आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई

IN THE INCOME TAX APPELLATE TRIBUNAL
"D" BENCH, CHENNAI

श्री चंद्र पूजारी, लेखा सदस्य एवं

श्री वी. दुर्गा राव, न्यायिक सदस्य के समक्ष

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER &
SHRI V. DURGA RAO, JUDICIAL MEMBER

आयकर अपील सं./ **I.T.A. Nos.1336 & 3072/Mds/2014**

(निर्धारण वर्ष **/** Assessment Years : 2009-2010 & 2010-2011)

M/s. Majestic Exports, No.9, College Road, Tirupur 641 602 [PAN: AAEFM 8827F] (**अपीलार्थी**/Appellant)	Vs	The Joint Commissioner of Income Tax, Tirupur Range, Tirupur (**प्रत्यर्थी**/Respondent)

अपीलार्थी की ओर से / Appellant by : Shri. T. Banusekar, C.A

प्रत्यर्थी की ओर से / Respondent by : Shri. Krishnamurthy, IRS, CIT.

सुनवाई की तारीख/Date of hearing : 08.06.2015

घोषणा की तारीख /Date of Pronouncement : .07.2015

आदेश / O R D E R

PER BENCH

These two appeals by the assessee are directed against different orders of Commissioner of Income Tax (Appeals)-II, Coimbatore for the above assessment years.

2. The first common ground in this appeal is with regard to confirmation of addition made by the Assessing Officer treating business loss as speculative loss in respect of loss on account of forex derivative contracts (Exotic Cross Currency Option Contracts).

3. The facts of the case are that the assessee company is engaged in the business of manufacturing and export of hosiery garments to various countries and receives Dollars or Euros. Payments from foreign buyers in foreign currencies are received through the State Bank of India. During the year under consideration the assessee entered into many forex derivative contracts including six structured contracts. These are stated to be called as Exotic Cross Currency Option contracts. In respect of one of the structured contracts with State Bank of India on various dates, the assessee incurred huge losses to the extent of ₹4,30,44,915/- and the assessee claimed the said loss as business loss**.** As per the assessee trading in futures and options is no longer speculative transactions as per proviso (d) to Sec.43(5) inserted by the Finance Act, 2005 w.e.f. 01.04.2006. However, the Assessing Officer observed that loss incurred out of trading in futures and derivatives contract could not be considered as business loss and it is to be considered as speculative transactions and

distinct from assessee's business and it is a speculative business of the assessee. Accordingly, the Assessing Officer treated the speculation loss not allowable to set off against business income of the assessee. Against this, the assessee carried the matter in appeal before the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) confirmed the view of the Assessing Officer. Aggrieved, the assessee is in appeal before us.

4. The ld. Authorised Representative for assessee submitted that derivatives had been excluded from the definition of ''speculative business" u/s.43(5) by sub-clause (d) to the Provision inserted with effect from 01.04.2006. Further, he submitted that Explanation to sec.73 was introduced to prevent companies from trading in their own group shares and showing losses to be set off against business profit. The legislature decided to exempt the derivatives from the purview of 'speculative transactions' only after confirming that there was sufficient transparency in the transactions i.e. only trading in derivatives carried out in a recognized stock exchange. He submitted that foreign currency or any currency is neither commodity nor shares. The Sale of Goods Act, specifically excludes cash from the definition of goods. Besides, no person other than authorized dealers and money changers

are allowed in India to trade in foreign currency, much less speculate. Section 8 of the Foreign Exchange Regulations Act, 1973, provides that except with prior general or special permission of the RBI, no person other than an authorized dealer shall purchase, acquire, borrow or sell foreign currency. Further he submitted that in the normal course of business of import and export, the assessee entered into foreign exchange contract to cover up the losses and differences in exchange valuation, the transaction is not a speculative transaction. Further, the ld. Authorised Representative for assessee further contented that the assessee is not a dealer in foreign exchange. For the purpose of hedging the loss due to fluctuation in foreign exchange while implementing the export contracts, the assessee had entered into forward contract with the banks. In some cases, the export could not be executed and the assessee had to pay certain expenses. These expenses the assessee claimed by way of expenditure towards business and the transaction can be stated to be in speculation as to cover under sub-section (5) of Section 43 of the Act.

5. The ld. Authorised Representative for assessee relied on the order of the Co-ordinate Bench in the case *of M/s. Cotton Blossom*

(India) P. Ltd, in ITA No.2032/Mds/2012, dated 21st February, 2013 wherein it was held that

> *''The assessee is an exporter of hosiery garments. There is no dispute that the assessee is not a dealer in foreign exchange. The assessee's forex transactions only in the course of its business and not as a separate business as observed by the Assessing Officer because the assessee is not a dealer in foreign exchange''.*

5.1 The ld. Authorised Representative for assessee relied on the order of the Co-Ordinate Bench, Delhi in the case of *Munjal Showa Ltd vs. DCIT, 94 TTJ 227, dated 26th June, 2003* wherein it was held that

> *Profit on cancellation of forward contract in foreign currency entered into for safeguarding against loss by fluctuation in foreign currency for purchase of plant and machinery with loan obtained in foreign currency is capital receipt and not speculative profit*.

