

**IN THE INCOME TAX APPELLATE TRIBUNAL "C", BENCH KOLKATA  
BEFORE SHRI A.T. VARKEY, JM & DR. A. L.SAINI, AM**

**ITA Nos.1047,1048 & 1049/Kol/2017**  
(Assessment Year: 2009-10, 2010-11 & 2011-12)

<b>DCIT, Circle-12(2), Kolkata</b>	Vs.	<b>M/s. Tega Industries Ltd.</b> 147, Block-G, New Alipore Kolkata – 700053.
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AABCT2074M		
(अपीलार्थी /Appellant)	..	(प्रत्यर्थी / Respondent)

&  
**C.O Nos.31, 32 & 33/Kol/2019**  
(A/o ITA No.1047,1048 & 1049/Kol/2017)  
(Assessment Year: 2009-10, 2010-11 & 2011-12)

<b>M/s. Tega Industries Ltd.</b> 147, Block-G, New Alipore Kolkata – 700053.	Vs.	<b>DCIT, Circle-12(2), Kolkata</b>
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AABCT2074M		
(Cross-Objector)	..	(प्रत्यर्थी / Respondent)

Appellant by : DR. P. K. Srihari, CIT-DR  
Respondent by : Shri Chidambaram, Advocate

सुनवाई की तारीख / Date of Hearing : 25/09/2019

घोषणा की तारीख/Date of Pronouncement: 31/10/2019

**आदेश / O R D E R**

**Per Dr. Arjun Lal Saini, AM:**

The captioned three appeals filed by the Revenue and three Cross Objections filed by the assessee pertaining to Assessment Years 2009-10, 2010-11 & 2011-12, are directed against separate orders passed by Id. Commissioner of Income Tax (Appeals)-22, Kolkata in Appeal No.212/CIT(A)-22/09-10/14-15/Kol, 52/CIT(A)-22/10-11/14-15/Kol & 55/CIT(A)-22/11-12/15-16/Kol; respectively, which in turn arise out of separate fair assessment orders passed by the Assessing Officer, which incorporate the findings of the Transfer Pricing Officer under section 92CA(3) of the Income Tax Act 1961 (hereinafter referred to as the 'Act').

2. Although, these appeals filed by the Revenue for Assessment Year 2009-10 (in ITA No.1047/Kol/2017), for Assessment Year 2010-11 (in ITA No.1048/Kol/2017), for Assessment Year 2011-12 (in ITA No.1049/Kol/2017) and Cross Objections filed by the assessee in C.O No.31/Kol/2019, C.O.No.32/Kol/2019 and C.O. No.33/Kol/2019; respectively, contain multiple grounds of appeal. However, at the time of hearing, we have carefully perused all the grounds raised by the Revenue as well as cross-objections raised by the assessee in respective years. We find that most of the grounds raised by the Revenue, as well as assessee are either academic in nature or contentious in nature. However, to meet the end of justice, we confine ourselves to the core of the controversy and impugned grievance of the Revenue and the assessee as well. With this background, we summarize and concise the grounds raised by the Revenue as well assessee as follows:

### **Transfer Pricing Grounds**

(i). Disallowance/addition on account of Corporate Guarantee fee (vide Ground No.3 to 5 raised by the Revenue in Assessment Year 2009-10 and Ground No.2 to 4 raised by the Revenue in Assessment Year 2010-11 and Ground Nos.2 to 4 raised by the Revenue in Assessment Year 2011-12.

(ii).Transfer Pricing Adjustment on account of interest on loan given to subsidiary company. This covers Ground No.6 and 7 raised by the Revenue in Assessment Year 2009-10 and Ground No.5 and 6 raised by the Revenue for Assessment Year 2010-11, and Ground No.5 raised by the Revenue in Assessment Year 2011-12.

### **Other grounds**

(i). Disallowance under section 14A r.w.r. 8D of Rs.4,51,190/-. This ground is raised by the Revenue in Assessment Year 2009-10 only.

(ii).Addition made by AO regarding loss from option contracts in foreign currency with banks held as "Speculative loss". This covers Ground No.2 raised by the Revenue for

Assessment Year 2009-10, Ground No.1 raised by the Revenue in Assessment Year 2010-11 and Ground No.1 raised by the Revenue in Assessment Year 2011-12.

3. First we shall take grounds relating to transfer pricing. Common and concise Ground No.1 raised by the Revenue is reproduced below for ready reference:

*“(i). Disallowance/addition on account of Corporate Guarantee fee (vide Ground No.3 to 5 raised by the Revenue in Assessment Year 2009-10 and Ground No.2 to 4 raised by the Revenue in Assessment Year 2010-11 and Ground Nos.2 to 4 raised by the Revenue in Assessment Year 2011-12.”*

4. When this appeal was called out for hearing, learned counsel for the assessee invited our attention to the order dated 21.09.2016, passed by the Division Bench of this Tribunal in assessee’s own case in ITA No.1912/Kol/2012, for the Assessment Year 2008-09 whereby the issue relating to “Corporate Guarantee Fee” has been discussed and adjudicated in favour of assessee. Learned Counsel for the assessee submitted before the Bench that the present issue, relating to ‘corporate guarantee fee’ is squarely covered by the aforesaid order of the Tribunal, a copy of which was also placed before the Bench.

5. Learned Departmental Representative relied upon the orders of the TPO/AO.

6. We see no reasons to take any other view of the matter than the view so taken by the Division Bench of this Tribunal in assessee’s own case vide order dated 21.09.2016. In this order, the Tribunal has inter alia observed as follows:

***“5.Issue No.2:Corporate Guarantee (Grounds of appeal Nos. 1 to 5 relate to corporate guarantee provided by the assessee for loans taken from ICICI bank, U.K.).***

*The facts of this issue are stated in brief. During the financial year 2006-07, the Tega Industries Ltd.( Assessee), set up Tega Investment Ltd-Bahamas, an associate enterprise (AE), as a special purpose vehicle in the Bahamas for undertaking an acquisition of companies based in South Africa i.e. 1) Beruc Equipment Pty Limited and 2) Bentod Manufacturing Limited. These two companies were merged to form Tega Beruc South Africa Pty Ltd. The assessee provided a shareholder loan to Tega Bahamas and a corporate guarantee to ICICI bank UK, to fund Tega Bahamas for acquiring the two south African entities. The TPO made transfer pricing adjustment in respect corporate guarantee @ 2.5% and created additional charge in connection with the corporate guarantee at Rs.9,00,979/-, observing the following:*

*“36 In a recent case, Hon`ble ITAT, Hyderabad Bench in the case of Four Soft Ltd. (ITA No.1495/HYD/2010) have stated the following in paragraph 21 of their order:*

*We have considered the rival submissions and perused the material available on record. We find that the TP legislation provides for computation on income from international transaction as per section 92B of the Act. The corporate guarantee provided by the assessee company does not fall within the definition of international transaction. The TP legislation does not stipulate any guidelines in respect to guarantee transactions. In the absence of any charging provision, the lower authorities are not correct in bringing aforesaid transaction in the TP study. In our considered view, the corporate guarantee is very much identical to the business of the assessee and hence, the same can not be compared to a bank guarantee of the bank or financial institution. In view of this matter, we hold that no TP adjustment is required in respect of corporate guarantee transaction done by the assessee company.*

*37. It is seen that it has not been brought to light that the corporate guarantee provided by the guarantor is in the nature of provision of service. Further, in any way, it has a bearing on the profit or losses of the transacting parties. On both grounds, it is covered under section 92B of the Act. Neither this nor the OECD Guidelines or international case law referred above appears to have been brought to the notice of the Hon'ble Tribunal.*

*38. The Hon'ble Supreme Court has laid out on many occasions that unless an issue or decision has been discussed in detail in a judicial pronouncement it cannot make good law. In the case of Shanmugavel Nadar V. State of Tamil Nadu. & Another (263 ITR 658), the Apex Court has pronounced the following : “Rup Diamonds V. Union of India, AIR 1989 SC 674, is an authority for the proposition that apart altogether from the merits of the grounds for rejection, the mere rejection by a superior forum, resulting in refusal of exercise of its jurisdiction which was invoked, could not by itself be construed as the imprimatur of the superior forum on the correctness of the decisions sought to be appealed against. In Supreme Court Employees Welfare Association V. Union of India, AIR 1990 SC 334. this Court observed that a summary dismissal, without laying down any law, is not a declaration of law envisaged by Article 141 of the Constitution. When reasons are not given, the decision of the Supreme Court becomes one which attracts article 141 of the Constitution which provides that the law declared by the Supreme Court shall be binding on all the courts within the territory of India. When no reasons are given, a dismissal simpliciter is not a declaration of law by the Supreme Court under article 141 of the Constitution. In Indian Oil Corporation Ltd. V. State of Bihar (1987) 167 ITR 897, AIR 1986 SC 1780, this court observed that the questions which can be said to have been decided by this court expressly, implicitly or even constructively, cannot be reopened in subsequent proceedings; but neither on the principle of res judicata nor on any principle of public policy analogous thereto, would the order of this Court bar the trial of identical issue in separate proceedings merely on the basis of an uncertain assumption that the issues must have been decided by this court at least by implication.”*

*Based on the above, and on the fact that Hon'ble Tribunal did not take into account that a service has been provided by the assessee and even otherwise, any transaction which has a bearing on the profit or loss of the entitles involved is covered by section 92B, it has to be humbly stated that the decision cited may not have a bearing to the present case.*

*39. It also needs to be mentioned that the Tax Court of Canada decision, mentioned earlier, has been upheld by the Canadian Federal Court of Appeal (Citation: 2010 FCA 344 in judgment delivered on December 15, 2010.*

*40. What remains to be looked into now is the issue of benefit arising to the subsidiary on account of the corporate guarantee is issued by the assessee. The interest rates in case of the*

subsidiary need to be found out had they ventured into the market on their own. The assessee has not provided any information about the credit rating of TILB. Thus, the effective interest rate available to the subsidiary in the market-place is also not available.

