

IN THE INCOME TAX APPELLATE TRIBUNAL

"E" BENCH, MUMBAI

BEFORE SHRI AMARJIT SINGH, ACCOUNTANT MEMBER AND

SHRI SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA no.4036/Mum./2023

(Assessment Year : 2013-14)

Khanna Industrial Pipes Pvt. Ltd.
1101, The Summit Business Bay,
Opp PVR, Near WEH Metro Station,
Chakala, Andheri (East),
Mumbai-400093
PAN- AAACK2240D

..... Appellant

v/s

Deputy Commissioner of Income Tax,
Circle-12(3)(1)
Room No.147B, 1st Floor, Aayakar
Bhavan, Maharishi Karve Road,
Churchgate, Mumbai-400020.

..... Respondent

Assessee by :Shri Jitendra Singh

Revenue by :ShriManoj Kumar Sinha, Sr. AR

Date of Hearing -02/08/2024

Date of Order - 24/10/2024

ORDER

PER SANDEEP SINGH KARHAIL, J.M.

The present appeal has been filed by the assessee challenging the impugned order dated 27/09/2023, passed u/s 250 of the Income Tax Act, 1961 ("*the Act*") by the learned Commissioner of Income Tax (Appeals), National Faceless Appeal Centre, Delhi, [*learned CIT(A)*], for the assessment year 2013-14.

2. In its appeal, the assessee has raised the following grounds: –

"1. On the facts and circumstances of the case, the National Faceless Appeal Centre (NFAC), Delhi (hereinafter referred to as the "Ld. CIT(A)") erred in passing the order dated 27th September 2023 upholding the action of the Ld. Deputy Commissioner of Income Tax, Circle 12(3)(1), Mumbai (hereinafter referred to as 'Ld. A.O.')] in passing the assessment order dated 23.03.2016 under section 143(3) of the Income Tax Act, 1961 [hereinafter referred to as "the Act"] determining the total income of the Appellant at Rs.1,54,07,469/- as against returned income of Rs.14,75,570/-. The Appellant strongly objects to the impugned order passed by Ld. CIT(A) as the same is illegal, arbitrary and perverse on the following amongst other grounds which are urged without prejudice to one another: -

2. Addition by treating the loss on forward contract booking cancellation as speculation loss unjustified - Rs.31,16,492/-

(1) The Ld. CIT(A) fell in error of law in upholding the action of the Ld. A.O. in making addition of Rs.31,16,492/- being loss incurred by the Appellant on cancellation of forward booking loss treating the same as speculation in nature. The Appellant, prays that the addition of Rs.31,16,492/- is unjustified and the same may be deleted.

(ii) The Ld. CIT(A) failed to appreciate that the loss on cancellation of forward contract booking is incurred during the course of business activity of the Appellant. Hence, the Appellant is entitled to claim the loss as business loss. Thus, treating the loss as speculation in nature is unjustified and the same may be deleted.

(iii) The Ld. CIT(A) further failed to appreciate that the loss on forward contract booking cancellation is supported by proper documentary evidences. Hence, addition of Rs.31,16,492/- by treating the loss on forward contract booking cancellation as speculation loss is unjustified and the same may be deleted.

3. Addition by capitalizing the interest towards Capital Work in Progress unjustified - Rs.1,08,15,107/-

(1) The Ld. CIT(A) fell in error of law in upholding the action of the Ld. A.O. in making addition of Rs.1,08,15,107/- by capitalizing the interest towards Capital Work in Progress without appreciating the facts and circumstances of the case. Hence, the addition of Rs.1,08,15,107/- is unjustified and the same may be deleted.

(ii) The Ld. CIT(A) failed to appreciate that the borrowed funds were exclusively used in carrying on the business activity of Appellant. Hence, making ad-hoc addition by capitalizing the interest towards Capital Work in Progress is unjustified and the same may be deleted.

(iii) The Ld. CIT(A) further failed to appreciate that the Appellant has already apportioned an amount of Rs.38,93,000/- towards capital work in progress. Thus, ad-hoc allocation of proportionate interest to the capital work in progress is without any basis and the same may be deleted.

4. The Appellant denies any liability to pay interest under section 234B and 234C of the Act. Hence, the same are not leviable.

