IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'D' MUMBAI

ITA No.1601/Mum/2010
Assessment Year: 2006-2007

ITA No.1602/Mum/2010
Assessment Year: 2007-2008

ELEGANT MARBLES & GRANITE INDUSTRIES LTD
C/O M/s RAVI & DEV, CHARTERED ACCOUNTANTS
377-B, FIRST FLOOR, JAGANNATH SHANKER SETH MARG
CHIRA BAZAR, MUMBAI-02
PAN NO:AAACE1584C

Vs

DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE-6(2), MUMBAI

N V Vasudevan, JM and T R Sood, AM

Dated: January 21, 2011

Appellant Rep by: Shri Devendra A Mehta
Respondent Rep by: Shri Jitendra Yadav

ORDER

Per: N V Vasudevan:

ITA No.1601 is an appeal by the assessee against the order dated 16/12/2009 of CIT(A) 12 Mumbai relating to assessment year 2006-07. Ground No.1 is general in nature and calls for no adjudication. Ground No.2 reads as follows:

"2.0 The learned Commissioner of Income-tax (Appeals) erred in law as well as in facts in confirming the disallowance of Rs. 5,92,584/- made by the assessing officer u/s. 14A of the Income Tax Act, 1961.

2. The assessee was in receipt of an income which did not form part of the total income of the assessee under Chapter – III of the Act. The Assessing Officer, invoking the provisions of section 14A r.w.r. 8D made a disallowance of Rs. 5,92,584/- as expenses incurred in earning income which is not chargeable to tax and added the same to the total income of the assessee. The same was confirmed by the CIT(A) giving rise to Ground No.2 by the assessee before the Tribunal.

3. The Hon'ble Bombay High Court in *INCOME TAX APPEAL NO.626 OF 2010 in the case of Godrej & Boyce Mfg.Co.Ltd. Mumbai. Vs. Dy. Commissioner of Income Tax, Range 10(2), Mumbai & Anr. And W.P. 758/10 Godrej & Boyce Mfg.Co.Ltd. Mumbai. Vs.Dy. Commissioner of Income Tax Range 10(2), Mumbai & Ors. by Judgment dated 12-8-2010* has dealt with the disallowance that can be made u/s.14-A of the

Act. The Hon'ble Court also dealt with the decision of the Special Bench of the ITAT in the case of *Daga Capital Management Pvt.Ltd. 117 ITD 169 (mum) (SB)* and has laid down the following proposition:

i) Dividend income and income from mutual funds falling within the ambit of Section 10(33) of the Income Tax Act 1961, as was applicable for Assessment Year 2002-03 is not includible in computing the total income of the assessee. Consequently, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income under the Act, by virtue of the provisions of Section 14A(1);

ii) The payment by a domestic company under Section 115O(1) of additional income tax on profits declared, distributed or paid is a charge on a component of the profits of the company. The company is chargeable to tax on its profits as

a distinct taxable entity and it pays tax in discharge of its own liability and not on behalf of or as an agent for its shareholders. In the hands of the shareholder as the recipient of dividend, income by way of dividend does not form part of the total income by virtue of the provisions of Section 10(33). Income from mutual funds stands on the same basis;

iii)The provisions of sub sections (2) and (3) of Section 14A of the Income Tax Act 1961 are constitutionally valid;

iv)The provisions of Rule 8D of the Income Tax Rules as inserted by the Income Tax (Fifth Amendment) Rules 2008 are not ultra vires the provisions of Section 14A, more particularly sub section (2) and do not offend Article 14 of the Constitution;

v) The provisions of Rule 8D of the Income Tax Rules which have been notified with effect from 24 March 2008 shall apply with effect from Assessment Year 2008-09;

vi)Even prior to Assessment Year 2008-09, when Rule 8D was not applicable, the Assessing Officer has to enforce the provisions of sub section (1) of Section 14A. For that purpose, the Assessing Officer is duty bound to determine the expenditure which has been incurred in relation to income which does not form part of the total income under the Act. The Assessing Officer must adopt a reasonable basis or method consistent with all the relevant facts and circumstances after furnishing a reasonable opportunity to the assessee to place all germane material on the record;

vii)The proceedings for Assessment Year 2002-03 shall stand remanded back to the Assessing Officer. The Assessing Officer shall determine as to whether the assessee has incurred any expenditure (direct or indirect) in relation to dividend income / income from mutual funds which does not form part of the total income as contemplated under Section 14A. The Assessing Officer can adopt a reasonable basis for effecting the apportionment. While making that determination, the Assessing Officer shall provide a reasonable opportunity to the assessee of producing its accounts and relevant or germane material having a bearing on the facts and circumstances of the case.

