IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD "D" BENCH

(BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER & SHRI MAHAVIR PRASAD, JUDICIAL MEMBER)

ITA. No: 1723/AHD/2011
(Assessment Year: 2007-08)

The Asstt. Commissioner of Income-tax, Circle-7, Surat	**V/S**	**M/s. Veer Gems 7/2982 Parsi Sheri Saiyedpura, Surat**
(Appellant)		**(Respondent)**

PAN: AABFV6446L

Appellant by	**: Shri Surendra Kumar, CIT/DR**
Respondent by	**: Shri Rashesh Shah, A.R.**

(आदेश)/ORDER

Date of hearing : 06 -04-2017
Date of Pronouncement : 25-04-2017

PER N.K. BILLAIYA, ACCOUNTANT MEMBER:

1. This appeal by the Revenue is preferred against the order of the Ld. CIT(A)-V, Surat dated 17.03.2011 pertaining to A.Y. 2007-08.

2. The revenue has raised as many as five substantive grounds. The first grievance of the revenue relates to the deletion of the addition of Rs. 30,27,85,170/- being expenditure disallowed by the A.O. on account of foreign exchange contract by treating them as speculation u/s. 43(5) of the Act.

3. Rival contentions have been heard at length. Having heard the rival submissions, we have carefully perused the orders of the authorities below and the relevant documentary evidences brought on record in the light of Rule 18(6) of the ITAT Rules.

4. During the course of the scrutiny assessment proceedings, the A.O. noticed that the assessee has debited an amount of Rs. 30,27,85,170/- in the Profit and Loss account as loss in forward contract cancellation. The assessee was asked to explain the nature of forward contracts and the reasons for the loss in forward contracts.

5. The assessee filed a detailed reply in justification of its claim of loss. It was explained that the contracts were made to hedge the future fluctuation in the foreign currency rate against the export/import orders of diamonds. The assessee furnished the bank-wise details of net foreign exchange forward contract loss which is as under:

(i) ABN Amro Bank	*(-) Rs. 30,29,26,409/-*
(ii) HDFC Bank	*Rs. 2,95,55,932/-*

(iii) ICICI Bank *(-) Rs. 2,94,14,693/-*

Net Loss *Rs. 30,27,85,170/-*

6. The A.O. sought details from the bank and the banks filed the necessary details as called by the A.O. After examining the details filed by the banks, the A.O. was of the opinion that the assessee has to prove with documentary evidences that the foreign exchange contracts were really meant for the purpose of minimizing its foreign exchange losses during its regular business of import of rough diamonds and export of polish diamonds and not for any other parties other than its regular business activity of import and export of diamonds. The A.O. was of the firm belief that the assessee has failed to establish the nexus between the hedging of the foreign exchange fluctuation currency contracts qua its business. The A.O. accordingly disallowed the claim of Rs. 30,27,85,170/- treating it as speculation loss.

7. Assessee carried the matter before the ld. CIT(A) and reiterated what has been submitted during the course of the assessment proceedings.

8. After considering the facts and the submissions, the ld. CIT(A) was convinced that since the assessee is exposed to significant risk arising out of fluctuation in rate of currency, therefore it has to enter into the contracts for hedging its probable losses. The ld. CIT(A) further observed that the Assessing Officer has no where denied that assessee is not exposed to such risk. The ld. CIT(A) further observed that this is not the first year in which

such kind of forward contracts have been made with banking authorities as in past years also. Assessee has entered into such transactions. The ld. CIT(A) concluded by holding that the loss arising on account of the cancellation of contract is nothing but business loss and the same cannot be treated as a speculation loss. The disallowance made by the A.O. was deleted.

9. Before us, the ld. D.R. strongly supported the findings of the A.O. and the Authorized Representative of the assessee relied upon the decision of the ld. CIT(A) .

10. The undisputed fact is that the assessee is in the business of manufacturing, import and export of diamonds. It is in this line of activities, the assessee was heavily exposed to foreign exchange currency fluctuation during its regular business activities. It is not the case of the Assessing Officer that assessee is a dealer in foreign currency. Although, the A.O. has treated the assessee as a dealer in foreign currency only on the strength of the volume of transactions entered into by the assessee to hedge its probable losses in foreign exchange rate fluctuation.

