IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 15TH DAY OF FEBRUARY 2021 PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE NATARAJ RANGASWAMY

I.T.A. NO.133 OF 2015

BETWEEN:

1. THE COMMISSIONER OF INCOME-TAX
C.R. BUILDING, QUEENS ROAD
BANGALORE.

2. THE DEPUTY COMMISSIONER OF INCOME-TAX
CIRCLE-12(2), RASHTROTHANA BHAVAN
NRUPATHUNGA ROAD BANGALORE-560001.

.... APPELLANTS

(BY MR. K.V. ARAVIND, ADV.,)

AND:

M/S. QUEST GLOBAL ENGINEERING
SERVICES PVT. LTD.,
SECOND FLOOR, PRIMOSE 7B
EMBASSEY TECH VILLAGE
SARJAPURA-MARATHAHALLI OUTER RING ROAD
DEVARABEESANA HALLI
VARTHUR HOBLI, BANGALORE-560103.

... RESPONDENT

(BY MR. CHYTHANYA K.K. ADV.,)

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THIS I.T.A. IS FILED UNDER SEC. 260-A OF INCOME TAX ACT 1961, ARISING OUT OF ORDER DATED 14.11.2014 PASSED IN ITA NO.275/BANG/2014 FOR THE ASSESSMENT YEAR 2009-10, PRAYING TO:

(i) FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED ABOVE.

(ii) ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT, BANGALORE IN ITA NO.275/BANG/2014 DATED 14.11.2014 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, CIRCLE-12(2), BANGALORE.

THIS I.T.A. COMING ON FOR HEARING, THIS DAY, ALOK ARADHE J., DELIVERED THE FOLLOWING:

JUDGMENT

This appeal under Section 260-A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act', for short) has been filed by the revenue. The subject matter of the appeal pertains to the Assessment Year 2009-10. The appeal was admitted by a Bench of this Court vide order dated 09.02.2016 on the following substantial questions of law:

> "1. Whether on the facts and in the circumstances of the case, the Tribunal is right in law in deleting the disallowances made by Assessing Officer on provision of loss on derivative contracts without appreciating that the provision for loss cannot be allowed when the actual sales had not even taken place and maturity date of the derivatives contracts has not arisen and the notional loss or notional income and deduction of liabilities which are

unascertained does not come within the purview of the I.T.Act?"

2. Whether on the facts and in the circumstances of the case, the Tribunal is right in law in deleting the addition made by assessing authority under section 14A read with Rule 8D without appreciating the Board's Circular No.5 of 2014 dated 11.2.2014 and the provision of section 14A read with rule 8D of the I.T. Act?".

3. Whether on the facts and in the circumstances of the case, the Tribunal is right in law in allowing carry forward of loss on derivatives contracts without appreciating that the transaction was speculative in nature in terms of Board's Circular No.3/2010 and Section 73 does not allow setting off of speculation loss against any other income other than speculation income?"

2. Facts leading to filing of this appeal briefly stated are that the assessee is a company engaged in the business of providing computer aided engineering analysis and software services. The assessee filed its return of income for the Assessment Year 2009-10 declaring a total income of

Rs.28,48,96,860/- and deduction of Rs.75,000/- was claimed under Chapter VI-A of the Act. The return was processed under Section 143(1) of the Act and was subsequently taken up for scrutiny. The Assessing Officer by an order dated 22.2.2013, inter alia, made the addition on account of disallowance of provision of loss of derivative contracts to the extent of Rs.16,35,54,352/- out of total provision made during the year of Rs.19,96,59,000/-. Out of the aforesaid amount, the Assessing Officer allowed a sum of Rs.3,61,04,648/- pertaining to Assessment Year 2008-09. The Assessing Officer also rejected the claim for disallowance under Section 14A of the Act and added a sum of Rs.7,34,975/- by applying Rule 8D(iii).

