IN THE INCOME TAX APPELLATE TRIBUNAL DELHI
(DELHI BENCH 'E' NEW DELHI)

BEFORE SH. PRADIP KUMAR KEDIA, ACCOUNTANT MEMBER
AND
SH. YOGESH KUMAR U.S., JUDICIAL MEMBER

ITA No. 6160/Del/2016 (A.Y. 2009-10)

DCIT Circle 13(2) C. R. Building New Delhi	Vs.	J. K. Techno soft Ltd. A-2, Shopping Complex, Masjid Moth, Greater Kailsah Part-II New Delhi **PAN: AAACJ0381L**
Appellant		**Respondent**

Assessee by	Shri Neeraj Jain, Adv & Sh. Himanshu Goel, CA
Revenue by	Shri Rajesh Mahajan, Sr. DR

Date of Hearing	18/04/2024
Date of Pronouncement	30/04/2024

ORDER

PER YOGESH KUMAR, U.S. JM:

This appeal is filed by the Assessee against the order of Learned Commissioner of Income Tax (Appeals) ["Ld. CIT (A)", for short], dated 26.08.2016 for the Assessment Year 2009-10.

2. The Grounds of Appeal are as under:-

"1. That the Ld. CIT (A) has erred on facts and in law in deleting the addition of Rs.55, 62,952/- made by the AO, being the loss on valuation of forward foreign exchange contract on M2M basis, a national loss, holding the same to be an allowable business loss."

2. "That CIT (A) erred on facts and in law in deleting the addition of Rs. 4,18,22,913/- made by the AO allowed by the CIT (A) although being of speculative nature.

3. "That the CIT (A) erred on facts and in law in deleting an addition of Rs. 18,44,736/-, being of speculative nature but treating the same as business loss."

4. That the grounds of appeal are without prejudice to each other.

5. That the appellant craves leave to add, alter, amend or forego any ground(s) of appeal raised above at the time of the hearing."

3. Brief facts of the case are that, the assessee filed return declaring current year loss of Rs. 59,76,849/-, the assessee also declared book profit u/s 115JB of the Income Tax Act, 1961 ('Act' for short) at Rs. 1,72,65,860/- and the tax has been paid on book profits. The assessment order came to be passed by assessing the income of the assessee at Rs. 4,32,53,750/- by making addition on account of difference in foreign exchange (M2M) of Rs. 55,62,952/-, on account of loss on forward contracts being speculative in nature of Rs. 4,18,22,913/- and addition on account of loss on forward premium account being speculative in nature at Rs. 18,44,736/-. Aggrieved by the assessment order dated 25/03/2013, the assessee preferred an Appeal before the CIT(A), the Ld. CIT(A) vide order dated 26/08/2016, deleted the addition made by the A.O. As against the order of the Ld. CIT(A) the

Department of Revenue has preferred the present Appeal on the grounds mentioned above.

4. The Ground No. 1 is regarding deletion of addition of Rs. 55,62,952/- made by the A.O. being the loss on valuation of foreign exchange contract on M2M basis. The Ld. Departmental Representative submitted that the Ld. CIT(A) has erred in deleting the said addition holding the same to be an allowable business loss. The Ld. Departmental Representative relying on the findings of the A.O. sought for intervention by the Tribunal.

5. Per contra, the Assessee's Representative relying on the order of the Ld. CIT(A), submitted that the Ground No. 1 sans merit and the order of the CIT(A) requires no interference.

6. We have heard both the parties and perused the material available on record. The Ld. A.O. while making the addition observed that claim of deduction on account of losses computed on Mark to Market basis cannot be allowed as the losses have not crystallized. The M2M losses merely represents a notional loss computed on a particular date with reference to the prevailing exchange rate in respect of contracts that have not matured i.e. the contracts are open contracts. The accounting of the

same is done in accordance with the AS 30 applicable to companies. It in no way represent the actual loss or crystallized loss. Therefore, M2M profits or losses have to be reversed while computing total taxable income under the Income Tax Act. Central Board of direct taxes have also vide Instruction No. 3 of 2010 clarified that M2M losses being notional in nature are not deductible. In the circumstances the loss of Rs. 55,62,952/- on account of difference in foreign exchange computed on M2M basis has been is disallowed by the A.O.