11. On identical set of facts, the Hon'ble High Court of Calcutta in the case of Soorajmull Nagarmull 129 ITR 169 had the occasion to consider the following facts and held accordingly:-

" The assessee-firm carried on the business of import and export of jute. In the course of its business it used to enter into forward contracts in foreign exchange in order to cover the loss arising due to difference in foreign exchange valuation. The assessee had entered into foreign exchange contracts in 1952 with the Hindustan Mercantile Bank. The difference payable by the assessee on the forward contract was determined in December, 1952, but the assessee disputed its liability. The dispute was settled in 1955, and its account in the bank was debited in June,1955. The assessee claimed this loss amounting to Rs. 80,491/- as a revenue expenditure in the assessment year1956-57. The ITO disallowed the claim on the ground that the loss was a speculation loss and, in any event, as the assessee was following the mercantile system, it could not claim the loss in 1956-57. The AAC found that the transaction in which the loss arose was not speculative and this finding was upheld by the Tribunal. The AAC held that the loss did not relate to the relevant accounting year but the Tribunal held that it was allowable in 1956-57 on a reference:

Held, (i) that the assessee was not a dealer in foreign exchange. Foreign exchange contracts were only incidental to the assessee's regular course of business. The AAC had made a categorical finding to this effect which had been upheld by the Tribunal. The loss was not a speculative loss but was incidental to the assessee' business and allowable as such.

12. A Similar view was taken by the Hon'ble High Court of Bombay in the case of Badridas Gauridu Pvt. Ltd. in 261 ITR 256, the relevant part reads as under:-

"The assessee was an exporter of cotton. The assessee had entered into forward contracts with the banks in respect of foreign exchange. Some of these contracts could not be honoured by the assessee for which it had to pay Rs. 13.50 lakhs, which was debited to the profit and loss account. The assessee claimed the same as business loss. The Assessing Officer held that the loss was not deductible as a

business loss as it was incurred in a speculative transaction. The Tribunal held that it was a business loss. On further appeal to the High Court:

Held, dismissing the appeal, that 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."

13. As mentioned elsewhere, the assessee has entered into the contracts in its regular course of business to hedge against foreign exchange fluctuation. Therefore, the activity of the assessee cannot be as a speculation activity.

14. Respectfully following the ratio laid down by the Hon'ble High Court (supra), we decline to interfere with the findings of the First Appellate Authority. The first grievance is accordingly dismissed.

15. The second grievance relates to the deletion of the addition of Rs. 2,69,00,000/- made by the A.O. on account of unexplained capital introduced by the partners.

16. While scrutinizing the return of income for the year under consideration, the A.O. noticed that during the year partners introduced capital as under:-

(i) Mukesh Shah	*Rs. 13,00,000/-*
(ii) Piyush Shah	*Rs. 3,00,000/-*
(iii) Hina Shah	*Rs. 2,53,00,000/-*

17. The assessee was asked to explain the source of capital introduced by these partners with supporting evidences. The assessee filed the copy of the returns of the partners along with supporting documentary evidences. The A.O. was of the firm belief that the assessee has failed to explain the credit entries in the partners capital account and made the addition of Rs. 2.69 crores u/s. 68 of the Act.

18. Before the First Appellate Authority, it was strongly contended that since the assessee has filed the necessary evidences pertaining to the Income Tax returns of the partners who are assessed to tax and the capital introduction made by partners stands reflected in their respective records, the same cannot be treated as unexplained in the hands of the assessee.

19. After considering the facts and the submissions and drawing support from the decision of the Hon'ble High Court of Gujarat in the case of Pankaj Dyestuff Industries in Tax Appeal No. 241 of 1993, the ld. CIT(A) deleted the addition.

20. Before us, the ld. D.R. supported the findings of the A.O. and the ld. counsel relied upon the order of the First Appellate Authority.

21. It is true that the assessee has filed the tax details of all the partners. It is also true that the Assessing Officer has not disputed that the credits in the accounts of the partners were not deposits from the partners. In our understanding of the law, the addition cannot be made in the hands of the

firm and if anything remains unexplained the addition can only be made in the hands of the partners. We find that the reliance placed by the ld. CIT(A) on the decision of the Hon'ble Jurisdictional High Court of Gujarat in the case of Pankaj Dyestuff Industries (supra) is well founded and, therefore, no interference is called for. The second grievance is also dismissed.

22. The third grievance relates to the deletion of the addition made by the A.O. on account of foreign travel expenses.

23. During the course of scrutiny assessment proceedings, the A.O. noticed that Mr. Sapin Shah and Ms. Priyanka shah have undertaken foreign travel. The assessee was asked to explain the expenses incurred by them and why the same should not be disallowed as these two persons are not the partners of the firm. The assessee was further asked to explain that it has actually done business at Hong Kong and Dubai in justification of the foreign travel.

24. Assessee filed a detailed reply which did not find any favour with the A.O. who disallowed Rs. 7,43,852/-.

25. Before the ld. CIT(A), the assessee once again filed the details relating to party wise sales made at Dubai and Hong Kong. After Considering the facts and the submissions, the ld. CIT(A) observed that Rs. 2,43,852/- has been disallowed by the A.O. only on the ground that Sapin Shah and Priyanka Shah are not the partners of the firm. The ld. CIT(A) further observed that

there was no justification in making the lump sum disallowance of Rs. 5 lakhs. The ld. CIT(A) deleted the addition of Rs. 7,42,852/-.

