

आयकर अपीलीय अधिकरण “सी” न्यायपीठ चेन्नई में।
IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH, CHENNAI

माननीय श्री महावीर सिंह, उपाध्यक्ष एवं
माननीय श्री मनोज कुमार अग्रवाल, लेखक सदस्य के समक्ष।
BEFORE HON’BLE SHRI MAHAVIR SINGH, VP AND
HON’BLE SHRI MANOJ KUMAR AGGARWAL, AM

आयकर अपील सं. ITA No.485/Chny/2023
(निर्धारण वर्ष / Assessment Year: 2009-10)

DCIT Corporate Circle Madurai.	बनाम/ Vs.	M/s. Standard Match Industries Pvt. Ltd. 5-2-15C, Sattur Road, Sivakasi-626 123.
स्थायी लेखा सं./जी आइ आर सं./PAN/GIR No. AACCS-5742-A		
(अपीलार्थी/ Appellant)	:	(प्रत्यर्थी / Respondent)

अपीलार्थी की ओर से/ Appellant by	:	Shri R. Clement Ramesh Kumar (CIT)- Ld. DR
प्रत्यर्थी की ओर से/ Respondent by	:	Shri S. Sridhar (Advocate) -Ld. AR

सुनवाई की तारीख/ Date of final Hearing	:	31-01-2024
घोषणा की तारीख / Date of Pronouncement	:	22-03-2024

आदेश / ORDER

Manoj Kumar Aggarwal (Accountant Member)

1. Aforesaid appeal by revenue for Assessment Year (AY) 2009-10 arises out of an order passed by learned Commissioner of Income Tax (Appeals)-19, Chennai [CIT(A)] on 20-02-2023 in the matter of an assessment framed by Ld. Assessing Officer [AO] u/s.143(3) of the Act on 30-12-2011. The grounds taken by the revenue are as under: -

1. The Order of the CIT(A) is opposed to law, on the facts and in the circumstances of the case.
2. The Learned CIT(A) erred in deleting the disallowances of losses made by the AO on Forward Foreign Exchange Contract and Foreign Exchange Derivative Contract by treating them as business loss and allowed them to set off and carry forward against the business income.

3. The learned CIT(A) erred in allowing the losses on Forward Foreign Exchange Contract and Foreign Exchange Derivative Contract are business loss thereby overlooking the fact that when no actual delivery has taken place, the transactions in question fall within the definition of speculative transaction as per section 43(5) of the Income-Tax Act?

4. Whether on the facts and in the circumstances of the case, the CIT(A) is legally correct by holding that the Forward Foreign Exchange Contract and Foreign Exchange Derivative Contract transactions carried on by the assessee through a Bank and not through a recognized stock exchange are also covered by the proviso (d) to Section 43(5) when the pre-conditions laid by the Explanation to the said proviso is not satisfied to constitute it as an eligible transaction?

As is evident, the sole issue that fall for our consideration is to determine the nature of losses on forward foreign exchange contracts and foreign exchange derivative contracts.

2. The Ld. CIT-DR drew our attention to the findings rendered by Ld. AO in the remand report and submitted that requisite details were not furnished by the assessee in support of its claim. The Ld. CIT-DR also submitted that the losses were speculative in nature and the assessee did not make any exports during the year but claimed losses on cancelled contracts only. Reliance has been placed on the decision of Mumbai Tribunal in **Araska Diamond Pvt. Ltd. Vs. ACIT (52 Taxmann.com 238)** to support the stand of Ld. AO. The Ld. AR, on the other hand, submitted that the transactions would not be covered u/s 43(5) but the losses were allowable to the assessee as business expenditure u/s 37(1). The Ld. AR submitted that adequate details were furnished by the assessee before lower authorities. The Ld. AR also submitted that the assessee entered into derivative contracts with State Bank of India (SBI) against foreign currency exposure which is an Authorized Dealer of RBI. The said contracts were pre-closed / cancelled and the losses arose out of cancellation of currency contracts. Having

heard rival submissions and upon perusal of case records, our adjudication would be as under.

Assessment Proceedings

3.1 The assessee being resident corporate assessee is stated to be engaged in manufacturing and sale of safety matches. In the return of income, the assessee declared loss of Rs.534.14 Lacs which was subjected to scrutiny proceedings.

3.2 It transpired that the assessee claimed foreign exchange contract cancellation loss of Rs.945.43 Lacs due to exchange fluctuation. In support, the assessee filed letter from SBI, Sivakasi wherein it was stated that the bank had debited the said sum towards loss on exchange rate contracts. From the assessment order, it appear that the assessee bifurcated losses into two parts i.e., a sum of Rs.409.46 was debited in the Profit & Loss account whereas the remaining amount of Rs.535.96 Lacs was claimed in the memo of adjustment.