5.2 The ld. Authorised Representative for assessee relied on the judgment in the case of *CIT vs. Badridas Gauridu (P) Ltd 261 ITR 256, (Mumbai)* wherein it was held that

> *The assessee was not a dealer in foreign exchange. The assessee was a cotton exporter. The assessee was an export house. Therefore, foreign exchange contracts were booked only as incidental to the assessee's regular course of business. The Tribunal has recorded a categorical finding to this effect in its order. The Assessing Officer has not considered these facts. Under section 43(5) of the Income-tax Act, "speculative transaction" has been defined to mean a transaction in which a contract for the purchase or sale of a commodity is settled otherwise than by the actual delivery or transfer of such commodity. However, as stated above, the assessee was not a dealer*

> *in foreign exchange. The assessee was an exporter of cotton. In order to hedge against losses, the assessee had booked foreign exchange in the forward market with the bank. However, the export contracts entered into by the assessee for export of cotton in some cases failed. In the circumstances, the assessee was entitled to claim deduction in respect of Rs. 13.50 lakhs as a business loss. This matter is squarely covered by the judgment of the Calcutta High Court, with which we agree, in the case of CIT v. Soorajmull Nagarmull [1981] 129 ITR 169.*

5.3 The ld. Authorised Representative for assessee relied on the order of the Co-Ordinate Bench, Mumbai in the case of *D. Kishore Kumar & Co vs. DCIT, 2 SOT 769* wherein it was held that

> *'' assessee engaged in importing rough diamonds and exporting cut and polished ones, profits from cancellation of forward contracts in foreign exchange entered into with a view to minimize risk were integral part of assessee's exports profits eligible for deduction u/s.80HHC and Expln.(baa) had no application* **''.**

5.4 The ld. Authorised Representative for assessee relied on the order of the Co-Ordinate Bench, Mumbai in the case of *DCIT vs. Intergold (I) Ltd, 124 TTJ 337*, wherein it was held that

> *''Profits on cancellation forward exchange contract were assessee's profits of business, but as such profits were not derived from export activity and were received from banks in India not in convertible foreign exchange in terms of sub-s(2), of s. 80HHC,90 percent of the same has to be reduced from profits of business as per Expln.(baa) of s.80HHC''.*

5.5 The ld. Authorised Representative for assessee relied on the judgment of Jurisdictional High Court in the case of M/s. *Rajshree Sugars & Chemicals vs. M/s Axis Bank Limited, in O.A. Nos.251 &252 of 2008 and others dated 14th October, 2008* wherein it was held that

> *''The above sequence of events would show that the transaction in question, from its very nature, cannot be termed as a wager. We have seen in paragraph-55 above that three tests are to be satisfied if a contract is to be termed as a wager. The first test is that there must be two persons holding opposite views touching a future uncertain event. The second test is that one of those parties is to win and the other is to lose upon the determination of the event. The third test is that both the parties have no actual interest in the occurrence or non-occurrence of the event, but have an interest only on the stake. The first test is satisfied in this case as there are 2 parties. But, the second test may not be satisfied in this case since the plaintiff may not always stand to lose. If the plaintiff loses in the underlying contract on account of currency fluctuation, it may get compensated by the hedging and vice versa. Therefore both parties cannot be taken to be winners or losers in absolute terms. Even if we take for the sake of argument that the first two tests are satisfied in this case, the third test is certainly not satisfied in the case on hand. Both the parties definitely have an actual interest in the rate of exchange hitting a high or low. This is because of the fact that the very intention of the transaction is to hedge an underlying exposure. It is like a contract of insurance, where, on the happening of an uncertain event, the sum assured becomes payable''*
>
> *Therefore the argument that the contract was a wager, that it was brought forth by misrepresentation, that Mr.P.K.Viswanathan had no authority and that there was a payment of premium by the Bank, are all rejected. As a matter of fact, the prices of derivatives are now scientifically determined on the basis of a mathematical model (or formulae) developed by 2 men by name Fischer Black and Myron Scholes in 1973. The formulae itself was named after them, as Black-Scholes Model. The application of the model, led to the award of the Nobel in*

Economics. The derivatives prices are determined by feeding certain inputs into this model. These inputs are (i) stock price of the underlying asset (ii) amount of time until expiration (iii) strike price of the option (iv) volatality of the underlying asset (how much it moves up or down during a given period) (v) risk free rate of return (usually the interest rate paid by Govt ot banks on guaranteed investments). After Black-Scholes model, several models were developed, the noted among them being the Garman-Kohlhagen model designed to arrive at the price of FX options. Therefore derivatives transactions ceased to be purely speculative deals, long time ago. The pricing of the deals, follows a scientific pattern on the basis of Financial Mathematics. Just as Actuaries scientifically determine the value of insurance risks and the premium payable, Financial Mathematicians (or Portfolio Managers) evaluate the price of these derivatives. Hence they cannot be termed as wagers..