26. Before us, the ld. D.R. simply relied upon the findings of the A.O. and the ld. counsel reiterated what has been stated before the ld. CIT(A).

27. It is true that Mr. Sapin Shah and Ms. Priyanka Shah are not partners of the assessee firm. It is also true that they are employees of the firm who travelled abroad for the purposes of the business of the assessee. We find that the assessee has filed the details of sales made at Hong Kong and Dubai in support of its foreign travel expenditure. Merely, because the two persons who went abroad were not partners of the assessee firm would not justify the disallowance made by the A.O. We also find that the lump sum disallowance of Rs. 5 lakhs is without any basis as the assessee has successfully proved the sales made at Dubai and Hong Kong. We, therefore, do not find any reason to interfere with the findings of the ld. CIT(A).

28. The next grievance of the revenue relates to the deletion of the addition of Rs. 2,51,91,060/- made u/s. 40(a)(ia) of the Act.

29. The A.O. noticed that as per the TDS returns, the assessee has deducted Rs. 5,19,047/- on total receipts of Rs. 4,74,71,878/-. The A.O. further noticed that the assessee has made payment of tax at Rs. 2,45,089/-. The A.O. assumed that the assessee has deducted tax @ 1.1% only on the payments

of labour contract charges and, therefore, made a disallowance of Rs. 2,51,91,060/-.

30. Assessee strongly agitated the matter before the ld. CIT(A) and vehemently contended that the A.O. has misunderstood the facts relating to the quantum on which the tax has been deducted at source. It was explained that the TDS of Rs. 2,73,958/- was made from rent amount of Rs. 12,27,600/-. It was further explained that the difference pertains to TDS on rent expenses.

31. After considering the facts and the submissions, the ld. CIT(A) observed that the assessee has made total TDS of Rs. 5,19,047/- on total amount of Rs. 4,74,71,878/- and has deposited the same. The ld. CIT(A) further observed that the TDS has been made under various sections i.e. 194C, 194H, 194J and 194I. The First Appellate Authority found that TDS of Rs. 2,45,091/- was made u/s. 194C, 194H and 194J of the Act whereas TDS of Rs. 2,73,958/- was made u/s. 194I of the Act on rent expenses. The ld. CIT(A) was convinced that there was no discrepancy found and accordingly deleted the addition of Rs. 2,51,91,060/-.

32. Before us, the ld. D.R. could not point out any factual error in the observations made by the ld. CIT(A) as mentioned hereinabove. We find that the assessee has successfully reconciled the TDS amount with the quantum involved and there remains no reason why the addition should be sustained. The First Appellate Authority has rightly deleted the

disallowance after reconciling the TDS amount with the quantum on which the tax has been deducted at source. Therefore, no interference is called for. This grievance is accordingly dismissed.

33. The last grievance of the revenue relates to the deletion of the addition made by the A.O. on account of labour charges.

34. The A.O. disallowed a sum of Rs. 1.16 crores only on the ground that inspite of fall in turnover, the labour charges have been found to be higher than the previous year. This was the only reason for making disallowance of 5% of total labour charges claimed by the assessee.

35. The ld. CIT(A) deleted the disallowance as he was of the opinion that the reasons given by the A.O. do not justify the addition.

36. We find that the assessee has debited labour charges of Rs. 23.22 crores during the year under consideration as compared to 22.75 crores incurred in the immediately preceding year. The rise in the labour expenses is only to the tune of Rs. 47 lakhs which is higher by 2% from the expenses incurred in the immediately preceding assessment year. In our considered opinion, this cannot be a reason for making the impugned disallowances as the A.O. has failed to justify the addition made by him. The First Appellate Authority has rightly deleted the same which calls for no interference. This grievance is also dismissed.

37.In the result, the appeal filed by the Revenue is dismissed.

Order pronounced in Open Court on 25 - 04- 2017

Sd/- Sd/-

(MAHAVIR PRASAD) **(N. K. BILLAIYA)**
JUDICIAL MEMBER **True Copy** **ACCOUNTANT MEMBER**

Ahmedabad: Dated 25 /04/2017

Rajesh

Copy of the Order forwarded to:-

1. The Appellant.
2. The Respondent.
3. The CIT (Appeals) –
4. The CIT concerned.
5. The DR., ITAT, Ahmedabad.
6. Guard File.

By ORDER

Deputy/Asstt.Registrar
ITAT,Ahmedabad