7. The Ld. CIT(A) while adjudicating the issue deleted the above said disallowance in following manners:-

> *"8. With regard to the ground no.2 related to the disallowance of loss of Rs.55,62,952/- being loss on valuation of forward exchange contract on Mark to Market basis, held by the AO as notional loss, the appellant has provided its elaborate submissions as reproduced earlier. It has been argued that as per the Accounting Standards and General Accounting Principles, the loss was required to be accounted for on the value of such foreign currency on the date of balance sheet. The appellant has claimed losses of Rs.55,62,952/- on the basis of fall in value of foreign currency, on the balance sheet date, even though the contract was suppose to be completed at a later date. It is further argued that this loss has been crystallized on the date of balance sheet, as the appellant is following the mercantile system of accounting. It is stated that there was no existing relationship between aforesaid derivative contracts and actual export transactions and accordingly, gain/loss on such options was required to be and was recognized in the profit and loss account of the year under consideration. It is also demonstrated by the appellant that it is consistently following the same method of accounting in*

different assessment years, and the profits earned in some of the years have been offered for taxation.

8.1 The AO considered this loss as not crystallized due to the fact that the value of foreign currency is subject to change on the date of completion of such contracts in future, and hence it is a contingent and un-crystallized loss. Thus, the same was not allowed.

8.2 The appellant has relied upon various decisions wherein the same issue was discussed and decided. It has been stated that in the case of CIT vs. Woodward Governor India P. Ltd. 312 ITR 254, the Hon'ble Supreme Court has elaborately discussed this issue and held that loss suffered by the assessee in respect of a revenue liability on account of exchange difference as on the date balance sheet would be allowable as expenditure under section 37(1) of the Act, in the year of accrual. The appellant has also mentioned the decision of Hon'ble Bombay High Court in the case of VS Dempo and Co. P. Itd. 206 ITR 291 wherein it is held that loss arising in the process of conversion of foreign currency is a trading loss. It was contended that the appellant booked forward contracts to hedge against the foreign currency fluctuation risk to business transaction viz. export orders under taken by the appellant and hence the taking of the aforesaid hedge cover was incidental to its business. The forward contracts were related to the exports proceeds expected to be received in the course of business and not for acquisition for any capital assets and hence the loss is arising on revenue account and allowable. It is further submitted that the contracts entered by the appellant are binding and enforceable in law and hence the loss incurred on the date of balance sheet, due to the adverse exchange fluctuations would be allowable under the mercantile system of accounting, notwithstanding that the same had not been actually paid. It is also stated that it is not a notional loss in view of the decision of Hon'ble Supreme Court discussed in the case of Woodward Governor, (Supra).

8.3 It is to be mentioned that the AO has placed reliance on the instruction 3/2010 dated 23.03.2010, issued by CBDT with respect to the speculative transactions, clarifying

regarding allowing loss on account of Forex derivatives. As per the said instruction the mark to market losses where no sale or settlement has actually taken place and the such loss on marked to market basis has resulted in reduction of book profits, such a notional loss would be contingent in nature and cannot be allowed to be set off against the taxable income and the same should therefore be added back for the purpose of computing the taxable income of an assessee.

8.4 In a recent judgment as brought out by the appellant in the case of Bechtel India P. Ltd. vs. Addl. CIT Range-2 33 Taxmann.com 213, dated 08.03.2013 for AY 2008-09, the Hon'ble ITAT Delhi Bench decided the issue in the favour of assessee on its appeal, placing reliance in the case of Woodward Governor India P. Ltd. (supra) It has been held by the Hon'ble ITAT that:-

> *Coming to the corporate additions i.e. disallowance of loss, it clearly emerges from the record that the assessee in respect of foreign exchange realization follows mercantile system of accounting and not cash system of accounting. The loss has been incurred for hedging of foreign currency fluctuation involved in sales invoices on the basis of forward contracts, which is a business decision to safeguard its interest, The loss has been incurred on the basis of scientific method in the ordinary course of business. The loss being based on a scientific method, on the basis of contractual liability with banks and on mercantile system has to be allowed to the assessee following Hon'ble Supreme Court judgment in the case of Woodward Governor India (P.) Ltd. (supra). Our view is further fortified by the fact that DRP in its own order in subsequent year has itself held that the issue about the loss on mercantile system is pending dispute in A.Y. 2008-09. Therefore, the allowability of the loss on actual payment in A.Y. 2009-10 has been made subject to the allowability of the loss for AY. 2008- 09. This stand of the DRP itself negates the observations of assessing officer that it is a notional loss and establishes that it is a business loss incurred by the assessee on mercantile system which method is consistently followed by the assessee. Under these circumstances, we are inclined to*

allow the foreign exchange fluctuation loss to assessee in this year. This ground of the assessee is allowed....."

