IN THE INCOME TAX APPELLATE TRIBUNAL
"I" BENCH, MUMBAI

SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER
SHRI RAHUL CHAUDHARY, JUDICIAL MEMBER

ITA No. 884/MUM/2003
(Assessment Year: 1993-94)

Deputy Director of Income Tax
(International Taxation)-2(1),
R. No. 523, 5th Floor,
Aayakar Bhavan, Mumbai-400020 .... **Appellant**

Standard Chartered Bank Vs
23-25, M. G. Road, Mumbai-400001
[PAN 35035CT8327] .... **Respondent**

CO No. 161/MUM/2003
Arising out of ITA No. 884/Mum/2003
(Assessment Year: 1993-94)

Standard Chartered Bank
23-25, M. G. Road, Mumbai-400001
[PAN 35035CT8327] .... **Appellant**

Deputy Director of Income Tax Vs
(International Taxation)-2(1),
R. No. 523, 5th Floor,
Aayakar Bhavan, Mumbai-400020 .... **Respondent**

Appearance

For the Appellant/Department	:	Shri Shri Soumendu Kumar Dash
For the Respondent/Assessee	:	Shri P. J. Pardiwala, Sr. Advocate Shri Madhur Agrawal

Date

Conclusion of hearing	:	01.05.2023
Pronouncement of order	:	27.07.2023

O R D E R

Per Rahul Chaudhary, Judicial Member:

1. The present appeal filed by the Revenue and Cross-Objection filed by the Assessee arise from the order of Commissioner of Income

Tax (Appeals)-XXIV [hereinafter referred to as 'the CIT(A)'] passed on 25/11/2002 for the Assessment Year 1993-94, which in turn arose from the Assessment Order, dated 20/09/1996, passed under Section 143(3) of the Income Tax Act, 1961 [hereinafter referred to as 'the Act'].

2. The Revenue has raised the concise grounds of appeal:

> 1. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing to delete the addition of Rs. 10,00,000/- made by disallowing the conveyance expenses incurred by employees on tour under Rules 6D without appreciating the fact that conveyance expenses on tour are part of tour expenses and are to be treated as per Rule 6D of IT Rules, 1962."*
>
> 2 *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the disallowance of Rs. 16,72,890/- made u/s. 37(2) in respect of the entertainment expenses incurred on assessee's employees on the ground that the expenditure incurred on its employees was incurred at the place of their work and therefore not covered u/s. 37(2)"*
>
> 3. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing the AO to delete the disallowance of Rs. 5,00,000/- made on account of club expenses."*
>
> 4. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition made of Rs. 1,15,75,022/- on account of unrealised forward profit on the ground that the forward transaction in foreign exchange have not been actually settled and therefore income has not accrued to the assessee."*
>
> 5. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing the Assessing Officer to allow claim in respect of bad debts recovered to the extent of Rs. 70,30,360/- on the ground that the bad debts recovered during the year cannot be subjected to tax as the provisions created for such debt in earlier years have not been allowed as deduction.*
>
> 6. *On the facts and in the circumstances of the case and in law,*

the Ld. CIT(A) erred in deleting the addition of Rs. 70,401/- made on account of penal interest charged by the RBI on the ground that the amount of Rs. 70,401/- neither represent a penalty nor a penal interest but the differential interest on the CRR balance maintained with RBI.

7. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 5,17,32,848/- made on account of broken period interest paid on purchase of securities, which were lying in stock at the end of the previous year on the ground that in case of trading in security, total cost of purchase of security, which included broken period interest and debited to P & A A/c. is an allowable deduction.*

8. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 14,23,38,910/- made on account of excess interest paid under Corporate Cash Deployment Scheme (CCDS) on the ground that the assessee has not claimed any deduction of expenses by way of interest and no penalty or prosecution has been imposed u/s. 46 or 47A of Banking Regulation Act or Sec. 58B of RBI Act and therefore infraction of law cannot be presumed for making disallowance of interest.*

9. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 74,86,000/- plus Rs. 4,91,500/- made on account of loss in transaction with broker on the ground that the assessee has not contravened provisions of sec. 15 of SECRA and as per the delivery order, the securities were to be delivered to the broker himself and this amounted to written consent that the broker was the principal in the transaction.*

10. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing to delete the disallowance of Rs. 40,21,73,018/- on account of losses in ready forward transaction.*

11. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing the Assessing Officer to delete the disallowance on account o losses in Securities transactions to the extent of Rs. 756.96 crores out the total disallowance of Rs. 1094.14 crores made by the Assessing Officer on the ground that the loss to the extent of Rs. 756.96 crores is allowable deduction u/s. 28 and 36(i)(vii) of the I.T. Act, 1961.*

12. The appellant craves leave to amend or alter any ground or add a new ground which may be necessary."

2.1 The Revenue has raised the additional grounds of appeal:

12.1 On the facts and in the circumstances of the case and in law, apart from erring in deleting the disallowance of Rs. 40,21,73,018 referred to in Ground 10 the learned CIT(A) failed to appreciate that as per explanation to section 37(1) inserted by the Finance(No 2) Act 1998 with retrospective effect from 01/04/1962, any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction shall be made in respect of such expenditure.

12.2 The learned CIT(A) further failed to appreciate that this was pertained to those ready forward transactions which were prohibited by section 16 of Securities Contract Regulation Act, hence these transactions were illegal and loss pertaining to them was not allowable in terms of Explanation to section 37(1).

12.3 The learned CIT(A) further failed to appreciate that as held by the Hon'ble Supreme Court in the case of B.O.I. Finance Ltd vs. Custodian And others [1997-(010)-SSC-0488-SC dated 19/03/1997], the purchase value of the shares/ securities relating to such illegal ready forward transactions could not be allowed as a deduction and consequently there could not be any loss.

12.4 The learned CIT(A) ought to have disallowed the entire purchase value of all illegal ready forward transactions.

12.5 It is prayed that the issue relating to determination and allowance of loss and disallowance of purchase cost of all securities in respect of illegal ready forward transactions be set aside to the file of the assessing officer for fresh determination as per law."

2.2 The Assessee has raised the following grounds of Cross-Objections:

"1. The additional grounds bearing nos. 12.1 to 12.5 should not be admitted since,:

(i) they do not appear to be in conformity with and proper compliance of the provisions of section 253(2) of the Act,

(ii) they are filed beyond the period of limitation or not within the reasonable time,

(iii) they involved investigation of fresh facts, which is not permitted at this stage (iv) they seek to raise totally fresh claims or grounds which were never before the lower authorities

2. The provisions of Explanation to section 37(1), inserted by the Finance (No. 2) Act, 1998, have no application in relation to the claim for allowance of Rs. 40,21,73,018 on account of losses in Ready Forward transactions, and also generally not to any of the issue or facts of the present case.

3. The provision of section 16 of the Securities Contract Act Regulation Act cannot be invoked in the manner in which it is proposed in the additional grounds, and without prejudice it has not application to the facts of the case.

4. The decision of the Supreme Court in B.O.I. Finance Limited v Custodian and Others cannot be applied in the manner in which it is proposed in the additional grounds,

None of the lower authorities have disallowed the entire purchase value of so- called Ready Forward transactions and consequently this ground cannot be taken for the first time by the Assessing Officer in an appeal before this Hon'ble Tribunal, and cannot be adjudicated at this stage before the Hon'ble Tribunal.

6. The new ground proposing disallowance of purchase cost of all securities should not be admitted and therefore there is no question of or justification for a set aside of this issue for fresh determination by the Assessing Officer."

3 The relevant facts in brief are that the Assessee is a foreign corporate body being a bank incorporated by the Royal Charter under the laws of England and Wales and registered in India under the Companies Act, 1956. The Assessee was engaged in the business of banking financial services and allied activities in India and filed return of income for the Assessment Year 1993-94 on 29/12/1993 declaring loss of INR 1,645.85 Crores. Assessment was framed on the Assessee vide Assessment order dated 20/09/1996, passed under Section 143(3) of the Act at net loss of INR 448.74

Crores after making various additions and disallowances.

3.1. Being aggrieved, the Assessee preferred appeal before CIT(A) which was disposed off vide order dated 25/11/2002 as partly allowed after granting substantial relief to the Assessee.

3.2. Being aggrieved, the Revenue has preferred the present appeal. Vide letter, dated 25/02/2008, Revenue filed concise grounds of appeal. Thereafter, vide Letter, dated 13/07/2009, the Revenue moved application raising additional grounds and therefore, the Assessee filed Cross-Objections.

3.3. The grounds of appeal (including additional grounds) and cross-objections reproduced in paragraph 2 to 2.2. above are taken up hereinafter in seriatim for adjudication.

4 **Ground No.1:**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing to delete the addition of INR 10,00,000/- made by disallowing the conveyance expenses incurred by employees on tour under Rules 6D without appreciating the fact that conveyance expenses on tour are part of tour expenses and are to be treated as per Rule 6D of I.T. Rules, 1962."

4.1. During the assessment proceedings, the Assessing Officer noted that while working out the disallowance of Travelling Expenses as per the provisions contained in Rule 6D of the Income Tax Rules, 1962 (hereinafter referred to as 'the Rules'), the conveyance expenses incurred by the employees of the Assessee while on Tour have not been included. The Assessing Officer was of the view that the conveyance expenses incurred by the employees of the Assessee while on Tour are to be included for the purpose of working out the disallowance under Rule 6D. Since the Assessee

was not able to furnish the details of the aforesaid conveyance expenses, the Assessing Officer made an ad-hoc disallowance of INR 10,00,000/- and computed disallowance in terms of Rule 6D at INR 47,46,791/- as against the disallowance of INR 37,46,791/- as computed by the Assessee.