3. The assessee thereupon filed an appeal before the Commissioner of Income Tax (Appeals), who by an order dated 18.11.2013, inter alia upheld the decision of the Assessing Officer in disallowing the provision for loss in derivative contracts. The Commissioner of Income Tax (Appeals), however, allowed the entire actual loss incurred in respect of derivative contracts for the Assessment Year

2009-10 on the ground that the loss had been actually incurred and there is no logic in restricting the loss to the extent of provision created in the earlier year. However, on the issue of disallowance under Section 14A of the Act, the Commissioner of Income Tax (Appeals) upheld the order of the Assessing Officer. In the result, the appeal preferred by the assessee was partly allowed. The assessee as well as the revenue filed appeals before the Income Tax Appellate Tribunal against the order of Commissioner of Income Tax (Appeals). The Tribunal, by a common order dated 14.11.2014 allowed the appeal preferred by the assessee and dismissed the appeal preferred by the revenue. Being aggrieved, the revenue has filed this appeal.

4. Learned counsel for the revenue submitted that the Tribunal failed to take into consideration the Instruction No.3/2010 issued by Central Board of Direct Taxes which clearly provide that where no sale of settlement has actually taken place and the loss on market to market basis has resulted in reduction of book profit, such a notional loss would be contingent in nature and cannot be allowed to be

set off against the taxable income. It was further submitted that the Tribunal failed to appreciate that derivative contract is not in relation to export of services to contend that the liability of the assessee has been assumed. It is further submitted that when a contract is to a transaction and if the transaction never takes place, the question of assuming any liability, consequently suffering any loss does not arise and otherwise, the entire purpose of entering into a derivative contract to protect a particular transaction will be defeated.

5. It is also urged that the Tribunal ought to have appreciated that there was no existing obligation arising out of the contract and merely reflecting the loss in the books of accounts said to be in accordance with accounting standards is not the determinative factor of the liability. It is also submitted that Supreme Court while dealing with the issue of foreign exchange fluctuation by considering Accounting Standards 11 has recognized the concept of foreign exchange fluctuation and has held that in view of existing liability though foreign exchange is either notional gain or notional loss, the same treatment has to be given to both gain and

loss. It is further submitted that system adopted by the assessee should be fair and reasonable and not with a view to reducing the incidence of taxation. It is further submitted that in case the decision of the Supreme Court in

'COMMISSIONER OF INCOME TAX Vs. WOODWARD GOVERNOR INDIA (P) LTD.' (2009) 312 ITR 0254 is applied to the facts of the case, the purpose of derivative contract is to protect from the foreign exchange fluctuations on sales and therefore, the case of the assessee who is claiming loss as a deduction without any sale, is contrary to the object of derivative contract and the same is with a view to reducing the incidence of taxation. It is also urged that since liability assumed is a contingent liability, the same would accrue only on sale being made and consideration is received. In the instant case, the liability assumed is on a non-existent liability / obligation and therefore, the same is a speculative loss as contemplated under Section 43(5) of the Act.

6. It is also contended that featured sales are obviously uncertain and action of the assessee in so far as hedging

anything such as future sales through forward contract is purely speculative transaction and since the loss has not arisen in the course of sale and also not on account of the reinstatement of assets and liabilities based on the exchange rate at the close of the year, loss is only a speculative loss which is not eligible to be allowed as an expenditure. Learned counsel for the revenue further submitted that substantial question of law No.2 is covered in favour of the revenue by a decision of this Court in '**THE COMMISSIONER**

OF INCOME-TAX Vs. M/s. KINGFISHER FINVEST INDIA LTD.' in ITA NO.100/2015 decided on 29.09.2020. It is also submitted that the decision in '**PRL. COMMISIONER OF**

INCOME-TAX & ANOTHER Vs. M/s. NOVELL SOFTWARE DEVELOPMENT (INDIA) PVT. LTD.' in ITA 271/2017 decided on 16.01.2021, do not apply to the fact situation

of the case as in the aforesaid decision, this Court has held that decision of the Supreme Court in **'MAXOPP INVESTMENT LTD. Vs. COMMISSIONER OF INCOME**