8.5 As discussed earlier, the facts of the case of the appellant is similar to that of the case of Bechtel India P. Ltd. (Supra) and the said decision has been taken by the Hon'ble ITAT, after the date of instruction 3/10 by the CBDT, wherein the said instruction has also been mentioned. The Hon'ble ITAT relied upon the decision of Woodward Governor India P. Ltd. (Supra) by Hon'ble Supreme Court and therefore respectfully following the said judgments, the addition made with regard to loss in the forward contract for foreign currency, due to the fall in value on the date of balance sheet i.e. 31.03.2009, deserves to be allowed as the appellant is following mercantile method of accounting and disclosing profit/loss as the case may be, with the same method of working, the forward contract are hedged due to the business expediency and the losses are required to be accounted for as per the accounting principal. Therefore, in view of the above and elaborate discussions in the foregoing paragraphs, the losses amounting to Rs.55,62,952/s directed to be allowed. Accordingly, this ground of appeal is allowed."

8. The addition has been made with regard to loss in the forward contract for foreign currency due to the fall in value on the date of balance sheet i.e. 31/03/2009. It is not in dispute that the assessee is following mercantile method of accounting and disclosing profit/loss as the case may be with the same method of working, the forward contract are hedged due to the business expediency and the losses are required to be accounted for as per accounting principal. The Hon'ble Supreme Court in the case of CIT Vs. Woodward Governor India Pvt. Ltd. 312 ITR 254, held that the loss suffered by the assessee in respect of a revenue

liability on account of exchange difference as on the date balance sheet would be allowable as expenditure u/s 37(1) of the Act, in the year of accrual. Further in the case of VS Dempo & Co. Pvt. Ltd. 206 ITR 291 the Hon'ble Bombay High Court held that loss arising in the process of conversion of foreign currency is a trading loss. It was the case of the assessee before the authorities that the assessee booked forward contracts to hedge against the foreign currency fluctuation risk to business transaction viz export orders undertaken by the assessee and hence the taking of the aforesaid hedge cover was incidental to the business. The forward contracts were related to the exports proceeds expected to be received in the course of the business and not for acquisition for any capital asset and hence the loss is arising on revenue account, thus the same is allowable. The contracts entered by the assessee are binding and enforceable in law and hence the loss incurred on the date of balance sheet, due to the adverse exchange fluctuations would be allowable under the mercantile system of accounting entered that the same had not been actually paid, thus the same cannot be termed as notional loss in view of the decisions of the Hon'ble Supreme Court in the case of Woodward Governor (supra). The Co-ordinate Bench of the Tribunal by relying on the Judgment of the Hon'ble Supreme Court in the case of Woodward Governor (supra) in the case of Bechtel India

Pvt. Ltd. Vs. additional CIT reported in Taxman.com 213 dated 08/03/2013 held as under:-

> "*Coming to the corporate additions i.e. disallowance of loss, it clearly emerges from the record that the assessee in respect of foreign exchange realization follows mercantile system of accounting and not cash system of accounting. The loss has been incurred for hedging of foreign currency fluctuation involved in sales invoices on the basis of forward contracts, which is a business decision to safeguard its interest, The loss has been incurred on the basis of scientific method in the ordinary course of business. The loss being based on a scientific method, on the basis of contractual liability with banks and on mercantile system has to be allowed to the assessee following Hon'ble Supreme Court judgment in the case of Woodward Governor India (P.) Ltd. (supra). Our view is further fortified by the fact that DRP in its own order in subsequent year has itself held that the issue about the loss on mercantile system is pending dispute in A.Y. 2008-09. Therefore, the allowability of the loss on actual payment in A.Y. 2009-10 has been made subject to the allowability of the loss for AY. 2008- 09. This stand of the DRP itself negates the observations of assessing officer that it is a notional loss and establishes that it is a business loss incurred by the assessee on mercantile system which method is consistently followed by the assessee. Under these circumstances, we are inclined to allow the foreign exchange fluctuation loss to assessee in this year. This ground of the assessee is allowed....."*

9. Considering the above facts and circumstances and the settled position of law, we find no error in the order of the Ld. CIT(A) in deleting the subject addition and find no merit in the Ground No. 1 of the Revenue, accordingly, Ground No. 1 of the Revenue is dismissed.

