

**IN THE INCOME TAX APPELLATE TRIBUNAL, BENCH "C", MUMBAI**  
**BEFORE SHRI R.C.SHARMA, ACCOUNTANT MEMBER AND**  
**SHRI PAWAN SINGH, JUDICIAL MEMBER**

**ITA No.233/Mum/2013 for Assessment Year: 2009-10**

Combine Diamonds Limited 10, The Jewel, M. P. Marg, Opera House, Mumbai-400004. <b>PAN: AAACC9949H</b>	Vs.	ACIT -5(1), Aayakar Bhavan, M. K. Road, Mumbai-400020.
(Appellant)		(Respondent)

Assessee by : Dr. K. Shivram (AR)  
Revenue by : Shri K. Mohandas (DR)  
Date of hearing : 02.08.2016  
Date of Pronouncement : 26.10.2016

**ORDER**

**PER PAWAN SINGH, JM:**

1. This appeal u/s. 253 of Income-tax Act is directed by the assessee against the order of CIT(A)-9, Mumbai dated 16.10.2012 for AY 2009-10
2. Brief facts of the case are that assessee-company is engaged in the business of trading, manufacturing and export of cut and polished diamonds and jewellery, filed its return of income on 29.09.2009 for relevant AY declaring total income at Rs. 68,42,900/-. The case was selected for scrutiny. During the course of assessment proceedings, the assessee was asked to explain why the revaluation of forward contract amounting to Rs. 41,52,450/- should not be disallowed. The assessee furnished the reply which was not accepted by the AO holding that Mark to Market loss should be considered as just notional losses who do not involved any actual outgo as the assessee is not liable to pay such losses and added back for the purpose of computing taxable income in the hand of assessee. Aggrieved by the order of AO, the assessee filed appeal before the CIT(A). During the appellate proceedings, the Id. CIT(A) issued a show cause

notice as to why loss on account of cancellation of forward contract should not be disallowed as speculation losses. The assessee replied show cause notice and contended that assessee had incurred/suffered a total loss of Rs. 2,07,29,831/- on forward forex transaction, it was further contended that assessee entered into forward contract to hedge the foreign exchange fluctuation. The forward contract were entered against the export invoices and they were settled otherwise then delivery either wholly and purely or on the expiry of forward contracts. The cancellation of forward contract is not a speculative transaction as per sub-section 5 of section 43 of the Act. The reply of the assessee was not accepted by Id CIT(A). The Id. CIT(A) held that the assessee failed to discharge his burden cast upon it. The Id CIT(A) further concluded that assessee has not produced any evidence to show that transaction are only hedging contract and loss cannot be set off against the assessee's business income as per explanation to section 73 of the Act and thus, enhance the income of assessee by a sum of Rs. 2,07,29,831/- in the impugned order dated 16.10.2012. Thus, the assessee filed the present appeal raising the following grounds of appeal:

**Ground No. 1:**

*On the facts and circumstances of the case and in law, the learned Commissioner of Income Tax (Appeals) (hereinafter referred as 'the Learned CIT (A)') has erred in conforming the action of the learned Assessing Officer for disallowance of business expenditure in the nature of marked - to - market (MTM) loss on restatement of outstanding forward contracts to the extent of Rs. 4,152,450/- by considering the loss as notional and speculative in nature.*

**Ground No. 2:**

*On the facts and circumstances of the case and in law, the Learned CIT (A) has erred in law and on facts in enhancing the income by a sum of Rs. 2,07,29,381/- being the losses incurred on settlement or cancellation of forward contracts by treating it as speculation loss without appreciating the facts available on records.*

**Ground No. 3:**

*On the facts and circumstances of the case and in law, the Learned CIT (A) has erred in making enhancement of assessed income of the appellant by Rs. 2,07,29,381/- which was inclusive of the disallowance of the MTM loss of Rs. 4,152,450/- on revaluation of forward contract, resulting into making twice disallowance of Rs. 41,52,450/-.*

3. We have heard the Id. Authorised Representative (AR) of the assessee and Id. Departmental Representative (DR) for Revenue and gone through the orders of

authorities below. The Id. AR of the assessee argued that the Ground No.1 of the appeal is squarely covered in favour of the assessee by various decisions of the Tribunal and the decision of Bombay High Court. On the other hand Id DR for revenue supported the order of authority below.

