

आयकर अपीलीय अधिकरण, 'बी' न्यायपीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH, CHENNAI

श्रीएन.आर.एस. गणेशन, न्यायिकसदस्य एवं
श्री ए. मोहन अलंकामणी, लेखा सदस्य केसमक्ष

BEFORE SHRI N.R.S. GANESAN, JUDICIAL MEMBER AND
SHRI A. MOHAN ALANKAMONY, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No. 1510/Mds/2015
निर्धारण वर्ष /Assessment Year : 2009-10

S.P.Apparels Ltd.,
39-A, Extension Street,
Kaikattipudur,
Avinashi – 641 654.

v. The Deputy Commissioner of
Income Tax,
Company Circle,
Tirupur.

PAN : AAJCS4031P

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

आयकर अपील सं./ITA No. 1699/Mds/2015
निर्धारण वर्ष /Assessment Year : 2009-10

The Deputy Commissioner of
Income Tax,
Circle -I,
Tirupur.

v. M/s. S.P.Apparels Ltd.,
39-A, Extension Street,
Kaikattipudur,
Avinashi – 641 654.

PAN : AAJCS4031P

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

Assessee by : Shri. T.Banusekar, C.A.
Department by : Shri. M.M.Bhusari, CIT

सुनवाईकीतारीख/Date of Hearing : 22.06.2016

घोषणाकीतारीख/Date of Pronouncement : 09.09.2016

आदेश / O R D E R**PER N.R.S. GANESAN, JUDICIAL MEMBER:**

Both the appeals of the assessee and revenue are directed against the same order of CIT(A) -3, Coimbatore dated 31.03.2015 and pertains to Assessment year 2009-10. Therefore, we heard the same together and disposing of the same by this common order.

2. Let us first take the assessee's appeal in ITA No.1510/Mds/2015. The first ground of appeal is disallowance of Rs.10,97,35,472/- as 'speculative loss'. Shri T.Banusekar, the learned representative for the assessee submitted that the assessee entered into cross currency hybrid option contract with several banks for the purpose of business. Subsequently, due to fluctuation in the foreign currency market, the assessee has suffered loss. The assessee claimed before the Assessing Officer derivative transaction in foreign currencies are not speculative transactions, therefore, the loss suffered by the assessee has to be allowed as a deduction while computing the taxable income.

3. The learned representative further submitted that the derivative transaction was carried on by the assessee in conformity with the guidelines issued by the Reserve Bank of India from time to time and it

was relatable to export orders. The transaction in foreign currency was made for the purpose of business and in the course of business. Therefore, the loss suffered by the assessee according to the learned representative shall be treated as business loss. An identical issue was considered by this tribunal in the assessee's own case in ITA 1327/Mds/2014 for the Assessment Year 2008-09 and this Tribunal found that an identical issue was considered by this Tribunal in M/s. SCM Garments Pvt.Ltd., in ITA No.1645/Mds/2013 and 2275/Mds/2014 dated 27.02.2015. After extracting the relevant finding of the Tribunal in M/s.SCM Garments Pvt.Ltd., this Tribunal found that an identical loss suffered by the assessee on the derivative transaction due to fluctuation in foreign currency was a business loss, therefore, it has to be allowed to be set off while computing the taxable income. Accordingly, the claim of the assessee was allowed and in view of the coordinate bench decision of this Tribunal in the assessee's own case for Assessment Year 2008-09, according to the learned representative, the CIT(A) is not justified in confirming the disallowance made by the assessing officer as speculative loss.

4. On the contrary, Shri M.M.Bhusari, the learned representative for the department submitted that admittedly, the assessee entered into Hybrid Option Contract with several banks purportedly, for the purpose of its business. According to the learned department representative, the

transaction carried on by the assessee is in the nature of speculative transaction with the intention to earn fast money in the fluctuating foreign currency market. In fact, the assessee claimed a sum of Rs.23.21 crores as loss on the derivative transaction. The assessing officer after examining the transaction of the assessee, found that forward contract entered into by the assessee was also a derivative. The assessing officer further found that derivative transaction in foreign currency would be normally used by exporters and importers to hedge their currency exposures. By entering into contract to sell currencies including cross currencies, the assessee in fact entered into speculative transaction for the purpose of exploiting fluctuation in foreign currency market. Referring to the series of activities done by the assessee with various banks, the assessing officer found that the assessee made an attempt to make quick money in the fluctuating foreign exchange market.

5. The learned department representative further submitted that the assessee had a regular transaction with State Bank of Mysore, Avinashi Branch through which the assessee was receiving the export proceeds. The assessee has also entered into contract with other banks namely ABN Amro Bank, HDFC Bank, Citi Bank, IDBI Bank, etc. for carrying on the transaction in foreign exchange derivative. The assessing officer found that the foreign derivatives are also commodities. Therefore, the hedging activity carried on by the assessee in the foreign exchange

currency has to be necessarily treated as speculative transaction. The loss or profit has to be necessarily treated as arising out of speculative transaction. Therefore, the assessee cannot set off the loss on speculative transaction while computing the taxable income.