10. Ground No.2 is regarding deleting the addition of Rs. 4,18,22,913/- made by the A.O. The Ld. Departmental Representative vehemently submitted that the CIT(A) committed error in deleting the above addition made by the A.O. although the same is being speculative in nature. The Ld. Departmental Representative relying on the findings of the A.O. sought for allowing the Ground No. 2 of the Revenue.

11. Per contra, the Assessee's Representative relying on the findings and the conclusion of the Ld. CIT(A) submitted that the Ground No. 2 of the Revenue is devoid of merit, accordingly sought for dismissal of the same.

12. We have heard both the parties and perused the material available on record. The assessee has declared loss of Rs. 4,18,22,913/- on account of loss on forward contracts during the year under consideration. As per the assessee, the losses suffered by the assessee are normal business losses and therefore deductable, the A.O. did not accepted the contention of the assessee and made the addition on the ground that since the transaction entered into Forex Directive by the assessee Company do not fall in the exclusionary clauses of Section 43(5) of the Act. The Forex Directive loss declared by the assessee Company

clearly falls within the definition of speculative transaction defined u/s 43(5) of the act and the speculative losses can only be set off against the speculative profits, the loss of Rs. 4,18,20,913/- debited to the profit and loss account on account of forward contract in foreign currency has been disallowed and added to the total income of the assessee Company. The said disallowance has been deleted by the CIT(A) in following manners:-

> *"9. In Ground Nos. 3 to 3.3., the assessee contested the disallowance of loss on forward contracts, which ahs been treated by the A.O. as speculation loss and hence not allowed to be set off with the current year's profit. The assessee has claimed loss on account of forward exchange contracts to the tune of Rs.4,18,22,913/- which was disallowed by the AO holding the same to be speculative in nature under section 43(5) of the Act. As reproduced earlier, in its submission, the appellant has stated that the provisions of section 43(5) of the Act apply only to transactions in "commodity" and the same is not applicable in the case of appellant as the foreign currency, in relation to which forward contracts were entered into, is not a "commodity" and hence does not qualify as speculative transactions. It is contended that in the circumstances, where there was no foreign remittance due to be received on the date of maturity of foreign contracts, the appellant, in order to safe guard its interest, resorted to cancellation of forward contracts on the respective dates of maturity and in compliance with the directions by FEDAI, the appellant paid the difference between the forward contract rate at the rate at which the cancellation was effected to/from ICICI Bank. Such rate differential coupled with the cancellation charges levied by the bank resulted in net loss of Rs.4,18,22,913/- on the cancellation of forward contracts.*
>
> *9.1 It has been contended by the appellant further that foreign currency are not a commodity with the meaning of section 43(5) of the Act and hence any dealing in such foreign currency will not be treated as speculated transaction. The term commodity has not been defined in the Act, however it refers to the*

tangible goods/article which can be traded. Here it is to be pointed out that appellant has emphasized that foreign exchange is not freely traded in the market and subject to various conditions and RBI norms. It is also contended that the appellant is not a dealer in foreign exchange and the contract in foreign exchange has been entered into in the normal course of business with certain legal obligations of the contract. This contract is entered into to hedge and safe guard the losses towards foreign exchange fluctuation.

9.2 The appellant has relied upon the various judgments, as reproduced earlier especially the decision of Hon'ble ITAT Delhi in the case of Munjal Showa Ltd. vs. DCIT 94 TTJ 227 wherein it is held that the foreign currency cannot be regarding as commodity for the purpose of the said section and accordingly derivate/forward contract in respect of same cannot also be considered as commodity for the purpose of said section.

9.3 It is also stated that the derivate contracts were genuine hedging contracts and were not entered into with the intention of speculation or deal in the same. It is mentioned that the RBI does not allow a resident person to enter into such derivative contracts, unless the same is to hedge the foreign currency fluctuations, arising in the normal course of business. If contracts are not for such purpose, the same are liable to be cancelled by RBI/banks, authorized dealers. It is stated that the losses has been incurred in the normal course of business transaction, for the purpose of hedging the foreign currency fluctuation risk. In some of the cases premature cancellation of contract has been done with a view to cut further losses that would have arisen, if the contract were to run their full course.

