

In the High Court of Judicature at Madras

Dated : 21.9.2020

Coram :

The Honourable Mr. Justice T.S.SIVAGNANAM  
and  
The Honourable Mrs. Justice V.BHAVANI SUBBAROYAN

Tax Case Appeal No.26 of 2018

The Commissioner of Income Tax,  
Chennai ...Appellant

Vs

M/s.Celebrity Fashion Ltd.,  
Chennai-45. ...Respondent

APPEAL under Section 260A of the Income Tax Act, 1961 against the order dated 26.5.2017 made in ITA.No.2516/Mds/2016 on the file of the Income Tax Appellate Tribunal, Chennai 'B' Bench for the assessment year 2011-12, against the order of the commissioner of Income Tax (Appeals)-1 Chennai dated 16.06.2016 ITA No.119/14-15 (New No.ITA 165/CIT (A)-1 2014-15) in the assessment year 2011-12

against the order of the Deputy Commissioner of Income Tax Company circlr1(3) chennai dated 25.03.2014 in the assessment year 2011-12 in PAN/GIR No.AAACC3696D.

For Appellant : Mr.T.Ravikumar, SSC  
For Respondent: Mr.A.S.Sriraman

Judgment was delivered by T.S.Sivagnanam, J

This appeal, filed by the Revenue under Section 260A of the Income Tax Act, 1961 (for brevity, the Act), is directed against the order dated 26.5.2017 made in ITA.No.2516/Mds/2016 on the file of the Income Tax Appellate Tribunal, Chennai 'B' Bench (for short, the Tribunal) for the assessment year 2011-12.

2. The Revenue filed the above appeal by raising the following substantial questions of law :

"i. Whether the Tribunal was right in holding that the provisions of Section 14A read with Rule 8D will have no applicability if there was no exempt income received when the Statute did not provide for such exemption to be granted ?

ii. Whether the Tribunal ought to have

applied the decision of the Bombay High Court in the case of Godrej and Boyce Manufacturing Co. Ltd. [reported in 328 ITR 81] wherein it was held that Section 14A is constitutionally valid and that Rule 8D was applicable from the assessment year 2008-09 onwards ? And

iii. Whether the Tribunal is right in holding that the loss incurred on account of cancellation of forward contracts is not speculative losses falling within the provisions of Section 43(5) of the Income Tax Act ?”

3. The assessee company filed their return on 29.9.2011 admitting -NIL- income and it was processed under Section 143(1) of the Act on 07.1.2012 resulting in determining a refund of Rs.54,04,290/-. Subsequently, the assessee's case was selected for scrutiny and a notice under Section 142(1) of the Act was issued on 10.9.2012 along with a questionnaire. The assessee furnished details and the assessment was completed under Section 143(3) of the Act by order dated 25.3.2014.

4. Two issues fall for consideration in this appeal. The first one is the disallowance made by the Assessing Officer under Section 14A of the Act and the second one is the disallowance of foreign exchange fluctuation loss.

5. In respect of the first issue, the Assessing Officer found that the assessee had invested in SBI Magnum Insta Cash Fund to the tune of Rs.7.25 Crores and secured loans, which were outstanding as on 31.3.2011. The Assessing Officer also found that the assessee incurred finance cost, out of which, a sum of Rs.12,93,10,000/- was towards interest on term loan and working capital facilities, that the assessee company made investments in mutual funds, out of which, there was a possibility of earning dividend income. Accordingly, a notice was issued to show cause as to why the disallowance should not be made under Section 14A of the Act.

6. The assessee sent a reply stating that they had not incurred any expenditure for making such investment and that in the absence of any expenditure incurred, the question of disallowance did not arise.

7. However, the Assessing Officer rejected the stand taken by the assessee.

8. With regard to the second issue namely disallowance on exchange fluctuation loss, the Assessing Officer found that the debit made in the ledger account was on account of a transaction pertaining to forward contract such as interest charges and bank charges on negotiation and forward contract cancellation charges and therefore proceeded to treat the same as a speculative transaction under Section 43(5) of the Act.