4.2. Being aggrieved, the Assessee carried the issue in appeal before CIT(A). It was contended on behalf of the Assessee that as per Rule 6D the expenses incurred by employees on local conveyance while on tour are not to be included while computing the disallowance under Rule 6D of the Rules. The Assessing Officer had, therefore, erred in holding that the expenditure incurred by the employees on hotels as well as on local conveyance are covered under Rule 6D of the Rules as said rule does not make any distinction on account of the nature of expenses incurred by the employees. The aforesaid contentions found favour with the CIT(A) who deleted the disallowance of INR 10,00,000/- made by the Assessing Officer.

4.3. Being aggrieved by the above relief granted by the CIT(A), the Revenue has preferred appeal on this issue before the Tribunal.

4.4. Having heard both the sides and on perusal of material on record, we note that the CIT(A) has deleted the addition by following, inter alia, the judgment of the Hon'ble Bombay High Court in the case of CIT Vs. Gannon Dunkerly and Co. : [1993] 114 CTR 56 wherein it has been held that the local conveyance expenses and other actual expenses which are incurred by the employee while on tour for conducting the assessee's business cannot be considered as travelling expenses of the employee under Rule 6D of the Rules. Further, the disallowance was made on ad-hoc basis. Thus, we do

not find any infirmity in the order passed by the CIT(A) deleting the ad-hoc disallowance of INR 10,00,000/- by invoking the provisions of Rule 6D of the Rules. Ground No.1 raised by the Revenue is, therefore, dismissed.

5 **Ground No.2:**

"*On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the disallowance of Rs. 16,72,890/- made u/s. 37(2) in respect of the entertainment expenses incurred on assessee's employees on the ground that the expenditure incurred on its employees was incurred at the place of their work and therefore not covered u/s. 37(2).*"

5.1. During the assessment proceedings, the Assessing Officer noted that the Assessee has disallowed entertainment expenses of INR 20,09,510/- incurred in relation to guest/visitors on the basis of the Tax Audit Report. However, no disallowance was made in respect of entertainment expenses aggregating to INR 16,72,890/- attributable to employees accompanying the guest/visitors. The Assessing Officer made disallowance of INR 16,72,890/- under Section 37(2) of the Act on the ground that after the amendment w.e.f. 01/04/1993 the entire expenditure incurred on providing hospitality to employees outside their place of work qualifies for entertainment expenditure in respect of which deduction could be allowed subject to the limit specified in Section 37(2) of the Act.

5.2. In appeal preferred by the Assessee, the CIT(A) deleted the disallowance of INR 16,72,890/- by, inter alia, placing reliance upon the Judgment of Hon'ble Delhi High Court in the case CIT Vs. Expo Machinery Ltd: 190 ITR 576.

5.3. Being aggrieved by the above relief granted by the CIT(A), the Revenue has preferred appeal on this issue before the Tribunal.

5.4. Having heard both the sides and on perusal of material on record, we are of the view that the order passed by the CIT(A) deleting the disallowance of entertainment expenses of INR 16,72,890/- does not call for any interference. Section 37(2) of the Act, as substituted w.e.f. 01/04/1993, placed restrictions on the quantum of deduction permissible on account of 'Entertainment Expenditure'. The expression 'Entertainment Expenditure' was defined in Explanation to Section 37(2) of the Act to include, inter alia, the expenditure on provision of hospitality of every kind by assessee to any person whether by way of provision of food or beverages or in any other manner whatsoever but excluding expenditure on food or beverages provided by an assessee to employees in office, factory or other place of their work. Vide Circular No. 644, dated 15/03/1993, the Central Board of Direct Taxes (CBDT), clarified that the provision of food or beverages in places other than the place of work in respect of specified employees shall not attract disallowance under Section 37(2) of the Act if such food or beverages are provided during working hours even in places other than the place of work, provided the expenditure is genuine and reasonable. In the present case, the genuineness/reasonableness of expenditure was never in doubt. Further, the Assessing Officer, in our view, despite referring to the aforesaid Circular No. 644 failed to appreciate that the true purport of the said circular and the benefit extended by it. Without examining whether the entertainment expenditure was incurred for provisions of food/beverages of specified employees, the Assessing Officer concluded that the expenditure qualified as 'Entertainment Expenditure' and proceeded to make the disallowance of the entire entertainment expenditure attributable to employees amounting to INR 16,72,890/-. We note that the Appellant had disallowed INR

20,09,501/-, being the amount of 'Entertainment Expenditure' incurred by the Appellant in relation to visitors & guests as per the Tax Audit Report. No disallowance was reported in the Tax Audit Report in relation to the entertainment expenditure of INR 16,72,890/- incurred for the provisions of food & beverages to the employees. The Assessing Officer has also not brought anything on record on the basis of which it can be concluded that the provisions of Section 37(2) of the Act would be attracted. Further, the CIT(A) had concluded that the entertainment expenditure were incurred by the Appellant on its employees for food and beverages while discharging their official duties and at their place of work where they have been sent by relying upon the judgment of the Hon'ble Delhi High Court in the case of CIT Vs. Expo Machinery Ltd: [1991] 190 ITR 576 (Del). Therefore, we do not find any infirmity in the order passed by the CIT(A) and hold that the CIT(A) was justified in deleting the disallowance of entertainment expenditure of INR 16,72,890/- made by the Assessing Officer under Section 37(2) of the Act. Accordingly, Ground No. 2 raised by the Revenue is dismissed.

6 **Ground No. 3**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing the AO to delete the disallowance of Rs. 5,00,000/- made on account of club expenses."

6.1. The Assessing Officer made a disallowance of INR 5,00,000/- (out of INR 9,60,412/-), on an ad-hoc basis, being the payments made to various club for corporate membership and subscription. The Assessing Officer observed that although it is true that club membership may facilitate interaction with customers, it cannot be said that the entire expenditure incurred wholly and exclusively for

the business of the Assessee. Therefore, the Assessing Officer made an ad-hoc disallowance of INR 5,00,000/-.

6.2. In appeal, the CIT(A) deleted the above disallowance of INR 5,00,000/- by following the judgment of Bombay High Court in the case of Otis Elevators Co. India Ltd. vs. CIT:195 ITR 682 as well as the decision of the Tribunal in the appeals preferred by the Revenue in the case of the Assessee pertaining to Assessment Year 1989-90 & 1990 1991.

6.3. Being aggrieved the Revenue has preferred the present appeal.

6.4. Both the sides agreed that similar issue has been decided in favour of the Assessee vide order, dated 29/05/2006, passed in case of Assessee [ITA No. 311/Mum/1996] for the Assessment Year 1991-92 by following the judgment of the Hon'ble Bombay High Court in case Otis Elevator Co. India Ltd.(supra) and the order, dated 03.04.1995, passed by the Tribunal rejecting the appeals preferred by the Revenue for the Assessment Years 1989-90 &1990-91 (ITA No. 9007&9008/Bom/1992). It would be pertinent to note that Reference Applications filed by the Income Tax Department against the order of the Tribunal for the Assessment Years 1989-90 & 1990-91 was dismissed, both, by the Tribunal under Section 256(1) of the Act and by the Hon'ble Bombay High Court under Section 256(2) of the Act. In view of the aforesaid, we do not find infirmity in the order passed by the CIT(A) on this issue. Therefore, Ground No. 3 raised by the Revenue is dismissed.

7 **Ground No.4:**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition made of Rs. 1,15,75,022/- on account of unrealized forward profit on the ground that the forward transaction in foreign exchange have not been actually settled and

therefore income has not accrued to the assessee."

7.1. During the assessment proceedings, the Assessing Officer noted that as part of the normal business of banking, the Assessee entered in to foreign exchange transaction on behalf of and with the customer including forward foreign exchange contracts. During the relevant previous year the Assessee earned net profit of INR 1,15,75,022/- on account of revaluation of the outstanding forward contracts which were credited to the Profit & Loss Account. However, in the computation of the income the aforesaid net profit was reduced from the figure of profit. The contention of the Assessee was that the figure of profit was only notional in nature. The actual profit or loss on such forward contract would be realized only on the maturity of the forward contract. The Assessee has been consistently offering to tax the income on forward contracts on the basis of actual realization on maturity of the contract. The credit to the Profit & Loss Account was made only for accounting purposes and in order for closely monitoring the outstanding forward contracts what is chargeable to tax is the real income, whereas the income arising on revaluation of the forward contract as on the last day of the previous year represents notional income which has not yet accrued and/or become due to the Assessee. However, the Assessing Officer was not convinced and therefore, an addition of INR 1,15,75,022/- was made while framing the assessment.

7.2. In appeal, the CIT(A) deleted the above said addition holding as under:

> *"5.3 I have carefully considered the facts of the case and arguments of the learned counsel. The Hon'ble Madras High Court in the case of Indian Overseas Bank vs. CIT 183 ITR 200 on similar facts has held that the amounts in question were only estimated*

anticipated income arrived at on the basis of the rates of exchange which prevailed, presumably on the last day of the accounting year, without an actual settlement of the forward contracts in foreign currencies having been brought about and in that sense the amount in question represented merely notional profits and could not be subjected to tax. In the case of the appellant bank also forward transaction in foreign exchange have not been actually settled and unless such transactions are actually settled it cannot be said that the income has accrued to the appellant. The amount credited by the appellant to profit and loss account are merely notional profits and cannot be subjected to tax in view of the decision of the Madras High Court (supra). In view of this issue has already been decided in favour of the appellant in earlier years by CIT(A), this ground of appeal is allowed in favour of the appellant and the addition of Rs.1,15,75,022/- is deleted.

The alternate ground, that the A.O. erred in not granting deduction of Rs.1,22,75,320/- being the amount of forward profit unrealized as on 31.3.92 offered for tax by the Appellant in the year under appeal, but taxed in the assessment for Assessment Year 1992-93, does not survive since as per the appellant, the CIT(A) has already allowed this issue in its favour in appeal for that year."