9.4 Therefore, it is contended that neither the foreign exchange contracts are commodity within the meaning of provisions of section 45(3) of the Act, nor the action and purpose for which the forward contract was entered into has any motive towards earning speculation profit, as it is not permissible to make such speculation.

9.5 The contention of the appellant has been considered and also the ratio laid down in the case laws mentioned therein is found applicable in the case of appellant. The appellant is not a

dealer in foreign exchange and contract in foreign exchange were to safe guard the business interest of the appellant and conducted in the regular course of business. Therefore, it cannot be termed as speculative in nature as no motive or action in this regard is present. It is true that there has been no delivery of foreign exchange, but the forex being not a traded commodity as held by the Hon'ble ITAT Delhi, cannot be treated as "commodity." Therefore, respectfully following the decision of Hon'ble ITAT Delhi in the case of Munjal Showa Ltd. vs. DCIT 94 TTJ 227 and also the decision of Hon'ble Calcutta High Court in the case of CIT vs. Soorajmull Nagarmull 129 ITR 169 and other case laws as mentioned therein, which is applicable in the case of appellant, the addition so made by the appellant treating the same as speculative in nature is not tenable and deserves to be deleted accordingly. The assessee gets a relief of Rs. 4,18,22,913/-. This Ground of appeal is allowed accordingly."

13. The assessee is not a dealer of Foreign Exchange and contract in foreign exchange were to safeguard the business interest of the assessee and conducted in regular course of business, therefore, it cannot be termed as speculative in nature as no motive or action in this regard is in exist. It is not in dispute that there has been no delivery of foreign exchange, but the Forex Company being not a traded commodity as held by the Co-ordinate Bench of the Tribunal in the case of Munjal Showa Ltd. Vs. DCIT 94 TTJ 227 and the decision of Hon'ble Karnataka High Court in the case of CIT Vs. Soorajmull Nagarmull 129 ITR 169. The Ld. CIT(A) while deleting the addition has relied on the above judicial precedents. In the absence of any contrary facts or the ratio brought to the notice of the Bench, we find no error or infirmity in the order of the

Ld. CIT(A) in deleting the addition, accordingly we dismiss the Ground No. 2 of the Revenue.

14. Ground No. 3 is regarding deleting the addition of Rs. 18,44,736/-. The Ld. Departmental Representative vehemently submitted that the Ld. CIT(A) committed error in deleting the above addition being speculative in nature but erroneously treated the same as business loss which requires interference at the hands of the Tribunal and by relying on the findings of the A.O., the Ld. Departmental Representative sought for allowing the Ground No. 3 of the Revenue.

15. Per contra, the Assessee's Representative relying on the order of the CIT(A) submitted that the losses incurred on cancellation of forward contract was treated as business loss, therefore, the Ld. CIT(A) rightly held that the expenditure claimed under the forward premium account is also treated as business expenditure which requires no interference at the hands of the Tribunal.

16. We have heard both the parties and perused the material available on record. During the previous year the assessee claimed deduction of Rs. 18,44,736/- under the forward premium account which represents the amortized loss, computed as the difference between the forward rate

and the spot rate at the date of the inspection of the forward exchange contract. The A.O. disallowed the same holding that expenditure claimed by the assessee is speculative in nature and hence not allowable as business expenditure which has been deleted by the Ld. CIT(A). We have already dealt with the issue in Ground No. 2 and held that the Ld. CIT(A) has committed no error in deleting the addition observing that the forward mark contracts on foreign currency is incurred during the normal course of business and the losses incurred are the part and parcel of the business activity of the assessee, which are allowable as business expenditure and not speculative in nature, thus any expenditure incurred for such premium account computed as difference between the forward rate and the spot rate in such contract is also to be treated as business expenditure incurred in the course of business by the assessee. Considering the above facts and circumstances, we find no error in the order of the Ld. CIT(A) in deleting the addition of Rs. 18,44,736/-, accordingly, the Ground No. 3 of the Revenue is dismissed.

17. Ground No. 4 & 5 being general in nature which requires no adjudication.

18. In the result, the Appeal of the Revenue in ITA No. 6160/Del/2016 is dismissed.

Order pronounced in the open court on 30th April, 2024.

Sd/- **Sd/-**

(PRADIP KUMAR KEDIA) **(YOGESH KUMAR U.S.)**
ACCOUNTANT MEMBER **JUDICIAL MEMBER**

Date:- 30 .04.2024

*****RN, Sr. PS*****

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT, NEW DELHI