TAX, NEW DELHI' (2018) 91 TAXMANN.COM 154 (SC),

and has held that aforesaid decision does not deal with issue

of applicability of Section 14A of the Act whereas decision of

the Supreme Court in **MAXOPP INVESTMENT**, supra deals with Section 14A of the Act only. In this connection, attention has been invited to paragraphs 15, 16 and 40 of the aforesaid decision. Therefore, the second substantial question of law deserves to be answered in favour of the revenue. In support of aforesaid submission, reliance has been placed on the decision in **'COMMISSIONER OF INCOME-TAX Vs. JOSEPH JOHN' (1968) 67 ITR 74 (SC), 'COMMISSIONER OF INCOME TAX Vs. WOODWARD GOVERNOR, supra, 'SOUTHERN TECHNOLOGIES LTD. Vs. JOINT COMMISSIONER OF INCOME-TAX, COIMBATORE' (2010) 187 TAXMAN 346 (SC), 'MAXOPP INVESTMENT supra AS WELL AS CIRCULAR NO.5/2014 dated 11.02.2014 issued by the Central Board of Direct Taxes.**

7. On the other hand, learned counsel for the assessee submitted that the assessee had entered into forward contracts with bankers to sell foreign currency at pre-determined rate and during the previous year there was a significant loss due to fall of Indian rupees against U.S.

dollar. Therefore, the assessee debited Rs.19,96,59,000/- as provision for loss of derivative contracts. It is further submitted that provision for loss on derivative contracts is charged to profit and loss account under operating another expenses and in financial statements it is stated that loss has been charged to profit and loss account as per requirements of Accounting Standards 11. It is further submitted that the authorities have accepted the fact that the assessee had taken the forward contract to cover diminishing in the value of export proceeds and services provided to over seas customers. It is also urged that following findings of facts recorded by the Tribunal are not disputed by the revenue and no question of perversity of the aforesaid findings has been raised:

(i) The forwarding contracts was to be revalued in accordance of Accounting Standards 11 and therefore, he has no option but to determine profit / loss in regard to unmatured foreign exchange contracts in accordance of currency rates as on valuation date i.e. 31st March (para 4.5.5).

(ii) The forward contracts had been entered into by the assessee in order to protect its interest against fluctuations in foreign currency in respect of consideration for export proceeds which is a revenue item (para 4.5.8).

8. It is submitted that the contention of the assessee in this regard has to be accepted for two reasons namely, that a binding obligation accrued against the assessee when it entered into foreign exchange forward contracts and forward contracts are in respect of consideration for export proceeds, which are revenue items. It is also submitted that there is an actual contract for sale of merchandise and the department did not question the genuineness and reasonableness of the transaction. It is also pointed out that the fact that estimation was made on reasonable basis and not on adhoc basis is not disputed by the revenue and the loss is claimed as deductible business expenditure. It is urged that provision for loss has to be allowed at the close of the year in accordance with para 36 to 39 of Accounting Standard 11 which deals with foreign exchange contracts. It is also pointed out that the Tribunal has held that assessee

can anticipate the loss on the valuation date with reasonable accuracy and therefore, the same is required to be accounted under prudent accounting and commercial principles.

9. It is pointed out from the order of the Tribunal that the Tribunal has recorded a finding that there is no contingent liability as event has already taken place and assessee has entered the contract and the obligation to meet the liability has been undertaken and only consequential effect of the same is required to be determined. It is also pointed out that the decision of the Supreme Court in

WOODWARD GOVERNOR, supra only relates to a legal liability that has been incurred before it is actually disbursed. It is further pointed out that the fact that forward contracts were entered to protect its revenue against foreign exchange fluctuation in respect of consideration for export proceeds is not disputed. Therefore, it is submitted that the fact that a binding obligation has accrued, forward contracts are in the state of consideration of export proceeds which are revenue items, the liability is determinable with reasonable certainty and is not a contingent liability, treatment is as per

accounting standard and ICAI guidelines and principles of **WOODWARD GOVERNOR**, supra are applicable, have not been disputed by the revenue.

10. It is also contended that notification No.3/2010 dated 23.03.2010 was issued on 23.03.2010 and is therefore, not applicable in respect of Assessment Years 2008-09 and 2009-10. It is also contended that a circular which is contrary to the statutory provision and decision of the Court has no existence in the eye of law and in several decisions, various High Courts have not followed the said instruction. It is also urged that speculative transactions which are incidental to assessee's main business cannot be treated as incidental loss. Explanation 2 to Section 28 provides that speculative transaction carried on by the assessee must be "of such a nature as to constitute a business". It is argued that once main business is identified and if some incidental activities or transaction or dealing in foreign exchange are undertake which are related to some extent to main business activity, then it could not be said that assessee is in speculative business. Therefore, the loss