5. The Appellant craves leave to add, alter, amend, delete, rescind or withdraw any of the grounds of appeal mentioned hereinabove."

3. The issue arising in ground no.1, raised in assessee's appeal, is general in nature and therefore, needs no separate adjudication.

4. The issue arising in ground no.2, raised in assessee's appeal, pertains to the disallowance of loss that arose on account of forward contract booking cancellation.

5. The brief facts of the case pertaining to this issue, as emanating from the record, are: The assessee is engaged in the business of manufacturing MS pipes and power generation. During the year under consideration, the assessee filed its return of income on 27/09/2013 declaring a total income of INR 14,75,870. The return filed by the assessee was selected for scrutiny through CASS and accordingly, statutory notices under section 143(2) and section 142(1) of the Act were issued and served on the assessee. During the year under consideration, the assessee claimed the forward contract booking cancellation expenses of INR 31,16,492. In the previous year, an amount of INR 5,72,867 was claimed as forward contract booking cancellation expenses. Accordingly, the assessee was asked to explain the reason for the disproportionate increase in expense as compared to the previous year. In response, the assessee submitted details and stated that in order to have cover for the fluctuations in foreign currency for its receivables, it has hedged its position by entering into a forward contract. In support of its contention, the assessee furnished the copy of the ledger

account for forward booking cancellation along with the bank confirmation letter evidencing the cancellation. The Assessing Officer ("AO") vide order dated 23/03/2016 passed under section 143(3) of the Act disagreed with the submissions of the assessee and held that the assessee has not justified the reasons for the increase in forward contract booking cancellation expenses as compared to the previous year. By referring to the details of the sales declared and data shown in the balance sheet, the AO held that there is not much variation in the financials of the assessee and the assessee has not furnished one-to-one hedging done against bills receivable. It was further held that in the absence of details and supporting and its reconciliation, it cannot be said that the assessee has done the forward bookings for the purpose of business. Thus, the AO came to the conclusion that the forward booking cancellation loss incurred during the year is without the nexus to the business of the assessee and the same can only be treated as a speculative loss and not a business loss. Accordingly, the AO treated the amount of INR 31,16,492 as a speculative loss and added the same to the total income of the assessee.

6. The learned CIT(A), vide impugned order, dismissed the ground raised by the assessee on this issue on the basis that the assessee has not been able to link its forward contracts to its supplies/export. The learned CIT(A) further held that the sale proceeds will be business receipts, while the gains from forward contracts can only be speculative income. Being aggrieved, the assessee is in appeal before us.

7. We have considered the submissions of both sides and perused the material available on record. In the present case, the assessee is carrying on the business of manufacturing of MS pipes and tubes, and Fabricated Steel Structures. As per the assessee, the products manufactured by it are sold in the domestic market as well as exported to various countries such as USA and Europe. As per the assessee, the bifurcation of the domestic as well as export sales, during the year, is as follows: –

	<i>Percentage of total sales</i>	<i>Gross sales</i>
<i>Local Sales</i>	<i>77%</i>	<i>79,59,66,892</i>
<i>Export</i>	<i>23%</i>	<i>24,38,23,342</i>
<i>Total Sales</i>		<i>103,97,90,234</i>

8. As per the assessee, while dealing with international clients, it has to quote the price in the currency as required by the customer. Further, due to the volatile money market, there are frequent changes in the currency rates which affect the realisation of the sale proceeds. Thus, as per the assessee, the sale value in Indian currency which the assessee realises depends on the rate of exchange prevailing at the time of the presentation of the export advice for payment and due to adverse fluctuation in the exchange rate, it can so happen that the assessee realises lesser amount in Indian currency than that contemplated at the time of negotiation of the export contract. Accordingly, in order to safeguard its realisation, the assessee entered into a forward contract with banks to avoid losses arising due to any fluctuation in the foreign exchange rates. In this regard, the assessee placed reliance upon the RBI Master Circular No. 6/2007-08 dated 02/07/2007 which permits Indian exporters to enter into forward contracts in foreign exchange

with an authorised dealer category-1 banks in India to hedge their exposure to foreign exchange risk in such cases. Therefore, it is the claim of the assessee that in order to save its business interest, it has entered into forward contract agreements with the banks and such booking of the forward contracts in foreign exchange is a necessary incident, normal and usual course of the assessee's export business.