Two of the earliest circulars so issued by the Reserve Bank of India, were A.D (M.A. Series) Circular Nos. 21 and 26 dated 23.12.1994. They were issued in exercise of the power conferred under Section 73(3) of the Foreign Exchange (Regulation) Act, 1973, permitting authorised dealers (of foreign exchange) to offer forward cover to resident customers in any currency of their choice. Normally customers used to require forward cover facilities in respect of the foreign currency, in which their receivables or payables are denominated, against the Indian Rupee. But these circulars acknowledged the fact that the customers may at times, wish to hedge against a third currency instead of the rupee. Therefore these circulars permitted the authorised dealers to provide forward sale or purchase facilities, in the currency of receivables or payables against a third currency, provided the latter currency is also a permitted currency and is actively traded in the market, if the customer wished to hedge against a third currency instead of the rupee.

Customers will ordinarily require forward cover facilities for the foreign currency in which their receivables or payables are denominated, against the Indian rupee. If for any reason, customers wish to hedge them against a third currency instead of the rupee, authorised dealers may provide forward sale or

> *purchase facilities as appropriate, in the currency of the receivables or payables against the third currency provided the latter currency is also a permitted currency and is actively traded in the markets. Partial hedging may also be permitted whereby the customer hedges the currency of receivables or payables against the third currency first and completes the hedge against the rupee subsequently. Partial hedging may also be permitted in reverse order wherein the third currency is hedged against the rupee first.*
>
> *The contents of the above circular show that it is not necessary for the Customers to seek forward cover facilities for the foreign currency in which their receivables or payables are denominated, against the Indian rupee. If for any reason, customers wished to hedge them against a third currency instead of the rupee, authorised dealers were permitted by this circular to provide forward sale or purchase facilities as appropriate, in the currency of the receivables or payables against the third currency provided the latter currency is also a permitted currency and is actively traded in the markets. This facility was allowed in view of the fact that at times, a third currency other than the rupee may be more stable, while the rupee may be volatile and in turbulent weather.*

5.6 The ld. Authorised Representative for assessee further placed reliance on the order of the Co-ordinate Bench, Mumbai in the case of *IVF Advisors Private Limited vs. ACIT in ITA No.4798/Mum/2012, dated 13.02.2015* wherein it was held that

> *''7.4 Considering the relevant provisions of the relevant Acts, discussed herein above in the light of Hon'ble Madras High Court and the answers given to frequently asked questions by the SEBI and the incorporation of exchange traded currency derivative from August, 2008, there remain no iota of doubt that the transaction of the assessee cannot be treated as speculative transaction. We have also gone through the copies of the contract notes incorporated in the paper book filed before us. A perusal*

> *of the contract note shows that the assessee has either entered into call option or put option and on the settlement day the transaction has been settled by delivery, either the assessee has paid US dollar on the settlement day or has taken delivery of US dollar.*
>
> *7.5 To sum up, the derivatives include foreign currency and call option/ put option, are transactions of derivative markets and cannot be termed as speculative in nature. Considering the totality of the facts and in the light of the judicial discussion herein above, we have no hesitation in setting aside the order of Ld. CIT(A). Appeal filed by the assessee is accordingly allowed''.*

5.7 The ld. Authorised Representative also placed reliance on the order of the Co-ordinate Bench, Madras in the case *of M/s. SCM Garments (P) Ltd vs. DCIT, in ITA No.1645/Mds/2013 and ITA No.2275/Mds/2014, dated 27.02.2015* wherein it was held that

> *''We have heard the rival submissions and carefully perused the material on record and case laws relied by both the parties. In this case before us, one of the major business activities of the assessee is export of business garments as it appears from the financial statements submitted by the assessee. Therefore, it is obvious that the assessee would be having huge sundry debtors resulting from export of garments which are receivable in the foreign currency. These sundry debtors are exposed to currency fluctuation risk. One of the methods to protect loss against foreign currency fluctuation is by way of 'hedging'. Hedging transactions are entered in order to protect against the loss due to compensatory price movement. It protects an asset or liability against fluctuation in foreign exchange rate. One of the tools for hedging the forex risk is by way of foreign currency derivatives. Section 45 of the Reserve Bank India Act, 1949 defines derivative as a financial instrument whose value depends on the value of the underlying exposures. In the case before us, the underlying exposure is the foreign currency. The commonly used forex derivatives are Forward contracts, Options contracts and Swap contracts. These instruments are used to hedge the currency risk on account*

of adverse currency movements. In the present case before us, the assessee has selected to book "Options Contract" as per the advice of its bankers in order to hedge its foreign exchange risk. "Options contract" is a right to exercise the option of buying or selling of a foreign currency at a particular price. However, the assessee is not compelled to buy or sell, if the spot market prices are favorable or not favorable. The cost of this "option" is called 'Option Premium'. Upon the payment of the same, the exporter is hedged against adverse currency movement and also not liable to loose in case of favorable currency movement. Therefore, it is apparent in the case of the assessee that the assessee had entered into "Options Contract" (derivative) with the bank in order to hedge its foreign exchange risk. In the case of the assessee, what has happened is that due to adverse foreign exchange movement, the bank has debited the loss to the assessee's account. Thus, the loss debited by the bank in the assessee's account has crystallized and is a realistic loss suffered by the assessee. In these circumstances, the issue under consideration before us is that, whether loss on account forex derivates are to be considered as a business loss in parlance with Section 28 of the Act. Further, in the case of the assessee before us, the following facts emerge and the legal issues involved are discussed and summarized herein below:-

(i) The assessee has entered into forex derivative transactions only in order to contain the foreign currency fluctuation risk.