3.3 The Ld. AO held that forward contracts were derivative transactions and speculative in nature. The assessee did not submit proper evidences to prove that loss was not speculative in nature. The loss was nothing but notional loss on account of foreign contracts / derivative transaction. Finally, the loss was disallowed in computation of income but allowed to be carried forward u/s.73 of the Act.

Appellate Proceedings

4.1 During the appellate proceedings, assessee submitted that it was exporting matches to foreign countries and the receivables were realized in foreign currency i.e., US Dollars and Euros through its bankers i.e., SBI. During the year 2006-07, foreign currency valuation was very much

volatile and the sundry debtors relating to exports were exposed to currency fluctuation risk. The assessee selected to book options contracts as per advice of SBI in order to hedge its foreign exchange risk. These forward contracts were designed to help / protect companies from adverse market movements by allowing them to lock-in an exchange rate in advance for future transactions. The company obtained permission from its authorized dealer to book forward contract against adverse currency movement. The booking of forward contract for hedging against currency movement was permissible one and the same was part of business transactions for securing assets against fluctuation in foreign exchange rate. The assessee also submitted that out of total turnover Rs.42.49 Crores, export turnover was Rs.42.11 Crores and export receivables were Rs.4.95 Crores.

4.2 Based on future estimates, the assessee undertook forward contract in US dollars to hedge foreign currency risk. The assessee also submitted that it was not able to procure export orders on account of flood and natural calamities and increase of currency valuation led to cancellation of orders. The assessee's intention to book forward contract was to safeguard the business against currency fluctuations. In support of its claim, the assessee submitted as under: -

- (i) The company is an exporter of Safety Matches to various foreign Countries and most of its receivables are in US Dollar and EURO Currency
- (ii) There was an unprecedented depreciation of Rupee against US Dollar and EURO due to which the bankers of the company advised the company to exercise sophisticated hedging tools such as options and swaps in order to contain the risk of foreign currency exposures.
- (iii) Thus, the company has acted only on the advice of its bankers in order to reduce the risk due to foreign currency exposures and there was no intention to indulge in any speculative activities.

(iv) In order to cover up the foreign currency exposures due to the normal business activity of the appellant, they had to enter into forward options contract which are mostly settled by delivery of currency.

(v) The profit or loss on account of forex derivative contract is incidental to the normal business of the appellant having a direct nexus.

(vi) This loss on account of forex contract was incurred by the company despite scientific analysis and expert advice due to global economic meltdown which had occurred during second half of 2008.

(vii) Foreign exchange is not a commodity or Shares but it is currency. Therefore, Section 43(5) of the Act will not be applied to us.

(viii) The forex derivative transactions entered by the company through its Authorised Dealer State Bank of India are regulated and permitted by Reserve Bank of India keeping in view the nature of the business carried on by the Company. There is no stock exchange to handle the Forward contract by the exporter instead RBI has permitted the Authorised Dealer to handle Forward contract Transaction for its Export Customer. It is pertinent to mention here that RBI does not permit any bank under its umbrella to entertain its client in any separate business of forex derivative transactions. Permission is granted only for the clients of the bank to hedge on foreign exchange in order to minimize the risk of the foreign currency exposure arising out of import and export trade.

(ix) These transactions carried out by the company in order to reduce the risk of foreign currency fluctuation during the course of the ordinary business of the company can be considered as business by itself bring it into the ambit of section 73(1) of the Act. Section 73(1) of the Act restricts the set off of speculation loss against the other business income in only those cases where speculative transaction carried on by the company.

The assessee also relied on various judicial decisions to support the submissions.

4.3 The assessee's submission were subjected to remand proceedings vide AO's remand report dated 24.04.2017. The Ld. AO considering the representation made by the assessee, noted that the assessee entered into hedging transactions to safeguard against currency fluctuations. However, rupee had depreciated against dollar and euro currencies and assessee had chosen to cancel the contracts prior to the due date. The assessee contended that these transactions were not speculative as per proviso (a) to section 43(5) of the Income-tax Act, 1961. The assessee furnished a certificate from the bank showing debits in his account, printouts of e-mails (genuineness of which is not verifiable), export