9. The assessee further submitted that the forward contract booked with the bank has a maturity date and it has to be utilised on or before this date. Thus, there may have been possibilities when the export payment is received after the date of the forward contract and in such a situation, the bank cancels the contract and if the rate of contract is less than the rate of currency on that particular date, then the difference between both rates is claimed by the bank. From the perusal of the paper book, we find that vide its submission dated 10/02/2016 filed before the AO, the assessee provided the following details of loss of INR 31,16,492 in relation to loss incurred on cancellation of forward contracts: –

Khanna Industrial Pipes Pvt Ltd										
Forward Booking Contract Cancellation details for F/Y 2012-13										
Contract Number	Date of Contract	Amount of Booking	Currency	Rate of Booking	Date of Cancellation	Cancelled Amount	Booking Rate	Cancellation Rate	Difference	Canellation Amount
0473211FP0000154	17.08.2011	180000	USD	46.575	31.05.2012	44739.09	46.575	56.2050	-9.6300	4,36,206
0473211FP0000155	17.08.2011	180000	USD	46.575	22.06.2012	66205.5	46.575	57.3110	-10.7360	7,10,833
0473211FP0000156	17.08.2011	180000	USD	46.695	22.06.2012	180000	46.695	57.3710	-10.6760	19,20,492
0473212FP0000143	25.09.2012	37750	EURO	68.98	15.11.2012	34675.08	68.98	70.0175	-1.0375	35,975
0473212FP0000036	29.03.2012	180000	USD	53.97	28.03.2013	37105.76	53.97	58.1277	-4.1577	12,986
										31,16,492

10. From the perusal of the paper book filed by the assessee, we also find that the assessee has placed on record the exchange contracts entered into with the State Bank of India in respect of export proceeds. From the perusal

of the exchange contracts, forming part of the paper book from pages 24-59, we find that it is specifically provided that the bank would levy a flat charge for every request for early delivery or cancellation of the contract and additionally, the difference between the contracted rate and the rate at which the contract is cancelled would be recovered from the assessee at the time of cancellation.

11. We further find that there has not been any change in the profile of the assessee as compared to the preceding as well as the succeeding assessment years. During the hearing, the learned AR also placed on record the copy of assessment orders passed in the assessment years 2011-12, 2012-13 and 2014-15, and submitted that no disallowance was made in respect of loss on account of forward contract booking cancellation. It is evident from the record that the AO accepted the fact that a similar loss was claimed by the assessee on account of foreign contract booking cancellation in the preceding year, i.e. the assessment year 2012-13.

12. We find that while considering a similar issue the Hon'ble Jurisdictional High Court in CIT v/s BadridasGauridu (P.) Ltd., reported in [2003] 261 ITR 256 (Bom.) held that the amount paid by the assessee in respect of the forward contracts with the banks in respect of foreign exchange, which could not be honoured, is a business loss. The relevant findings of the Hon'ble High Court, in the decisions cited supra, are reproduced as follows: –

"3. 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."

13. In the present case, it is pertinent to note that there is no dispute regarding the fact that apart from selling the product manufactured by it in India, the assessee also exports the same to various countries outside India. Further, as per the assessee, it has also been honoured with the status of Star Export House as a manufacturer exporter by the DGFT. The Revenue, on one hand, has alleged that the assessee has not been able to link its forward contracts to its supplies/exports, however, on the other hand, has not brought any material to show that these forward contracts executed by the assessee with the bank were for a purpose other than as claimed by the assessee. The learned CIT(A) further held the loss to be a speculative loss, and thus upheld the findings of the AO. Therefore, since the assessee has been accepted to be an exporter and as per the RBI regulations is allowed to hedge against any loss arising due to foreign exchange fluctuation, respectfully following the decision cited supra we are of the considered view that the loss on account of cancellation of forward contract booking is incidental to its business and thus is allowable as a business loss. Further, these transactions, being in the nature of hedging transactions, would fall under the exempted category of speculative transactions provided in proviso (a) to section 43(5) of the Act. Therefore, we find no basis in the findings of the lower authorities on this issue and the same are set aside. Accordingly,

the addition on account of the forward contract booking cancellation loss is deleted. As a result, ground no.2 raised in assessee's appeal is allowed.

