

Loss incurred under forward exchange contracts was allowable business exp. as it wasn't a speculative loss

Summary – The Visakhapatnam ITAT in a recent case of Maddi Lakshmaiah & Co. Ltd., (the Assessee) held that Loss incurred under forward exchange contracts to hedge underlying exposure arising out of borrowing converted into foreign currency could not be said to be speculative in nature within definition of section 43(5)(d) and, hence, is an allowable expenditure

Conversion of Indian currency loan into foreign currency loans for purpose of reducing cost of interest could not be considered as foreign currency loans acquired for purpose of acquiring an asset from a country outside India and, hence, provision of section 43A would not apply

Activity of drying and threshing of tobacco leaves amounts to manufacture and hence assessee is eligible for additional depreciation as per provisions of section 32(1)(ia) of Act

Facts

- The assessee was a company engaged in the business of tobacco processing, export and warehousing. It borrowed certain term loans in Indian currency to purchase a software park in India - It convert said term loan into foreign currency loans for the purpose of reducing interest cost. Further, it entered into forward contracts to hedge the currency to mitigate the possible loss in fluctuation in currency in its normal course of business.
- The Assessing Officer disallowed loss incurred on forward contracts for the reason that the loss claimed by the assessee was a speculative loss, which could not be allowed as a deduction while computing the income from business. The Assessing Officer was of the opinion that the transaction entered by the assessee with its bankers was for the purpose of trading in currency, but not for the purpose of hedging currency to mitigate fluctuation in currency.
- On appeal, the assessee submitted that it had entered into forward contracts to hedge the loss in currency movement with its bankers. The assessee further submitted that it had entered various forward contracts to hedge the currency to mitigate the possible loss in fluctuation in currency in its normal course of business and the total value of forward contracts does not exceed the underlying exposure in the form of external borrowings.
- The Commissioner (Appeals) deleted additions made by the Assessing Officer towards disallowance of premium charges on forward contracts/underlying options.
- On appeal by the revenue to the Tribunal:

Held

- In this case, the assessee is into the business of processing and export of tobacco. The assessee also is into the business of warehousing. The assessee has purchased a software park at Navi Mumbai from Maharashtra Industrial Development Corporation Limited for which it has borrowed certain

term loans from banks. Subsequently, those term loans were converted into foreign currency loans for the purpose of reducing interest cost. The assessee entered into forward exchange contracts to hedge the underlying exposure in the form of external borrowings to mitigate the possible loss in fluctuation of currency. In the process, it has incurred loss, which has been debited to profit & loss account under the head premium charges on FC forward contracts. The total forward contracts entered into with the bankers, does not exceed the value of underlying exposure to foreign currency at any point of time. The forward contracts entered by the assessee does not falls within the definition of section 43(5)(d) of the Act. Therefore, the Assessing Officer was erred in disallowing premium charges on FC forward contracts on the ground that the loss incurred by the assessee is a speculative loss, which falls under section 43(5)(d) of the Act. The Commissioner (Appeals) after considering the relevant provisions of the Act and also relied upon certain judicial precedents, directing the Assessing Officer to delete additions made towards premium charges. There is no error in the order of the Commissioner (Appeals). Hence, the ground raised by the revenue is rejected.