9. The assessee submitted their objections to the same by contending that the loss for foreign exchange derivative was a business loss and not business expenditure and was allowable under Section 28 of the Act, that the crystallized losses on account of foreign exchange derivative contracts were not speculative in nature within the meaning of Section 43(5) of the Act, that Explanation to Section 37(1) was not applicable in the light of the decision of the Hon'ble Supreme Court in the case of Dr.T.A.Quereshi Vs. CIT [reported in (2006) 287 ITR 547] and that the said Explanation was applicable only to business expenditure and for business loss.

10. It was further contended by the assessee that in terms of the decision of the Hon'ble Supreme Court in the case of CIT Vs. Woodward Governor India Pvt. Ltd. [reported in (2009) 312 ITR 254], the notional losses in foreign currency were allowable. However, in the assessee's case, losses were real and tangible losses not assumed or a creation of accounting principle. The assessee also contended that for the assessment year 2009-10, in the assessee's own case, the Tribunal held in favour of the assessee following the decision of the Calcutta High Court in the case of CIT Vs. Soorajmull Nagarmull [reported in (1981) 129 ITR 169].

11. The Assessing Officer did not agree with the said submissions, rather she distinguished the decision of the Hon'ble Apex Court in the case of Woodward Governor India Pvt. Ltd., and stated that the said decision was in respect of trade loss on account of import and export and not on account of loss on forward contract cancellation. Placing reliance on the decision of the Bangalore Tribunal in the case of ACIT Vs. K.Mohan & Co. (Exports) Pvt. Ltd., the Assessing Officer held that cancellation of forward contract was speculation business and not business profits for the purpose of computation of deduction under Section 10B of the Act. With regard to the decision in the assessee's own case for the assessment year 2009-10, it was pointed out that the Department preferred an appeal against that decision.

12. Being aggrieved by the said order passed by the Assessing Officer dated 25.3.2014, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals)-1, Chennai [for brevity, the CIT(A)], who allowed the appeal by order dated 16.6.2016. With regard to the first issue namely the disallowance under Section 14A of the Act, the CIT(A) accepted the stand taken by the assessee that the investments were in growth funds and not dividend funds and therefore, did not constitute tax free income. In this regard, the CIT(A) referred to the decision of the Delhi High Court in the case of Cheminvest Ltd. Vs. CIT [reported in (2015) 378 ITR 33] as well as the decision of the Chennai Tribunal in the case of ACIT Vs. M.Baskaran [ITA.No.1717/Mds/2013 dated 31.7.2014] and accordingly set aside the finding rendered by the Assessing

Officer.

13. So far as the issue pertaining to disallowance of exchange fluctuation loss was concerned, the CIT(A) took note of the order passed in the assessee's own case for the assessment year 2009-10 dated 27.2.2013, which was affirmed by the Tribunal in ITA.No.1250/ Mds/2013 vide order dated 27.8.2013. Ultimately, the CIT(A) allowed the appeal filed by the assessee.

14. Challenging the findings on both the grounds, the Revenue preferred an appeal before the Tribunal.

15. So far as the first issue is concerned, the Tribunal took note of the decision of this Court in the case of Redington India Ltd. Vs. CIT [reported in (2017) 77 Taxmann.com 257] and dismissed the appeal filed by the Revenue. On the second issue, the Tribunal referred to the order passed by it in the assessee's own case and held that the transaction done by the assessee was not a speculative transaction to be brought under Section 43(5) of the Act. Aggrieved by such decision, the Revenue is before us by way of this appeal.

16. We have elaborately heard Mr.T.Ravikumar, learned Senior Standing Counsel appearing for the appellant - Revenue and Mr.A.S. Sriraman, learned counsel appearing for the respondent - assessee.

