



IN THE INCOME TAX APPELLATE TRIBUNAL

"F" BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY, JUDICIAL MEMBER AND
SHRI MANOJ KUMAR AGGARWAL, ACCOUNTANT MEMBER

ITA no.2578/Mum./2018
(Assessment Year : 2012-13)

UNI Design Jewellery Pvt. Ltd.
Plot no.4-5-6, UNI Design
SEEPZ, Andheri (East)
Mumbai 400 056
PAN - AAACU0572G

..... Appellant

v/s

Dy. Commissioner of Income Tax
Central Circle-9, Mumbai

..... Respondent

Assessee by : Shri Anuj Kisnadwala
Revenue by : Shri Sushil Kumar Poddar

Date of Hearing - 10.10.2019

Date of Order - 30.12.2019

ORDER

PER SAKTIJIT DEY, J.M.

The captioned appeal has been filed by the assessee challenging the order dated 20th February 2018, passed by the learned Commissioner of Income Tax (Appeals)-48, Mumbai, pertaining to the assessment year 2012-13.

2. In ground no.1, the assessee has challenged the disallowance of loss of foreign currency forward contract amounting to ₹ 39,02,500.

3. Brief facts are, the assessee, a resident company, is engaged in the business of manufacture and export of jewellery. For the aforesaid activity, the assessee has set-up three units located in SEEPZ, Mumbai. A search and seizure operation under section 132 of the Income Tax Act, 1961 (for short "*the Act*") carried out on the assessee on 8th August 2011. Pursuant to such search and seizure operation, proceedings under section 153A of the Act were initiated against the assessee by issuing a notice on 21st September 2012. In response to the said notice, the assessee filed its return of income on 7th December 2012, declaring total income of ₹ 55,09,485. During the assessment proceedings, the Assessing Officer noticed that the assessee has claimed loss of ₹ 39,02,500, on account of cancellation of foreign currency forward contract. In response to the query raised by the Assessing Officer, the assessee submitted that since the assessee has entered into foreign currency forward contracts to hedge against the fluctuation in price of foreign currency towards payable and receivables against imports and exports, the loss arising on cancellation of foreign currency forward contract is allowable as business loss. In support of such contention, the assessee relied upon certain judicial precedents. The Assessing Officer, however, did not find merit in the submissions. The Assessing Officer observed, the assessee failed to demonstrate that the foreign currency forward

contracts are linked to any specific export or import transaction so as to treat them as hedging transactions. He observed, the assessee failed to furnish any evidence to establish one-to-one linkage between the foreign currency forward contracts and the underlying import or export transaction. Thus, he held that purchase and sale of diamond and the forward contracts are two separate and distinct transactions independent of each other. Therefore, he treated the loss arising from cancellation of foreign currency forward contract as speculation loss under section 43(5) of the Act and disallowed claim of set-off against the business profit. The assessee challenged the aforesaid disallowance before the first appellate authority.

4. Learned Commissioner (Appeals) upheld the disallowance by more or less agreeing with the reasoning of the Assessing Officer. The learned Commissioner (Appeals) observed, the assessee was unable to establish the linkage between the purchase and sale of diamond/jewellery with the specific hedging contracts. She observed, merely because the exposure in the international market was of higher value than the amount of forward contract, the transaction cannot be treated as hedging transaction. Referring to the proviso to section 43(5) of the Act, she observed, exception is available only to the contracts in the nature of guard against loss through future price

fluctuation. She observed, unless the assessee proves that foreign currency forward contracts are held as a guard, the claim of loss is not allowable. Further, she observed, the decision of the Tribunal in assessee's own case in assessment year 2003-04 would be of no help as in the facts of that case, linkage between the forward contracts and import/export transaction were established. Thus, on the aforesaid reasoning, she upheld the decision of the Assessing Officer.