41. It has already been mentioned while analysing loan pricing that credit rating is not an exact science. In the present case, as has been shown above, the subsidiary can be rated at CC level. Such ratings are in the nature of 'very high credit risk'. It has been shown that TILB should be charged a margin of 600 bps, However, it has been charged a margin of 225 bps. **This difference is required to be shared between the guarantor and the borrower in an arm's length situation.** However, the bargaining power of TILB vis-a-vis the assessee is minimal in an arm's length situation. Thus, 250 bps could be safely considered the price of the guarantee.

42. Based on the above, it is held that the assessee should have charged a Guarantee commission at the annual rate of 2.5% on the amount of credit availed by the subsidiary which was guaranteed by it. The loan amount stood at Rs.3,60,39,150/- as on 31.03.2008. Accordingly, the guarantee fee is computed at Rs.9,00,979/-. Thus, the total income of the assessee is to be upwardly adjusted by this amount.

5.1. Aggrieved from the order of the TPO, the assessee filed an application before the Hon'ble DRP. The Hon'ble DRP has also confirmed the action of the TPO by observing the following:

"5.1.6 The Assessee has submitted in the reply to the remand report that from the facts as already presented and discussed before the Ld. Panel Members vide submission dated 14.06.2012, it is evident that the purpose of setting up of the SPV (Tega Bahamas) was to facilitate the acquisition of the South African entities. The assessee's expectation from the loan funds provided to Tega Bahamas and the guarantee provided for the third party borrowings of Tega Bahamas was never to earn an interest income or a guarantee fee but to benefit itself. This is evident as in a third party scenario no entity would have lent any funds to Tega Bahamas given its skewed debt - equity ratio evident from its balance sheet. Thus it is clear that the intention of the assessee for funding the SPV was that of an investor and not a lender. In light of the same, it would be appropriate to classify the funds loaned and guarantee provided to infuse third party funds as quasi-equity in nature and as a shareholder service meriting no consideration. The Assessee has also submitted that depending on the facts and circumstances of the particular case, it may be appropriate for tax administrations in applying the relevant transfer pricing provisions to examine the purpose and object of providing the funding in the form of debt vis-a-vis infusion of equity. The permissibility of infusing additional amounts of funding required in the form of debt would need to be viewed from a commercial viability perspective and whether such loans would have been advanced by third parties in the instant case.

5.1.7 We have carefully read the submission of the Assessee to understand as to what action is the appropriate for the Tax Administration in Transfer pricing case. Assessee submits that the Tax Administration should examine the purpose and object of providing the funding in the form of debt vis-a-vis infusion of equity. Accordingly, we have examined the purpose of providing the funding in the form of debt. We find that the Assessee has infused funds in the AE because either looking to the financial position of the AE no third party would have provided funds to the AE or the cost of funds would have been very high. It means that by rendering financial services, a benefit has accrued to the AE, which in case third party had rendered such service it would have charged the

*price for the same. In Transfer Pricing two related parties are viewed as unrelated and transacting at arm's length. This being the cardinal principle, for this service the Assessee should also charge the price as two unrelated parties transacting at Arm's length do. In this back ground if we see what is the structure of the international transactions entered in to by the Assessee with the AE, we find that they are interest free loan and Corporate Guarantee given to ICICI UK bank, on behalf of the AE. If this is the structure of the transactions, then the Assessee must charge interest on loan and Guarantee fee from AE. If Assessee does not do so it leads to erosion of tax base as third parties charge interest and fees for such services. Therefore, this Panel holds the view that the TPO was right in making adjustment in the TP Order on this account. There is no scope in our view to restructure the international transaction of interest free loan as Shareholder service or quasi-equity. Restructuring should be the judicious discretion of the Tax Administration and it could be applied only if the Assessee had claimed expenditure for interest or fees on Guarantee. In this case facts are different and interest and Guarantee fees adjustment made by the TPO are in the nature of income and not expenditure."*

*Being aggrieved from the order of the Hon,ble DRP, the assessee is in further appeal before us.*

*5.2 The ld. Authorised Representatives for the assessee has submitted that:*

- i. During the FY 2006-07, the assessee set up Tega Bahamas as a special purpose vehicle ('SPV') for acquiring two companies based in South Africa:
 
  - a) Berne Equipment Pty Limited; and*
  - b) Bentod Manufacturing Limited (now merged & collectively referred to as TegaBeruc South Africa (Pty) Ltd.).**
- ii. The assessee's equity investment in Tega Bahamas was of Rs. of 23 lacs. It additionally provided a loan amounting to Rs. 80 lacs to it. Further, in order to fund the acquisition of the Tega Beruc South Africa (Pty) Ltd. (Tega South Africa), Tega Bahamas obtained a loan from ICICI Bank UK amounting to USD 1.4 million (approximately Rs.5 crores) on the basis of a corporate guarantee provided by the assessee to ICICI Bank UK.*
- iii. The assessee's letter dated 14.06.2012 mentions that "While deliberating on an arm's length price that could be charged for the loan provided to Tega Bahamas, the assessee was of the view that the loan funds provided to Tega Bahamas was a means to mitigate its risk vis-a-vis infusion of additional funds in the form of equity and hence the loan funds provided were quasi-equity in nature. Additionally, in connection with the guarantee provided to ICICI Bank UK, the assessee opted for providing a guarantee vis a-vis blocking its own funds to facilitate its objective of acquiring the two South African companies. In light of the same, the assessee was of the belief that the same was in the nature of a shareholder service and the loan funds generated from such guarantee provided was quasi - equity in nature and hence merited no consideration.*
- iv. The assessee has cited section 92(1) of the IT Act, 1961, Article 9 of the OECD MC and section 147 of the UK legislation (Title not mentioned, Taxation*

*(International and Other Provisions) Act 2010 presumed) to suggest that the 'arm's length principle is the same across jurisdictions. But as the 'Indian Transfer Pricing Legislation "does not provide any guidelines, notes or circulars to interpret the arm's length principle for different nature of transactions", the assessee has "placed reliance on guidelines, notes and circulars available across different jurisdictions dealing with the arm's length principle for cross-border financing arrangements.*

- v. *The assessee is of the view that as the purpose of setting up of Tega Bahamas was to facilitate the acquisition of the South African entities, its expectation from the loan funds provided to Tega Bahamas and the guarantee provided for the third party borrowings of Tega Bahamas was not to earn an interest income or a guarantee fee. The assessee believes that in a third party scenario no entity would have lent any funds to Tega Bahamas given its skewed debt - equity ratio evident from its balance sheet and thus, the basis of providing funds to Tega Bahamas was as an investment and not as loan. Thus, it would be appropriate to classify the funds loaned and guarantee provided to infuse third party funds as quasi-equity in nature and as a shareholder service meriting no consideration.*
- vi. *The assessee has referred to UK Manual INTM 501010 issued by HMRC which deals with the case of a UK lender and guarantor. The assessee has then mentioned that the UK Transfer Pricing Legislation further provides guidance as to how one could decide whether a loan or a guarantee provided for a loan is quasi-equity in nature or a shareholder service. This assertion is based on a reference to the UK transfer pricing legislation "Taxation (International and Other Provisions) Act 2010". The sections referred to are 152 and 153 of that Legislation. The assessee is of the view that on considering the above sections of the UK transfer pricing legislation, it is evident that prima-facie the question that needs to be addressed is whether the loan would be provided in a third party scenario without the backing of any Group Company. It is the assessee's case that no third party would have provided the loan to Tega Bahamas given the minimal amount of capital in its books and the lack of operating profits available at its disposal.*
- vii. *The assessee has also referred to HMRC INTM 542005 and drawn the conclusion that these guidelines allow for situations where a borrowing entity (like Tega Bahamas) would not have entered into the loan arrangement on its own account as it would not have been able to obtain the loan on a standalone basis. It is also suggested that based on these guidelines, it can be said that as the guarantee was provided by the assessee to enable Tega Bahamas to obtain the loan to further its own business interest i.e. acquisition of the South African entities, the service rendered by the assessee in the form of provision of guarantee could be said to be a shareholder service not meriting any consideration.*
- viii. *The assessee has then referred to HMRC INTM 542012, 542040, 542090, and 542100 and suggested that these also support the contentions made by it.*

