



2026:KER:21788

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT

THE HONOURABLE MR. JUSTICE DEVAN RAMACHANDRAN

&

THE HONOURABLE MR. JUSTICE BASANT BALAJI

WEDNESDAY, THE 11<sup>TH</sup> DAY OF MARCH 2026 / 20TH PHALGUNA,

1947

ITA NO. 71 OF 2025

ORDER DATED 21.03.2025 ITA 363/COCH/2023

APPELLANT/RESPONDENT/RESPONDENT:

THE PRINCIPAL COMMISSIONER OF INCOME TAX  
(CENTRAL), 2ND FLOOR, C.R. BUILDING I.S.  
PRESS ROAD KOCHI, PIN - 682018.

BY ADVS.  
SHRI.JOSE JOSEPH  
SRI.NAVANEETH.N.NATH

RESPONDENT/APPELLANT/APPELLANT:

KALYAN JEWELLERS INDIA LTD, TC/32/2()4/1,  
SITARAM MILL ROAD, PUNKUNNAM, THRISSUR  
(PAN: AADCK6079K, PIN - 680002.

BY ADVS.  
SRI.R.JAIKRISHNA  
KUM.NARAYANI HARIKRISHNAN  
SHRI.AKHIL SHAJI  
SRI.C.S.ARUN SHANKAR  
SHRI.ANISH P.  
SHRI.K.SURESH CHANDRAN



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THIS INCOME TAX APPEAL HAVING COME UP FOR ADMISSION  
ON 11.03.2026, THE COURT ON THE SAME DAY DELIVERED THE  
FOLLOWING:



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'C.R.'

JUDGMENT

Devan Ramachandran, J.

The appellant calls into question the correctness of the order of the learned Income Tax Appellate Tribunal Cochin Bench ('ITAT' for short) in ITA No.363/Coch/2023, asserting that its findings are wrong and contrary to the declarations of law by the Hon'ble Supreme Court in *Commissioner of Income Tax, Delhi v. Woodward Governor India (P.) Ltd.* [(2009) SCC OnLine SC 710].

2. Sri.Jose Joseph - learned counsel for the appellant, argued that, when the respondent - assessee, admitted that they had included notional profits in their accounts - which they gained out of a 'mark-to-market' instrument in



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respect of a Forward Contract in Commodity Derivatives, the said amount was taxable; but that the Tribunal has held otherwise. He prays that, consequently, the impugned order be set aside.

3. Sri.R.Jaikrishnan - learned counsel for the respondent, on the other hand, submitted that the learned Tribunal has relied upon *Woodward Governor India* (Supra), as also on *Godhra Electricity Co. Ltd., Ahmedabad v. Commissioner of Income Tax, Gujarat-II* [(1997) 225 ITR 746], to hold correctly that notional profits or notional losses cannot either be treated as income or expenditure respectively, until the same is to accrue. He pointed out that, in *Woodward Governor India* (Supra), the Hon'ble Supreme Court has categorically held



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that no prudent trader would show anticipated profit, in the shape of appreciated value of the closing stock, before it is actually realized; and that, this is the same with anticipated loss also. He argued that, as also declared by the afore two judgments, unless such principles stand superseded or modified by legislative enactments, unrealized profits in the shape of appreciated value of goods, remaining unsold at the end of the accounting year and carried over to the following years account, is a continuing business alone.

4. There is force in the afore submissions of Sri.R.Jaikrishna because, in *Woodward Governor India* (Supra), the Hon'ble Supreme Court has held without any ambiguity as under:



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14. In the case of M.P. Financial Corporation v. CIT [1987] 165 ITR 765 the Madhya Pradesh High Court has held that the expression "expenditure" as used in section 37 may, in the circumstances of a particular case, cover an amount which is a "loss" even though the said amount has not gone out from the pocket of the assessee. This view of the Madhya Pradesh High Court has been approved by this Court in the case of Madras Industrial Investment Corpn. Ltd. v. CIT [1977] 225 ITR 802. According to the Law and Practice of Income-tax by Kanga and Palkhivala, section 37(1) is a residuary section extending the allowance to items of business expenditure not covered by sections 30 to 36. This section, according to the learned Author, covers cases of business expenditure only, and not of business losses which are, however, deductible on ordinary principles of commercial accounting. (see page 617 of the eighth edition). It is this principle which attracts the provisions of section 145. That section