sustained by the assessee is not a speculative loss under Section 43(5) of the Act. Alternatively, it is contended even if provisions of Section 43(5) of the Act are attracted, then the case of the assessee is covered by proviso (i) to Section 43(5) of the Act. It is also urged that the expression 'commodity' used in Section 43(5) of the Act does not cover within its ambit exchange of currency and the same would be covered by the definition 'goods'. In this connection, our attention ahs been invited to Section 116(5) of Finance Act, 2003 and Section 2(bb) and 2(bc) of Securities Contracts (Regulation) Act, 1956 and therefore, the expression 'commodity' does not include exchange of currency. Reference has also been made to Article 366(12) of the Constitution, Section 2(52) of the Goods and Service Tax Act and Section 2(7) of the Sale of Goods Act, 1930. It is also urged that foreign exchange is neither a commodity nor a share. Alternatively, it is urged that the assessee is entitled to exemption under section 10A for the Assessment Year 2008-2009. In support of aforesaid submission, reliance has been placed on the decisions in **'COMMISSIONER OF INCOME TAX, BANGALORE Vs. JSW STEEL LTD.' (2020)**

121 TAXMANN.COM 39 (KAR), 'COMMISSIONER OF INCOME TAX-16, MUMBAI Vs. D.CHETAN & CO.' (2016) 75 TAXMANN.COM 300 (BOMBAY), 'COMMISSIONER OF INCOME TAX Vs. BADRIDAS GAURIDU (P) LTD.' (2003) 261 ITR 256 (BOM), 'COMMISSIONER OF INCOME TAX, CHENNAI Vs. M/s. CELEBRITY FASHION LTD., CHENNAI-45' IN TAX CASE APPEAL NO.26/2018 DECIDED ON 21.09.2020, 'COMMISSIONER OF CENTRAL EXCISE, BOLPUR Vs. RATAN MELTING & WIRE INDUSTRIES' (2008) 17 STT 103 (SC), 'MUNJAL SHOWA LTD. Vs. DEPUTY COMMISSIONER OF INCOME-TAX' (2016) 382 ITR 555 (DELHI), PRINCIPAL COMMISSIONER OF INCOME-TAX, NEW DELHI Vs. McDONALD'S INDIA (P) LTD.' (2019) 101

TAXMANN.COM 86 (DELHI) AND 'PRAGATHI KRISHNA GRAMIN BANK Vs. JOINT COMMISSIONER OF INCOME-TAX' (2018) 256 TAXMAN 349 (KAR).

11. We have considered the submissions made on both sides and have perused the record. Substantial questions of law No.1 and 3 are interlinked, therefore, we proceed to deal

with the same together. Before proceeding further it is apposite to take note of the relevant statutory provisions which are reproduced below for the facility of reference:

> "**Section 14A:** Expenditure incurred in relation to income not includible in total income.— For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.".
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> (2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.
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> (3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act.

Explanation 2 to Section 28- Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as" speculation business") shall be deemed to be distinct and separate from any other business.

Section 43(5): "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 scripts:

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; [or]

(e) an eligible transaction in respect of trading in commodity derivatives carried out in a recognised association, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013 (17 of 2013),

shall not be deemed to be a speculative transaction.

Section 43AA: Subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, and such gain or loss shall be computed in accordance with the income computation and

disclosure standards notified under sub-section (2) of section 145.

(2) For the purposes of sub-section (1), gain or loss arising on account of the effects of change in foreign exchange rates shall be in respect of all foreign currency transactions, including those relating to -

(i) monetary items and non-monetary items.

(ii) translation of financial statements of foreign operations;

(iii) forward exchange contracts;

(iv) foreign currency translation reserved.