(ii) Thus, the loss on account forex derivative transactions are directly attributable to the normal business of the assessee.

(iii) The loss incurred by the assessee is realistic and not notional.

(iv) Only money changers and banks are allowed to trade in foreign currency and the assessee is neither a money changer nor a bank.

(v) The assessee has only utilized the service of nationalized bank in order to iron out the loss arising out of foreign currency fluctuation risk by entering into forex derivative contract.

(vi) The Special Bench of the ITAT, Kolkata Bench in the case of Shri Capital services Ltd Vs. ACIT in 121 ITD 498(Kol.)(SB) has held that foreign currency is neither commodity nor shares as defined U/s. 43(5) of the Act.

(vii) The Instructions issued by CBDT Instruction No.03/2010 dated 23.03.2010 has recognized the loss out of forex derivatives on actual settlement/conclusion of contracts as allowable business loss, however they have directed the Revenue to examine whether the transactions would fall U/s. 43(5)(d) of the Act, and if so to treat the same as non-speculative transaction. By the above directions, it appears that though the CBDT has recognized the loss arising out of forex derivatives on actual settlement of the contracts, directed the Revenue to treat the same as speculative transaction when they are transacted through nationalized banks and as not speculative, when these transactions are transacted through recognized stock exchange.

(viii) It is pertinent to note here that the bankers act as an advisory agent to the assessee in order to protect them from foreign exchange exposure by using their expertise and these services cannot be obtained by the assessee in the stock exchange where their scope of service is very limited.

(ix) In the present case the assessee has taken a hedging position to the extent of ₹1.05 crores and USD `3 crores during the period 2007-2009 based on the RBI guidelines. The guidelines permitted hedging to the extent of last three years annual average turnover, or current year's actual export turnover whichever is higher. Where exact amount of underline transaction was not ascertainable according to RBI guidelines, the contracts could be booked on the basis of reasonable estimate. The assessee has taken its hedging position in accordance with the guidelines of RBI and the same is not disputed.

(x) The claim of the assessee was that the underlying exposure both in respect of Euro and USD is more than adequate to cover the hedging positions taken in respect of cross currency derivative contracts entered into by the assessee. The Revenue has not brought out

any material on record to controvert to this claim of the assessee.

(xi) Since the assessee has entered into foreign currency derivative contract adequate enough to cover the overall exposures of foreign currency, the contention of the Revenue that the proportion of the loss in derivatives is eight times more than the loss from currency fluctuation does not have any merits.

(xii) The forex derivative transactions transacted by the assessee are through nationalized banks in compliance with the RBI regulations. These regulations permit the assessee to enter into such derivative transactions only by fulfilling certain conditions in the course of the business of the assessee. These regulations do not permit the assessee to enter into forex derivative contract as a separate business.

(xiii) Section 73(1) of the Act restricts the set off of speculation loss against the other business income in only those cases were speculative transactions carried on by the assessee are of such nature so as to constitute a business by itself. It is pertinent to mention here that RBI does not permit any bank under its umbrella to entertain its client in any separate business of forex derivative transactions. Permission is granted only for the clients of the bank to hedge on foreign exchange in order to minimize the risk of the foreign currency exposure arising out of import and export trade.

(xiv) The Hon'ble jurisdictional Madras High Court in the case M/s.Rajashree sugars and chemicals Ltd Vs. Axis Bank Ltd., in O.A Nos.251 & 252 of 2008 in C.S.No.240 of 2008 O.A. Nos.526 & 527 of 2008 in C.S No.240 of 2008A. Nos.1926, 1927, 2446 and 2447 of 2008 in S.S No.240 of 2008 vide order dated 14.10.2008 reported in 8 MLJ 261 has held that derivative transactions ceased to be speculative transactions or wages because pricing of the deal follows a scientific pattern on the basis of financial mathematics. Just as actuaries scientifically determined the value of insurance risk and the premium payable, Financial Mathematician/Portfolio Managers evaluate the price of these derivatives.

Thus to sum up in the present case before us, the assessee is an exporter of garments who has entered into forex derivative transactions through its bankers with a view to effectively hedge its foreign currency risk. Therefore, these forex derivative transactions have a close proximity or rather incidental to the export business of the assessee, which cannot be considered as speculative. Moreover in the case of the assessee foreign currency contracts cannot be treated as wagering contracts for the reasons discussed herein above. Section-43(5) of the Act is applicable to transactions in commodity or stocks and shares. If currency is treated as commodity, then according to Section 43(5) (a) of the Act, such transaction shall not be deemed to be speculative transaction. Further currency cannot be treated as stock or shares because inherently they have different characteristic. Further, in the case of the assessees, the foreign exchange exposure for the "relevant period" specified by "R.B.I" regulations is quiet substantial in order to justify the forex derivative transactions made by the assessee through Government recognized channel, otherwise the RBI would not have entertained these transactions and would have restrained the banks from entering into such transaction with its clients. Thus considering the totality of the facts and circumstance of the case and the decisions relied upon herein above, we allow the grounds raised by the assessee's on this issue for all the three appeals in favour of the assessee and accordingly we hereby direct the Revenue to set off of the losses incurred by the assessee on account of forex derivatives contracts against the business income of the assessee''.