17. On the first issue, we find that the Tribunal rightly understood the scope of the transaction done by the assessee. The consistent case of the assessee was that they invested a sum of Rs.7.25 crores in SBI Magnum Insta Cash Fund, that the amount was invested on 30.3.2011, that they had not incurred any expenditure in making such investment and that at the year end, the assessee did not earn tax free income from such investments. In terms of Section 14A of the Act, the only expenditure, which was proved to be incurred in relation to earning of tax free income, could be disallowed and such provision could not be extended to disallow the expenditure, which was assumed to have been incurred for earning tax free income.

18. Therefore, to apply the provisions of Section 14A of the Act, the Assessing Officer should have recorded a finding as to how Sub-Section (1) of Section 14A of the Act would stand attracted. In the absence of any such finding, the disallowance made was not justifiable. In fact, the Assessing Officer straightaway proceeded to the second limb of Section 14(2) of the Act, which is impermissible. The Tribunal rightly took note of the decision in the case of Redington India Ltd., wherein it was held that the provisions of Section 14A of the Act read with Rule 8D of the Income Tax Rules, 1962 cannot be made applicable in vacuum i.e in the absence of exempt income. Therefore, we find that the Tribunal was right in deciding the issue against the Revenue and in favour of the assessee.

19. In respect of the second issue regarding disallowance of exchange fluctuation loss, the Tribunal, in the assessee's own case, examined the facts and that order was reproduced in

paragraph 5.2 of the impugned order.

20. Mr.T.Ravikumar, learned Senior Standing Counsel has placed reliance on the decision of the Bombay High Court in the case of CIT Vs. Bharat R.Ruia (HUF) [reported in (2011) 337 ITR 0452]. The learned Senior Standing Counsel has drawn our attention to paragraph 19 of the said judgment wherein the Court referred to the nature of derivative transaction, which had been brought out in the decision of this Court in the case of Rajshree Sugars & Chemicals Ltd. Rep.by its Director and Chief Operating Officer R.Varadaraj Vs. Axis Bank Ltd. [reported in (2008) 8 MLJ 261]. This decision was pressed into service to explain as to what are all the four categories of derivatives namely forward contracts, future contracts, swaps and options.

21. It is true that the said decision explains the nature of contracts. However, we find that on facts, the assessee therein entered into future contracts for purchase of shares of certain companies on a specified future date and at a specified price, which was to be settled in cash without actual delivery of the shares. In the instant case, the assessee is not a person in business of finance nor involved in the purchase of any commodity. Therefore, the decision of the Bombay High Court in the case of Bharat R.Ruia (HUF) is distinguishable.

22. The learned Senior Standing Counsel appearing for the respondent - Revenue has referred to the decision of the Hon'ble Supreme Court in the case of Snowtex Investment Ltd. Vs. PCIT [reported in (2019) 414 ITR 0227].

23. The decision of the Hon'ble Supreme Court in the case of Snowtex Investment Ltd., also pertains to the principal business activity of the assessee therein namely trading in shares and securities. Hence, this decision also will not render any assistance to the Revenue.

24. We had an occasion to consider a similar question in the case of CIT, Corporate Circle-3, Chennai Vs. Visual Graphics Computing Services India Pvt. Ltd. [TCA.No.414 of 2018 dated 19.8.2020]. In the said appeal, question of law No.5, which was framed for consideration, was as to whether the Tribunal was right in holding that the provisions of Section 14A of the Act read with Rule 8D of the said Rules will have no applicability if there is no exempt income earned or received during the previous year though the disallowance is linked to expenditure incurred on investment fetching exempt income. The said case was decided in favour of the assessee and against the Revenue and in doing so, we have followed the decision of the Hon'ble Division Bench of this Court in the case of CIT Vs. Chettinad Logistics Pvt. Ltd. [reported in (2017) 80 Taxmann.com 221]. This decision would come to the aid and assistance of the assessee.

25. It is contended on behalf of the Revenue that an appeal had been preferred against the order passed by the Tribunal in the assessee's own case for the earlier assessment year, which

was referred to and relied upon by the Tribunal in the impugned order.