5. The learned Authorised Representative submitted, foreign currency forward contracts entered into by the assessee are only for hedging the loss arising in payables and receivables in foreign currency with regard to import and export transactions. He submitted, foreign currency forward contracts entered into by the assessee are much lesser than the actual underlying exposure. He submitted, the aforesaid fact clearly demonstrates that foreign currency forward contracts are in the nature of hedging transaction to guard against the anticipated loss due to fluctuation in foreign currency. He submitted, now it is fairly well settled that to prove the foreign currency forward contract as hedging transaction, the assessee need not establish one-to-one linkage with export or import transaction. In this context, he relied upon the following decisions:-

i) CIT v/s D. Chetan & Co., [2017] 380 ITR 36 (Bom.); and

ii) DCIT v/s Mahendra Bros. Exports Pvt. Ltd., [2016] 161 ITD 772 (Mum.).

6. The learned Authorised Representative, drawing our attention to the CBDT Circular no.23D(xxxix), dated 12th September 1960, submitted, it clearly says that hedging sales can be taken to be genuine only to the extent the total of such transactions does not exceed the total cost of raw materials or merchandise in hand. Thus, he submitted, since the foreign currency forward contracts are far lesser than the underlying exposure in foreign market, there is no reason to consider them as speculative transaction so as to disallow assessee's claim of business loss. Further, the learned Authorised Representative submitted, while deciding identical issue in assessee's own case in assessment years 2003-04, 2008-09 and 2009-10, the Tribunal has taken a favourable view and has allowed the claim of loss by reversing the decision of the Revenue authorities in treating them as speculative transaction. In support, he drew our attention to the relevant observations of the Tribunal in these orders.

7. The learned Departmental Representative strongly relying upon the observations of the Assessing Officer and learned Commissioner (Appeals) submitted, unless the assessee is able to establish one-to-one linkage between the foreign currency forward contracts and the underlying import and export transactions, they cannot be treated as

hedging transaction. Drawing our attention to section 43(5) r/w its proviso, he submitted, linkage of hedging contract with actual exposure has to be established to come out of ambit of speculative transaction. He submitted, assessee's claim of hedging loss was allowed in assessment year 2003-04 as the linkage between the forward contract and actual exposure was established which is not the case in the impugned assessment year. Therefore, assessee's claim has been rightly disallowed.

8. We have considered rival submissions and perused the material on record. We have also applied our mind to the decisions relied upon. It is evident, assessee's claim of loss arising out of foreign currency forward contract has been denied/disallowed by the Assessing Officer and learned Commissioner (Appeals) for the primary reason that the assessee had failed to establish one-to-one linkage between the forward contracts and the underlying export/import transactions. However, it is a fact on record that the assessee is engaged in the business of import of raw material and export of jewellery for which it has set-up units in special economic zone. Therefore, the fact that the assessee undertakes transaction in foreign currency is beyond doubt. It is the claim of the assessee that to guard against loss arising due to fluctuation in the price of foreign currency towards payables and

receivables, the assessee has entered into hedging through forward contracts. From the facts on record, it is further evident that the foreign currency forward contracts held by the assessee are far lesser than the underlying exposure on account of imports and exports. The Hon'ble Jurisdictional High Court in CIT v/s D. Chetan & Co., has held that hedging transaction entered in regular course of business activity cannot be treated as speculative transaction. The Co-ordinate Bench in Mahendra Brothers (supra), has held that it is not required by the assessee to establish a one-to-one linkage between the forward contracts and the export/import transaction. What is required to look at is, whether the amount of hedging transaction is within the amount of underlying transaction of imports and export. In fact, CBDT circular no. 23D (xxxix), dated 12th September 1960, also says that hedging transaction can be taken to be genuine if the total of such transaction does not exceed the total cost of raw material or merchandise in hand. In fact, in assessee's own case for the assessment year 2003-04, the Tribunal in ITA no.8804/Mum./2004, dated 30th October 2009, has allowed assessee's claim of loss resulting from cancellation of forward contract in foreign exchange by treating it as genuine business loss. The same view was expressed by the Tribunal while deciding the issue in the assessment year 2008-09 in ITA no.4341/Mum./2016, dated 2nd July 2018. In the latest order passed for the assessment year 2009-