- ix. *The assessee has also referred to paragraph 1.65 of the OECD Transfer Pricing Guidelines (2010) and suggested that it allows for loan to be recharacterised as equity.*
- x. *The assessee has then referred to paragraph 7.9 of the OECD Transfer Pricing Guidelines (2010) and suggested that its activities are fully covered by this (i.e. shareholder activity).*
- xi. *It has also referred to the paragraphs 183 & 184 of chapter V of earlier 1979 version of OECD Transfer Pricing Guidelines and suggested that it supports recharacterisation of loan as equity.*
- xii. *In the end, reference has been made to ATO's Taxation Ruling TR92/11. It has been mentioned that the TPO has relied on this Ruling issued by the Australian Taxation Office to reject the arguments of the assessee. However, the assessee has cited the full Ruling and suggested that clauses (c) (d) and (g) of paragraph 60 of the Ruling allows for recharacterisation of loan as equity.*
- xiii. *It is mentioned that the TPO has rejected the arguments of the assessee by stating that 'thin capitalisation' rules are not provided in Indian legislation. The assessee has stressed that thin capitalization rules stem from the arm's length principle and they were "introduced across the world to check lop-sided capital structures that were employed by multinational corporations to enable profit extraction from their AEs in the form of interest". The assessee has referred to HMRC INTM 542005 where it has been mentioned that thin capitalization is a form of transfer pricing.*

*Based on the above, the ld.AR for the assessee has submitted before us that the TPO's determination of arm's length price of the guarantee fee is erroneous.*

*Ld. AR also submitted that assessee's expectation from provision of loan and guarantee are not that of a lender or guarantor i.e. to earn a market rate of interest or guarantee fee, rather, the expectation was of a shareholder- to protect its investment interest, help it to achieve acquisition of Tega Beruc for furtherance of its own business and get return in terms of appreciation in value and dividends. It can be verified from the fact that no third party would have agreed to grant loans, on an independent basis, to the tune of Rs. 5 Crores to Tega Bahamas given its skewed debt-equity ratio reflected in the balance sheet, as equity funding is mere Rs.23 Lakhs. The AR also relied on various ( OECD) guidelines dealing with the arm's length principles in relation to guarantee. The Ld AR also relied on the following judicial precedents:*

- (i) Bharati Airtel Vs. Addl.CIT [2014] 63SOT 113*
- (ii) Redington India Ltd Vs. Jt. CIT [2014] 49 Taxmann.com 146 ( Chennai)*
- (iii) Videocon Industries Ltd Vs. Addl.CIT[2015] 55 taxmann.com 263 (Mum)*
- (iv) Micro Ink Ltd. Vs. Asst.CIT [2015]63 taxmann.com353 ( Ahmedabad-Trib)*

*Specially in the case of Micro Ink Ltd. Vs. Asst.CIT [2015]63 taxmann.com353 ( Ahmedabad-Trib), the hon`ble Tribunal held that if guarantee is shareholder activity then no TP adjustment is required. Vide para 48 and 51, of the decision which read as under:*

*“Issuance of corporate guarantees were in the nature of shareholder activities- as was the uncontroverted claim of the assessee, and, as such, could not be included in the ‘provision for services’ under the definition of ‘international transaction’ under section 92B of the Act. ITAT have also held, taking note of the insertion of Explanation to Section 92B of the Act, that the issuance of corporate guarantees is covered by the residuary clause of the definition under section 92B of the Act but since such issuance of corporate guarantees, on the facts of the present case, did not have “bearing on profits, income, losses or assets”, it did not constitute an international transaction, under section 92B, in respect of which an arm’s length price adjustment can be made. In this view of the matter, and for both these independent reasons, ITAT have to delete the impugned ALP adjustment.*

**(Para48)**

*ITAT uphold the grievance raised by the assessee. The impugned ALP adjustment of Rs 2,23,62,603, thus stands deleted. As ITAT do so, however, ITAT must add that, in ITAT considered view, the way forward, to avoid such issues being litigated and to ensure satisfactorily resolution of these disputes, must include a clear and unambiguous legislative guidance on the transfer pricing implications of the corporate guarantees as also on the methodology of determining its ALP, if necessary. Of course, no matter how good is the legislative framework, the importance of a very comprehensive analysis, in the transfer pricing study, of the nature of corporate guarantees issued by the assessee, can never be overemphasized. The sweeping generalizations, vague statements and evasive approach in the transfer pricing study reports, which are quite common in most of the transfer pricing reports, cannot do good to a reasonable cause. When judicial calls on the complex transfer pricing issues are to be taken, utmost clarity in the legislative framework and a comprehensive analysis of relevant facts, in the transfer pricing documentation, are basic inputs. Unfortunately, both of these things leave a lot to be desired. ITAT can only hope, and ITAT do hope, that things will change for better.*

**(PARA51)**

*Based on the above cited facts and case law, the ld AR for the assessee has prayed before us to treat the guarantee as shareholder activity and therefore the addition made by the TPO/AO may be deleted.*

*5.3 On the other hand ,the Ld. Departmental Representative (DR) has primarily reiterated the stand taken by TPO and DRP, which we have already noted in earlier paras, cited above, and is not being repeated for the sake of brevity.*

*5.4 Having hard the rival submissions, we are of the view that there is merit in the submissions of the assessee, as the propositions canvassed by the ld AR for the assessee have been supported by the facts and precedents ( case law) cited above. As the assessee`s expectation from provision of loan and guarantee are not that of a lender or guarantor i.e. to earn a market rate of interest or guarantee fee, rather, the expectation was of a shareholder- to protect its investment interest, help it to achieve acquisition of Tega Beruc for furtherance of its own business and get return in terms of appreciation in value and dividends. It can be verified from the fact that no third party*

*would have agreed to grant loans, on an independent basis, to the tune of Rs. 5 Crores to Tega Bahamas given its skewed debt-equity ratio reflected in the balance sheet, as equity funding is mere Rs.23 Lakhs, therefore in the present case the guarantee is a shareholder activity hence no TP adjustment on account of corporate guarantee should be required. Accordingly, we direct the Ld.DRP/AO to delete the addition.”*

7. As the issue is squarely covered in favour of the assessee by the decision of the coordinate bench, in assessee`s own case and there is no change in facts and law and the Revenue is unable to produce any material to controvert the aforesaid findings of the Division Bench (supra) and the ld CIT(A) deleted the addition by following the judgment of the Division Bench. We find no reason to interfere in the said order of the Division Bench, therefore, we uphold the order of ld CIT(A) in deleting the addition made by AO/TPO on account of corporate guarantee fee, for A.Y 2009-10, 2010-11 & 2011-12. Therefore, grounds raised by the Revenue are dismissed.

8. Transfer Pricing Adjustment on account of interest on loan given to subsidiary company. This covers Ground No.6 and 7 raised by the Revenue in Assessment Year 2009-10 and Ground No.5 and 6 raised by the Revenue for Assessment Year 2010-11, and Ground No.5 raised by the Revenue in Assessment Year 2011-12.

9. When this appeal was called out for hearing, learned counsel for the assessee invited our attention to the order dated 21.09.2016, passed by the Division Bench of this Tribunal in assessee`s own case in ITA No.1912/Kol/2012, for the Assessment Year 2008-09 whereby the transfer pricing issue relating to attribution of additional interest on loan given to subsidiary ( that is, the Transfer Pricing Adjustment on account of interest on loan given to subsidiary) has been discussed and adjudicated in favour of assessee. Learned counsel for the assessee submitted that the present issue in assessee`s appeal is squarely covered by the aforesaid order of the Tribunal, a copy of which was also placed before the Bench.

