आयकर अपीलीय अधिकरण, मुंबई
IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES 'E' MUMBAI

सर्वश्री आई.पी.बंसल, न्यायिक सदस्य.एवं नरेन्द्र कुमार बिल्लैय्या, लेखा सदस्य के समक्ष
BEFORE SHRI I.P. BANSAL, JM AND SHRI N.K. BILLAIYA, AM

आयकर अपील सं. / **ITA No.6342/MUM/2011**
निर्धारण वर्ष /Assessment Year 2008-09

The ACIT, Cen. Cir.22, Room No.403, 4th Floor, Aaykar Bhavan, MK Road, Mumbai -400020	बनाम/ Vs.	M/s. Sharekhan Financial Services Pvt. Ltd., 206/A, Phoenix House, Senapati Bapat Marg, Lower Parel, Mumbai 400013
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AACS 5627E		
(अपीलार्थी **/Appellant**)	..	(प्रत्यर्थी / **Respondent**)

अपीलार्थी ओर से/ **Appellant by:**	Shri Rajendra Kumar
प्रत्यर्थी की ओर से/**Respondent by :**	Shri Hiro Rai

सुनवाई की तारीख **/ Date of Hearing : 11/07/2013**
घोषणा की तारीख /**Date of Pronouncement : 11/07/2013**

आदेश / O R D E R

PER I.P.BANSAL, J.M:

This is an appeal filed by the revenue. It is directed against order passed by Ld. CIT(A)-39 Mumbai dated 30/6/2011 for assessment year 2008-09. Grounds of appeal read as under:

" a. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition to Rs 9,76,648/- without appreciating the fact that the AO has rightly disallowed the loss due to mark to market provision of loss as there is no provision under the I T Act in which notional loss is allowed as deduction.

The Appellant craves to leave to add, to amend and/or to alter any of the grounds of appeal, if need be.

The Appellant, therefore, prays that on the grounds stated above, the order of the CIT(A), Central-IV, Mumbai may be set aside and that of the Assessing Officer restored."

2. At the outset it was pleaded by Ld. AR that the issue raised by revenue in the present appeal is covered by following decisions :

1. Edelweiss Capital Ltd. vs. ITO, ITA No.5324/Mum/2007, A.Y. 2004-05 order dated 10th November, 2010.
2. Shri Ramesh Kumar Damani vs. Addl. CIT, ITA No.1443/Mum/09, A.Y.2006-07, order dated 26th Nov.2010.

2.1 Reference was invited to following observations of the Tribunal from the aforementioned decision in the case of Edelweiss Capital Ltd.

> *"5. The third and last ground is against the disallowance of the provision for loss of Rs.9,36,256/- made by the assessee on "Mark to Market" basis in respect of trading derivatives. The brief facts in this connection are that the aforesaid provision was made in the Profit and Loss Account being anticipated loss on Equity Index / Stock Futures Account. The breakup is Rs.8,86,912/- and Rs.49,344/ respectively. When asked to furnish the details and the basis of the claim, the assessee filed a Note stating that the provision was made in accordance with the suggestions of the Institute of Chartered Accountants of India to the effect that a provision should be made at the end of the year by a debit to the Profit and Loss Account for anticipated loss equivalent to the debit balance in the Mark to Market Margin Index / Stock Futures Account. According to the assessee, the loss should be anticipated and provided for, though anticipated profit cannot be taken credit. The assessee further pointed out that there is no difference between valuation of stock and the valuation of the derivates and that in both provision should be made for anticipated losses though anticipated profits cannot be taken note of.*
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> *6. The Assessing Officer did not accept the assessee's submissions. He noted that the provision has been created in respect of contracts pending on 31.03.2004, which will be squared off in the next financial year and there was always the possibility that there may not be any loss when they are squared off. He viewed it as a contingent liability which may or may not arise in future. According to him there is no room for allowing a contingent liability under the mercantile system of accounting under which only a liability in present time can be allowed. He referred to certain authorities in support of his view. As regards the guidelines issued by the Institute of Chartered Accountants of India, which were claimed to have been followed by the assessee, the Assessing Officer observed that the accounting entries cannot control or' decide the allowability of the claim. In this view of the matter, he*

disallowed the provision. The disallowance having been upheld by the CIT(A) for substantially the same reasons, the assessee is in further appeal before the Tribunal.

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 assessee 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. vs. 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."

3. The aforementioned decision was later on followed in the case of Shri Ramesh Kumar Damani vs. Addl. CIT (supra). No contrary decision was brought to our notice on behalf of the revenue and Ld. DR relied upon the order passed

by A.O. Therefore, after hearing both the parties, respectfully following the aforementioned decisions we find no infirmity in the order passed by Ld. CIT(A) and the appeal of the revenue is dismissed.

4. In the result, the appeal of the revenue is dismissed.

Order pronounced in the open court on 11/07/2013
आदेश की घोषणा खुले न्यायालय में दिनांकः 11/07/2013 को की गई ।

Sd/-	Sd/-
(नरेन्द्र कुमार बिल्लैय्या / **N.K.BILLAIYA**)	(आय.पी. बंसल **/ I.P. BANSAL**)
लेखा सदस्य **/ ACCOUNTANT MEMBER**	न्यायिक सदस्य **/ JUDICIAL MEMBER**

मुंबई Mumbai; दिनांक Dated 11/07/2013

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)-
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**

व.नि.स./*Vm*, Sr. PS