10, in ITA no.2577/Mum./2018, dated 19th August 2019, the Tribunal reiterating the view taken by it earlier has allowed assessee's claim of loss. In fact, a perusal of the order passed by the Tribunal in assessee's own case in the assessment year 2009-10, as referred to above, would reveal that the reasoning on the basis of which learned Commissioner (Appeals) has disallowed assessee's claim of business loss arising out of foreign currency forward contract is identical to the reasoning of learned Commissioner (Appeals) while disallowing assessee's claim of loss in respect of hedging contract in the impugned assessment. Therefore, considering the overall facts and circumstances of the case in the light of the decisions relied upon and more particularly, the consistent view taken by the Tribunal in assessee's own case for the assessment year 2003-04, 2008-09 and 2010-11 on identical issue, as referred to above, we hold that loss arising on cancellation of foreign currency forward contracts cannot be treated as speculative loss under section 43(5) of the Act. Accordingly, we allow assessee's claim of loss. This ground is allowed.

9. In grounds no.2 and 3, the assessee has challenged the additions/disallowances made of ₹ 3,70,237 and ₹ 4,49,017, under section 69A and 69B of the Act respectively.

10. Brief facts are, during the search and seizure operation in the business premises of the assessee, stock of diamond, gold, platinum, silver and palladium was found physically and were valued through a Government approved valuer. On the basis of such valuation certain discrepancies were found in the physical stock and stock as per books as on the date of search and seizure operation. In the course of assessment proceedings, the Assessing Officer called upon the assessee to reconcile the aforesaid difference. In response to the query raised by the Assessing Officer, the assessee furnished a chart reconciling the difference between the physical stock and stock as per books for each category of goods with some supporting evidence. However, even on the basis of reconciliation chart furnished by the assessee, some minor difference arose which the assessee tried to explain to be on account of weighing. However, the Assessing Officer was not convinced with the explanation of the assessee as he observed that the assessee uses latest technology with high precision and accuracy, hence, there cannot be any weighing difference. He further observed that the assessee has not taken the plea of such weighing difference at the time of search. Therefore, in respect of excess physical cost, the Assessing Officer made addition of ₹ 4,49,017, as unexplained investment under section 69B of the Act and where there was shortage in physical stock, the Assessing Officer

treated them as out of book sales and made addition of ₹ 3,70,237, under section 69A of the Act. The assessee challenged the aforesaid additions before the learned Commissioner (Appeals) without any success.

11. Reiterating the stand taken before learned Commissioner (Appeals), the learned Authorised Representative submitted, the difference arising after the reconciliation is very minor difference which could be due to the weighing and the custom allowed loss which was taken on an estimate basis. He submitted, no addition/disallowance should have been made by the Assessing Officer either under section 69A or 69B of the Act on account of such difference. He submitted, the valuation of loss made on the date of search is also without any basis as loss cannot be valued on a particular day. Without prejudice, the learned Authorised Representative submitted, even if there is a minor difference in stock, the addition, if any, can be made by applying the gross profit rate.

12. The learned Departmental Representative strongly relying upon the observations of the Assessing Officer and learned Commissioner (Appeals) submitted that the difference in stock was established on record as the assessee was unable to reconcile the difference with valid explanation. Therefore, the additions made should be sustained.

13. Having considered rival submissions, we are of the view that the assessee was unable to reconcile the difference between the physical stock and the stock as per books of account with valid reasoning. Therefore, to that extent, the facts are established. However, we find merit in the alternative plea of the assessee for restricting the addition to the gross profit. The Assessing Officer is directed to compute the disallowance accordingly. Grounds are partly allowed.

14. In the result, assessee's appeal is partly allowed.

Order pronounced in the open Court on 30.12.2019

Sd/-
MANOJ KUMAR AGGARWAL
ACCOUNTANT MEMBER

Sd/-
SAKTIJIT DEY
JUDICIAL MEMBER

MUMBAI, DATED: 30.12.2019

Copy of the order forwarded to:

- (1) The Assessee;
- (2) The Revenue;
- (3) The CIT(A);
- (4) The CIT, Mumbai City concerned;
- (5) The DR, ITAT, Mumbai;
- (6) Guard file.

Pradeep J. Chowdhury
Sr. Private Secretary

True Copy
By Order

Assistant Registrar
ITAT, Mumbai