10. Learned Departmental Representative relied upon the orders of the TPO/AO.

11. We see no reasons to take any other view of the matter than the view so taken by the Division Bench of this Tribunal in assessee's own case vide order dated 21.09.2016. In this order, the Tribunal has inter alia observed as follows:

*"4.4. Having heard the rival submissions, we are of the view that there is merit in the submissions of the assessee, since the propositions canvassed by the ld AR are supported by the facts cited above and the decisions of the hon`ble ITAT & Courts referred above. As the assessee has pointed out that loan advanced by the holding company to its subsidiary company was for commercial expediency. The assessee company merged to expand its business in foreign countries. Therefore, it is injecting the loan to the subsidiary company by way of taking loan from the ICICI bank and giving the guarantee. We noticed that the subsidiary company has a low capital that is, share capital only Rs.23 lakhs, therefore without injecting the funds, it was not possible for the subsidiary company to run the business for the benefit of the holding company and entire group. Therefore, the loan injected by the holding company to its subsidiary company is kind of a quasi equity, i.e. in the form of equity.*

*For benchmarking the interest rate on loan, either an internal CUP or an external CUP in the same priority of application could have been applied in a case. An internal CUP could be applied where same/similar transactions (i.e. with same/similar terms and conditions) have been entered into by the appellant / AE with third parties. If no internal CUP is available, an external CUP could be looked at i.e. transactions entered outside the group between third parties under same/similar terms and conditions. The Ld AR cited an example stating that , if the price charged in the open market for a particular type of product could be say INR 100. In order to manufacture that product a person incurs a cost of INR 105 or INR 60. The market pays INR 100 only as the market price is INR 100 and not INR 105 or INR 60 i.e. the cost incurred by him.*

*With respect to credit spread, the Ld. TPO mentioned that the same needs to be based upon the creditworthiness of the borrower, citing detailed explanation about credit rating, the agencies determining the same and Standard & Poor's Corporate Rating Criteria as provided by them in a booklet issued in 2006 (S&P Criteria). However, the Ld. TPO erred in applying the same in a biased manner and came to a conclusion that the rating of Tega US and Australia would not be more than 'B'.*

*The Ld. TPO has only placed reliance on four out of seven ratios as prescribed by the S&P Criteria to arrive at the credit rating for AEs even after acknowledging the fact that S&P prescribes all seven ratios. Ld. TPO has identified a single loan transaction as comparable from 'Loan Connector' having 'B' rating commanding a spread of 3% for the risks associated with its rating therefore, we find that the methodology adopted by the TPO may be wrong. However, the assessee has submitted before us some additional evidence pertaining to credit rating.*

*As we noticed in the additional evidences that the assessee has computed credit rating of Tega Australia at "BBB" and Tega US at "AA" by applying scientific and logical method, as explained above, and submitted before us additional evidences, accordingly, we are of the view that this issue requires fresh examination at the end of the TPO/AO, therefore we restore this issue to the file of the TPO/AO with the direction to ascertain, the arm`s length price of the loan.*

*4.5 In the result, the appeal filed by the assessee on this ground is allowed for statistical purposes.”*

12. As the issue is squarely covered in favour of the assessee by the decision of the coordinate bench, in assessee`s own case and there is no change in facts and law and the Revenue is unable to produce any material to controvert the aforesaid findings of the Division Bench (supra). We find no reason to interfere in the said order of the Division Bench, therefore, respectfully following the judgment of the Coordinate Bench in assessee`s own case wherein the Division Bench of this Tribunal noticed in the additional evidences that the assessee has computed credit rating of Tega Australia at “BBB” and Tega US at “AA” by applying scientific and logical method, and submitted before this Tribunal additional evidences and directed Id. TPO/A.O for fresh examination. Accordingly, we also direct the Id. TPO/Assessing Officer to examine credit rating of Tega Australia at “BBB” and Tega US at “AA” which was computed by assessee by applying scientific and logical method. Therefore we restore this issue to the file of the TPO/AO with the direction to ascertain the arm`s length price of the loan. Therefore grounds raised by Revenue are dismissed.

### **13. Other grounds raised by the Revenue**

*“(i). Disallowance under section 14A r.w.r. 8D of Rs.4,51,190/-. This ground is raised by the Revenue in Assessment Year 2009-10 only.”*

14. Brief facts qua the issue are that during the scrutiny proceedings, the AO noticed that assessee has earned exempt income to the tune of Rs.13,28,486/-. The assessee has disallowed expenses against exempted income. However, AO noticed that the determination of expenditure incurred in relation to exempt income should be done as per Rule 8D of the I.T. Rules. The AO worked out the disallowance as per Rule 8D of the Income Tax Rules at Rs. 4,51,190/-. The Assessee had disallowed only Rs. 3,50,000/-, which was lower than Rs. 4,51,190/-. Therefore, the AO disallowed the balance amount of Rs.1,01,190/- (Rs. 4,51,190 - Rs. 3,50,000).

15. Aggrieved by the addition made by the Assessing Officer, the assessee carried the matter in appeal before the Id. CIT(A) who has partly deleted the addition made by the Assessing Officer. Aggrieved, the Revenue is in appeal before us.

16. The Id. DR for the Revenue has primarily reiterated the stand taken by the Assessing Officer, which we have already noted in our earlier para and the same is not being repeated for the sake of brevity. On the other hand, the Id. Counsel for the assessee defended the order passed by the Id. CIT(A).

17. We have heard both the parties and perused the materials available on record. We note that the issue raised by the revenue in respect of disallowance u/s 14A r.w.r 8D of the Income Tax Rules is no longer res integra. We note that Coordinate Bench of ITAT, Kolkata in the case of REI Agro vs. DCIT, 144 ITD 141 (Kol-Trib) has held that it is only the investments which yielded dividend during the previous year that has to be considered while adjudicating the average value of investment for the purpose of Rule 8D(2)(ii) and (iii) of the Rules. The aforesaid view of the Tribunal has since been affirmed as correct by the Hon'ble Calcutta High Court in GA No.3581 of 2013 in the appeal against the order of the Tribunal in the case of REI Agro Ltd. (supra). We note that in assessee's case, the assessee has not disallowed any expenditure under Rule 8D(2)(i), as there was no direct expense incurred by the assessee. No disallowance is attracted under Rule 8D(2)(ii) as the assessee's own funds are more than investments. Now coming to the third limb, namely Rule 8D(2)(iii), wherein we note that the disallowance can be made with reference to the dividend bearing securities. We note that the disallowance as per Rule 8D(2)(iii) by taking into account only dividend bearing securities, as per assessee's computation comes to Rs.86,863/-, whereas the assessee has suo moto disallowed Rs.3,50,000/- which is more than Rs.86,863/- therefore, no further disallowance is required. That being so, we decline to interfere in the order passed by the Id. CIT(A), his order on this issue is hereby upheld, and ground No.1 raised by the Revenue in ITA No.1047/Kol/2017, is dismissed.

18. Other ground No.(ii): reads as follows:

*“(ii).Addition made by AO regarding loss from option contracts in foreign currency with banks held as “Speculative loss”. This covers Ground No.2 raised by the Revenue for Assessment Year 2009-10, Ground No.1 raised by the Revenue in Assessment Year 2010-11 and Ground No.1 raised by the Revenue in Assessment Year 2011-12.”*

19. Brief facts qua the issue are that during the scrutiny proceedings, assessing officer, noticed that assessee has debited Rs.4,74,97,275/- as loss from option contracts of currency with bank. The assessing officer was of the view that it is a speculative loss and cannot be set off from business income. The assessee was asked to explain the nature of option contracts and to explain further that whether they are for the purpose of business? In response, the assessee submitted before AO that the option contracts with banks were entered to offset the future risk that arise in normal business activities and hence should be allowed as business loss. However, the AO rejected the contention of the assessee and held that the option contract in foreign currency with banks is not covered by any of the four clauses mentioned in section 43(5) of the Act and therefore, the loss of Rs.4,74,97,275/- should be treated as speculative loss and cannot be set off from business income.

20. Aggrieved by the stand so taken by the Assessing Officer, the assessee carried the matter in appeal before the Id. CIT(A) who has deleted the addition made by the Assessing Officer.