7.3. Now the Revenue is in appeal before us against the order of CIT(A) deleting the addition of INR 1,15,75,022/-.

7.4. We have considered the rival submissions and perused the material available on record. We find that the CIT(A) granted relief to the Assessee by placing reliance upon the Judgment of the Hon'ble Madras High Court in the case of Indian Overseas Bank Vs. CIT: [1990] 183 ITR 200 (Madras), the relevant extract of which reads as under:

"4. We may point out that in respect of the very same assessee, for the assessment years 1968-69 and 1969-70, the question arose whether the assessee is entitled to a deduction of Rs. 9,23,125 being the provision against profit on exchange and Rs. 4,32,152 being the provision for anticipated loss on outstanding forward exchange contracts, respectively. In deciding this question, in IT Appeal No. 1864 (Mad.) of 1974-75, for those

assessment years, the Tribunal, after noticing the nature of the forward transactions carried on by the assessee in foreign exchange, was of the view that the profit or loss in each year has to be determined with reference to the events that had taken place in the accounting year and that merely because they may change by the time the contract is settled, there is no warrant for postponing the determination and, therefore, the loss claimed by the assessee was admissible as a deduction. The correctness of this view was the subject-matter of the reference dealt with in Indian Overseas Bank's case (supra). The contention urged by the revenue in that case was that neither the notional profit nor the notional loss can be taken into account and whether a future settlement of the outstanding contract will result in a loss or profit, will become known only when the outstanding contracts are settled and that notional profit or loss, without a settlement of the outstanding foreign exchange contracts, cannot be subjected to tax treatment and, therefore, the deductions accepted as allowable by the Tribunal, were not in order. This contention of the revenue was accepted and it was held that whether there is a loss or profit on foreign exchange transactions can be ascertained only alter a settlement of the forward contracts and not before and that so long as that stage had not been reached, the loss can only be notional and not actual or real and notional loss cannot be claimed as a deduction. Whether a loss or profit, the principle applicable would be the same and the estimated profit, till the settlement of the forward foreign exchange contracts, could be regarded only as notional and not actual or real and such notional profits cannot also be assessed. Though the principle laid down in Indian Overseas Bank's case (supra) related to a case of notional loss, in view of the applicability of the same principle even to a case of notional profit, we hold that the amounts of Rs.1,72,911 and Rs.l5,57,022.40 represented notional profit only and not actual profit for the assessment years 1972-73 and 1973-74 and could not be subjected to tax. We may also in this connection usefully refer to Shoorji Vallabhdas & Co. (supra)where the Supreme Court pointed out that the levy of income-tax is on income and though the Act had taken note of the twin points of time at which the liability to tax is attracted, viz., the accrual of income or its receipt, yet, the substance of the matter is income and if income does not result at all, there cannot be a tax, even though for purposes of book-keeping an entry is made about hypothetical income, which does not materialise and a mere book-keeping

entry cannot be income, unless an income has actually resulted. The amounts in these references were only estimated anticipated income arrived at on the basis of the rates of exchange which prevailed, presumably on the last day of the accounting year, without an actual settlement of the forward contracts in foreign currencies having been brought about and in that sense, the amounts in question represented merely notional profits and could not have been subjected to tax treatment in the hands of the assessee. <u>We are unable to accept the reasoning of the Tribunal that the events in the accounting year have to be taken note of in determining the profit or loss in each year and that the changes that may be brought about on a settlement of the forward contracts in foreign exchange would not in any manner affect the assessability of the amounts of tax. We are also unable to accept the contention of the learned counsel for the revenue that the amounts in question are assessable, based on the reasoning of the Tribunal</u>. We, therefore, answer the common question referred to us in the negative and in favour of the assessee, with the costs of the assessee. Counsel fee Rs. 500."

7.5. On perusal of the above judgment, we find that the Hon'ble Madras High Court has held that observed whether future of the outstanding contract will result in a profit or loss will become known only when the outstanding contracts are settled and not before that, and therefore, so long as that stage has not been reached the loss can only be notion and actual or real. However, in a subsequent judgment the Hon'ble Supreme Court has, in the case of Commissioner of Income Tax, Delhi Vs. Woodward Governor India Pvt. Ltd. : [2009] 312 ITR 254 (SC), held as under:

"15. <u>For the reasons given hereinabove, we hold that, in the present case, the "loss" suffered by the assessee on account of the exchange difference as on the date of the balance sheet is an item of expenditure under section 37(1) of the 1961 Act</u>.

16. xx xx

17. xx xx

18. AS-11 deals with giving of accounting treatment for the effects of changes in foreign exchange rates. <u>AS-11 deals with effects of</u>

Exchange Differences. Under para 2, reporting currency is defined to mean the currency used in presenting the financial statements. Similarly, the words "monetary items" are defined to mean money held and assets and liabilities to be received or paid in fixed amounts, e.g., cash, receivables and payables. The word "paid" is defined under section 43(2). This has been discussed earlier. Similarly, it is important to note that foreign currency notes, balance in bank accounts denominated in a foreign currency, and receivables/payables and loans denominated in a foreign currency as well as sundry creditors are all monetary items which have to be valued at the closing rate under AS-11. Under para 5, a transaction in a foreign currency has to be recorded in the reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. This is known as recording of transaction on Initial Recognition. Para 7 of AS-11 deals with reporting of the effects of changes in exchange rates subsequent to initial recognition. Para 7(a) inter alia states that on each balance sheet date monetary items, enumerated above, denominated in a foreign currency should be reported using the closing rate. In case of revenue items falling under section 37(1), para 9 of AS-11 which deals with recognition of exchange differences, needs to be considered. Under that para, exchange differences arising on foreign currency transactions have to be recognized as income or as expense in the period in which they arise, except as stated in para 10 and para 11 which deals with exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which topic falls under section 43A of the 1961 Act. At this stage, we are concerned only with para 9 which deals with revenue items. Para 9 of AS-11 recognises exchange differences as income or expense. In cases where, e.g., the rate of dollar rises vis-a-vis the Indian rupee, there is an expense during that period. The important point to be noted is that AS-11 stipulates effect of changes in exchange rate vis-a-vis monetary items denominated in a foreign currency to be taken into account for giving accounting treatment on the balance sheet date. Therefore, an enterprise has to report the outstanding liability relating to import of raw materials using closing rate of exchange. Any difference, loss or gain, arising on conversion of the said liability at the closing rate, should be recognized in the P&L account for the reporting period.

19. xx xx

20. xx xx

> *21. In conclusion, we may state that in order to find out if an expenditure is deductible the following have to be taken into account (i) whether the system of accounting followed by the assessee is mercantile system, which brings into debit the expenditure amount for which a legal liability has been incurred before it is actually disbursed and brings into credit what is due, immediately it becomes due and before it is actually received; (ii) whether the same system is followed by the assessee from the very beginning and if there was a change in the system, whether the change was bona fide; (iii) whether the assessee has given the same treatment to losses claimed to have accrued and to the gains that may accrue to it; (iv) whether the assessee has been consistent and definite in making entries in the account books in respect of losses and gains; (v) whether the method adopted by the assessee for making entries in the books both in respect of losses and gains is as per nationally accepted accounting standards; (vi) whether the system adopted by the assessee is fair and reasonable or is adopted only with a view to reducing the incidence of taxation."*

7.6. As per the judgment of the Hon'ble Supreme Court the loss/gain arising on account of foreign exchange fluctuation is to be recognized in the Profit & Loss Account for the relevant previous year. Accordingly, the gain arising on account of revaluation of the outstanding forward contract as on the last of the previous year as per the provisions of Accounting Standard 11 would have to be recognized as profits of the relevant previous year. A perusal of notes to financial statements for the year ended 31/03/1993 shows that the Assessee has been following account policy in relation to transactions involving foreign exchange:

> *"(b) Transaction involving foreign exchange*
>
> *(i) Monetary assets and liabilities in foreign currencies are translated at market rates of exchange notified by the Foreign Exchange Dealers Association of India at the close of the year*
>
> *(ii) Income and Expenditure items are translated at the exchange rates prevailing on the date of the transaction.*

(iii) Outstanding forward contracts are revalued at the forward exchange rates prevailing at the year end and it resulting profit or loss accounted for."

7.7. On perusal of the above, we find that even as per the accounting policy followed by the Assessee the gains/loss arising out of foreign exchange fluctuation is recognized as profit or loss accruing to the Assessee during the relevant previous year. Accordingly, we reverse the order passed by the CIT(A) and reinstate the addition on account of foreign exchange fluctuation gains with the directions to the Assessing Officer to recompute the quantum of addition foreign exchange gain/loss on outstanding forward contracts after taking into account the profit/loss offered to tax by the Assessee on the date of actual settlement of the aforesaid forward contracts in order to avoid double taxation of the same foreign exchange gain or loss. In terms of the aforesaid Ground No. 4 raised by the Revenue is allowed.

8 **Ground No.5:**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing the Assessing Officer to allow claim in respect of bad debts recovered to the extent of Rs. 70,30,360/- on the ground that the bad debts recovered during the year cannot be subjected to tax as the provisions created for such debt in earlier years have not been allowed as deduction."

8.1. The relevant facts in brief are that during the relevant previous year the Assessee recovered INR 70,30,360/- in respect of debts for which provisions for bad debts was created in earlier years. The Assessee did not offered the aforesaid amount of INR 70,30,360/- to tax despite the fact that same was credited to the Profit & Loss Account of the Assessee for the relevant previous year on the ground that the provisions created for such bad debts, through debited to the Profit & Loss Account in the earlier years, were added

back while computing the taxable income. As the deduction was not claimed in the return of income for earlier years in respect of the provisions created for such bad debts, the amount of bad debts now recovered was also not offered to tax by the Assessee. However, the Assessing Officer convinced and made an addition of INR 70,30,360/-.