4. In view of the aforesaid decision of the Hon'ble Bombay High Court the issue with regard to disallowance under section 14A has to be made in accordance with the

principle laid down by the Hon'ble Bombay High Court. Rule 8D should not be applied because the assessment in question is prior to A.Y.08-09. The AO has to adopt a reasonable basis or method consistent with all relevant facts and circumstances and after affording reasonable opportunity to the assessee to place all germane material on the record, has to decide on the quantum of amount to be disallowed. We, therefore, remand the issue to the A.O for fresh consideration as stated above.

5. Ground No.3 raised by the assessee reads as follows:

"3.0 The learned Commissioner of Income Tax (Appeals) erred in law as well as in facts in confirming the denial of set-off by the assessing officer in respect of loss from derivatives amounting to Rs. 25,00,260/- against short term capital gains and/or business income."

6. The assessee had brought forward loss of Rs.25,00,260/- from trading in future, options and derivatives , as per details given below:

Assessment year	**Loss from derivatives (Rs.)**
2003-2004	12,865
2004-2005	20,24,118
2005-2006	4,63,277
Total	**25,00,260**

During the year, the Assessee had income in the form of short term capital gain. The Assessee sought to set off the brought forward loss from trading in futures, options and derivates against the short term capital gain. The Assessing Officer rejected the assessee's contention by holding that brought forward loss from trading in derivatives, future and options was a speculation loss pursuant to section 43(5) of the Income Tax Act, 1961 and such loss can be set off only against speculation income in view of the provisions of Sec.73 of the Act. Accordingly, he did not allow its set off as claimed by the assessee.

7. On appeal by the assessee the CIT(A) confirmed the action of the Assessing Officer.

8. We have heard the rival submissions. *Sec.43(5*) defines speculative transactions as follows:

"speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips:

***Provided** that for the purposes of this clause-*

(a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or

(b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member; [or]

(d) an eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) carried out in a recognised stock exchange;

shall not be deemed to be a speculative transaction.

Explanation. -For the purposes of this clause, the expressions-

(i) "eligible transaction" means any transaction,-

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) or the Securities and Exchange Board of India Act, 1992 (15 of 1992) or the Depositories Act, 1996 (22 of 1996) and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act;

(ii) "recognised stock exchange" means a recognised stock exchange as referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose;

9. Clause(d) referred to above, was inserted by the Finance Act, 2005 w.e.f. 1-4-2006, i.e., applicable from AY 04-05. The Kolkata Special Bench in *Shree Capital Services Ltd. vs. ACIT 121 ITD 498 (SB) (Kol)* [ITA no. 1294 {Kol) of 2008 dated 31-7-2009 for A.Y. 2004-05] dealt with two issues. Firstly, whether loss from transactions in share derivatives was a speculation loss within the meaning of section 43 [5] of the Income Tax Act, 1961, more particularly because there was apparently no delivery observed. Secondly, whether the Finance Act 2005 amendment to section 43 [5], by insertion of new clause [d] in the proviso with effect from 1-4-2006, was clarificatory in nature? By this clause [d], transactions in derivatives carried on approved stock exchanges are treated as non speculative transactions. Prior to this Special Bench decision, two decisions of Mumbai Tribunal in *DCIT vs. SSKI Investors Pvt. Ltd . 113 TTJ 511* and *RBK Securities Pvt. Ltd. vs. ITO ITA 2465/Mum/2006* respectively, had held that such derivative transactions, even before the amendment, were non speculative. In the Special Bench decision, both the above

issues have been answered against the assessee. The Special Bench has firstly ruled that the derivative was very much a 'commodity' within the meaning of section 43 [5] and that since there is no delivery of this commodity involved, the transaction was essentially speculative in terms of this section. The Special Bench has further held that the amendment in clause [d] was prospective and not clarificatory in nature.

10. Sec.73 of the Act, provides for set off of Losses in speculation business. It reads as follows:

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

(2) Where for any 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 [four] assessment years immediately succeeding the assessment year for which the loss was first computed.

[Explanation.-Where any part of the business of a company ([other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources"], or a company the principal business of which is the business of 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, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.]

11. From the above it is clear that the loss in Futures incurred by the assessee for A.Y 2005-06 would be a speculative loss. The short term capital gain against which the Assessee seeks to set off the brought forward speculation loss is not a speculation income. The brought forward speculation loss could not be set off against short term capital gain as it was not a speculation income. In view of the provisions of section 73(2) of the Act the speculation loss carried forward could be set off only against the profits of speculation business. We, therefore, do not find any merits in

the case of the Assessee on this issue. For the reasons stated above we uphold the order of the CIT(A).