*“1. I have carefully considered the submissions of the assessee-company, and also the discussions made by the Ld. AO in the impugned order. In Para 4.1 of the impugned order, the Ld. AO observed that in its P&L A/c, the assessee had debited Rs.4,74,97,275/- as loss from option contracts in foreign currency with banks. When asked to clarify why such loss be allowed, the assessee-company stated that option contracts were entered into to offset future risks that might arise in the course of its export business and therefore should be allowed as a business loss. Referring to provisions of Section 43(5) which defines 'speculative transaction' for the purposes of assessment of business profits, the AO held that "options contract" in foreign currency with bank was not covered by any of the four exceptions provided in the Explanation under Section 43(5) of the Act. With merely such remarks, the Ld. AO disallowed loss of Rs.4,74,97,275/- holding it as "speculative loss" and did not allow its set off in assessment of appellant's business income for the relevant year. However, quite on the contrary, I find that in*

*the course of assessment proceedings, the appellant had furnished before the Ld. AO its detailed submissions in support of allowability of such loss by filing a letter dated 22.03.2013. Along with this letter, the appellant had also furnished copies of the relevant option contracts and export orders against which option contracts were entered into with banks. Although the relevant documentary evidences in support of the appellant's explanations were furnished, in the impugned order there is no mention either of the documents or explanations furnished. I therefore find merit in the submissions made by the Ld. A.Rs that the Ld. AO had completely overlooked the appellant's explanations and the evidences and after ignoring the relevant evidences and explanations the AO disallowed the loss holding it to be speculative loss in terms of Section 43(5) of the Act.*

*2. From the material documents and the explanations furnished, both before the Assessing Officer as well as before me, I find that during the relevant year, the appellant was engaged in the business of manufacture and export of engineering goods. From the annual accounts of the appellant for the year under consideration, it is observed that the appellant's turnover for the year under consideration and for the subsequent year was Rs.163.42 crores, and Rs.173.06. Out of the same, export turnover accounted for Rs.110.99 crores & Rs.103.32 respectively, It further emanates from the details furnished that the assessee had executed export orders in various foreign currencies such as US dollars, Euros, Australian Dollars etc. Since the assessee's business had sufficiently large exposure to international trade and in the post-2008 scenario prevailing internationally, Indian Rupee was fluctuating substantially against major currencies of the world. The appellant therefore deemed it necessary to make arrangements to hedge its currency risk which might have been caused due to adverse currency movements. Accordingly, as a prudent business practice, the appellant entered into long term option contracts with Axis Bank, Citibank & Standard Chartered Bank. Copies of the option contracts as well as the contract confirmations upon cancellations were filed. On perusal of the option contract dated 13.09.2007 with Axis Bank, it is observed that in the said agreement the Bank expressly stated as follows:*

*"The following structure has been done to hedge your underlying exports. You agree to sign all the relevant documents and provide the details of the underlying.*

*The client acknowledges that AXIS Bank Ltd has explained each element of the transaction and it is a sophisticated investor who has the ability to understand the terms & conditions of transactions and familiarized himself with above terms & conditions and has entered into such a transaction for hedging purposes and not as a speculative activity.*

*The company has suitable and adequate underlying exposures to hedge through the deal and will execute and sign the relevant documents."*

*3. Similar affirmations were there in the agreement with Citibank. The relevant portions of the contract were as follows:*

*" The Transaction has been booked against the exposure referred to below, details of which have been provided by the Counterparty's authorized employees to the Treasury Marketing Officer of Citibank. Party B represents and warrants to Citibank on the date on which it enters into the Transaction that:*

*(i) The underlying exposure for the Transaction is genuine and no cover exists with any other bank and no cover from any other bank will be taken against the same exposure, during the currency of the Transaction with Citibank."*

*From the above, it was evident that the contemporaneous documentary evidences showed that the option contracts were entered into with the Banks being authorized dealers against underlying asset being, export proceeds receivable in foreign currency against export orders in hand and which were to be executed by the appellant during the FYs 2008-09, 2009-10 & 2010-11. It therefore transpired from the transactional documents that the option contracts were specifically entered into to hedge against currency fluctuation risks associated with appellant's export business and it was not as if the assessee had entered into speculative transactions for dealing in foreign currency simplicitor.*

5. *For instance, from the option contracts with Axis Bank & Citibank, it was noted that even though the appellant had entered into option contracts for overall export orders worth Euro 1.2 million and Euro 3.6 million, but the maturity/strike periods were spread over the period beginning from and ending on Sep 2007 to Aug 2008 & Nov 2007 to October 2010 respectively. On attaining the maturity period/strike period, the relevant option contracts were terminated and at the relevant times the banks issued FX contract confirmations, copies of which were furnished both before the Ld. AO as well as if this appellate forum. In these FX contract confirmations, the Banks confirmed as follows:*

*"(b) The underlying exposure for the Transaction is genuine and no cover exists with any other bank and no cover from any other bank will be taken against the same exposure, during the currency of the contract with Citibank.*

*(c) The maturity and the amount of the contract does not exceed the tenor and the amount (or reasonable estimate of the amount where is exact amount is not known) respectively, of the underlying exposure.'*

6. *From the above affirmations by the Banks in the transactional documents, it is quite evident that the appellant-company did not conduct any trading in the foreign currency itself so as to attract provisions of Section 43(5) of the Act. In fact, the extant provisions of FEMA, did not permit the private parties other the Banks and Financial Institutions to conduct proprietary trading in foreign currency. Under the relevant provisions of FEMA, the Indian residents are permitted to enter into forward contracts in foreign currency or option contracts only when they can prove that such transactions are being entered into for the purposes of managing borrowings or investments or for the purpose of hedging the underlying assets or liabilities or in connection with line of business and not otherwise. In the present case, the documents on record establish that the appellant-company was having substantial exposure to international trade. The assessee was regularly exporting and earning income in foreign currencies such as US dollars, Euros, Australian Dollars etc. The export sales turnover for the year was in excess of Rs.110 crores. The appellant was having a continued foreign currency exposure because the appellant had sufficient export orders in hand which were to be executed in the subsequent accounting years as well. Having regard to these underlying facts, it was evident that the assessee had substantial exposure to foreign currency exchange risk since foreign currency market was volatile. It is also revealed from the transactional documents that the assessee was permitted by the Banks to enter*

into forward contracts against foreign currency underlying in the form of export orders which were to be executed during FYs 2008-09, 2009-10 & 2010-11.

7. In support of these facts, the appellant furnished details of currency option contracts vis-a-vis the corresponding details of export orders for which such hedge was obtained. From the details, it appeared that the option contracts which matured and got cancelled were intrinsically connected with the export orders executed by the appellant. For instance, I find that the option contract of EUR 1.2 million with Axis Bank was entered into to hedge the following export orders.

Customer Name	Order No. & Date	Amount (EUR)
Outotec	24524 dt. 05/10/07	7,53,772
Societe Ashanti De Guinee	0D025171 dt 14/09/07	1,02,225
Societe Ashanti De Guinee	0D025170 dt 14/09/07	1,26,153
Societe Ashanti De Guinee	0D024102 dt 26/06/07	45,635
LKAB	301085-00-STFG dt 03/07/07	1,09,880
Biliden Mineral AB	717664/BAKMALI dt. 11/1/07	48,220
TBK	200705.25 dt 24/05/07	36,639
<b>TOTAL</b>		<b>12,22,524</b>

8. The appellant-company has placed on record, copies of the above underlying i.e. the export orders, for which the currency hedge was taken from Axis Bank. Similarly, option contract of EUR 3.6 million with Citibank was entered into to hedge the currency fluctuation risk in respect of the export orders received of equivalent amount from Tega Beruc South Africa Pty Ltd. From these facts, I find that the option contracts which the appellant entered with the Banks were backed by the export orders received by the appellant from its foreign customers in the course of its business of manufacture & export of engineering goods.

9. It further transpired that forward contracts were having different maturity periods. The option contracts were executed in a manner whereby an individual contract's maturity would coincide with the realization of export sale proceeds by the appellant. In support, the appellant furnished details of matured/cancelled option contracts vis-a-vis the details of export proceeds realized correspondingly. From the details furnished, it appears that the option contracts which matured and got cancelled were closely connected with the export realization. For example, on 04.07.2008, the option contract of USD 2,00,000. Prevailing equivalent was to mature at a strike price of Rs.40.25/\$. In the same month, the appellant had export realization of USD 2,00,000. Prevailing exchange rate at which the monies were actually received was Rs.43.23/\$. Since the export realization was made @ 43.23, the same was included in the export sales value and was credited in the Profit & Loss Account as "export sales". Since the assessee realized higher exports value in Indian rupees, compared with the rate at which the option was booked i.e. Rs.40.25/\$. Upon cancellation, the appellant paid option premium of Rs.5,96,000/- to Bank and claimed it as loss arising on cancellation of 'option contract'. It was thus noted that just as the assessee debited loss on cancellation of option contract being premium paid, the appellant accounted the corresponding gain in the form of realization of export proceeds at higher rate.