4. We have considered that rival contentions of the parties and observed that similar issues was considered by the coordinate bench of this Tribunal in case of The Paper Products Ltd Vs ACIT in ITA No.7761/M/ 2012 and the coordinate bench held as under:

*“we find that this issue of marked to market loss on foreign exchange contract is covered in favour of the assessee not only by the decision of the Hon'ble Supreme Court in Woodward Governor India P. Ltd. (supra) but also series of decisions of the co-ordinate bench of the Tribunal. For the sake of ready reference, the relevant findings of the Tribunal in Reliance Industries Ltd. (supra), as relied upon by the learned Counsel, is reproduced herein below:–*

*“8. We have carefully considered the order of Id. Commissioner of Income Tax and the submissions of Id. Representatives of the parties. We have also carefully considered the cases cited before us (supra). It is relevant to state that in the case of Woodward The Paper Products Ltd. 4 Governor India (P.) Ltd. (supra), the Hon'ble Apex Court observed and held that the assessee debited to its profit and loss account certain unrealized loss due to foreign exchange fluctuation in foreign currency transactions towards revenue items as on the last day of the accounting year. The A.O. held that the liability as on the last date of the previous year was not an ascertained but a contingent liability. Resultantly, the same was added back to the total income. The CIT(A) echoed the assessment order. However, the Tribunal held that the claim of the assessee for deduction of unrealized loss due to foreign exchange fluctuation as on the last date of the previous year was deductible. The said order of the Tribunal was upheld by the Hon'ble High Court. On further appeal by the department, the Hon'ble Supreme Court held that the loss suffered by the assessee is on revenue account towards foreign exchange difference as on the date of balance sheet and is an item of expenditure deductible u/s 37(1). It further observed that an enterprise has to report outstanding liability relating to import of raw material using closing rate of foreign exchange and any difference, loss or gain, arising on conversion of said liability at closing rate should be recognized in profit and loss account for reporting period. From the judgment of the Hon'ble Supreme Court it can be clearly deduced that unrealized loss due to foreign exchange fluctuation in foreign currency transactions on revenue item as on the last date of the accounting year is deductible.*

*9. ITAT, in the case of Kotak Mahindra Investment Ltd. (supra) also considered a similar issue. In the said case the assessee company was engaged in the business of granting of loans and advances against shares and securities also traded in derivative segment by entering into future and option contract. Some of the future contracts could not be squared up at the end of the financial year. The assessee booked the expected loss in such contracts on MTM basis. The assessee thus*

*claimed a loss as calculated on MTM basis claiming that he was following this practice consistently. That it was also as per recognized Accounting Standard. AO rejected the claim on the ground that the derivative contracts were not stock in trade as there was no cost of acquisition. He finally held that the loss on account of "MTM" basis was thus a notional loss and was contingent in nature and could not be allowed to be set off against taxable income. On appeal, the Id. CIT(A) allowed the same by agreeing with the contention of the assessee that such loss on such valuation which is called "MTM" has to be allowed even though it may appear to be a notional loss. The Tribunal while confirming order of Id. CIT(A) and allowing the said loss placed reliance on the decision of Hon'ble Apex Court in the case of Woodward Governor India (P.) Ltd. (supra) and also the decision of Tribunal in the case of Edelweiss Capital Ltd V/s ITO in ITA No.5324/ Mum/2007 (AY- The Paper Products Ltd. 5 2004-05) dated 10.11.2010 and the decision in the case of Ramesh Kumar Damani V/s Addl.CIT in ITA No.1443/Mum/2009 (AY-2006-07) dated 26.11.2010. Copies of which are placed in the compilation of case laws at pages 76 to 84 and pages 85 to 90 respectively.*

*We also observe that similar issue was considered by Hon'ble Apex Court in the case of ONGC Ltd (supra). The assessee a public sector undertaking was engaged in the capital intensive exploration and production of petroleum products for which it had to heavily depend on foreign loans to cover its expenses, both capital and revenue and for payment to non-resident contractors in foreign currency for various services rendered. The assessee made three types of foreign exchange borrowings i.e.(i) on revenue account; (ii) on capital account, and (iii) for general purposes. Some of the loans became repayable in the relevant accounting year and the date of payment of some loans fell after the end of the relevant accounting year. The assessee revalued its foreign exchange loans in foreign exchange on revenue account, on capital account and for general purposes outstanding as on 31- 3-1991, and claimed the differences between their respective amounts in Indian currency as on 31-3-1990 and 31-3-1991 as revenue loss under section 37(1) in respect of loans used in revenue account. The assessee also treated the similar difference in foreign exchange as an increased liability u/s 43A. The AO allowed the deduction claimed u/s 37(1), taking into consideration the increased foreign exchange liability and repaid in the accounting year for the purpose of depreciation. He did not however, allow the claim for foreign exchange loss on loans both in relation to capital as well as revenue account which were outstanding on the last day of accounting year. On appeal, the CIT(A) affirmed the view of AO in relation to deduction u/s 37 of the interest on loans outstanding on the last day of the accounting year but allowed the benefit of increased liability for computation u/s 43A in relation to loss outstanding on the last day of the accounting year. Hence, the assessee as well as department took the matter in appeal to the Appellate Tribunal. The Tribunal held that the loss claimed by the assessee on revenue account was allowable u/s 37(1) and also rejected the appeal of the department and held that the assessee was entitled to adjust actual cost on imported assets acquired in foreign currency on account of fluctuation in the rate of exchange in terms of section 43A. On appeal by the department, the Hon'ble High Court reversed the decision of the Tribunal on both the issues. On further appeal to the Apex Court, the decision of the High Court was reversed and it was held that (a) that the loss claimed by the assessee on account of fluctuation in the rate of foreign exchange as on the date of the balance-sheet was allowable as an The Paper Products Ltd. 6 expenditure u/s 37(1), and (b) that the assessee was entitled to adjust the actual cost of imported assets acquired in*