12. In the result, ITA No. 1602 /Mum/2010 is partly allowed for statistical purposes.

ITA NO. 1602/M/2010:

13. This is an appeal by the assessee against the order dated 16/12/2009 of CIT(A) 12, Mumbai relating to assessment year 2007-08. Ground No.2 raised by the assessee reads as follows.

"2.0 The learned Commissioner of Income-tax (Appeals) erred in law as well as in facts in confirming the disallowance of Rs.8,02,448/- made by the assessing officer u/s. 14A of the Income Tax Act, 1961."

14. The assessee was in receipt of an income which should not form part of the total income of the assessee under Chapter –III of the Act. The Assessing Officer, invoking the provisions of section 14A r.w.r. 8D made a disallowance of Rs. 8,02,448/- as expenses incurred in earning income which is not chargeable to tax and added the same to the total income of the assessee. The same was confirmed by the CIT(A) giving rise to Ground No.2 by the assessee before the Tribunal.

15. The Hon'ble Bombay High Court in INCOME TAX APPEAL NO.626 OF 2010 in the case of Godrej & Boyce Mfg.Co.Ltd. Mumbai. Vs. Dy. Commissioner of Income Tax,Range 10(2), Mumbai & Anr. And W.P. 758/10 Godrej & Boyce Mfg.Co.Ltd. Mumbai. Vs.Dy. Commissioner of Income Tax Range 10(2), Mumbai & Ors. by Judgment dated 12-8-2010 has dealt with the disallowance that can be made u/s.14-A of the Act. The Hon'ble Court also dealt with the decision of the Special Bench of the ITAT in the case of *Daga Capital Management Pvt.Ltd 117 ITD 169 (mum) (SB)* and has laid down the following proposition:

i) Dividend income and income from mutual funds falling within the ambit of Section 10(33) of the Income Tax Act 1961, as was applicable for Assessment Year 2002-03 is not includible in computing the total income of the assessee. Consequently, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income under the Act, by virtue of the provisions of Section 14A(1);

ii) The payment by a domestic company under Section 115O(1) of additional income tax on profits declared, distributed or paid is a charge on a component of the profits of the company. The company is chargeable to tax on its profits as a distinct taxable entity and it pays tax in discharge of its own liability and not on behalf of or as an agent for its shareholders. In the hands of the shareholder as the recipient of dividend, income by way of dividend does not form part of the total income by virtue of the provisions of Section 10(33). Income from mutual funds stands on the same basis;

iii) The provisions of sub sections (2) and (3) of Section 14A of the Income Tax Act 1961 are constitutionally valid;

iv)The provisions of Rule 8D of the Income Tax Rules as inserted by the Income Tax (Fifth Amendment) Rules 2008 are not ultra vires the provisions of Section 14A, more particularly sub section (2) and do not offend Article 14 of the Constitution;

v) The provisions of Rule 8D of the Income Tax Rules which have been notified with effect from 24 March 2008 shall apply with effect from Assessment Year 2008-09;

vi) Even prior to Assessment Year 2008-09, when Rule 8D was not applicable, the Assessing Officer has to enforce the provisions of sub section (1) of Section 14A. For that purpose, the Assessing Officer is duty bound to determine the expenditure which has been incurred in relation to income which does not form part of the total income under the Act. The Assessing Officer must adopt a reasonable basis or method consistent with all the relevant facts and circumstances after furnishing a reasonable opportunity to the assessee to place all germane material on the record;

vii) The proceedings for Assessment Year 2002-03 shall stand remanded back to the Assessing Officer. The Assessing Officer shall determine as to whether the assessee has incurred any expenditure (direct or indirect) in relation to dividend income / income from mutual funds which does not form part of the total income as contemplated under Section 14A. The Assessing Officer can adopt a reasonable basis for effecting the apportionment. While making that determination, the Assessing Officer shall provide a reasonable opportunity to the assessee of producing its accounts and relevant or germane material having a bearing on the facts and circumstances of the case.

16. In view of the aforesaid decision of the Hon'ble Bombay High Court the issue with regard to disallowance under section 14A has to be made in accordance with the principle laid down by the Hon'ble Bombay High Court. Rule 8D should not be applied because the assessment in question is prior to A.Y.08-09. The AO has to adopt a reasonable basis or method consistent with all relevant facts and circumstances and after affording reasonable opportunity to the assessee to place all germane material on the record, has to decide on the quantum of amount to be disallowed. We, therefore, remand the issue to the A.O for fresh consideration as stated above.

17. In the result ITA No.1601/M/10 is partly allowed for statistical purposes. ITA No.1602/M/10 is allowed for statistical purposes.

(Order pronounced in the open court on the 21.1.2011)