10. It is also to be observed that a similar pattern emanates in respect of other contracts which were cancelled during the year as well. For example, another option contract of USD 2,00,000 equivalent matured on 05.01.2009. The contracted FX rate was Rs.41.60/\$ whereas the

*prevailing exchange rate at which the monies were actually received was Rs.48.37l\$, Since the prevailing exchange rate was higher than the contracted rate, it was prudent for the appellant-company to realize export proceeds at the prevailing market rate and cancel the option contract.*

*Accordingly, the export realization was made @ Rs.48.37l\$ and the exchange gain realized was included in the export sales value credited in the assessee's Profit & Loss Account. On the other hand, the appellant paid option premium of Rs.13,54,000/- to Bank on cancellation, which was separately claimed as loss arising on cancellation of option contract.*

*11. From the foregoing discussion, it is therefore evident that just as the assessee accounted loss on foreign exchange option contracts to its P&L A/c, the gain which the assessee made by realizing export proceeds at higher exchange rates was credited in its P&L A/c as 'export sales', Instead of disclosing the gain on account of currency fluctuation separately, the gain realized on exchange fluctuation was credited in the P&L A/c under the nomenclature of 'Sales'. The transactional documents therefore clearly supported the contentions of the Ld. A.Rs that the option contracts which the appellant had entered into were connected intrinsically with assessee's business of export of industrial goods and the transactions were not in foreign currency simplicitor as alleged in the assessment order.*

*12. The issue as to whether the loss incurred by an assessee in foreign currency forward contracts or option contracts executed against underlying assets in the form of foreign currency receivables or payables has engaged attention of various judicial forums for long. In international trade, obtaining foreign currency forward contracts or entering into foreign currency derivatives is a standard business practice which is resorted to guard against likely losses arising from adverse exchange rate fluctuations. The Hon'ble jurisdictional Calcutta High Court had considered this issue in the case of **CIT Vs Soorajmull Nagarmull (129 ITR 169)**. In that case the assessee firm was carrying on business of export and import of jute goods. With a view to hedge its international trade, the assessee executed foreign exchange forward contracts which were partly used against the imports made and the unutilized contracts were cancelled and by paying the difference. The AO disallowed the loss incurred on cancellation on the ground that such loss was speculative loss since the contract was settled otherwise than by delivery. On these facts the Hon'ble High Court held as follows:*

*“The point upon which learned advocate for the revenue stressed was that, even there, there was a breach of contract for non-performance of the contract; as in this case, in the sense that the contract or the right to use up to 1,00,000, but the assessee had utilised only 55,000 and the assessee did not wish or did not want to utilise the remaining portion of the bargain for foreign exchange, such a loss was a speculative loss under Section 24, Explan. 2 of the Indian I.T. Act, 1922, and would be referable only to speculative transaction and cannot be treated as a loss in carrying on the assessee's business to be set off as a revenue loss. Though this Explan. 2 in Section 24 of the Indian I.T. Act, 1922, has been considered in several decisions it would be necessary to set out this Explanation. Before we do so it is necessary to bear in mind that where an assessee under Sub-section (1) of Section 24 sustains a loss of profit or gains in any year under any of the heads mentioned in Section 6, he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year,*

*provided that in computing the profits and gains chargeable under the head " Profits and gains of business, profession or vocation", any loss sustained in speculative transactions which are in the nature of a business shall not be taken into account except to the extent of the amount of profits and gains, if any, in any other business consisting of speculative transactions. Therefore, if the assessee carried on speculative transactions which are in the nature of the business of the assessee then such loss resulting from such speculative loss can be set off against the speculative gains but cannot be set off against other gains. In that context, Explan. 2 defines what is a speculative transaction. The said Explan. 2 is to the following effect:*

*"Explanation 2.--A speculative transaction means a transaction in which a contract for purchase and 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 section,--*

*(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; shall not be deemed to be a speculative transaction. "*

*Here there is no finding that entering into foreign exchange contract was the nature of the business of the assessee. This was only an incidental part of the business operation for the export and import of the goods by the assessee. The assessee was not a dealer in foreign exchange contracts as such. Foreign exchange contracts were only incidental to the assessee's regular course of business. Therefore, all the arguments regarding whether it comes within the Explan.2, in our opinion, is not quite relevant because the loss was not sustained in speculative transactions which are in the nature of the business of the assessee. The AAC had made a categorical finding to this effect in his order which has been upheld by the Appellate Tribunal and that finding of fact has not been in any way challenged in the question referred before us. Learned advocate for the revenue drew our attention to [Section 56](#) of the Contract Act and submitted in aid of his submission that there was an implied term that the assessee might not be able to perform the full extent of the amount covered by the foreign exchange contract. Here, in this case, the contract was for 1,00,000 and what the assessee paid in fulfilment of that obligation which was an implied term at the time of entering into the contract' did not amount to a*

breach of the contract. He referred us to [Section 56](#) of the Contract Act and the decision of the Supreme Court in the case of [Naihati Jute Mills Ltd. v. Khyaliram Jagannath](#) . He specially drew our attention to the observations appearing at p. 825 (of SCR) onwards where undoubtedly the question of liquidated damages arose in the case of non-performance of a breach of contract. [Section 56](#) of the Contract Act itself provides that for bargain and in certain contingencies of non-performance liquidated damages might be provided for in the contract, but the liquidated damages proceed on the basis that the contract has been breached by the conduct of the parties, i. e., the rights of the parties are adjusted in the manner contemplated by the parties at the time of bargain. After considering several other decisions this view was expressed by this court in the case of [CIT v. Pioneer Trading Co. P. Ltd.](#) [1968] 70 ITR 347, where this court held that a claim based on breach of contract did not come within the meaning of " contract settled " as used in Explan. 2 of s, 24(1) of the [Indian I.T. Act](#), 1922. "Contract settled" meant contract settled before breach. After breach of contract, the cause of action was no longer based on the contract itself but on its breach. Where the money which the assessee received was in settlement of the amount of damages suffered by the assessee by reason of breach of the contract to deliver, it was held that the receipt was not a receipt from a speculative transaction as defined in Explan. 2 and the money received was not liable to be set off against speculation loss of earlier years. This view has been consistently followed by this court. Reference may be made to the decision in the case of [CIT v. Ramjeevan Sarawgee & Sons](#) [1977] 107 ITR 845, where this court also considered the decision of the Supreme Court in the case of [Davenport & Co. P. Ltd. v. CIT](#) [1975] 100 ITR 715, on which reliance was placed on behalf of the revenue and it was distinguished. We are in respectful agreement with the observations of Mr. Justice Sen in that case at p. 849 of the report in so far as it distinguished the decision of the Supreme Court in the case of [Davenport & Co. P. Ltd.](#) [1975] 100 ITR 715. We may also refer to the decision of this court in the case of [CIT v. Arun General Industries Ltd.](#) [1977] 110 ITR 286, where all these previous decisions of this court have been noted. Except the Madras High Court in the case of [R. Chinnaswami Chettiar v. CIT](#) [1974] 96 ITR 353, all other High Courts have taken a similar view. The decision of the Supreme Court in the case of [Davenport & Co. P. Ltd.](#) [1975] 100 ITR 715 upon which reliance was placed by learned advocate for the revenue is in our opinion not relevant in view of the nature of the transaction with which we are dealing. Furthermore, in view of the clear finding of the AAC and the Tribunal, we are of the opinion that question No. 1 must be answered in the affirmative and in favour of the assessee.

13. The ratio laid down by the Hon'ble Calcutta High Court in the above case was followed by the Hon'ble Gujarat High Court in the cases of [CIT Vs Panchmahal Steel Ltd](#) (215 Taxman 140) & [CIT Vs Friends & Friends Shipping \(P\) Ltd](#) (217 taxman 267).

14. In a recent judgment rendered by Hon'ble Bombay High Court in the case of [CIT Vs D Chetan & Co.](#) (243 Taxman 356), the Hon'ble Bombay High Court reiterated the same view. In this case, the assessee was engaged in import & export of diamonds and to guard against currency fluctuation risks, the assessee had entered into forward contracts. The assessee incurred loss of Rs.78.10 lacs on cancellation of foreign currency forward contracts and claimed

*deduction in computing its business income which was disallowed by the AO treating it to be speculative in nature as per Section 43(5). On appeal the Bombay High Court held as follows:*