8.2. In appeal preferred by the Assessee, the CIT(A) granted relief on this issue and deleted the addition holding as under:

> *"6.3 I have considered both the issues under this ground carefully. I agree with the appellant's submissions that Rs 70,30,360/- being bad debts recovered during the year cannot be subjected to tax on the ground that the provisions created for such debts in earlier years have not been allowed as deduction. Such provisions were not allowed in earlier years in view of the fact that the same were in excess of limits u/s.36(1)(viia) of the Act. Since, the recoveries made during the year are in respect of such debts, the provisions which have been taxed in earlier years, the recoveries cannot again be taxed otherwise it would amount to double taxation. The appellant had filed complete details during the course of assessment and has filed the details before me as well. After perusal of details filed. I direct the A.O. to allow the claim of the appellant for Rs. 70,30,360/-." (Emphasis Supplied)*

8.3. Being aggrieved, the Revenue is in appeal before us against the above relief granted by the CIT(A).

8.4. Having heard the rival submission and on perusal of the material on record, we find that the factual findings returned by the CIT(A), to the effect that the deduction for the provisions for INR 70,30,360 was not allowed in the earlier years since the same was in excess of the limits specified under Section 36(1)(vii)(a) of the Act, has gone uncontroverted in the appellate proceedings before us. Therefore, we concur with the reasoning given by the CIT(A) on this issue. The

amount of bad debts recovered during the year in respect of which provisions were created in earlier years but not allowed/claimed as deduction would not be taxable as income in the hands of the Assessee. Accordingly, Ground No. 5 raised by the Revenue is dismissed.

9 **<u>Ground No.6:</u>**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 70,401/- made on account of penal interest charged by the RBI on the ground that the amount of Rs. 70,401/- neither represent a penalty nor a penal interest but the differential interest on the CRR balance maintained with RBI."

9.1. The Assessing Officer added back an amount of INR 91,402/- being the interest on Cash Reserve Ratio (CRR) not received/receivable from RBI on account of deficiencies in the maintenance of CRR balance, alleging the same to be penal in nature and in infraction of law, therefore, not allowable.

9.2. The CIT(A) deleted the above addition accepting the contention of the Assessee that INR 91,402/- was neither a penalty nor a penal interest but the amount of interest not received/receivable from RBI.

9.3. Being aggrieved, the Revenue is in appeal before us on this issue.

9.4. Having heard the rival submission and on perusal of the record, we are of the view, the CIT(A) was correct in deleting the addition of INR 91,402/- since the amount of interest not received could not be regarded as payment of penalty or penal interest in the facts and circumstances of the present case. Our view also draws support from the decision of the Tribunal in the case of the Assessee for the Assessment Year 1992-93 [ITA No. 4978/Mum/1998, dated

08/02/2007] wherein dealing with the identical facts and issue, the Tribunal held as under:

> *"13. Ground No.7 relates to deletion of interest to R.B.L. at Rs. 68,896/-*
>
> *13.1 The Assessing Officer made an addition of Rs. 68,896/- on account of interest on Cash Reserve Ratio maintained by the assessee with R.B.I. by observing that this amount of interest is penal in nature, therefore, is not allowable.*
>
> *13.2 It was argued before the CITIA), that during the year under appeal, no penalty has been levied by R.B.I. as contemplated by section 42(3) or (5) of RBI. Act. Further detailed reply was filed before the CITIA). It was also submitted that during the year under appeal the assessee did not receive interest of Rs 68,896/-, in view of the short fall in CRR balances. It was further stated that the percentage of shortfall is very marginal and far below 22.93% The amount of Rs. 68,896/-is not penal in nature ne penalty paid to R.B.I. but represents the interest dint would have been received had there been no shortfall. It was also submitted that the amount has not been received nor is eligible to receive the same. After considering the submissions, the CITIA) allowed the claim of the assessee."*

9.5. In view of the above, we confirm the order passed by the CIT(A) on this issue. Ground No. 6 raised by the Revenue is dismissed.

10 **Ground No.7:**

> *"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 5,17,32,848/- made on account of broken period interest paid on purchase of securities, which were lying in stock at the end of the previous year on the ground that in case of trading in security, total cost of purchase of security, which included broken period interest and debited to P & A A/c. is an allowable deduction."*

10.1. The facts relevant for adjudication of the issue under consideration are that while purchasing a securities, the Appellant made a payment for broken-period interest (i.e. interest due from the

coupon date or last interest date upto the date of purchase) which was debited to the Profit & Loss Account of the Appellant. In respect of the securities which were lying in stock at the end of the relevant previous year, the Assessing Officer disallowed deduction of broken period interest of INR 5,17,32,848/- on the ground that the same is capital in nature and should form part of cost of purchase of the closing stock.

10.2. In appeal, the CIT(A) allowed deduction for broken period interest of INR 5,17,32,848/- as revenue expenditure by following the judgment of the Hon'ble Bombay High Court in the case of American Express International Banking Corporation Vs. Commissioner of Income Tax : [2002] 258 ITR 601 (Bombay) holding as under:

> *"8.3 I have carefully considered the facts of the case and the detailed arguments of the Counsel. The very same issue was subject matter of dispute in appellant's own case in the AY 1991-92 & 1992/93. In AY. 1991/92, the CIT(A) after discussing the Vijaya Bank's case and considering various submissions of the appellant bank decided that addition on account of broken period interest made by the A.O.. separately was not justified. He held that the case would have been different if appellant had held this security as investments. However, in case of trading in security, total cost of purchase of security which included broken period interest and debited as such to profit and loss account is an allowable deduction. In arriving at this conclusion, the CIT(A) relied on the decision of the Hon'ble Tribunal and decision of the CIT(A) in appellant's own case for earlier years. Respectfully following the decision of the CIT(A) and the Hon'ble Tribunal and the decision of the Bombay High Court in the case of American Express International Banking Corporation v/s CIT in Income Tax Reference No.173 of 1983. I hold that there is no case for disallowance of broken period interest paid by the appellant and duly debited to the profit and loss account. The addition of Rs. 5,17.32,848/- is therefore, deleted and the ground is allowed.*
>
> *As regards Appellant's alternate claim of Rs.8,94.51.565/- representing broken period interest disallowed in Assessment Year*

1992-93 and allowable in the year under appeal on sale of the relevant securities during the year, since the claim is already allowed by CIT(A) in favour of the appellant in appeal for AY. 1992/93, the claim cannot be considered in present appeal and accordingly, rejected."

10.3. Being aggrieved, the Revenue in now in appeal before us on this issue.

10.4. Having considered the rival submissions and on perusal of record, we are of the view that the issue stands decided in favour of the Assessee in Assessee's own case for the Assessment Year 1989-90 & 1990-91 [ITA No. 4243 & 4244/Mum/2000, dated 20/05/2004] wherein the Tribunal by following the decision of the Hon'ble Bombay High Court in the case of American Express International Banking Corporation Vs. Commissioner of Income Tax: 258 ITR 601 held as under:

"10 The second issue is regarding the treatment of the broken period Interest. At the time of purchasing a security, banks usually make payments towards broken period interest. This is the Interest due from the broken date fill the date of purchase. The interest so paid by the banks usually known as broken period interest is debited in the Profit & Loss account of the banks and further claimed as deduction In computing the taxable Income. The claim has been disallowed by the AO on the ground that such broken period interest is in the nature of capital outlay. The contention of the bank is that the securities are held by the bank as its stock-in-trade and therefore such payment should be treated as revenue in nature. This issue has been considered and decided by the Hon'ble Bombay High Court in the case of American Express International Banking Corporation v. CIT (255 ITR 601). The Hon'ble Court has held therein mat the accrued interest paid by the assessee bank upto the date of purchase should be allowed as revenue expenditure. The same view has been followed by the Hon'ble Bombay High Court in CIT v. Citi Bank N.A. (264 ITR 18). The very same view has been adopted by the Hon'ble Kerala High Court in the case of South Indian Bank Ltd, and Nedungadi Bank Ltd. reported in 241 ITR 374 204 ITR 545

respectively.

11. We find that this issue is now almost settled. As far as the bank is concerned, broken period Interest paid by it on the securities acquired by the bank in its course of business as trading stock need to be allowed as revenue expenditure in computing its taxable income. Therefore, grounds raised by the Revenue on this issue fall and the issue is decided against it."

10.5. In view of the above, we do not find any infirmity in the order passed by the CIT(A) on this issue are the CIT(A) has allowed deduction for broken period interest of INR 5,17,32,848/- by following the above said decision of the Tribunal wherein the judgment of the Hon'ble Bombay High Court has been followed. Accordingly, Ground No. 7 raised by the Revenue is dismissed.

11 **Ground No. 8:**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 14,23,38,910/- made on account of excess interest paid under Corporate Cash Deployment Scheme (CCDS) on the ground that the assessee has not claimed any deduction of expenses by way of interest and no penalty or prosecution has been imposed u/s. 46 or 47A of Banking Regulation Act or Sec. 58B of RBI Act and therefore infraction of law cannot be presumed for making disallowance of interest."

11.1. The Appellant operated a Corporate Cash Deployment Scheme (for short 'CCDS') which was stated to have been implemented with the object of facilitating the deployment of surplus corporate funds in PSU Bonds, units, debentures, etc. According to the Assessee the funds under the CCDS were to be managed by the Assessee in a fiduciary capacity. However, the Assessing Officer concluded that CCDS was in the nature of portfolio management scheme operated by the Assessee in violation of the guidelines issued by the Reserve Bank of India on portfolio management. The amounts received under the CCDS by the Assessee were nothing but short-term deposits on

which the Assessee has paid interest in excess of the rates prescribed by the Reserve Bank of India. Therefore, the Assessing Officer calculated excess interest paid at INR 14,23,38,910/- and added the same to the income of the Assessee.