12. After having noticed the relevant statutory provisions, we may advert to the facts of the case in hand. The assessee has entered into forward contract with the bank to buy or sell foreign exchange at an agreed price at a specified future date in order to hedge against possible future financial loss due to fluctuation in the rate of foreign currency. The Tribunal, inter alia, has held that foreign exchange forward contract means an agreement to exchange different currencies at a forward rate. It has further been held that the aforesaid contract created a continuing binding

obligation on the date of contract against the assessee to fulfill the same on the date of maturity and it is in the nature of a hedging contract because it is a contract entered into against possible future financial losses. The assessee would come to know of the actual profit/loss only on the date of maturity only unless there is any premature cancellation of the contract. Thereafter, the Tribunal has noted the well settled principles regarding the accounting principles and in Paragraph 4.5.5 has held that the contention of the assessee that, forward contract was to be revalued in accordance with Accounting standards 11 and therefore, the assessee had no option but to determine the profits / loss with regard to unmatured foreign exchange forward contracts in accordance with currency rates as on the date of the valuation i.e., 31st March has not been disputed by the revenue. Thereafter, in Paragraph 4.5.8, the Tribunal has held that it is not in dispute that the forward contracts have been entered into by the assessee in order to protect its interest against fluctuation in foreign currency, in respect of consideration for export proceeds which is a revenue item and has concluded as follows:

(i) A binding obligation accrued against the assessee when it entered into foreign exchange forward contracts;

(ii) The forward contracts are in respect of consideration for export proceeds, which are revenue items;

(iii) The liability is determinable with reasonable certainty when an obligation is pending on the balance sheet date and such a liability cannot be said to be a contingent liability.

(iv) The accounting treatment is as per Accounting Standards and the ICAI Guidelines.

(v) The principles enunciated by the Hon'ble Apex Court in the case of Woodward Governor India Pvt. Ltd. (supra) are applicable to the facts of the case on hand.

13. It is pertinent to mention here that the revenue has not questioned / doubted the genuineness and reasonableness of the transaction. Similarly, the revenue has not disputed the fact that the estimation was made on reasonable basis and not on adhoc basis which is evident from Paragraph 6.1 of the order of Commissioner of Income Tax (Appeals). The loss which is claimed by the assessee, is claimed as deductible business expenditure and therefore,

provision for loss has to be allowed at the close of the year in accordance with Paragraphs 3 to 39 of the Accounting Standard 11, which deals with foreign exchange contract. It is not disputed by the revenue that forward contracts were entered to protect the assessee from foreign exchange fluctuation in respect of consideration for export proceeds. The tribunal, therefore, rightly relied on the decision in **WOODWARD GOVERNOR INDIA** supra while allowing the market to market loss as relating to forward exchange contract as deduction. It is pertinent to mention here that Instruction No.3 of 2010 was issued on 23.03.2010 and same is not applicable for the Assessment Years 2008-09 and 2009-10 in view of well settled legal position that a circular which is beneficial in nature applies retrospectively but a circular which is oppressive has to be applied prospectively

(SEE: CCE VS. MYSORE ELECTRICAL INDUSTRIES LTD (2006) 12 SCC 448). It is pertinent to note that the aforesaid has not been given effect o by several high courts namely in **MUNJAL SHOVA LTD VS DCIT (2016) 382 ITR 555 (DELHI)** and in **CIT VS. VINERGY INTERNATIONAL PVT LTD ITA NO.376/2014 (BOMBAY HIGH COURT).**

The loss sustained by the assessee due to fluctuation in foreign exchange while implementing export contract is incidental to assessee's course of business, therefore, such a loss is not a speculative loss but a business loss. The aforesaid findings have not been demonstrated to be perverse. For the aforementioned reasons, the substantial questions of law No.1 and 3 are answered against the revenue and in favour of the assessee.

14. Now we may advert to the second substantial question of law. It is pertinent to note that for Assessment Year 2009-10 the assessee has not earned dividend income. The aforesaid fact has not been disputed by the revenue. It is also relevant to mention that Circular No.5/2014 dated 11.02.2014 is not applicable in the instant case as the instant case pertains to Assessment Year 2009-10. The aforesaid Circular has no retrospective operation. It is noteworthy that aforesaid Circular was not even relied by the parties. This court in **COMMISSIONER OF INCOME TAX VS.**

KINGFISHER INVESTMENT INDIA LTD. vide judgment dated 29.09.2020 inter alia held that disallowance under