*“The impugned order of the Tribunal has, while upholding the finding of the CIT (Appeals), independently come to the conclusion that the transaction entered into by the Respondent assessee is not in the nature of speculative activities. Further the hedging transactions were entered into so as to cover variation in foreign exchange rate which would impact its business of import and export of diamonds. These concurrent finding of facts are not shown to be perverse in any manner. In fact, the Assessing Officer also in the Assessment Order does not find that the transaction entered into by the Respondent assessee was speculative in nature. It further holds that at no point of time did Revenue challenge the assertion of the Respondent assessee that the activity of entering into forward contract was in the regular course of its business only to safeguard against the loss on account of foreign exchange variation. Even before the Tribunal, we find that there was no submission recorded on behalf of the Revenue that the Respondent assessee should be called upon to explain the nature of its transactions. Thus, the submission now being made is without any foundation as the stand of the assessee on facts was never disputed. So far as the reliance on Accounting Standard-11 is concerned, it would not by itself determine whether the activity was a part of the Respondent-assessee's regular business transaction or it was a speculative transaction. On present facts, it was never the Revenue's contention that the transaction was speculative but only disallowed on the ground that it was notional. Lastly, the reliance placed on the decision in S. Vinodkumar (supra) in the Revenue's favour would not by itself govern the issues arising herein. This is so as every decision is rendered in the context of the facts which arise before the authority for adjudication. Mere conclusion in favour of the Revenue in another case by itself would not entitle a party to have an identical relief in this case. In fact, if the Revenue was of the view that the facts in S. Vinodkumar (supra) are identical / similar to the present facts, then reliance would have been placed by the Revenue upon it at the hearing before the Tribunal. The impugned order does not indicate any such reliance. It appears that in S. Vinodkumar (supra), the Tribunal held the forward contract on facts before it to be speculative in nature in view of Section 43(5) of the Act. However, it appears that the decision of this court in CIT vs. Badridas Gauridas (P) Ltd. was not brought to the notice of the Tribunal when it rendered its decision in S. Vinodkumar (supra). In the above case, this court has held that forward contract in foreign exchange when incidental to carrying on business of cotton exporter and done to cover up losses on account of differences in foreign exchange valuations, would not be speculative activity but a business activity.”*

*15. It is also to be noted that the jurisdictional benches of Hon'ble ITAT, Kolkata considered this issue in few of the cases involving facts similar to the facts involved in the present case. In its decision dated 07.10.2015 in the case of **ITO Vs LGW Limited (ITA No. 267/Kol/2013)**, the Hon'ble ITAT dealt with a case where the forward contract loss arising on cancellation was disallowed by the AO by invoking provisions of Section 43(5). In that case also the assessee, an exporter of cotton yarn had entered into forward contracts to hedge against export orders and on cancellation, the loss incurred was claimed as business loss. This was disallowed by the Ld. AO as speculation loss because in AO's opinion the assessee had entered into transactions in foreign currency which was not permitted. On appeal the Hon'ble ITAT, Kolkata held as follows:*

*“We have considered the rival submissions. We shall as a test case consider one of the contract for export of contract and the forward contract entered into by the Assessee in connection with*

*such export contract. Page 134 of the Assessee's paper book contains the list of contract in which forward contract in Euro currency were booked. KS-0000026 is a forward contract dated 17.7.2008 entered into by the Assessee with State Bank of India Trade Finance CPC, Kolkata. The Assessee had an export order for Indian Raw Cotton of 4409200 LBS of the value of 31,74,624 US \$ equivalent to 10,00,000 Euros, to supply to one M/S.Nassa Spinning Ltd., Bangladesh. The contract was cancelled by HB Cotton who was agent of M/S.Nassa Spinning Ltd., Bangaldesh on 21.10.2008. The period of the contract for supply of cotton to Bangaldesh was upto 22.1.2009. Since the contract was cancelled by communication dated 24.10.2008, the Bank intimated the Assessee that in view of the adverse fluctuation of Euro currency, the Assessee had to bear the loss of Rs.1,56,80,527 because the booking rate as on 17.7.2008 was 1.5711 the cancellation date was 22.1.2009 on which date the rate was 1.2613. Thus the Assessee suffered a loss on the forward contract in question. From the sample case set out above it is clear that the forward contract in question was purely hedging transactions entered into by the Assessee to safeguard against loss arising out of fluctuation in foreign currency. Such transactions have been held in the following cases to be not speculative transactions falling within the ambit of Sec.43(5) of the Act, CIT Vs. Soorajmull Nagarmull (1981) 5 Taxman 289 (Cal), CIT Vs. Badridas Gauridu (P) Ltd., (2004) 134 Taxman 376 (Bom), CIT Vs. Friends and Friends Shipping Pvt.Ltd., Tax Appeal No.251 of 2010 dated 23.8.2011 and CIT Vs. Panchmahal Steel Ltd. Tax Appeal No.131 of 2013 dated 28.3.2013 by the Hon'ble Gujarat High Court. The conclusions of the CIT(A) on this issue, in our view therefore deserve to be upheld. Accordingly, the ground of appeal raised by the revenue in this regard is rejected.”*

16. *The identical issue was considered by yet another coordinate Bench of the Hon'ble ITAT, Kolkata in the case of Jayant Bhura vs ITO (ITA No.901/Kol/2013) dated 29.10.2015 wherein the ITAT had observed as follows:*

*“9. We find from the above facts that the entire basis for disallowance of loss for AO was on the assumption as if ban on export of maize was the sole reason for cancellation of the export orders. He lost sight of the fact that the assessee exported diverse commodities and cancellation of export orders took place not only because of ban on export of maize but also because of global recession and world-wide slow down. Admittedly, the assessee had Shipped part quantities against several of the export orders and the exports proceeds were converted at the forward contract rate. Since the buyers did not open the letters of credit and thus cancelled the balance quantity, the assessee had no other alternative but to cancel the forward contracts to the extent unutilised. The assessee had the option to convert the export proceeds at the rate stipulated in the forward contract or alternatively at the spot market rate. In the latter case, the forward contract had to be cancelled. As a prudent businessman, in respect of export proceeds of US\$ 31,15,167.41, the assessee opted for conversion at the spot market rate instead of the rate stipulated in forward contracts of the value of US\$ 28,00,000. The option exercised by the assessee resulted in higher export realization to the extent of Rs.1,35,11,357. Additionally, the assessee was able to obtain higher export incentives by way of drawback, OEPB, etc. with reference to the higher export realization. Such forward contracts for US\$ 28,00,000 were consequently cancelled but the higher export realisation to the extent of Rs.1,35,11,357 and the higher export incentives went to offset the loss arising from such cancellation. To minimize the loss, the assessee took the spot rates which were more beneficial instead of conversion as per forward contract rates. Relevant details in this behalf are furnished in a statement annexed to the paper book of the assessee. Even, copies of the relevant export orders are included in the paper book. Due to cancellation of the forward contracts partially or fully, the assessee had to pay the*

*difference between the contract rate and the market rate to the bank. Such payment was a business loss incurred by the assessee in course of its export business and is Jayant Kr. Bhura AY 2000-10 an allowable deduction. The assessee had filed before the AO copies of all the 16 material export orders in the forward contracts relating to which loss of Rs.3,78,44,872/- was incurred in support of his contention that forward contracts were made on the basis of export orders in hand. The purported findings of the AO that the assessee had not submitted the export orders or that forward contracts were booked without having export orders in hand are contrary to the record. The assessee has since obtained from the AO certified copies of the export orders filed by him in course of the assessment proceedings which bear out the assessee's contention. Even AO has not correctly prepared Annexures A and B to the Assessment order as he has omitted to incorporate in the said Annexures the details of the export orders in respect of which the forward contracts were booked. As such, the Bank in its response to the AO, stated that the forward contracts were booked based on past performance but simply because the assessee did not submit copies of the export orders to the Bank does not mean that the assessee did not in fact have the export orders in hand. As against export orders of US\$ 2,16,08,278, the assessee had entered into forward contracts only for US\$ 1,00,70,000. Due to market conditions, such forward contracts could be utilised only to the extent of US\$ 53,32,334.34 and the remaining contracts for US\$ 47,37,665.66 had to be cancelled. We further observed that the findings of the AO that the assessee dealt in forward contracts or that it was an independent business are without any basis. Indisputably, the assessee is in export business. The booking of forward contracts in foreign exchange is a normal and necessary incident of the export business. This position is also borne out from the RBI circular. The forward contracts were booked to hedge the assessee's exposure to exchange risk in his export business as permitted by the RBI. The loss arising to the assessee upon cancellation of the forward contracts was referable to and related to the assessee's export business and arose out of the export business. The booking of forward contracts was not the assessee's business. It was not permissible for the assessee to carry on any business in forward contracts in foreign exchange. The AO also admitted that the forward contracts were made by the assessee in accordance with RBI guidelines. The AO and CIT(A) were wholly unjustified in treating the business loss as speculative in nature.*

*10. This issue is now covered by the judgment of the Hon'ble Calcutta High Court in CIT v Soorajmull Nagarmull, (1981) 129 ITR 169 (Cal), wherein the assessee was a firm Jayant Kr. Bhura AY 2000-10 engaged in the business of import and export of jute and in course of business, the assessee would enter into forward contract in foreign exchange in order to cover the loss which may arise due to difference in foreign exchange valuation. In one such contract, the assessee had to pay to the Bank difference of Rs.80,491/- which was claimed by the assessee as revenue expenditure. The Assessing Officer disallowed the claim. The Hon'ble High Court held that the assessee was not a dealer in foreign exchange and the foreign exchanges were only incidental to the assessee's regular course of business and the loss was thus not a speculative loss but incidental to the assessee's business and allowable as such. Facts in the present case are very similar. Admittedly, the assessee is not a dealer in foreign exchange. For the purpose of hedging the loss due to fluctuation in foreign exchange while implementing the export contracts, the assessee had entered into forward contract with the banks. In some cases, the export could not be executed and the assessee had to pay certain charges to the Bank and thereby incurred certain expenses. These expenses the assessee claimed by way of expenditure towards business. Accordingly, Hon'ble High Court held that the transaction can be stated to be in speculation as to cover under sub-section (5) of section 43 of the Act.*