26. However, in our considered view, there is nothing on record to indicate that the appeal had been filed and the matter had been pending. Be that as it may, we have considered the reasons assigned by the Tribunal in the assessee's own case for the earlier assessment year wherein the Tribunal rightly took note of the earliest decision of the Calcutta High Court on the said point in the case of Soorajmull Nagarmull and pointed out that under Section 43(5) of the Act, 'speculative transaction' has been defined to mean a transaction, in which, a contract for the purchase or sale of commodity is settled otherwise than by the actual delivery or transfer of such commodity. However, as stated, the assessee herein was not a dealer in foreign exchange, but was an exporter of cotton. Therefore, the Tribunal rightly took note of the transaction done by the assessee though, in order to hedge against the losses, the assessee booked foreign exchange in the forward market with the bank. However, the export contracts entered into by the assessee for the export of cotton in some cases failed and therefore, the assessee was held to be entitled to claim deduction in respect of the said amount as business loss.

27. Mr.T.Ravikumar, learned Senior Standing Counsel for the Revenue has sought to distinguish the decision of this Court in the case of Redington India Ltd.

28. In fact, an identical argument was raised for consideration before the Hon'ble Division Bench of this Court in the case of Chettinad Logistics Pvt. Ltd., and such a contention was rejected by rendering the following findings :

"13. Mr.Senthil Kumar, seeks to distinguish the judgment in Redington (India) Ltd. case (supra) based on the fact that Rule 8D had not kicked-in by AY 2007-08, which was the AY being considered in the said case.

14. According to us, this was not the argument, put forth, before the Division Bench. As a matter of fact, the Revenue relied heavily on Rule 8D.

14.1 Mr.Ravikumar, who appeared for the Revenue, in that matter and who is present in this Court, informs us that he had in fact argued that the Rule was clarifactory in nature and would apply retrospectively, and that, the Division Bench, therefore, discussed the impact of Rule 8D of the Rules.

15. However, it is, our view, as indicated above, independent of the reasoning given in Redington (India) Ltd. case (supra) that Rule 8D cannot be read in

a manner, which takes it beyond the scope and content of the main provision, which is, Section 14 A of the Act.

15.1 Therefore, as adverted to above, Rule 8D, cannot come to the rescue of the Revenue.

15.2 In any event, the Tribunal, via, the impugned judgment has remitted the matter to the Assessing Officer.

15.3 Therefore, for the foregoing reasons, we are of the view, that no interference is called for qua the impugned judgment."

As against the decision of this Court in the case of Chettinad Logistics Pvt. Ltd., the Revenue preferred appeals before the Hon'ble Supreme Court and the special leave petitions were dismissed on the ground of delay as well as merits in the decision reported in (2018) 95 Taxmann.com 250.

29. It will be beneficial to refer to the decision of the Bombay High Court in the case of CIT Vs. Badridas Gauridu Pvt. Ltd. [reported in (2003) 261 ITR 256]. In that case, the assessee was not a dealer in foreign exchange, but was an exporter of cotton as in the case before us. The assessee therein booked foreign exchange contracts, which were held to be only incidental to the assessee's regular course of business. While testing the correctness of the order of the Tribunal, which held that the transaction was not a speculative transaction, it was observed as follows :

"3. 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 Vs. Sooraj Mull Nagarmull [1981] 129 ITR 1691]."

30. In the light of the above discussions, the substantial questions of law raised are required to be answered in favour of the assessee and against the Revenue.

31. Accordingly, the above tax case appeal is dismissed and the substantial questions of law raised are answered against the Revenue and in favour of the assessee. No costs.

Sd/-  
Assistant Registrar

//True Copy//

Sub Assistant Registrar

RS

To

1.The Income Tax Appellate Tribunal, Chennai 'B' Bench.  
Rajaji Bhavan Bazant Nagar Chennai-90.

2.The Commissioner of Income Tax (Appeals)-1, Chennai-34.

3.The Commissioner of Income Tax Chennai.

4.The Deputy Commissioner of Income Tax Company circle 1(3),  
Chennai.

+1 cc to M/s.Mr.Ravikumar, Advocate Sr.No. 30684

TCA.No.26 of 2018

MG (CO)  
RMP (20/10/2020)

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