11.2. Before CIT(A) the Assessee contended the interest should not be added back as the Assessee had not claimed deduction for interest expenses. The CIT(A) following the order, dated 25.11.2002, passed in the case of the Assessee in appeal against the Assessment Order for the Assessment Year 1992-93, deleted the addition of 14,23,38,910/-.

11.3. Being aggrieved, the Revenue has filed appeal before us on this issue.

11.4. We have considered the rival submissions and perused the material on record. The factual finding retuned by the CIT(A) that the Assessee had not claimed deduction for interest/payments made to the investors has not been controverted. We note that the order of CIT(A) for the Assessment Year 1992-93 followed by the CIT(A) on this issue has been confirmed by the Tribunal. Vide order dated 08/02/2007 passed in appeal preferred by the Revenue for the Assessment Year 1992-93 [ITA No.4978/Mum/1998], the Tribunal has held as under:

> *"16.1 This issue has been decided by the Tribunal in case of assessee itself while disposing the appeal for AY. 1991-92 vide its order dated 29.5.2006. The Tribunal by observing the following observations has deleted the similar additions in appeal for A.Y. 1991-92.*
>
> > *"We have given a careful consideration to the rival submissions vis-à-vis the facts of the case and in the light of the ITAT, Delhi Bench decision in the case of ANZ Grindlays Bank (supra). There is no dispute about the facts: The assessee has*

maintained separate account in respect of CCD Scheme and the expenses including payment of interest is not debited to the P&L account of the assessee. The assessee has earned only commission, which is the difference between the inflow and the outflow in the CCD scheme. This commission income has been duly credited to the P&L account of the assessee. The ITAT Delhi Bench decision, which is in respect of Portfolio Management Scheme is clearly applicable to the facts of the assessee's case. In the present case also, the assessee has not claimed any deduction for any loss arising under CCD Scheme Accordingly, the addition of Rs 39,76,05,782/-is deleted."

In view of the above reasoning given by the Tribunal, we confirm the order of the CIT(A) for the year under consideration also."

11.5. Respectfully following the above decision of the Tribunal, we confirm the order passed by the CIT(A) deleting the addition of INR 14,23,38,910/-. Ground No. 8 raised by the Revenue is dismissed.

12 **Ground No.9:**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 74,86,000/- plus Rs. 4,91,500/- made on account of loss in transaction with broker on the ground that the assessee has not contravened provisions of sec. 15 of SECRA and as per the delivery order, the securities were to be delivered to the broker himself and this amounted to written consent that the broker was the principal in the transaction."

12.1. During the course of assessment proceedings, on perusal of special audit report under Section 142(2A) of the Act, the Assessing Officer noted that the Assessee has entered into transactions with brokers as counterparties.

12.2. The Assessing Officer noticed that the special auditors had worked out a loss of INR 74,86,000/- in the transactions in GIC Rise II Units undertaken by the Appellant with C. Mackertich and Stewart & Co. According to the Assessing Officer, the aforesaid transaction were hit by the provisions contained in Section 15 of the Securities

Contract (Regulation) Act, 1956 (SCRA) as the same were undertaken by the broker with the Appellant as a counterparty without obtaining written consent of the Appellant. Therefore, the Assessee Officer concluded that the Appellant was not entitled to claim loss of INR 74,86,000/- from the aforesaid transactions were not legal. However, the Assessing Officer, did not make a separate addition of INR 74,86,000/- *(mentioned as INR 75 lakhs in paragraph 13.2 of the assessment order)*, since the transactions were covered under the disallowance made in respect of the Corporate Cash Deployment Scheme (CCDS).

12.3. The Assessing Officer also note that the original document in respect of the transaction in units of face value of INR 1 Crore, being the deal slips, did not mention any name of the counterparty. According to the Assessing Officer if there was an understanding that the broker were acting as a principal the deal slips should have reflected the name of the broker as counterparty which was not the case. Therefore, the Assessing Officer concluded that the these transactions were undertaken by the Appellant with broker as counter party without the prior written consent of the Appellant and therefore, the same were hit by the provision of Section 15 of SCRA. The Assessing Officer rejected the contention of the Appellant that the fact that as per the delivery order the securities were to be delivered to the broker himself amounted to a written understanding that the broker would be acting as counterparty. Therefore, the Assessing Officer disallowed loss of INR 4,91,500/- claimed by the Assessee in respect of the aforesaid transactions.

12.4. Being aggrieved, the Assessee carried the issue in appeal before the CIT(A). The CIT(A) held that the provisions of Section 15 of SCRA were not applicable to the Assessee and overturned the finding

returned by the Assessing Officer concluding that the transaction under consideration were not illegal.

12.5. The Revenue is now in appeal before us against the relief granted by the CIT(A).

12.6. The Learned Departmental Representative placed reliance on the order passed by the Assessing Officer and submitted that the transactions under consideration were clearly undertaken in violation of the provisions of Section 15 of SCRA. The broker was not permitted to enter into transaction with the Assessee without written consent from the Assessee. The deal slips were blank and did not contain the name of the broker. There was no prior written consent given by the Assessee to the broker to act as a principal. Clearly the transactions were in violation of the provisions of Section 15 of SCRA.

12.7. Per contra, it was submitted on behalf of the Appellant that there was no absolute bar against the broker acting as a counterparty. The fact that as per delivery contract the securities were to be delivered to the broker showed that the broker was acting as a principal under the consent of the Assessee. Without prejudice to the aforesaid it was also submitted that the CIT(A) was correct in holding that the provisions of Section 15 of SCRA were not applicable to the Assessee since the Assessee was not a member of stock exchange.

12.8. We have considered the rival submissions and perused the material on record. The issue that raises for consideration is the applicability of Section 15 of SCRA which reads as under:

"Members may not act as principals in certain circumstances.

> *15. No member of a recognised stock exchange shall in respect of any securities enter into any contract as a principal with any person other than a member of a recognised stock exchange, unless he has secured the consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal:*
>
> *Provided that where the member has secured the consent or authority of such person otherwise than in writing he shall secure written confirmation by such person or such consent or authority within three days from the date of the contract:*
>
> *Provided further that no such written consent or authority of such person shall be necessary for closing out any outstanding contract entered into by such person in accordance with the bye-laws, if the member discloses in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as a principal."*

12.9. Section 15 of SCRA deals with a contract between a member of a recognized stock exchange and a non-member. Therefore, the conclusion drawn by the CIT(A) that the provisions of Section 15 shall not apply to transaction between the Assessee and broker is not correct. Section 15 of SCRA provides that a member of stock exchange can enter into a contract with a non-member provided such member (a) secures consent or authority of the non-member in writing and (b) discloses in the note, memorandum or agreement of sale or purchase that such member is acting as a principal. In the facts of the present case both the aforesaid conditions were not complied with. The mere fact that the delivery contract provides for delivery of the securities to the broker is not sufficient and does not meet the requirements of Section 15 of SCRA. The Assessing Officer had returned a finding deal note did not disclose that the member was acting as a principal. This finding has gone uncontroverted in the appellate proceedings. Accordingly, we hold that the transaction undertaken under consideration have been undertaken in violation

of provisions contained in Section 15 of the SCRA. Therefore, the Assessee would not be allowed to claim benefit of loss arising from such transaction. Since we have confirmed the order passed by the CIT(A) of deleting the addition made by the Assessing Officer in relation to CCDS while adjudicating Ground No. 8 above, we direct the Assessing Officer to compute income of the Assessee without allowing set off of loss of INR 74,86,000/- suffered in the transactions in GIC Rise II Units undertaken by the Assessee with C.Mackertich and Stewart & Co., and the loss of the INR 4,91,500/- pertaining to sale transaction of units of the face value of INR 1 Crore. Ground No. 9 raised by the Revenue is allowed in terms of the aforesaid.

13 **Ground No.10:**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing to delete the disallowance of Rs. 40,21,73,018/- on account of losses in ready forward transaction."

13.1. The Assessing Officer observed that the Janki Raman Committee had given a finding that Ready-forward transactions were used by the banks to divert their funds to stock brokers. These transactions were undertaken at rate which had no relation to the market rates and sole purpose of such transactions was to advance funds in an unauthorized manner to the stock brokers. Therefore, special audit under Section 142(2A) of the Act was directed on this issue. The special auditors examined all the transactions in order to segregate transactions which were in the nature of Ready-forward transactions as the Assessee Bank did not provide data bifurcating Ready-forward transaction without rate transactions. The special auditors identified transactions of purchase and sale in the same security of the same face value with same counter-party to be ready-forward

transaction where certain other ingredients such as exchange of BRS or SGL form representing a particular lot of securities was exchanged between counter-parties. The special auditors computed net profit of INR 54,06,54,475/- from the aforesaid Ready-forward transactions as under:

	Particulars	Amount (INR)
	Profit in ready-forward transactions in approved securities with bank clients	60,35,48,806/-
Less	Loss in ready-forward in non-approved securities with bank clients	17,60,23,450/-
Less	Loss in ready-forward in approved securities with non-bank clients	1,39,47,400/-
Add	Profit in ready-forward in non-approved securities with non-banking clients	14,32,62,451/-
Less	Loss in ready-forward in non-approved securities with CCDS account	1,61,85,932/-
	Total	54,06,54,475/-

13.2. During the assessment proceedings, the Assessee filed letters highlighting factual/ other inaccuracies and errors in the computation made by the special auditor, some of which were accepted by the Assessing Officer. The Assessing Officer finally computed profits/loss from Ready-forward transactions as under:

	Profit (INR)	Loss (INR)	Net (INR)
Approved Securities SBI/ Nationalized Bank	17,95,07,496	4,047,36,130	(+) 13,87,71,133
Approved Securities Other banks/non-banks	24,75,28,187,	38,44,22,046	(-) 13,68,93,859
Non-approved All counterparties	15,08,74,680	61,53,839	(-) 26,52,79,159
		Net Illegal Loss	(-) 40,21,73,018

13.3. The Assessing Officer concluded that the Ready-forward transaction

in approved securities with nationalized banks were legal whereas all the other Ready-forward transactions undertaken by the Assessee were illegal. Therefore, the Assessing Officer disallow the set off of loss of INR 40,21,73,018/- holding the same to be losses suffered in illegal transactions which could not be set off against profits from legal business activities.

