

आयकर अपीलिय अधिकरण, "बी" न्यायपीठ, चेन्नई
IN THE INCOME-TAX APPELLATE TRIBUNAL 'B' BENCH, CHENNAI
श्री रमित कोचर, लेखा सदस्य एवं श्री धुव्वुरु आर.एल रेड्डी, न्यायिक सदस्य के समक्ष
Before Shri Ramit Kochar, Accountant Member &
Shri Duvvuru R.L. Reddy, Judicial Member

आयकर अपील सं./I.T.A. No. 2642/Chny/2019
निर्धारण वर्ष/Assessment Year: 2012-13

The Deputy Commissioner of
Income Tax,
Corporate Circle 3(1),
Chennai 600 034.

M/s. TANFAC Industries Limited,
Vs. No. 66, Oxford Centre, 1st Floor,
Sir C P Ramaswamy Road,
Alwarpet, Chennai 600 018.
[PAN:AACT2591A]

(अपीलार्थी /Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से / Appellant by : Shri Guru Bashyam, Addl. CIT
प्रत्यर्थी की ओर से/Respondent by : Shri R. Vijayaraghavan, Advocate
सुनवाई की तारीख/ Date of hearing : 25.11.2019
घोषणा की तारीख /Date of Pronouncement : 26.12.2019

आदेश /O R D E R

PER DUVVURU RL REDDY, JUDICIAL MEMBER:

This appeal filed by the Revenue is directed against the order of the Id. Commissioner of Income Tax (Appeals) 7, Chennai dated 28.06.2019 relevant to the assessment year 2012-13. The effective ground raised in the appeal of the Revenue is that the Id. CIT(A) has erred in deleting the addition made towards hedging expenditure of ₹.3,52,72,000/- while releasing premium for the forex cover.

2. Brief facts of the case are that the assessee has filed its return of income for the assessment year 2012-13 dated 28.09.2012 declaring loss of

₹.22,90,55,703/-. Subsequently, a revised return was filed on 03.03.2014 admitting a loss of ₹.23,07,13,703/-. The case of the assessee was selected for scrutiny. After considering the details furnished by the assessee against statutory notices and other submissions, the Assessing Officer completed the assessment under section 143(3) of the Act by determining the loss at ₹.19,29,14,962/- after making various disallowances.

3. With regard to the deletion of the addition towards forex fluctuation and forward premium, from the submissions of the assessee, the Assessing Officer noticed that the assessee has hedged their outstanding forex liability of USD 86.33 lacs. The difference between the purchase and hedging rate was booked as exchange fluctuation as on 31.03.2012 and the cost of such hedging was ₹.3,52,72,000/-. The total forex fluctuation expenditure of the assessee amounted to ₹.4,45,32,000/-. The Assessing Officer observed that the assessee hedged the fluctuation by fixing the price of its receivables, payments and ECB loan repayments. It was further observed that out of the total forex fluctuation of ₹.4,45,32,000/- an amount of ₹.3,52,72,000/- was spent on the premium for the forex cover. Since the expenditure on hedging was not allowable expenditure, the Assessing Officer disallowed the same and brought to tax. On appeal, by following the decision of the Tribunal in the case of SCM Garments (P) Ltd. v. DCIT [2015] 59 taxmann.com 395, the Id. CIT(A) has held that the disallowance is liable to be deleted and accordingly allowed the ground raised by the assessee.

4. The Revenue is in appeal before the Tribunal. The Id. DR has submitted that there was no actual delivery taken place and thus, the transactions in question fall within the definition of speculative transaction as per section 43(5) of the Act. It was further submission that the forex derivative transactions carried on by the assessee through Banker as Over the Counter Transactions (OTC) and not through a recognized stock exchange are also covered by proviso (d) to section 43(5) when the preconditions laid by the Explanation to the said proviso is not satisfied to constitute it as an eligible transaction and pleaded for reversing the findings of the Id. CIT(A).

5. Per contra, the Id. Counsel for the assessee has submitted that the assessee has entered into forex derivative transactions through its bankers and these transactions are not speculative nature because they are transacted in the normal course of business to hedge the loss from depreciation of rupee against purchase of raw materials under different contract in foreign currency, which is in accordance with the regulations laid down by the Reserve Bank of India (RBI). Hence, it is not a transaction as stipulated under section 43(5) (a) of the Act. By filing the exchange fluctuation working for outstanding as on 31.03.2012 along with notes forming part of accounts containing details of foreign currency exposure which are not hedged as on 31.03.2012, etc. and placing reliance on the decision of the Hon'ble Supreme Court in the case of CIT v. Woodward Governor India (P) Ltd. 312 ITR 254 (SC), the Id. Counsel for

the assessee strongly supported the order passed by the Id. CIT(A) and prayed for its confirmation on this issue.