Section 14A read with Rule 8D has to be made even when taxpayer in a particular year has not earned any exempt income. This court relied on the decision of the Supreme Court in **MAXOPP INVESTMENT LTD** supra which was reproduced in Paragraph 5 of the decision and reliance was also placed on Circular dated 11.02.2014 issued by Central Board of Direct Taxes (CBDT). However, the aforesaid decision was subsequently considered by this court in judgment dated 16.01.2021 passed in **I.T.A.No.271/2017 (PRINCIPAL COMMISSIONER OF INCOME TAX VS.**

NOVEL SOFTWARE DEVELOPMENT) in which it was held that decision of this court in **KINGFISHER FINVEST LTD**. was distinguishable as the basis of the aforesaid decision of this court was the decision of the Supreme Court in **MAXOPP INVESTMENTS LTD.** supra and it was held that the aforesaid decision does not deal with applicability of Section 14A of the Act. However, eventually this court agreed with the view taken by High Court of Madras in **CIT VS.**

CHETTINAD LOGISTICS P LTD., (2017) 80 TAXMANN.COM 221 (MAD.) AND KEM INVEST LTD. VS. CIT, (2015) 16 TAXMANN.COM 118 (DELHI) and held

that since no exempt income has accrued to the assessee therefore, the provisions of Section 14A of the Act do not apply to the fact situation of the case. Therefore, it has become necessary for us to clarify the view taken in the two decisions viz., **KINGFISHER FINVEST INDIA LTD. AND M/S NOVEL SOFTWARE INDIA (P) LTD**. supra. At this

stage, we may refer to Paragraph 40 of the decision of the

Supreme Court in **MAXOPP** supra, the relevant extract of

which reads as under:

> It is to be kept in mind that in those cases where shares are held as 'stock-in-trade', it becomes a business activity of the assessee to the deal in those shares as a business proposition. Whether dividend is earned or not becomes immaterial. In fact, it would be a quirk of fate that when the investee company declared dividend, those shares are held by the assessee, though the assessee has to ultimately trade those shares by selling them to earn profits. The situation here is therefore, different from the case like Maxopp Investment Ltd. where the assessee would continue to hold those shares as it wants to retain control over the investee company. In that case, whenever dividend is declared by the investee

company that would necessarily be earned by the assessee and the assessee alone. Therefore, even that the time of investing into those shares, the assessee knows that it may generate dividend income as well and as and when such dividend income is generated that would be earned by the assessee. In contrast, where the shares are held as stock-in-trade, this may not be necessarily a situation. The main purpose is to liquidate those shares whenever the share price goes upon order to earn profits. In the result, the appeals filed by the revenue challenging the judgment of the Punjab and Haryana High Court in State Bank of Patiala also fail, though law in this respect has been clarified hereinabove.

15. From perusal of the relevant extract of the Supreme Court, it is evident that the decision in **MAXOPP INVESTMENT LTD**. supra deals with applicability of Section 14A of the Act. Therefore, the observations made with regard to applicability of Section 14A in **M/S NOVEL SOFTWARE INDIA (P) LTD**. are factually incorrect and we hasten to clarify the same. However, from relevant extract of Paragraph 40, it is evident that only expenses proportionate to earning of exempt income could be disallowed under

Section 14A of the Act and the decision of **MAXOPP INVESTMENT LTD** is an authority for the aforesaid proposition that the provision is relatable to earning of actual income. The object of Section 14A is to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail of the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The High Court of Madras has relied on the decision of the Supreme Court in

COMMISSIONER OF INCOME TAX VS. WALFORT SHARE AND STOCK BROKERS (2010) 326 ITR 1 wherein it has been held that Section 14A is relatable to income of actual income or not notional or anticipated income. Therefore, the conclusion arrived at by us in **M/S NOVEL SOFTWARE INDIA (P) LTD.** is affirmed but for different reasons. It is also clarified by us that while recording the conclusion in **KINGFISHER FINVEST LTD.** that disallowance under Section 14A has to be made even taxpayer has not earned any exempt income, this court has misread the ratio of the decision of the Supreme Court in **MAXOPP INVESTMENT**

LTD supra and therefore, the aforesaid view being contrary to the law laid down by the Supreme Court is not a binding precedent.

In view of preceding analysis, the second substantial question of law is also answered against the revenue and in favour of the assessee. In the result, we don to find any merit in this appeal, the same fails and is hereby dismissed.

Sd/-
JUDGE

Sd/-
JUDGE

RV/SS