13.4. Being aggrieved, the Assessee carried the issue in appeal. Before the CIT(A), the Assessee placed reliance upon Instruction dated 28/02/1995 issued by the Central Board of Direct Taxes wherein it was instructed that all Ready-forward transaction should be considered as a constituting as a single class of business, and hence, inter-se set off of profit and losses should be made and only the net profits should be brought to tax. The CIT(A) concluded that the aforesaid instruction was binding upon the Assessing Officer and deleted the disallowance of INR 40,21,73,018/- made by the Assessing Officer since as per the report of special auditor the net result of Ready-forward transactions was a profit of INR 54,06,54,475/-. The CIT(A) also took note of the fact that no disallowance was made by the Assessing Officer in identical facts and circumstance for immediately preceding Assessment Year 1992-93.

13.5. Being aggrieved with above relief granted by the CIT(A), the revenue is now in appeal before us.

13.6. The Ld. Departmental Representative submitted that the losses of INR 40,21,73,018/-, being losses from illegal transactions undertaken in contravention of Securities Contract (Regulation) Act, 1956, could not have been set off against the profits from legal

transactions. The special auditor incorrectly set off the losses from illegal Ready-forward transactions with the profits arising from legal Ready-forward transactions. During the course of assessment proceedings, the Assessee had filed revised working which shows that there was a net loss of INR 26.32 Crores and not a profit of 54.06 Crores. Further, the Ld. Departmental Representative placed reliance on the order passed by the Assessing Officer on this issue.

13.7. Per contra, the Ld. Senior Counsel appearing for the Assessee submitted that the Instruction dated 28/02/1995 issued by the Central Board of Direct Taxes (CBDT) clearly provided that in case the net result, after inter-se set off of profit and losses of Ready-forward transactions, was a loss, then the same would not be allowed to be set off against other profits from the banking business. The aforesaid instructions were clear and were correctly followed by the special auditor while computing the overall/net profit of INR 54,06,54,475/- arising from Ready-forward transactions. The Ld. Senior Counsel further submitted that the computation furnished vide letter dated 13/09/1996 containing re-worked position of profit and losses from Ready-forward transactions was submitted as per the directions given by the Assessing Officer to include transactions where broker was involved in one leg of the transactions while the other leg of the transactions was direct. The aforesaid directions were issued by the Assessing Officer on the basis of the act apprehension that same broker who was involved in the one leg of the transaction was also involved in the second leg of the transactions even though the second leg of the transaction was shown to be direct. Therefore, the revised computation furnished vide letter dated 13/09/1996 containing re-worked position could not be considered as the correct working of

net/overall profits or losses arising from Ready-forward transactions.

13.8. We have heard the rival contention and perused the material on record. Having perused Letter, dated 28/02/1995, issued by CBDT we are of the view that the same was issued after taking into consideration all the facts and circumstances prevalent at the relevant time and clearly provided that all the Ready-forward transactions, whether legal or illegal, were to be regarded as constituting a single class of business. The relevant extract of the aforesaid instruction read as under:

". F.No.225/313/94-ITA/II
Government of India,
Ministry of Finance, Department of Revenue
CENTRAL BOARD OF DIRECT TAXES

New Delhi, the 28th February, 1995.

To,

The Chief Commissioners/Directors General of Income-tax,
Bombay/Calcutta/Madras/Delhi/Bangalore/Hyderabad.

Sir,

Sub: Assessment of Banks - Issue arising out of transactions in securities - reg.

I am directed to say that in the light of representations received from both Indian and foreign banks, the Board has considered certain issues arising out of the transactions in securities in the context of assessments under the Income-tax Act, 1961. The following guidelines may be kept in view while finalising the bank's assessments.

1. *The first issue is whether the loss incurred in the ready-forward transactions can be set off against the profits arising out of ready-forward transactions. In the light of the notification dated 27-6-69 (copy enclosed) issued under section 16 of the Securities Contracts (Regulation) Act, 1956 a view is possible that ready-forward transactions in any form*

were not legally permissible. Further, several banks had also violated the statutory directions of the Reserve Bank of India in this regard by undertaking transactions in non-approved securities, by dealing with non-bank clients, by transacting at artificial rates having no correlation with market values, by dealing in securities without actually holding the same, etc. It is noticed that, in view of the violations, the losses incurred in such transactions have been disallowed in the assessments of certain banks without however setting off the profits earned in such transactions. The Board is of the view that all the ready-forward transactions should be considered as constituting a class of business, and hence, inter se set off of profits and losses should be made and only the net profit should be brought to tax. In case the net result is a loss, however, the same should not be set off against other profits from the banking business for the reason that such losses have arisen out of either transactions prohibited by the Central Government or undertaken in violation of the statutory directions of the R.B.I. and hence would be per se illegal".

2. – 6. xx xx

The above guidelines may be brought to the notice of all assessing officers assessing the banks in your region.

xx xx
Director (ITA.II)
Central Board of Direct Tax"

13.1 Keeping in view the above guidelines issued by the CBDT, the CIT(A) granted relief to the Assessee holding as under:

"14.3.1 I have very carefully considered the basis of disallowance by the Assessing Officer and the detailed arguments of the learned Counsel. I have also very carefully examined the instruction dated 28.2.1995 issued by the Board. In my considered view, the Board has made it very clear vide para 1 that ready-forward transactions in any form were not legally permissible. The Board while expressing its view has made it clear that all the ready- forward transactions should be considered as constituting a class of business, and hence, inter se set off of profits and losses should be made and only the net profit should be brought to tax. In case the net result is a loss, however, the same should not be set off against other profits from the banking business for the reason that such losses have arisen out of either

transactions prohibited by the Central Government or undertaken in violation of the statutory directions of the R.B.I. and hence would be per se illegal."

13.2 We concur with the CIT(A) on this issue as the guidelines issued by CBDT clearly provided that all the Ready-forward transactions should be considered as constituting a class of business; inter-se set off of profits and losses should be made; and only the net profit should be brought to tax.

13.3 As regards, computation furnished by the Assessee vide letter, dated 13/09/1996 containing re-worked position of profit and losses from Ready-forward transactions is concerned, we find merit in the submission advanced on behalf of the Assessee that the same was furnished as per the directions issued by the Assessing Officer and could not be considered as reflecting the correct overall/net profits/or losses arising from Ready-forward transactions. On perusal of Assessment Order we find that the direction issued by the Assessing Officer to file the aforesaid computation was given on the basis of apprehension harbored by the Assessing Officer. According to the Assessing Officer, there was a possibility of involvement of a broker where the broker name was mentioned as 'Direct' in the special audit report. There was no material on record to show the leg of the transactions shown to be 'direct' actually involved a broker. The Assessing Officer did not have any basis to change the parameters of identifying Ready-forward transactions adopted by the special auditor and the computation of net/overall profits as computed by the special auditor. As per the computation by the special auditor the Ready-forward transactions resulted in overall profit of INR 54,06,54,475/-.

13.4 In view of the above, we are not inclined to accept the contentions raised by the Revenue and decline to interfere with the order passed

by the CIT(A) on this issue. Ground No. 10 raised by the Revenue is, therefore, dismissed.

13.5 Additional Ground 12.1 to 12.5 raised by the Revenue also pertain to ready-forward transactions.

13.6 By placing reliance of Explanation to section 37(1) inserted by the Finance (No 2) Act 1998 with retrospective effect from 01/04/1962, the Revenue has contended that no deduction can be allowed for loss of INR 40,21,73,018/- arising from Ready-forward transactions. We have already rejected the contention of the Revenue that the Ready-forward contracts resulted in overall loss and have accepted the contention of the Assessee that the Ready-forward transactions resulted in the overall/net profits. Therefore, the question of claiming deduction of losses does not arise. Ground No. 12.1 raised by the Revenue has been rendered infructuous and is, therefore, dismissed.

13.7 As regards Ground No. 12.2. to 12.5 whereby it has been contended that entire purchase/sale cost of the Ready-forward Contract must be disallowed as per Explanation 1 to Section 37 of the Act, we are of the view that the adjudication of this ground would require investigation into facts which are not on record. Ready-forward transactions contain two inter-connected legs, namely, the first or the ready-leg, consisting of purchase/sale of certain securities at a specified price, and the second or forward leg, consisting of the corresponding sale/purchase of the same of similar securities at a letter date at a price determined on the first date. The Hon'ble Supreme Court has, in the case of BOI Finance Limited Vs Custodian : 14 [1997] 12 SCL 99 (SC), held that Section 16 of the Securities

Contracts (Regulation) Act prohibited only the entering into of a forward contract, i.e., sale at a future date. The first leg involving purchase/sale of securities was legal. The two legs of the Ready-forward Transaction were severable. The adjudication of Ground No. 12.2. to 12.5., which have been raised for the first time before the Tribunal, would require further investigation into the bifurcation of Ready-forward transactions into first leg and second leg transaction. Further, investigation would be required to identify first-leg transaction involving purchase of securities since according to Explanation 1 to Section 37 of the Act only expenses incurred can be disallowed. In our view, the facts necessary for adjudication of Ground No 12.2 to 12.5 are not on record and would require further inquiry/investigation. Accordingly, we decline to admit Ground No. 12.2 to 12.5 raised by the Revenue after expiry of more than 7 years the date of institution of appeal before the Tribunal.