6. We have considered the rival submissions on either side and also perused the material available on record. The assessee entered into the Cross Currency Hybrid Derivative Contract with Axis Bank, Citi Bank, HDFC Bank, IDBI Bank, ING Vysya Bank and ABN Amro Bank. Admittedly, the above six bankers are not regular bankers for the assessee. Admittedly, the assessee had regular transaction with State Bank of Mysore, Avinashi Branch. From the order of the CIT(A), it appears that Citi Bank is also one of their regular banker for assessee. The main contention of the assessee before this Tribunal is that derivative contract entered into by the assessee have a contract underlying currency exposure on account of export proceeds receivable by the assessee. The assessee also contends before this Tribunal that foreign exchange is not a commodity. Therefore, it is outside the purview of Section 43(5) of the Income Tax Act. The CIT(A) after examining the provisions of Section 43(5) of the Income Tax Act found that derivative transactions are excluded from the provisions of Section 43(5) of the Act.

7. However, by placing reliance on the decision of this Tribunal in *Craftsman Automation (Pvt.) Ltd. Vs. Additional Commissioner of Income Tax, Range –IV, Coimbatore* in ITA No.2153/Mds/2011 found that the derivative transaction entered into by the assessee are short term speculative transaction. Hence, the loss suffered by the assessee to the extent of Rs.10,97,35,472/- has to be treated as speculative loss.

8. We have carefully gone through the provisions of Section 43(5) of the Income Tax Act. Section 43(5) defines “speculative transaction” as “Speculative transaction is one in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips”. This Tribunal in the assessee’s own case for the assessment year 2008-09 found that a similar arrangement made by the assessee to protect the loss that may arise due to foreign exchange fluctuation in the export of garments to various countries has to be allowed as business loss. In fact, by placing reliance on the earlier decision of this Tribunal in the case of *SCM Garments Pvt.Ltd.*, it was found that the loss suffered by the assessee has to be allowed as business loss. This Tribunal has also placed its reliance on the judgment of the Bombay High Court in the case of *CIT Vs. Badridas Gauridu (P) Ltd.* reported in [2003] 261 ITR 256 (Bom.). In view of this decision of the Tribunal in the assessee’s own case, this Tribunal is of the considered

opinion that the loss suffered by the assessee on the derivative transaction pursuant to cross currency hybrid derivative contract with several banks are business loss, therefore, it has to be allowed as 'business loss' while computing the taxable income. Therefore, this Tribunal is unable to uphold the order of the lower authorities. Accordingly, the orders of the lower authorities are set aside. The assessing officer is directed to allow a sum of Rs.10,97,35,472/- as business loss.

9. The next ground of appeal is disallowance made by the assessing officer under Section 14A of the Act. Shri T.Banusekar, the learned representative for the assessee submitted that the assessee disclosed a sum of Rs.12,22,743/- as dividend income exempted from tax. The assessee claimed before the assessing officer that no expenditure was incurred. However, the assessing officer found that 0.5% of the average value of the investment to the extent of Rs.7,99,000/- has to be added to the return income. Referring to Rule 8D of the Income Tax Rule, the learned representative for the assessee submitted that under Rule 8D (2)(iii), 0.5% of the average investment as disclosed in the balance sheet income from which does not form part of the total income has to be taken into consideration. In this case, the assessing officer has taken the entire investment made by the assessee.

Therefore, according to the learned representative, the assessing officer is not justified in making an addition of Rs.7,99,000/-.

10. On the contrary, Shri M.M.Bhusari, the learned representative for the department submitted that even though a specific ground was raised by the assessee with regard to the disallowance made under Section 14A read with Rule 8D, the CIT(A) has not recorded any finding. In fact, the CT(A) has disposed off the ground which relates to derivative transactions and he has not recorded any finding with regard other grounds raised by the assessee. Therefore, the matter may be remanded back to the file of the CIT(A) for re-consideration.

11. We have considered the rival submissions on either side and also perused the material available on record. The assessee has specifically raised a ground with regard to disallowance of Rs.7,99,000/- under Section 14A. As rightly submitted by the department representative, the CIT(A) while reproducing the grounds raised by the assessee has taken out the disallowance made by the assessing officer under Section 14A. However, he has not recorded any finding with regard to grounds raised by the assessee. Therefore, this Tribunal is of the considered opinion that the matter needs to be reconsidered. The disallowance under Section 14A has to be estimated on the basis of the method prescribed under Rule 8D(2) of Income Tax Rules. Even though, the assessee claims that

no expenditure was incurred for earning the exempted income, the assessing officer was expected to compute the expenditure in case he is not satisfied about the claim made by the assessee. The assessing officer apparently has taken 0.5% of the average value of the investment without considering the income earned by the assessee which does not form part of the total income. The assessing officer has not considered Rule 8D(2)(ii) with regard to expenditure incurred by the assessee which is not directly attributable to any particular income.