invoices, shipping bills, copies of exchange contracts with the bank, copy of its ISDA master agreement with SBI etc. However, it was not ascertainable as to how much losses were relatable to the events such as floods and bombings and how much were attributable to cancellations done by the assessee on its own to take advantage of weakening rupee. Therefore, the assessee was asked to explain the losses claimed with reference to purchase orders, invoices vis-a-vis exchange contracts with banks for specific transactions, at least on a sample basis. In spite of further opportunities given, the assessee could not provide such details. The assessee merely submitted that it did not get individual purchase orders but had regular orders arranged by its foreign agent. As such, the assessee could not relate any individual bills to the forward contracts entered with the bank. Further, no purchase orders against which the forward contracts had been entered were provided during the course of either the assessment proceedings or remand proceedings. The assessee claimed that it had firm export orders for 35 containers per month (420 containers per year). However, as per the copies of contracts, the assessee had orders for 380 containers per year only. The assessee's representatives were not able to furnish details of such valid export orders from parties. Further, the assessee submitted break up of forward losses for Rs.786.02 Lacs but it claimed loss of Rs.945.43 Lacs. Therefore, Ld. AO justified the disallowance.

4.4 The Ld. AO also pointed out that as per clause (5) of section 43, 'speculative transaction' would mean a transaction in which a contract for the purchase or sale of commodity, including stocks and shares, is periodically or ultimately settled otherwise than by actual delivery or

transfer of the commodity or scrips. However, in the present case, the assessee had entered into forward contracts with regard to foreign exchange but the assessee was not in the business of foreign exchange. It is also a fact that loss shown by the assessee was due to forward contracts against which no actual delivery or foreign exchange was made. Also, in this case the forward contracts were cancelled and hence, settled otherwise than by actual delivery. Therefore, it was quite evident that the assessee's case falls within the definition of speculative transactions. The assessee referred to proviso to section 43(5) and submitted that it had undertaken forward contract and derivative contract as hedging against any foreign exchange fluctuation to fulfill its commitments of exports. However, the said proviso provides that 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. The assessee's case would not be at all covered by the said proviso as per the decision of Mumbai Tribunal in **Vinodkumar Diamonds Pvt. Ltd. (ITA No.506/Mum/2013)** wherein it was held that in order that forward transactions in commodities may fall within proviso (a) to section 43(5) of the Act, it would be necessary that the raw materials or merchandise in respect of which the forward transactions have been made by the assessee must have a direct connection with the goods manufactured or the merchandise sold by him. Such direct connection was missing in the assessee's case. The Ld. AO also considered Board's Instruction No.3/2010 dated 23.03.2010 on

implications of forward foreign exchange contracts. As per the accepted commercial norms, object of a hedging contract is to secure oneself against loss in a future delivery contract. In order to be genuine and valid hedging contracts of sales, the total of such transactions should not exceed the total stocks of the raw materials or the merchandise on hand which would include existing stocks as well as the stocks acquired under the firm contracts of purchase as held by Mumbai Tribunal in the case of **Araska Diamond (P.) Ltd v. ACIT (supra)**. This decision considered the decision of Hon'ble Allahabad High Court in **CIT vs. MP Sugar Mills (P.) Ltd. [148 ITR 203]** which held that it will depend upon the facts of each case whether a particular transaction by way of forward sale, which is mutually settled otherwise than by actual delivery of the said goods, has been entered into with a view to safeguard against loss through price fluctuation in respect of the contract for actual delivery of the goods manufactured. Therefore, the loss was held to be not allowable either u/s 43(5) or under proviso thereof.

4.5 The Ld. CIT(A) observed that the assessee produced relevant details of cancelled export orders. Due to cancellation of orders, the assessee had no option but to cancel the forwards booking also and was forced to pay the differential amount to its banks. Such payment was a business loss incurred in the course of export business. The assessee filed copies of export orders in the forwards contracts relating to which loss was incurred in support of his contention that forward contracts were made on the basis of export orders in hands. The assessee was in manufacturing and export business. The booking of forward contracts in foreign exchange was a normal and incident of export business. The

contracts were booked to hedge the assessee's exposure to exchange risk in export business. Therefore, AO erred in treating the loss as speculative in nature. The expenditure so incurred was towards business only. Relying on various judicial precedents, the claim was held to be allowable against which the revenue is in further appeal before us.

Our findings and Adjudication

5. From the facts as enumerated in the preceding paragraphs, it would emerge that the assessee is engaged in export business and exposed for currency fluctuation risk. The assessee has taken foreign exchange contracts to safeguard against exchange fluctuation and incurred loss of Rs.945.43 Lacs. However, it appears that the assessee the assessee bifurcated losses into two parts i.e., a sum of Rs.409.46 was debited in the Profit & Loss account whereas the remaining amount of Rs.535.96 Lacs was claimed in the memo of adjustment. This fact would show that the nature of contracts is different and the loss has arisen out of two different set of transactions, the details of which are not available on record.