5.8 Further, he also relied on the order of the Co-ordinate Bench in the case of *M/s. S.P. Apparels Ltd vs. DCIT. in ITA No.1327/Mds/2014, dated 17.04.2015* in support of his contentions.

5.9 To sum up the contention the ld. Authorised Representative submitted is as follows:-

(i) Foreign Exchange is not a commodity and therefore it was outside the purview of Section 43 (5).

(ii) Derivative contracts entered into by the assessee have a direct underlying currency exposure on account of export proceeds receivable by the assessee.

(iii) The decision to go for cross currency option contract was a decision purely to hedge the currency exposure of the assessee

and he prays that both the appeals may be allowed.

6. On the other hand, the Departmental Representative submitted that one has to examine whether the derivative transaction for foreign currency will be included in the definition of 'commodity' or not. According to ld. Departmental Representative a perusal of Section 43(5) would indicate that it reads as "a contract for purchase and sale of any commodity including stocks and shares .... ". From this it was clear that it was an inclusive definition and not an exclusive definition. Further Sec.43(5)(d) excludes trading in derivatives carried out through a recognized stock exchange from the ambit of speculative transaction. This

clearly excludes derivatives trading through stock exchanges and conversely there cannot be any exclusion without an earlier inclusion. Unless it was the intention of the legislature that trading derivatives are included in commodity, they would not have specifically excluded trading through stock exchange under Section 43(5)(d) of the Act. Therefore, it was evident that derivatives will form part of 'commodity' mentioned u/s.43(5). He placed reliance on the order of the Special Bench of the Calcutta Tribunal in the case of *Sri Capital Services vs. ACIT(2009) (121)TD (Cal)* wherein it was clarified that derivatives are commodities for the purpose of Sec.43(5)(d). The relevant head notes of the judgement is reproduced as under:

> *"Section* 43(5) of *the Income tax Act* 1961 - *Speculative transactions - Assessment year 2004-05 -whether clause (d)* of *proviso* to *section* 43(5) *is prospective in nature and will be effective from date on which Legislature made it effective i.e.1.4.2006 - Held Yes - Whether term ''derivatives' in which underlying assets is shares, would fall within meaning* of 'commodity' *used in section* 43(5) - *Held, yes – whether, therefore, where assessee suffered* a *loss on account* of *futures and options, i.e.,* a *form* of *derivatives, in which underlying asset was shares, said loss was rightly disallowed by revenue authorities by invoking provisions* of *section* 43(5)- *Held yes".*

6.1 Further, ld. Departmental Representative submitted that the Bombay High Court in the case of *CIT vs. Bharat R. Ruia(HUF) 337 ITR 452(Bom)* wherein it was held that transactions in derivatives are speculative transactions and not business loss. It was held as under:-

> *"Held, allowing the appeal, that the assessee had entered into futures contracts for purchase* of *shares* of *certain companies* at a *specified future date and* at a *specified price, which were* to *be settled in cash without actual delivery* of *shares. The exchange traded derivative transactions carried on by the assessee during assessment year 2003-04 were speculative transactions covered under section* 43(5) of *the Act and ,the loss incurred in those transactions was liable* to *be treated* as *speculative loss and not business loss. "*

6.2 A perusal of the above judgements and averments contained therein, it was evident that the derivative transactions are included in the meaning of commodities and in these cases the transactions were held as speculative transactions before Section 43(5)(d) was brought in by Finance Act 2005, wherein transactions in shares alone were treated as non- speculative. The dictionary meaning of commodity is "any product that can be used for commerce or an article of commerce which is

traded on an authorized commodity exchange was known as commodity". By this definition foreign exchange such as US Dollar and Japanese Yen or derivatives arising from these currencies have to be treated as articles of commerce which was traded on a commodity exchange. Therefore, forex derivatives are clearly commodities as understood in business parlance. Further till the liberalization of Indian economy undertaken in 1991 foreign exchange was treated as scarce commodity and was not available for trade or purchase by individuals. It was only in mid 2000, that the Government and Reserve Bank of India allowed the trading in foreign currency. It was much later, in 2007, that the State Bank of India come out with a scheme for trading in foreign currency derivatives. Therefore it is evident that when the Income Tax Act framed in 1962 the Parliament in its wisdom could not have foreseen large scale forex and forex derivatives transactions could be undertaken by the assessee. This is the reason why trading in forex derivatives was not separately incorporated into the Income Tax Act.