14. The issue arising in ground no.3, raised in assessee's appeal, pertains to the addition by capitalising the interest towards capital work in progress.

15. The brief facts of the case pertaining to this issue, as emanating from the record, are: During the year under consideration, the assessee debited an amount of INR 2,62,42,878 to the profit and loss account on account of finance cost. Upon verification of the balancesheet as on 31/03/2012, it was observed that the assessee has shown capital work in progress of INR 17,37,25,138. During the year under consideration, the assessee after converting the work in progress to fixed assets showed work in progress of INR 24,27,205. Accordingly, the assessee was asked to show cause as to why the proportionate interest should not be capitalised as borrowed funds have been utilised for the purpose of capital work in progress. In response, the assessee submitted that it has already capitalised interest amounting to INR 38,93,000. It was further observed that the assessee has capitalised the work in progress and converted it as assets only after 6 months and the amount of such an addition to fixed assets is shown at INR 22,01,32,465. In the absence of a breakup of utilisation of funds and its direct nexus, the proportionate interest amounting to INR 1,47,08,107 up to the date of assets put to use was capitalised. Since the assessee had already capitalised INR 38,93,000, the differential amount of INR 1,08,15,107 was capitalised on account of interest expense and added to the total income of the assessee.

16. The learned CIT(A), vide impugned order, dismissed the ground raised by the assessee on this issue. Being aggrieved, the assessee is in appeal before us.

17. We have considered the submissions of both sides and perused the material available on record. As per the assessee, it was carrying on the manufacturing activity of MS pipes from its Khativali Unit from the year 1985. The 2nd unit was set up by the assessee at Asangaon, which started manufacturing on 15/04/2013. Accordingly, as per the assessee, the interest and other finance costs incurred by the assessee up to 14/03/2013 relating to the setting up of Asangaon Unit was capitalised by the assessee in its books of account. It is further the plea of the assessee that it has transferred the capital work in progress relating to Asangaon Unit from 15/03/2013 to its fixed assets and also claimed depreciation on the same from 15/03/2013 onwards. In this regard, reliance was placed on the working of capital work in progress relating to Asangaon Unit, as noted in the impugned order from pages 24-29. Thus, as per the assessee it has capitalised the interest paid on the amount borrowed for Khativali Unit and used in the setup of Asangaon Unit amounting to INR 38,93,000. As per the assessee, it has made borrowings exclusively for the setup of Asangaon Unit and has capitalised the interest and other finance costs amounting to INR 91,58,617 till the commencement of manufacturing activity by the Asangaon Unit. Hence, as per the assessee, the total amount capitalised by the assessee during the year under consideration is INR 1,30,51,617. However, it is evident from the record that the AO proceeded to compute

proportionate interest for capitalisation in the absence of any breakup to support the working of the assessee. We find that even the learned CIT(A) did not consider the detailed working of capitalisation of work in progress relating to Asangaon Unit by the assessee. Accordingly, in view of the facts and circumstances as noted above, we deem it appropriate to restore this issue to the file of the jurisdictional AO to verify the working of capitalisation of work in progress as submitted by the assessee. We order accordingly. Needless to mention, no order shall be passed without affording the reasonable and adequate opportunity of hearing to the assessee. With the above directions, the impugned order on this issue is set aside and ground no.3 raised in assessee's appeal is allowed for statistical purposes.

18. Ground no.4 raised in assessee's appeal pertains to the levy of interest under section 234B and section 234C of the Act, which is consequential in nature. Therefore, ground no.4 needs no separate adjudication.

19. In the result, the appeal by the assessee is allowed for statistical purposes.

Order pronounced in the open Court on 24/10/2024.

Sd/-
AMARJIT SINGH
ACCOUNTANT MEMBER

Sd/-
SANDEEP SINGH KARHAIL
JUDICIAL MEMBER

MUMBAI, DATED: 24/10/2024

Copy of the order forwarded to:

- (1) *The Assessee;*
- (2) *The Revenue;*
- (3) *The PCIT / CIT (Judicial);*
- (4) *The DR, ITAT, Mumbai; and*
- (5) *Guard file.*

By Order

Assistant Registrar
ITAT, Mumbai