturbed. Similar view was expressed by the Hon'ble Apex Court in the case of *CIT vs. Woodward* Governor 294 ITR 451 (SC). In this decision, the Hon'ble Apex Court has held that the accounts and the accounting method followed by an assessee continuously for a given period of time needs to be presumed to be correct till the Assessing Officer comes to the conclusion for reasons to be given that the system does not reflect true and correct profits. In the said case, the Hon'ble Apex Court has held that the loss on account of fluctuation in the rate of exchange has to be allowed and the same has to be computed at each balance sheet date, pending actual payment of the liability. Hence, this decision also supports the proposition that even though the loss has not finally crystallized if as per prudent and regular system of accounting, the loss has to be accounted for, the same should be allowed. Hence, in the background of the aforesaid discussion and precedent from the Hon'ble Apex Court decision, we find that the aforesaid CBDT Circular is in contradiction of Hon'ble Apex Court decision. Hence, we do not find any infirmity in the order of the ld. Commissioner of Income Tax (Appeals). We uphold the order of the ld. Commissioner of Income Tax (Appeals) that the mark to market loss in this case is allowable.

33. In the result, these appeals by the assessee stands partly allowed.

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