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recognizes the rights of a trader to adopt either the cash system or the mercantile system of accounting. The quantum of allowances permitted to be deducted under diverse heads under sections 30 to 43C from the income, profits and gains of a business would differ according to the system adopted. This is made clear by defining the word "paid" in section 43(2), which is used in several sections 30 to 43C, as meaning actually paid or incurred according to the method of accounting upon the basis on which profits or gains are computed under section 28/29. That is why in deciding the question as to whether the word "expenditure" in section 37(1) includes the word "loss" one has to read section 37(1) with section 28, section 29 and section 145(1). One more principle needs to be kept in mind. Accounts regularly maintained in the course of business are to be taken as correct unless there are strong and sufficient reasons to indicate that they are unreliable. One more aspect needs to be



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highlighted. Under section 28(1), one needs to decide the profits and gains of any business which is carried on by the assessee during the previous year. Therefore, one has to take into account stock-in-trade for determination of profits. The 1961 Act makes no provision with regard to valuation of stock. But the ordinary principle of commercial accounting requires that in the P&L account the value of the stock-in-trade at the beginning and at the end of the year should be entered at cost or market price, whichever is the lower. This is how business profits arising during the year needs to be computed. This is one more reason for reading section 37(1) with section 145. For valuing the closing stock at the end of a particular year, the value prevailing on the last date is relevant. This is because profits/loss is embedded in the closing stock. While anticipated loss is taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into account, as no prudent



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trader would care to show increase profits before actual realization. This is the theory underlying the Rule that closing stock is to be valued at cost or market price, whichever is the lower. As profits for income-tax purposes are to be computed in accordance with ordinary principles of commercial accounting, unless, such principles stand superseded or modified by legislative enactments, unrealized profits in the shape of appreciated value of goods remaining unsold at the end of the accounting year and carried over to the following years account in a continuing business are not brought to the charge as a matter of practice, though, as stated above, loss due to fall in the price below cost is allowed even though such loss has not been realized actually. At this stage, we need to emphasise once again that the above system of commercial accounting can be superseded or modified by legislative enactment. This is where section 145(2) comes into play. Under that section, the Central Government is empowered to notify



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from time to time the Accounting Standards to be followed by any class of assessee or in respect of any class of income. Accordingly, under section 209 of the Companies Act, mercantile system of accounting is made mandatory for companies. In other words, accounting standard which is continuously adopted by an assessee can be superseded or modified by Legislative intervention. However, but for such intervention or in cases falling under section 145(3), the method of accounting undertaken by the assessee continuously is supreme. In the present batch of cases, there is no finding given by the Assessing Officer on the correctness or completeness of the accounts of the assessee. Equally, there is no finding given by the Assessing Officer stating that the assessee has not complied with the accounting standards.

15. For the reasons given hereinabove, we hold that, in the present case, the "loss" suffered by the assessee on account of the exchange difference as on the date of the balance sheet is an



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item of expenditure under Section 37(1)  
of the 1961 Act.

5. In *Godhra Electricity Co. Ltd.* (supra) also, the Hon'ble Supreme Court took a similar view as under:

13. Under the Act income charged to tax is the income that is received or is deemed to be received in India in the previous year relevant to the year for which assessment is made or on the income that accrues or arises or is deemed to accrue or arise in India during such year. The computation of such income is to be made in accordance with the method of accounting regularly employed by the assessee. It may be either the cash system where entries are made on the basis of actual receipts and actual outgoings or disbursements or it may be the mercantile system where entries are made on accrual basis, i.e., accrual of the right to receive payment and the accrual of the liability to disburse or



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pay. In CIT v. Shoorji Vallabhdas and Co.it has been laid down : (ITR p.148).