12. Therefore, this Tribunal is of the considered opinion that it needs to be reexamined by the assessing officer instead of CIT(A) as suggested by the department representative. Accordingly, the orders of the lower authorities are set aside and the disallowance made by the assessing officer under Section 14A is remitted back to the file of the assessing officer. The assessing officer shall re-examine the matter afresh in the light of the material that may be filed by the assessee and therefore compute the disallowance strictly as per the provisions of Rule 8D(2) of the Income Tax Rules.

13. The next ground of appeal of the assessee relates to the deduction under Section 35D of the Income Tax Act. Shri T.Banusekar, the learned representative for the assessee submitted that the assessee claimed Rs.14,44,673/- being the 1/5th expenditure under Section 35D of

the Act. According to the learned representative, this is the third year claim of the capital issue expenses to the extent of Rs.72,23,365/-. The Assessing Officer as well as the CIT(A) has not considered the claim of the assessee.

14. On the contrary, Shri M.M.Bhusari, the learned representative for the department submitted that it is not known whether the assessee made a claim under Section 35D before the Assessing Officer. However, the grounds reproduced by the CIT(A) shows that the assessee raised the issue before the CIT(A). Therefore, the CIT(A) ought to have disposed off the grounds raised by the assessee. Since the CIT(A) has not disposed off the grounds, the learned representative submitted that the matter may be remitted back to the file of the CIT(A) or the Assessing Officer.

15. We have considered the rival submissions on either side and also perused the material available on record. The claim of deduction under Section 35D was not considered by the Assessing Officer as well as by the CIT(A). Therefore, this Tribunal is of the considered opinion that in the interest of justice, the Assessing Officer has to consider the issue first. Accordingly, the claim made by the assessee under Section 35D is remitted back to the file of the Assessing Officer. The Assessing Officer shall reconsider the issue with regard to the claim made by the assessee

under Section 35D and decide the same in accordance with law after giving reasonable opportunity to the assessee.

16. Now coming to the revenue's appeal in ITA No.1699/Mds/2015, the only issue arises for consideration is disallowance of speculation loss of Rs.12,23,87,167/- on account of cancellation of foreign currency forward contract. Shri M.M.Bhusari, the learned department representative submitted that even though the CIT(A) treated transaction as speculative loss in respect of cancellation of forward contract, the CIT(A) found that cancellation of forward contract cannot be equated without derivative contract. According to the learned department representative, the forward contracts are not relatable to any specific export bills of the assessee. The assessee failed to substantiate the transaction in respect of export bills. Therefore, the CIT(A) is not correct in allowing the claim of the assessee.

17. On the contrary, Shri T.Banusekar, the learned counsel for the assessee submitted that the assessee entered into forward contract in the ordinary course of business as on export of garments. The CIT(A) after considering the material available on record found that the contract note filed by the assessee shows that the forward contract is the part of the regular business activity of the assessee. The CIT(A) placing his reliance on the judgment of the Gujarat High Court decision in the case of

CIT Vs. Panchmahal Steel reported in [2013] 215 taxmann 140 (Guj.) and the judgment of Bombay High Court in the case of CIT Vs. Badridas Gauridu (P) Ltd. reported in [2003] 261 ITR 256 (Bom.) found that the assessee has entered into forward contract in the ordinary course of business transaction. Therefore, the loss arising from forward contract has to be treated as a normal business loss. Accordingly, he allowed the same.

18. We have considered the rival submissions on either side and also perused the material available on record. Admittedly, the assessee is engaged in the business of export of garments to various countries. In the course of business activities, the assessee claims that it entered into forward contract to guard itself from the loss that may be incurred due to foreign exchange fluctuation. However, the assessing officer disallowed the claim of the assessee on the ground that the forward contracts entered into by the assessee are in the nature of speculative transaction. As discussed earlier, this Tribunal is of the considered opinion that the derivative transaction entered into by the assessee to guard itself from the loss that may arise due to foreign exchange fluctuation cannot be considered to be a speculative transaction. Therefore, the CIT(A) has rightly allowed the claim of the assessee by placing his reliance in Gujarat High Court decision in the case of Panchmahal Steel and the judgment of Bombay High Court in the case of Badridas Gauridu (P) Ltd.

cited supra. Therefore, this Tribunal do not find any reason to interfere with the order of CIT(A). Accordingly, the same is confirmed.

19. In the result, the appeal of the assessee in ITA No. 1510/Mds/2015 is allowed and the revenue's appeal in ITA No.1699/Mds/2015 is dismissed.

Order pronounced on 09th September, 2016 at Chennai.

Sd/-

(ए. मोहन अलंकामणी)

(A. Mohan Alankamony)

लेखा सदस्य/Accountant Member

Sd/-

(एन.आर.एस. गणेशन)

(N.R.S. Ganesan)

न्यायिक सदस्य/Judicial Member

चेन्नई/Chennai,

दिनांक/Dated, the 09th September, 2016.

sp.

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.