13.8 In view of the above, the Cross – Objections filed by the Assessee become infructuous and therefore, the same are dismissed.

14 **<u>Ground No.11:</u>**

"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing the Assessing Officer to delete the disallowance on account o losses in Securities transactions to the extent of Rs. 756.96 crores out the total disallowance of Rs. 1094.14 crores made by the Assessing Officer on the ground that the loss to the extent of Rs. 756.96 crores is allowable deduction u/s. 28 and 36(i)(vii) of the I.T. Act, 1961."

14.1 In the return of income the Assessee had claimed loss of INR 1,427.59 Crores on account of securities transaction scam. During the assessment proceedings, the Assessee claimed that during the security scam various payments were made by the Assessee for purchase of securities which were never delivered to the Assessee. Similarly, the Assessee had sold several securities but did not

receive the sale consideration. The aforesaid amounts, represented loss suffered by the Assessee during normal course of business which was allowable as deduction under Section 28 of the Act. Alternatively, it was contended by the Assessee that Assessee should be allowed deduction for the aforesaid amount under Section 36(1)(vii) of the Act being bad debts. In this regard, the Assessee relied upon Circular dated 27/04/1992, issued by CBDT.

14.2 The Assessing Officer examined the allowability of loss in individual transactions by testing the transaction of the following parameters:

First: Whether the transaction was genuine and the loss had accrued to the Appellant.

Second: If the transaction was genuine, whether the same was in the regular course of banking or whether any other motive can be inferred in the overall context of the security scam.

Third: If the transaction was genuine and done in the regular and normal course of business, whether the loss crystallized or became final in this year.

14.3 The Assessing Officer was of the view that deduction could be allowed to the Assessee only in case where all the above three criteria were satisfied. After examining each of the transactions in respect of which the Assessee has made a claim for loss, the Assessing Officer allowed deduction for INR 333.45 Crores only. As regards balance claim of deduction for Loss of INR 1,094.14 Crores out of the total deduction of INR 1,427.59 Crores claimed by the Assessee, the Assessing Officer disallowed the same. The Assessing Officer concluded that the Loss of INR 1,094.14 Crores pertained to transactions which were irregular and were not undertaken in the

normal course of business by the Assessee. Therefore, the Assessee was not entitled to claim deduction Section 28 or Section 36(1)(vii) of the Act.

14.4 Being aggrieved, the Assessee preferred appeal before CIT(A) against the denial of deduction of INR 1,094.14 Crores which consisted of the following:

Particular	INR (Crores)
Losses in transactions with BOK/MCB, which are in liquidation	403.14
Settlement reached with the counterparties	156.97
Suits decided in favour of the Appellant and recoveries made subsequent to the accounting year	180.19
Cases pending before Special Court/Supreme Court, etc.	353.84
Total	**1,094.14**

14.5 Before the CIT(A), the Assessee filed various submissions including submissions dated 12/04/2000 and 03/05/2002. It was contended on behalf of the Assessee as under:

(a) The Assessee bank was a victim of massive fraud perpetrated by a broker in collusion with the employees of the Assessee resulting in embezzlement of funds. The loss thus suffered by the Assessee was allowable as deduction under Section 28 of the Act. Reliance in this regard was placed on Circular No. 35-D (XLVII-20) [F. No. 10/48/65-IT(A-1)], dated 24/11/1965.

(b) The Assessee suffered loss of INR 1,427.59 Crores in securities transactions undertaken in compliance with the provisions of Banking Regulation Act, 1949.

(c) The losses incurred by the Assessee were investigated by the

Janakiraman Committee which estimated gross loss incurred by the Assessee at INR 1,482.14 Crores which consisted of the following:

Sl.	Particulars	INR (Crores)
(i)	Total value of investments made by banks for which they do not hold any securities, SGL transfer forms or BRs	506.61
(ii)	Total exposure against BRs/SGL transfer forms issued by Bank of Karad Ltd. or Metropolitan Co-operative Bank Ltd. (for which there appears to be no security backing)	931.84
(iii)	Other items	43.69
	Gross Exposure	1,482.14

The Assessee had claimed deduction for INR 1,427.59 Crores. The difference between the loss estimated by the Janakiraman Committee Report and the loss claimed by the Assessee was on account of no tax claim made by the Assessee. The loss incurred by the Assessee stood established by the finding of the Janakiraman Committee.

(d) Investigations were also carried out by CBI in relation to transactions resulting in loss to the Assessee.

(e) The Assessee had filed a suit against Canara Bank and Others (Suit No. 13 of 1994) before the Special Court established under the Special Court (Trial of Offences Relating to Transaction in Securities) Act, 1992 (for short 'the Special Court') wherein the respondents in the said suit had set up a defense that arrangement between the Assessee and its broker whereby the Assessee would be ensured of a return of 15% provided the Assessee undertook purchase/sale of securities under instructions of the broker – Mr. Hiten P Dalal (hereinafter referred to as the '15% Arrangement') was against public policy. However, the Special Court rejected the aforesaid defense and held that the transactions under the alleged 15% Arrangement were neither against the circular issued by RBI nor opposed to public policy. The decision of the

Special Court was confirmed by Hon'ble Supreme Court in Civil Appeal No. 4456 of 1096 vide order and judgment dated 30/10/2001 whereby the appeal preferred by Canara Bank and Others was dismissed.

(f) The losses had crystallized during the relevant previous year as the same were written off in the books of accounts during the relevant previous year.

(g) Alternatively, it was also contended by the Assessee that the securities in question were held by the Assessee as stock-in-trade as the Assessee has written of the losses in the books of accounts during the relevant previous year, the Assessee was entitled to claim deduction for the amount written off as bad debts under Section 36(1)(vii) of the Act. Reliance in this regard was place on Circular No. 551 dated 23/01/1990 issued by CBDT [183 ITR 37]

14.6 The above submissions advanced by the Assessee found favour with the CIT(A) who allowed deduction for losses to the extent of INR 756.96 Crores being losses of INR 867.50 Crores written off by the Assessee reduced by the recoveries of INR 110.53 Crores. The balance claimed for deduction of losses amounting to INR 337.18 Crores (INR 1094.14 Crores – INR 756.96 Crores) was not allowed by the CIT(A) on the ground that the same were either not written off during the relevant previous year or could not be considered as having become final during the relevant previous year.

14.7 Now, the Revenue is in appeal before us against the order of CIT(A) allowing deduction of INR 756.96 Crores under Section 28 read with Section 36(1)(vii) of the Act.

14.8 The Learned Departmental Representative submitted that the transactions undertaken by the Assessee were against public policy

and therefore, deduction for the same cannot be allowed. In this regard, the Learned Departmental Representative relied upon the order passed by the Assessing Officer. He submitted that the transaction which resulted in losses were undertaken under an illegal arrangement between the Assessee and broker. The loss, if any, was suffered by the Assessee on account of entering into illegal transactions and not on account of embezzlement by an employee. He further submitted that it could not be said that the loss crystallized during the relevant previous year. Thus, the Learned Departmental Representative supported the order passed by the Assessing Officer on this issue.

14.9 Learned Senior Counsel appearing for the Assessee took us through the order passed by the CIT(A) and submission filed before the CIT(A) to support the order passed by the CIT(A). Learned Senior Counsel submitted that the Assessee bank was a victim of fraud discovery in June 1992 in which some of the employees of the Assessee were also involved. The Assessee filed a complaint on the basis of which First Information Report (FIR) was registered with the Central Bureau of Investigation (CBI). On the complete review and reconciliation of stock of securities as per books and the physical holding of securities, it was would found that the Assessee had suffered a loss aggregating to INR 1,427.59 Crores. The Appellant initiated the process of negotiation/mediation with the counter-parties. A number of civil suits were also filed by the Appellant against the counter-parties. The Reserve Bank of India (RBI) also appointed a committee under the chairmanship of Sh. Janakiraman, the then Deputy Governor of RBI to conduct inquiry into the irregularities in the conduct of banking and security transactions in the banking industry. The preliminary inquiry by the

said committee indicated that two banks viz Bank of Karad (BOK) and Metropolitan Co-operative Bank (MCB) had undertaken large number of sale transactions without holding the stocks. The funds received by these banks were siphoned off by certain brokers. In the event, these banks were not in a position to honor their contractual obligations for delivery of securities. Both the aforesaid banks were placed under liquidation, during the previous year relevant to Assessment Year 1993-94. Investigation of losses suffered by the banks was also conducted by the committee which estimated that the Assessee had exposure of INR 1,482.14 Crores. On the second test applied by the Assessing Officer that whether the transaction was genuine and was in the regular course of banking, the Learned Senior Counsel relied upon the judgment of the Hon'ble Supreme Court, dated 30/10/2001, passed in Civil Appeal No.4456 of 1996. Explaining the background, Learned Senior Counsel submitted that a suit was filed by the Appellant against Canara Bank and Others before the Special Court [being Suit 13 of 1994]. In that suit, the Defendants (i.e. Canara Bank and Others) sought to take a defense that the suit transactions were part of an internal arrangement between the Assessee (i.e. Standard Chartered Bank) and the broker, who was a notified party and the said arrangement was opposed to public policy. The suit was decided in favour of the Assessee-bank by the Special Court. In the appeal filed by Canara Bank and Others against the order of the Special Court, the Hon'ble Supreme Court, vide order dated 30/10/2001 passed in Civil Appeal No.4456 of 1996, confirmed the decision of the Special Court whereby it was held that the 15% Arrangement was not against the Circulars of the RBI, or not opposed to public policy. Placing reliance on Circular No.35-D

(XLVII-20) [F.No.10/48/65-11 (A-1)] dated 24/11/1965 issued by the CBDT the Learned Senior Counsel submitted that in view of the decision of the Supreme Court in Badridas Daga vs. CIT (34 FTR 10) and Associated Banking Corporation of India Ltd. vs. CIT (561TR 1), the legal position now clear that the loss by embezzlement by employees should be treated as incidental to business.