6. It is the finding of Ld. AO in the assessment order that the assessee did not submit proper evidences to prove that loss was not speculative in nature and it was concluded that the loss was nothing but notional loss on account of foreign contracts / derivative transaction.

7. During appellate proceedings, it is the submission of the assessee that going by the experience of earlier years, it was advised by its bankers to book options contracts in order to hedge its foreign exchange risk which would protect the assessee from adverse currency movements by allowing them to lock-in an exchange rate in advance for

future transactions. Based on future estimates, the assessee undertook forward contract in US dollars to hedge foreign currency risk. However, the basis of such estimation is not available on record. The fact that how much currency exposure was foreseen by the assessee is also not available on record. The assessee merely stated that it was not able to procure export orders and adverse market conditions led to cancellation of export orders. The Ld. AO, in the remand report, noted that the assessee entered into hedging transactions to safeguard against currency fluctuations. However, it was not ascertainable as to how much losses were relatable to the adverse market conditions such as floods and bombings and how much were attributable to cancellations done by the assessee on its own to take advantage of weakening rupee. Though the assessee was asked to explain the losses claimed with reference to purchase orders, invoices vis-a-vis exchange contracts with banks for specific transactions, at least on a sample basis, it could not provide such details. It merely submitted that it did not get individual purchase orders but had regular orders arranged by its foreign agent. As such, the assessee could not relate any individual bills to the forward contracts entered with the bank. Further, no purchase orders against which the forward contracts had been entered were provided during the course of either the assessment proceedings or remand proceedings. Pertinently, the assessee could submit break up of forward losses for Rs.786.02 Lacs only but it claimed loss of Rs.945.43 Lacs. All these factors, in our considered opinion, would have material bearing to adjudicate the issue in hand.

8. Proceeding, further Ld. AO has invoked the provisions of Sec.43(5) to conclude that such transactions were speculative in nature whereas Ld. CIT(A) held that the loss would be allowable as business expenditure. In our opinion, specific provisions would prevail over general provisions and therefore, Ld. CIT(A) erred in overlooking the invocation of provisions of Sec.43(5) by Ld. AO. The assessee, in the present case, is not a dealer in foreign exchange and therefore, it could not be said that such transactions were part and parcel of business transactions unless interse nexus thereof was established by the assessee. In the decision of Mumbai Tribunal in **Vinodkumar Diamonds Pvt. Ltd. (ITA No.506/Mum/2013)**, it was held by the bench that in order that for forward transactions in commodities may fall within proviso (a) to section 43(5) of the Act, it would be necessary that the raw materials or merchandise in respect of which the forward transactions have been made by the assessee must have a direct connection with the goods manufactured or the merchandise sold by him. Further, as per Board's Circular, in order to be genuine and valid hedging contracts of sales, the total of such transactions should not exceed the total stocks of the raw materials or the merchandise on hand which would include existing stocks as well as the stocks acquired under the firm contracts of purchase as held by Mumbai Tribunal in the case of **Araska Diamond (P.) Ltd vs. ACIT (supra)**. This decision considered the decision of Hon'ble Allahabad High Court in **CIT vs. MP Sugar Mills (P.) Ltd. [148 ITR 203]** which held that it will depend upon the facts of each case whether a particular transaction by way of forward sale, which is mutually settled otherwise than by actual delivery of the said goods, has been

entered into with a view to safeguard against loss through price fluctuation in respect of the contract for actual delivery of the goods manufactured. Therefore, the loss was held to be not allowable either u/s 43(5) or under proviso thereof.

9. In the light of all these facts, the adjudication of Ld. CIT(A) is set aside and the issue is restored back to the file of Ld. CIT(A) for de novo adjudication with a direction to the assessee to substantiate its case and by filing requisite details / explanations. All the issues are kept open.

10. The appeal stand allowed for statistical purposes.

Order pronounced on 22nd March, 2024

Sd/-
(MAHAVIR SINGH)
उपाध्यक्ष / **VICE PRESIDENT**

Sd/-
(MANOJ KUMAR AGGARWAL)
लेखा सदस्य / **ACCOUNTANT MEMBER**

चेन्नई Chennai; दिनांक Dated : 22-03-2024
DS

आदेशकीप्रतिलिपिअग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकरआयुक्त/CIT
4. विभागीयप्रतिनिधि/DR
5. गार्डफाईल/GF