*foreign currency on account of fluctuation in the rate of exchange at each of the relevant balance sheet dates, pending actual payment of the liability u/s 43A, prior to its amendment by Finance Act, 2002.*

*11. In view of above decisions, it is clear that the loss due to foreign exchange fluctuation in foreign currency transactions in derivatives has to be considered on the last date of accounting year and it is deductible u/s 37(1) of the Act. Therefore, in allowing the said claim of the assessee by AO, the action of the AO is in consonance with the decisions of the Hon'ble Apex Court and also the view taken by the Tribunal in the cases cited hereinabove (supra). Hence, the view taken by AO to allow loss of Rs.43.78 crores while making assessment u/s 143(3) on account of derivative contract outstanding is not an erroneous view taken by AO , nor the action of AO is prejudicial to the interest of revenue. Hence, the order of Commissioner of Income Tax u/s 263 of the Act to hold that the action of AO is erroneous to the extent the loss considered as allowable on account of derivative contracts outstanding as on the date of balance sheet i.e. 31.3.2008 is neither justified nor in accordance with law. Hence, we quash the said order of Id. Commissioner of Income Tax by allowing the grounds of appeal taken by the assessee."*

*8. Thus, following the aforesaid decisions, which in turn, are based on the ratio laid down by the Hon'ble Supreme Court in Woodward Governor (India) P. Ltd. (supra), we set aside the impugned order passed by the learned Commissioner (Appeals) and direct the Assessing Officer to allow the loss claimed by the assessee on account of marked to market loss on foreign exchange contract amounting to Rs. 1,13,88,976. Thus, ground no.1, raised by the assessee is allowed".*

5. Thus, respectfully following the decision of the coordinate bench of this tribunal the Marked to Market loss claimed by the assessee was liable to be allowed. Hence, Ground No. 1 of the appeal is allowed.
6. The Ground No.2 is related with enhancement enhancing the income by a sum of Rs. 2,07,29,381/- on settlement or cancellation of forward contracts by treating it as speculation loss. The ground no. 3 is that CIT(A) while enhancing the income again made the disallowance of Rs. 41,52,450/- (double disallowance)
7. The Id. AR for assessee argued that assessee suffered loss on forex contracts matured during the year, for which the assessee were entitled for the purpose of hedging against Forex Fluctuation risk. The Id. CIT(A) issued notice for enhancement and disallowed the amount holding that the same constitutes speculation loss. It was argued by the Id. AR for assessee that forex contracts were entered only for the purpose of hedging, details of which are available at page no. 82 to 125 of PB. The Id. AR for assessee argued that the disallowed

amount includes Rs. 41,52,450/- which resulted in double disallowance on account of loss suffered on forex cancelled contracts. The Id. AR relied on the decision of Mumbai Tribunal in London Star Diamond Co. I. Pvt. Ltd. vs. DCIT (2013) 38 taxmann.com 38 (Mum) (Trib.). Without prejudice in alternative, it was submitted that disallowance on this count should be at Rs. 1,65,77,381/-, (2,07,29,831 – 41,52,450). The Id. DR for Revenue strongly relied on the decision of the Id. CIT(A).

8. We have considered the rival contentions of the parties and perused the material available on record. The Id. CIT (A) during the first appellate stage, issued notice for enhancement as to why, the loss of cancellation of forward sale contract should not be disallowed. The Id. AR for the assessee contended that they entered into forward contract to hedge the foreign exchange fluctuation. The assessee relied on sub-section 5 of section 43 of the Act and contended that loss suffered in forward exchange contract is not a speculation loss. The Id. CIT(A) concluded that the assessee failed to discharge the onus lies upon him. We have seen that the assessee has placed on record the export invoices at (page 84 to 127 of PB) which has not been examined at the end of Id. CIT(A). Hence, we deem it appropriate to restore this ground of appeal to the file of AO to examine if the contract entered into by assessee is hedging contract as per the provisions of section 43(5) on speculative transaction as per the provisions of section 73 of the Act. The AO shall examine the issue in accordance with the decision of London Star Diamond Co.I. Pvt. Ltd. (supra). The AO shall further examine, if there is double disallowance of amount of Rs. 41,52,534/-. After examining the issue the AO shall pass order in accordance with law. Thus, Ground No. 2 & 3 of appeal are allowed for statistical purpose.

9. In the result, appeal filed by the assessee is allowed.

Order pronounced in the open court on 26<sup>th</sup> October 2016.

Sd/-

Sd/-

**(R.C.SHARMA)**

**(PAWAN SINGH)**

**ACCOUNTANT MEMBER**

**JUDICIAL MEMBER**

Mumbai; Dated 26/10/2016

S.K.PS

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

BY ORDER,

(Asstt.Registrar)  
**ITAT, Mumbai**