6.3 The Ld. Departmental Representative further contented that a perusal of the contract note and scenario analysis and risk

would clearly indicate that these contracts have nothing to do with overall forex earnings of the assessee either in US Dollars or Japanese Yen. The assessee's account is debited or credited on settlement date given in the contract based on the currency movements upto maturity date. In this derivative contracts assessee can neither deliver US dollars nor Japanese Yen from the export earnings. The assessee can derive a profit or loss based on the currency movement ie. Japanese Yen Vs. US Dollars. Therefore, the claim of the assessee that these are hedging based on the export earnings cannot be accepted. The argument of the assessee that these contracts were entered into based on development research report of the RBI is merely a fiction created by the assessee to justify its entering into derivative transactions If the assessee had export receivables in US Dollars or Japanese Yen, that could be hedged by forward contract based on the maturity of the bills. However, the analysis of the derivatives transactions given in the assessment order would clearly indicate that the assessee was only having a speculative bet on the currency movement between US Dollars and Japanese Yen. All these transactions based on currency movements between US Dollar and Japanese Yen on maturity

date/knock of date mentioned in the contract has resulted in huge losses to the assessee as shown in-the copy of the ledger account. Further it may be noticed that the assessee's export bills for the past four years did not have a single exports in Japanese Yen. Therefore, it is also pointed out the fact that these transactions had nothing to do with export receivables of the assessee. A careful analysis of the nature and type of cross currency derivative transactions whether to be treated as business loss or speculation loss can be concluded as speculation loss based on the following points

a) The derivative transactions entered into by the assessee with State Bank of India is not in the ordinary course of business of the assessee who is an exporter of garments. Export bills or receivables of the assessee cannot be linked to the derivative transactions.

b) By entering into a currency derivative transaction the assessee is clearly taking a speculative bet on the movement of Japanese Yen with US Dollars during a fixed period. These transactions are clearly a speculative bet on the currency which are in the nature of a wager contract.

c) The forex derivative transactions are not settled by actual delivery of foreign exchange but only the difference between the agreed price on the maturity date that is credited or debited to the account of the assessee.

d) The assessee claims that his transactions are as per RBI guidelines and FEMA regulations a conclusive view cannot be taken in this matter at present. It is

pertinent to note that Orissa High Court judgement in the case of *Pravanjan Patra Vs. Republic of India in WP (RL) No. 344 of 2009* directing the CBI to conduct enquiries is a pointer to the fact that the derivative transactions entered into by the banks are not within the four corners of law.

e) An analysis of the complex derivative transactions entered into by the assessee does not correlate to their trade exposure. In these derivatives the assessee had undertaken the risk of buying dollars and selling Japanese Yen, when the company was never a buyer of Dollars nor did they ever have any Japanese Yen assets. These derivative transactions were complex leveraged structures which were sold by the bankers to the assessee. Based on the currency movement at the maturity date or at the knock out time the assessee suffered huge losses which were disproportionate to their normal business.

f) The fact that the Reserve Bank of India has passed penalty orders on many bankers including SBI.

g) The Contract Notes mentioned certain scenario analysis and risk statement. However, a perusal of the same would indicate that these scenarios and risks have not been properly analysed by the assessee but have been merely incorporated in the Contract Note. Similarly the declaration of the exposure given in the second page of the Contract Note" *The size and tenor* of *the above transaction is not in excess* of *the underlying exposure in Balance Sheet"* is a_statement made in the contract note which is devoid of any merit. Neither the bank nor the assessee has analysed or stated any specific underlying exposure or balance sheet exposure of the assessee in the derivative transaction. If there was a real underlying exposure as mentioned, the assessee could not have suffered such a huge loss. Therefore, what is mentioned in the Contract Note is a mere recital to overcome the conditions mentioned by the Reserve Bank of India for the bank and the assessee to enter into derivative transactions.

h) A Forex derivative transaction, if it is a hedge should

> reduce the risk and loss to the assessee. A perusal of the contract notes and corresponding huge loss incurred by the assessee during the short period would indicate that the derivate transactions have only increased the risk to the assessee and not reduced the risk like as a 'hedge'.

6.4 The Ld. Departmental Representative further submitted that the Assessing Officer has considered all the arguments but forward by the assessee and has passed a detailed assessment order and the Commissioner of Income Tax (Appeals) confirmed the view of the Assessing Officer. He placed reliance on the order of the Tribunal in the case of *Shri Vinodkumar Diamonds, (P) Ltd. vs. Additional Commissioner of Income Tax (2013) 35 Taxmann 337*, the Tribunal wherein it was held as under

> Section 43(5) of the Income-tax Act, 1961 - Speculative transactions [Hedging transactions] - Assessment year 2008-09 - Assessee company exporter of diamond entered into forward contracts in respect of foreign exchange and incurred loss on cancellation of such contracts - It claimed that these transactions were hedging contracts to cover risk of fluctuation in foreign currency rates and not speculative transaction as held by revenue - Whether, where a contract for purchase or sale of commodity is periodically or ultimately settled otherwise than by actual delivery, same would fall within speculative transaction - Held, yes - Whether for hedging transactions it is necessary that commodity in respect of which forward transactions have been made by assessee must have a direct connection with goods manufactured or sold by assessee -

> Held, yes - Whether, where assessee was dealing in diamonds and forward contract transactions entered into by it was in foreign exchange, same could not be held as hedging transactions - Held, yes Whether, therefore, forward contract transactions in foreign exchange, against which there was no actual delivery by assessee were speculative and not hedging transactions and, thus, loss on same was not allowable - Held, yes in favour of revenue.