"... Income tax is a levy on income. No doubt, the Income Tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. if income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a 'hypothetical income', which does not materialise."

14. This principle is applicable whether the accounts are maintained on case system or under the mercantile system. If the accounts are maintained under the mercantile system what has to be seen is whether income can be said to have really accrued to the assessee company. In H.M. Kashiparekh & Co. Ltd. v. CIT the Bombay High Court had said :

"...Even so, (the failure to produce account losses) we shall



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proceed on the footing that, the assessee company having followed the mercantile system of account, there must have been entries made in its books in the accounting year in respect of the amount to commission. In our judgment, we would not be justified in attaching any particular importance in this case to the fact that the company followed mercantile system of account. That would not have any particular bearing in applying the principle of real income in the facts of this case".

18. In State Bank of Travancore v. CIT after considering the various decisions of this Court, Sabyasachi Mukharji, J. (as the learned Chief Justice then was) has said : (ITR p. 154 : SCC pp. 65-66, para 67)

"An acceptable formula of correlating the notion of real income in conjunction with the method of accounting for the purpose of the computation of income for the purpose of taxation is difficult to evolve.



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Besides, any strait-jacket formula is bound to create problems in its application to every situation. It must depend upon the facts and circumstances of each case. When and how does an income accrue and what are the consequences that follow from actual of income are well-settled. The accrual must be real taking into account the actuality of the situation. Whether an accrual has taken place or not must, in appropriate cases, be judged on the principles of real income theory. After accrual, non-charging of tax on the same because of certain conduct on the ipse dixit of a particular assessee cannot be accepted. In determining the question whether it is hypothetical income or whether real income has materialised or not, various factors will have to be taken into account. It would be difficult and improper to extend the concept of real income to all cases depending upon the ipse dixit of the assessee which would then become a value judgment only. What has really



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accrued to the assessee has to be found out and what has accrued must be considered from the point of view of real income taking the probability or improbability of realisation in a realistic manner and dovetailing of these factors together but once the accrual takes place, on the conduct of the parties subsequent to the year of closing an income which has accrued cannot be made 'no income'."

19. If the matter is examined in the light of the aforementioned principles laid down by this Court, it must be held that even though the assessee company was following the mercantile system of accounting and had made entries in the books regarding enhanced charges for the supply made to the consumers, no real income had accrued to the assessee company in respect of those enhanced charges in view of the fact that soon after the assessee company decided to enhance the rates in 1963 representative suits



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(Civil Suits Nos. 152 of 1963 and 50 of 1964) were filed by the consumers which were decreed by the trial court and which decree was affirmed by the appellate court and learned Single Judge of the High court and it is only on 3-12-1968 that the letters patent appeals filed by the assessee company were allowed by the Division Bench of the High Court and the said suits were dismissed. But appeals were filed against the said judgment by the consumers in this Court and the same were dismissed by the judgment of this Court dated 26-2-1969. Shortly thereafter, on 19-3-1969, the Under Secretary to the Government of Gujarat wrote a letter advising the assessee company to maintain status quo for the rates to the consumers for at least six months and the Chief Electrical Inspector was directed to go through the accounts of the assessee company from year to year and to report to the Government about the actual position about the reasonable returns earned by



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the assessee company. On 16-5-1969 another representative suit (Suit No 118 of 1969) was filed by the consumers wherein interim injunction was granted by the Court and which was finally decreed in favour of the consumers on 23-6- 1974. It would thus appear that after the decision was taken by the assessee company to enhance the charges it was not able to realise the enhanced charges on account of pendency of the earlier representative suits of the consumers followed by the letter of the Under Secretary to the Government of Gujarat and the subsequent suit of the consumers and during the pendency of the subsequent suit the management of the undertaking of the assessee company was taken over by the Government of Gujarat under the Defence of India Rules, 1971 and the undertaking was subsequently transferred to the Gujarat State Electricity Board.