6. We have heard both the sides, perused the materials available on record and gone through the orders of authorities below. Out of the total expense of ₹.4,45,31,851/- claimed under the head "Expenses on account of fluctuation in exchange rates", the Assessing Officer disallowed ₹.3,52,72,000/- by observing that the said sum was spent on the premium for the forex cover and such hedging expenses are not allowable. By filing audited annual report, it was the submission before the Id. CIT(A) that the above expenses disallowed by the Assessing Officer was not a premium paid but loss due to difference between the forward cover spot rate and rate on the date of accounting the import bill. It was also explained the ways in which the forex fluctuation was computed against the transactions and the same are reproduced as under:

- (i) For hedged transactions, difference between forward cover spot rate and the exchange rate at the time of import bill accounting.
- (ii) For outstanding import bills without forward cover, the difference between closing rate (exchange rate as on the last day of the financial year) and the exchange rate at the time of import bill accounting.

Before the Id. CIT(A), the assessee has submitted that it has provided the breakup of its claim before the AO vide their submission dated 12.03.2015, which was not considered by the Assessing Officer before concluding the assessment and by ignoring the same the Assessing Officer disallowed the exchange loss on forward contract and exchange loss on outstanding import bills holding that the said amounts were spent towards premium in respect of

forward contract, where expenditure on hedging was not to be allowed. After considering the submissions of the assessee and by following the decision in the case of SCM Garments (P) Ltd. v. DCIT (supra), the Id. CIT(A) held that the disallowance is liable to be deleted and this ground stands allowed by passing two sentence order.

7. One of the methods to protect loss against foreign currency fluctuation is by way of 'hedging'. Hedging transactions are entered in order to protect against the loss due to compensatory price movement. It protects an asset or liability against fluctuation in foreign exchange rate. One of the tools for hedging the forex risk is by way of foreign currency derivatives. Section 45 of the Reserve Bank India Act, 1949 defines derivative as a financial instrument whose value depends on the value of the underlying exposures. In the case before us, the underlying exposure is the foreign currency. The commonly used forex derivatives are Forward contracts, Options contracts and Swap contracts. These instruments are used to hedge the currency risk on account of adverse currency movements. In the present case before us it was not emanating from the assessment order as to what was the derivative used by the assessee to hedge its foreign exchange risk. Moreover, the Assessing Officer has not given any reason for treating the hedging expenses as a non allowable expense.

8. As per the Instruction No.03/2010 dated 23.03.2010, the CBDT has recognized the loss out of forex derivatives on actual settlement/ conclusion of contracts as allowable business loss. However, they have directed the Revenue

to examine whether the transactions would fall under section 43(5)(d) of the Act, and if so to treat the same as non-speculative transaction. By the above directions, it appears that though the CBDT has recognized the loss arising out of forex derivatives on actual settlement of the contracts, directed the Revenue to treat the same as speculative transaction when they are transacted through nationalized banks and as not speculative, when these transactions are transacted through recognized stock exchange. Moreover, as per proviso (a) to sub-section 5 of section 43 of the Act, the legitimate contract entered to guard against the loss that may arise through future price fluctuations cannot be treated as speculative transactions and are to be treated as regular business expense. Since the bankers act as an advisory agent to the assessee in order to protect them from foreign exchange exposure by using their expertise and these services cannot be obtained by the assessee in the stock exchange where their scope of service is very limited, the Tribunal has consistently allowing the transactions carried out through recognized bank. In the present case, it is also not clear from the orders of authorities below as to whether the assessee has transacted through recognized bank or not.

9. However, no details such as, number of contracts, nature of the contract, details of forward contract entered into, banker details, currency details, another party willing to take a reverse position, which is a pre-requisite of a forward contract, etc. are brought on record while making the disallowance by the Assessing Officer or any relevant detail exists in the appellate order while the

Id. CIT(A) held that the disallowance is liable to be deleted. Accordingly, we set aside the order of the Id. CIT(A) and direct the Assessing Officer to pass detailed speaking order by giving all details and valid reason for treating the hedging expenses as a non-allowable expense by affording an opportunity of being heard to the assessee.

10. In the result, the appeal filed by the Revenue is allowed for statistical purposes.

Order pronounced on the 26th December, 2019 at Chennai.

Sd/-
(RAMIT KOCHAR)
ACCOUNTANT MEMBER

Sd/-
(DUVVURU RL REDDY)
JUDICIAL MEMBER

Chennai, Dated, the 26.12.2019

Vm/-

आदेश की प्रतिलिपि अग्रेषित/Copy to: 1. अपीलार्थी/Appellant, 2. प्रत्यर्थी/Respondent, 3. आयकर आयुक्त (अपील)/CIT(A), 4. आयकर आयुक्त/CIT, 5. विभागीय प्रतिनिधि/DR & 6. गार्ड फाईल/GF.