6.5 The Ld. Departmental Representative submitted that a perusal of the above judgement clearly indicates that foreign currency was treated as a commodity and transactions including cancellation of foreign currency forward contracts which was settled otherwise than the actual delivery will be treated as speculative transaction. The derivative transaction entered into by the assesses are without hedge, underlying and there cannot be any delivery against derivative transactions. The principle laid down in the above judgement will squarely apply in the case of the assessee. The claim of the assessee's derivative transactions are having an underlying hedge against export bills of the assessee, is akin to saying that an exporter visiting Hong Kong and having a loss from his gambling in a Casino in Macau are to be treated as a business loss. The exporter may have receivables in Hong Kong dollars. However

his gambling in Macau casino, if resulted in a loss was a separate speculative activity even though the loss in gambling was paid in Hong Kong dollars. Similar was the situation here with the assessee. The assessee's export bills in the last 4 years have permitted him to enter into derivative transactions with the bank. However, the assessee's decision to enter into separate cross currency derivative transactions were a separate activity to obtain speculative profit based on the currency movements ie. US Dollar Vs. Japanese Yen during a particular period. In other words US Dollar and Japanese Yen were mere dices on the gambling table. The movement of Japanese Yen Vs. US Dollar went against assessee's call on them. This resulted in a huge speculation loss. Therefore, the derivative transactions undertaken by the assessee have no relation whatsoever with the assessee's export business either as underlying or a hedge.

7. We have heard both the parties and perused the material on record. In this case, the assessee was engaged in the business of manufacturing and export of hosiery garments. During the course of export, the assessee entered into derivative contract. The assessee incurred loss in this transaction. The assessee claimed it as business

loss. According to the Assessing Officer this loss was not business loss and it is a speculative loss and this transaction is speculative in nature as such the loss incurred on this transaction cannot be set off against business income of the assessee. According to the ld. Authorised Representative for assessee, the derivative transaction cannot fall under sec.73. Explanation to sec.73 creates a deeming fiction by which among the assessee, who is a company, as indicated in the said Explanation dealing with the transaction of share and suffer loss, such loss should be treated to be speculative transaction within the meaning of sec.73 of the Act, notwithstanding the fact that the definition of speculative transaction mentioned in sec.43(5) of the Act, the transaction is not of that nature as there has been actual delivery of the scrips of share. As per the definition of sec.43(5), trading of shares which is done by taking delivery does not come under the purview of the said section. Similarly, as per clause (d) of sec.43(5), derivative transaction in shares is also not speculation transaction as defined in the said section. Therefore, both profit/loss from all the share delivery transactions and derivative transactions are having the same meaning, so far as sec.43(5) of the Act is concerned. Again, in view of the fact that both delivery transactions and derivative transactions are non-speculative as far as sec.43(5) is concerned, it

follows that both will have the same treatment as far as application of Explanation to sec.73 is concerned. Therefore, aggregation of the share trading profit and loss from derivative transactions should be done before the Explanation to sec.73 is applied. The above view has been taken by Special Bench of this Tribunal, Mumbai Bench, in the case of *CIT v. Concord Commercial Pvt. Ltd. (2005) 95 ITD 117 (Mum)(SB).* In this case, the Special Bench held that :

> *"Before considering whether the assessee's case is hit by the deeming provision of Explanation to Sec. 73 of the Act, the aggregate of the business profit / loss has to be worked out based on the non-speculative profits; either it is from share delivery or from share derivative*."

8. From the above, it is concluded that both trading of shares and derivative transactions are not coming under the purview of Section 43(5) of the Act which provides definition of "speculative transaction" exclusively for purposes of section 28 to 41 of the Act. Again, the fact that both delivery based transaction in shares and derivative transactions are non-speculative as far as section 43(5) is concerned goes to confirm that both will have same treatment as regards application of the Explanation to Section 73 is concerned, which creates a deeming fiction. Now, before application of the said Explanation, aggregation of the business profit/loss is to be worked out

irrespective of the fact, whether it is from share delivery transaction or derivative transaction.

8.1 Now, this view has been taken by Co-Ordinate, Chennai in the case *M/s. Aishwarya & Co P. Ltd in ITA No.860/Mds/2014, dated 29.05.2015*, wherein they followed the judgment of the Calcutta High Court in the case of *M/s. Baljit Securities Pvt. Ltd. (88 CCH 313*) wherein held as under:-