20. It is no doubt true that the latter addressed by the Under



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Secretary to the Government of Gujarat to the assessee company had no legally binding effect but one has to look at things from the practical point of view [see : R.B. Jodha Mal Kuthiala v. CIT]. The assessee company, being a licensee, could not ignore the direction of the State Government which was couched in the form of an advice, whereby the assessee company was asked to maintain status quo for at least six months and not to take steps to recover the dues towards enhanced charges from the consumers during this period. Before the expiry of the period of six months the subsequent suit had been filed by the consumers and during the pendency of the said suit the undertaking of the assessee company was taken over by the Government of Gujarat under the Defence of India Rules, 1971 and subsequently it was transferred to the Gujarat state Electricity Board and, as a result, the assessee company was not in a position to take steps to recover the enhanced charges.



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22. The question whether there was real accrual of income to the assessee company in respect of the enhanced charges for supply of electricity has to be considered by taking the probability or improbability of realisation in a realistic manner. If the matter is considered in this light it is not possible to hold that there was real accrual of income to the assessee company in respect of the enhanced charges for supply of electricity which were added by the Income Tax Officer while passing the assessment orders in respect of the assessment years under consideration. The Appellate Assistant Commissioner was right in deleting the said addition made by the Income Tax Officer and the Tribunal had rightly held that the claim at the increased rates as made by the assessee company on the basis of which necessary entries were made represented only hypothetical income and the impugned amounts as brought to tax by the Income Tax Officer did represent the



income which had really accrued to the assessee company during the relevant previous years. The High Court, in our opinion, was in error in upsetting the said view of the Tribunal.

6. We notice that the learned Tribunal has adverted to the afore two precedents and has entered its opinion to the effect that the unrealized 'mark-to-market' gains made on Forward Exchange Contracts are not liable to tax, thus deleting the addition made by the Assessment Officer; which was then confirmed by the CIT (Appeals).

7. It is doubtless that, in a 'mark-to-market' forward commodities contract, the gains and losses fluctuate until the instrument matures on the period of expiry. In one year it is likely that there would be losses, which



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would perhaps transmute to be profits in the next year; and it continues in that cycle until the maturity happens. This is why, in *Woodward Governor India* (Supra), the Hon'ble Supreme Court has spoken luculently that no prudent trader would account for anticipated profit, in the shape of appreciated value of the closing stock, until it is actually realized.

8. In fact, Sri. Jose Joseph also agrees that the actual accrual of profit or loss - as the case may be, under the derivative, happens only at the close of the expiry of the instrument; but his argument is that, when the assessee shows it as a profit in their account for the relevant year, it becomes exigible to tax.

9. We are afraid that we cannot find



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favour with the afore argument for the singular reason that *Woodward Governor India* (Supra) answers the question to the contrary.

In the afore circumstances, we see no reason to intervene with the impugned order of the learned Tribunal; and therefore, dismiss this Appeal; however, clarifying that all consequences upon the maturity of the instrument would apply as per law.

Sd/-

DEVAN RAMACHANDRAN

JUDGE

Sd/-

BASANT BALAJI

JUDGE

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APPENDIX OF ITA NO. 71 OF 2025

PETITIONER ANNEXURES

ANNEXURE A	TRUE COPY OF THE ASSESSMENT ORDER UNDER SEC. 143 FOR THE ASST. YEAR 2015-16 DATED 18-12-2017
ANNEXURE B	TRUE COPY OF THE ORDER OF THE COMMISSIONER OF INCOME TAX UNDER SEC. 263 OF THE INCOME TAX ACT DATED 28-10-2019
ANNEXURE C	TRUE COPY OF THE ASSESSMENT ORDER UNDER SEC. 143(3) R.W.S 263. DATED 12-07-2021.
ANNEXURE D	TRUE COPY OF THE ORDER U/S. 154 PASSED BY THE ASSESSING OFFICER DATED 19-04-2022
ANNEXURE E	TRUE COPY OF THE ORDER OF CIT (A) IN APPEAL NO. ITA. 31/TH CR/CIT(A)-III/2022-23 DATED 28-03-2023
ANNEXURE F	CERTIFIED COPY OF THE ORDER OF THE TRIBUNAL IN ITA. 363/COCH/2023 DATED 21-03-2025