14.10 We have heard both the sides at length on this issue, consequent the rival submissions, perused the material on record and examined the position in law.

14.11 On perusal of record, we find that the Assessee had claimed deduction in respect of losses suffered by the Assessee on account (a) loss suffered in the securities transactions, where the Appellant either paid the consideration for purchase of securities but did not receive delivery of the same or (b) sold securities but had not received the consideration. It is admitted position that the Assessee-bank was permitted to undertake transaction of purchase and sale of securities. However, the Assessing Officer was of the view that 15% arraignment entered into by the Assessee with its broker was in irregular transaction which could not have been said to have been undertaken in the normal course of business. In appeal before CIT(A), the Assessee had placed reliance upon the findings of the Special Court in suit filed by the Assessee against Canara Bank and Others (Suit No. 13 of 1994) and had contended that the same have been confirmed by the Hon'ble Supreme Court while dismissing the appeal preferred by Canara Bank and Others (Civil Appeal No. 4456 of 1995). On perusal of paragraph 37 of the order passed by the Special Court reproduced in the judgment, dated 30/10/2001, passed by the Hon'ble Supreme Court. We find

that the Special Court had concluded as under:

> *"37. Further, before a contract can be said to be void on grounds of public policy it must be shown that the object and consideration of that contract was one which was illegal. The object and consideration of the suit contracts are purchase/sale of the securities and payment of price. Such securities contracts are normally entered into by banks. These may be for SLR purposes or in the normal course of business of the bank. It is the business of the bank to try and make profit. Thus, even if these were part of the 15% arrangement, provided there was such an arrangement, would not make them against public policy if it was a genuine security transaction. None of the circulars relied upon by Mr. Salve prohibit such transactions. In my opinion, none of the circulars have any bearing on the point under consideration. The suit transactions or transactions under the alleged 15% arrangement are not against the subject matter of these circulars. They are also not even against any policy laid down therein. I thus see no illegality. For this reason also no evidence can be permitted.*
>
> *38. However, it must be immediately stated that if there was a fictitious transaction, it could possibly be construed as being against public policy, even de hors these circulars. It is also possible that the practice, if any, of arriving at a derived price, which is different from contract rates, can be termed as against public policy. These however, do not arise for consideration in this case. It is not the defendants case that the suit contracts are fictitious. In fact, as set out above, it is the defendant's case that the suit transactions are genuine and entered into in normal course of securities business. There is no averment that the prices under the suit contracts are derived prices. There is no averment that on the basis of derived prices, plaintiffs made a profit of 15% on a resale of the securities purchased from the defendants. No such case has been pleaded in the pleadings. In fact, even though the alleged 15% arrangement is set out in the written statement and even though it is averred that the suit contracts are part of the 15% arrangement, it has significantly not been averred that in these transactions, profit of 15% had been earned by the plaintiffs. If that be so, there is no question of permitting evidence in support of such a plea."*

14.12 On perusal of above, it can be seen that on the issue of the 15% Arrangement being opposed to public policy, the Special Court did

not permit the defendants in the suit to lead evidence to show that the 15% Arrangement was opposed to public policy since no such case was pleaded by the defendants in the suit. The Special Court had, in paragraph 38 (reproduced hereinabove), noted that it was the defendants case that the suit transaction were genuine and were entered into in normal course of securities business. Thus, the decision of the Special Court cannot be relied upon to contend that the Special Court has given a finding that 15% Arrangement was not opposed to public policy.

14.13 However, we note that dismissing the appeal preferred by the defendants the Hon'ble Supreme Court has observed : "*We are also not satisfied that there is any merit in the contention that the transaction in question would be void on the grounds of public policy".* The relevant extract of aforesaid judgment of the Hon'ble Supreme Court under:

> *"8. In our opinion, the decision of the Special Court calls for no interference. The plea which had been taken in the written statement essentially was that there was a squaring up of the transaction. This did not succeed as there was lack of evidence. The other plea of repayment also failed. <u>We see no infirmity with the decision of the Special Court on this account with regard to the contention that the transaction was opposed to public policy. The Special Court was right in observing that no such plea has been raised in the written statement and we agree with the Special Court that permitting such a plea to be raised would be contrary to the plea already taken in the written statement namely, of squaring up or of repayment</u>. The order relating to the admissibility of the cheque wherein the Special Court had come to the conclusion that such a plea could not be raised was passed on 2/3-3-1995. The appellant herein chose not to file any application for amendment of the written statement before the Special Court. It proceeded with the case and in our opinion it is now too late to allow such an amendment in this Court. <u>We are also not satisfied that there is any merit in the contention that the transaction in question would be void on the grounds of public policy</u>. The*

allegation in this connection which the appellant wanted to prove was that there was an understanding between the respondent and Hiten Dalal to the effect that Hiten Dalal will ensure a return of 15 per cent in turn and purchase and sale of securities would take place under the instructions of Hiten Dalal so as to ensure that the Bank got this return. It was sought to be contended that such a transaction was contrary to the circulars of the RBI and were opposed to public policy. We agree with the observations of the Special Court which had been referred to herein above in connection with this connection and furthermore, as held by this Court in B.O.I. Finance Ltd. v. Custodian [1997] 10 SCC 488. The instructions which were issued by the RBI were meant to be complied with only by the Banking Companies and could not be regarded as binding on the other parties. There was no evidence raised or sought to be raised in the present case which could possibly have led the Court to the conclusion that the transaction was opposed to public policy.

9. In our opinion the Special Court, after taking into consideration the pleadings and the evidence on the record, was right in decreeing the suit of the respondent. We, accordingly, affirm the decree and dismiss the appeal with no order as to costs. In view of the above, all the interlocutory applications also stand dismissed." (Emphasis Supplied)

14.14 The above observations of the Hon'ble Supreme Court are binding upon us. Therefore, we reject the contention of the Revenue that 15% Arrangement was against public policy.

14.15 Further, we note that that the Special Court has held that the circular on which reliance was placed by the Defendants did not support the contention of the Defendants that the suit transactions undertaken under 15% Arrangement were in violation of Guidelines issued by RBI. Even during the appellate proceedings before us noting has been placed on record to show that the transactions in respect of which claim of loss has been made by the Assessee were in violation of any of the guidelines issued by RBI.

14.16 In view of the above, we concur with the CIT(A) and hold that the

transactions under consideration were regular transactions undertaken by the Assessee during the ordinary course of business.

14.17 There is no dispute that the Assessee had written off the amount to this extent of deduction for loss allowed by the CIT(A) during the relevant previous year and, therefore, the CIT(A) was correct in holding that the losses can be said to have crystallized during the relevant previous year. We note that the CIT(A) has reduced the amount of losses written off by the amount of recoveries made and had not allowed deduction for losses of INR 337.18 Crores for the reason the same were either not written off during the relevant previous year or could not be considered as having become final during the relevant previous year.

14.18 Further, in our view, the genuineness of the loss suffered by the Assessee cannot be doubted in view of the independent assessment of gross exposure made by the Janakiraman Committee. Given the facts and circumstances in the present case, we are of the view that the loss suffered by the Assessee was a result of, both, the nature of arrangements Assessee had with the brokers and the misconduct on the part of the employees/ex-employees of the Assessee during. Thus, we hold that the loss was suffered by the Assessee during the normal course of business. On behalf of the Assessee reliance was placed on Circular No. 35-D (XLVII-20) [F. No. 10/48/65-IT(A-1)], dated 24/11/1965 wherein it was clarified by the CBDT that loss arising due to embezzlement by the employees should be treated as incidental to the business.

14.19 In view of the above, we hold that deduction of INR 1,094.14 Crores allowed by the CIT(A) represented loss suffered by the Assessee on

account of regular transactions undertaken in ordinary course of business which were written off during the relevant previous year. Thus, we do not find any infirmity in the order passed by CIT(A) in allowing deduction for such loss under Section 28 or Section 36(1)(vii) of the Act. Accordingly, Ground No. 11 raised by the Revenue is dismissed.

14.20 In result, the appeal preferred by the Revenue is partly allowed, while the Cross- Objections preferred by the Assessee are dismissed as being infructuous.

Order pronounced on 27.07.2023.

Sd/-
(Prashant Maharishi)
Accountant Member

Sd/-
(Rahul Chaudhary)
Judicial Member

मुंबई Mumbai; दिनांक Dated : 27.07.2023
Alindra, PS

<u>आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to</u> :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त/ The CIT
4. प्रधान आयकर आयुक्त / Pr.CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार /(Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai

Sr. No.	Details	Date	Initials	Designation
1	Draft dictated on/Draft dictation sheets are attached/Dictated directly on PC			Sr.PS/PS
2	Draft Placed before author			Sr.PS/PS
3	Draft proposed & placed before the Second Member			JM/AM
4	Draft discussed/approved by Second Member			JM/AM
5	Approved Draft comes to the Sr.PS/PS			Sr.PS/PS
6	Order pronouncement on			Sr.PS/PS
7	File sent to the Bench Clerk			Sr.PS/PS
8	Date on which the file goes to the Head clerk			
9	Date on which file goes to the AR			
10	Date of Dispatch of order			