> *"Clause (d) of Section 43(5) became effective with effect from 1st April, 2006. Therefore, prior to 1st April, 2006 any transaction in which a contract for the purchase or sale of any commodity including stocks and shares was periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrip was a speculative transaction. Sub-section 1 of Section 73 provides as follows:*
>
> *'(1) Any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business.'*
>
> *The resultant effect was that any loss arising out of speculative transaction could only have been set off against profits arising out of speculative transaction. In the present case, the assessee, as already indicated, has been dealing in shares where delivery was in fact taken and also in shares where delivery was not ultimately taken. In other words, the assessee has been dealing in actual selling and buying of shares as also dealing in shares only for the purpose of settling the transaction otherwise than by actual delivery. The question arise whether the losses arising out of the dealings and transaction in which the assessee did not ultimately take delivery of the shares or give delivery of the shares could be set off against the income arising out of the dealings and transactions in actual buying and selling of shares. An answer to this question is to be found in the explanation appended to Section 73 which reads as follows:*

'Explanation: where any part of the business of a company other than a company whose gross total income consists mainly of income which is chargeable under the heads "interest on securities", or a company the principal business of which is the bu9siness of banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase. In order to resolve the issue before us, the section has to be read in the manner as follows:

"Explanation : Where any part of the business of a company (… … … … … … … … … … … … … … …. … … … … … …. … … … … … … … … …. … … .. .. … .. … … … .. … .. … … … .. … … … .. … … .. …. … … … .. … .. … … … … …. … … …) consist in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares."

It would, thus, appear that where an assessee, being the company, besides dealing in other things also deals in purchase and sale of shares of other companies, the assessee shall be deemed to be carrying on a speculation business. The assessee, in the present case, principally is a share broker, as already indicated. The assessee is also in the business of buying and selling of shares for self where actual delivery is taken and given and also in buying and selling of shares where actual delivery was not intended to be taken or given. Therefore, the entire transaction carried out by the assessee, indicated above, was within the umbrella of speculative transaction. There was, as such, no bar in setting off the loss arising out of derivatives from the income arising out of buying and selling of shares. This is what the learned Tribunal has done."

9. From the above decision of the Calcutta High Court in the case of *Baljit Securities Pvt. Ltd*. cited supra, the issue stands covered in favour of the assessee. However, we make it clear that total transaction considered for determining this business loss from

derivative transactions cannot be more than the total export turnover of the assessee for the assessment year under consideration and if the derivative transaction is in excess of export turnover, then that loss suffered in respect of that portion of excess transactions to be considered as speculative loss only as that excess derivative transaction has no proximity with export turnover and the Assessing Officer is directed to compute accordingly. This ground is allowed as indicated above.

10. The next ground in ITA No.1336/Mds/2014 for assessment year 2009-2010 is with regard to treating the capital of the firm introduced by the partner by cash as unexplained income u/s.68 of the Income Tax Act.

11. The Facts of the case are that the Assessing Officer had added a sum of ₹25,23,500/- introduced by cash in the name of Mrs. K. Angathal in the capital account of the firm. The assessee was unable to furnish the source for the same to the Assessing Officer. Similarly during the course of appeal before the Commissioner of Income Tax (Appeals) also, the assessee was not able to establish the source of capital introduced by Mrs. K. Angathal. Even a perusal of the Mrs.Angathals return of income would show that apart from share from Majestic Exports her individual income was only ₹2,94,818/- The

assessee not able to explain any accumulation of income in any bank of K. Angthal. In the absence of any evidence, it was perused that there was no source for introduction of capital and the same was confirmed in the hands of the firms as undisclosed income by the Assessing Officer, which was confirmed by the Commissioner of Income Tax (Appeals). Against this, the assessee is in appeal before us.

12. We have heard both the parties and perused the material on record. If any capital is introduced by the partner, the assessee shall prove the identity of the partner, genuineness of the transaction and credit worthiness of the partner. In the present case, if the partner confirmed the introduction of the capital from their account then the burden cast upon the assessee is discharged as held by the Andhra Pradesh and *Telangana High Court in the case of CIT vs. M. Venkateswara Rao, 57 taxmann.com 373.* Accordingly, in the interest of justice, we remit the issue back to the file of the Assessing Officer with a direction to the assessee to place necessary evidence confirming the capital contribution by above partner before the Assessing Officer. This issue is remitted back to the file of the Assessing Officer for fresh consideration.

13. The issue involved in ITA No.3072/Mds/2014 is identical to ITA No.1336/Mds/2014 with regard to speculative loss. Accordingly, this issue is decided as in earlier para Nos.7 to 9 in ITA No.1336/Mds/2014 and thus the appeal is partly allowed.

14. In the result, the appeals of the assessee are partly allowed.

Order pronounced on Friday, the 24th day of July, 2015, at Chennai.

Sd/-	Sd/-
(वी. दुर्गा राव)	**(चंद्र पूजारी)**
V. DURGA RAO	**(CHANDRA POOJARI)**
न्यायिक सदस्य / JUDICIAL MEMBER	**लेखा सदस्य/ ACCOUNTANT MEMBER**

चेन्नई/Chennai.
दिनांक/Dated:24.07.2015.
KV
आदेश की प्रतिलिपि अग्रेषित/Copy to: 1. अपीलार्थी/Appellant 2.प्रत्यर्थी/ Respondent 3. आयकर आयुक्त (अपील)/CIT(A) 4. आयकर आयुक्त/CIT 5. विभागीय प्रतिनिधि/DR
6. गार्ड फाईल/GF.