11. Further, this issue is also covered by the judgment of Hon'ble Bombay High Court in *CIT v Badridas Gauridu (P) Ltd.*, (2003) 261 JTR 256 (Bom), wherein, the judgment of the Hon'ble Calcutta High Court was followed. To quote from the judgment of the Hon'ble Bombay High Court (at pages 257-8 of 261 HR) : "The assessee was not a dealer in foreign exchange. The assessee was a cotton exporter. The assessee was an export house. Therefore, foreign exchange contracts were booked only as incidental to the assessee's regular course of business. The Tribunal has recorded a categorical finding to this effect in its order. The Assessing Officer has not considered these facts. Under section 43(5) of the Income-tax Act, "speculative transaction" has been defined to mean a transaction in which a contract for the purchase or sale of a commodity is settled otherwise than by the actual delivery or transfer of such commodity. However, as stated above, the assessee was not a dealer in foreign exchange. The assessee was an exporter of cotton. In order to hedge against losses, the assessee had booked foreign exchange in the forward market with the bank. However, the export contracts entered into by the assessee for export of cotton in some cases failed. In the circumstances, the assessee was entitled to claim deduction in respect of Rs. 13.50 lakhs as a business loss. This matter is squarely covered by the judgment of the Calcutta High Court with which we agree, in the case of *CIT Vs. Sooraj Mull Nagarmull (1981) 129 ITR 169.*"

12. In view of the above facts and circumstances of the case, we are of the view when the assessee is not a dealer in foreign exchange but an exporter of commodities and *Jayant Kr. Bhura AY 2000-10* assessee had entered into forward contracts with banks in respect of foreign exchange but some of these contracts could not be honoured by the assessee for which it has to pay and which was debited to the P&L Account and claimed the same as business loss/hedging loss. In order to hedge against losses, the assessee had booked foreign exchange in the forward market with the bank but the export contract entered into by the assessee for export of commodities in some cases failed, the assessee is entitled to claim for deduction of loss as a business loss. Accordingly, respectfully following Hon'ble jurisdictional High court in the case of *Soorajmull Nagarmull, supra*, we allow the claim of the assessee. This issue of assessee's appeal is allowed."

17. On a careful perusal of these judgments and taking into account the facts narrated in the foregoing, I find that the ratio laid down in the above decisions is squarely applicable to the appellant's case. As per the transactional documents, it was evident that the assessee had entered into foreign exchange option contracts to guard against exchange fluctuation risks associated with realization of export sale proceeds. In the option contracts the Bank categorically stated that the contracts were entered into against underlying in form of export orders. The evidence on record also establish that during the contractual period when the options matured, the appellant had executed expoft orders and also export proceeds were realized. Export sales were realized at the exchange rates prevailing at the time of realization. The export sales realization was made at exchange rates higher than contracted rates with Banks and therefore the assessee had opted to realize the export value at the prevailing rates instead of the option rates. The higher realization of exports was credited in the P&L A/c in the form of export sales. However, upon termination of option, the assessee settled the contracts by paying the premium & claimed it as loss on option contracts. These transactional documents therefore lead only to one conclusion i.e. the option contracts were directly and intimately connected with assessee's business of manufacture & export of industrial products. The option contracts were entered into by the appellant to guard against adverse consequences arising from exchange fluctuation risks and there was no intention on the assessee's part to deal in foreign currency simplicitor. In view of these facts which are

*apparent from the materials & documents available on record, I have no hesitation in holding that the loss had occurred in the course of assessee's business and the same was allowable in computing business income. The Ld.AO is accordingly directed to allow the deduction for loss of Rs.4,74,97,275/-. As a result, the ground stands allowed."*

21. Aggrieved by the order of the CIT(A), the Revenue is in appeal before us.

22. We have heard both the parties and perused the materials available on record. The ld. AR has supported the order of ld. CIT(A). On the other hand, the ld. DR for the Revenue has primarily reiterated the stand taken by the Assessing Officer which we have already noted in our earlier para and the same is not being repeated for the sake of brevity. We note that the currency option contracts were executed by the assessee with the sole purpose of hedging the export receivables & import payables. Therefore, the ld CIT(A) has rightly held that the loss of Rs.4,74,97,275/- incurred in such option currency contracts was non-speculative in nature and allowable as deduction from the profits of the business. That being so, we decline to interfere with the order of Id. C.I T.(A) in deleting the aforesaid additions. His order on this addition is, therefore, upheld and the grounds of appeal of the Revenue are dismissed.

23. Now we shall take Cross-objections filed by the assessee in C.O No.31 to 33/Kol/2019. The solitary grievance of the assessee in these Cross Objections are that the ld. Assessing Officer as well as ld. CIT(A) has erred in not allowing deduction of the amount of education cess debited in the books of accounts of the company.

24. These cross objections filed by the assessee is barred by limitation by 598 days. The Assessee has moved a petition requesting the Bench to condone the delay. We have heard both the parties on this preliminary issue. Having regard to the reasons given in the petition, we condone the delay and admit these cross objections filed by assessee.

25. After giving our thoughtful consideration to the submissions of the parties and perusing the judicial decisions relied upon by the ld. Counsel for the assessee. We note that the education cess is allowable for deduction u/s 37(1) of the Act. For this, we rely on the judgment of the Coordinate Bench of ITAT Kolkata in the case of ITC Limited vs. ACIT in ITA No.685/Kol/2014, for A.Y.2009-10, order dated 27.11.2018 wherein it was held as follows:

*“12. The assessee’s additional last/ substantive ground avers that it is entitled for the education secondary higher education cess as overhead deduction amounting to Rs. 423618317.0 u/s 37 of the Act. We note that hon’ble Rajasthan high court’s decision in DB Income Tax Appeal No. 52/Kol/2018 M/s Chambal Fertilizers Ltd. vs. DCIT decided on 31.07.2018 takes into account CBDT circular dated 18.05.1967 for holding such cess(es) to be allowable as deduction. Their lordships hold that section 40a(ii) applies only on taxes such than earn cess(es). We therefore reject the Revenue’s contentions supporting the impugned disallowance . The assessee’s instant substantive ground is accepted. The Assessing Officer is direction to verify all the relevant facts and allow the impugned cess (es) as deduction u/s 37 of the Act. The assessee’s appeal I.T.A. No. 685/Ko/2014 is partly accepted in above terms.”*

However, the ld. DR for the Revenue submitted before the Bench that the Income Tax Appellate Tribunal (ITAT), Kolkata in the case of Srei Infrastructure Ltd, in ITA No.1302/Del/2012 and ITA No.1318/Del/2012, for A.Y. 2008-09, order dated 27.02.2019 held that the education cess is not allowable expenditure under section 37(1) of the Act. On appeal by assessee, the Hon’ble High Court of Calcutta, vide ITAT No.121 of 2019, order dated 08.08.2019, has remanded the matter back to the ITAT Kolkata to reconsider the issue. Hence there is no contrary view on this issue which survive as on date. Therefore, respectfully following the judgment of this Coordinate Bench in the case of ITC Limited (supra), we allow the claim of the assessee.

26. In the result, the Cross Objections filed by the assessee (in C.O No.31,32,33/Kol/2019) are allowed.

27. In the result, appeals filed by the Revenue ( ITA Nos. 1047, 1048 and 1049) are dismissed and Cross objections filed by the assessee ( In CO Nos. 31, 32 and 33) are allowed.

Order pronounced in the open court on this 31/10/2019.

**Sd/-**  
**(A.T. Varkey)**

न्यायिक सदस्य / JUDICIAL MEMBER

**Sd/-**  
**(A. L. Saini)**

लेखा सदस्य / ACCOUNTANT MEMBER

कोलकाता /Kolkata;

Dated: 31/10/2019

RS, Sr.PS

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

1. अपीलार्थी / The Appellant- DCIT, Circle-12(2), Kolkata
2. प्रत्यर्थी / The Respondent.- M/s. Tega Industries Ltd.
3. आयकर आयुक्त(अपील) / The CIT(A), Kolkata.
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, कोलकाता / DR, ITAT, Kolkata
6. गार्ड फाईल / Guard file.

//True Copy//

By Order

Assistant Registrar,  
I.T.A.T, Kolkata Benches,  
Kolkata.