

INCOME TAX : Where assessee, engaged in manufacturing and trading of jewellery, entered into a forward contract to hedge against fluctuation in price of gold and silver and claimed profits earned on these contracts to be business profits for purpose of deduction under section 10AA, since fact remained unverified as to whether forward contracts entered into by assessee were covering only actual transaction of purchase and sale so as to refer hedging transaction to safeguard future loss due to fluctuation of prices, issue was to be remanded back to Assessing Officer for re-adjudication

INCOME TAX : Where assessee earned interest on security deposits kept with JVVNL for getting its factory's electricity connection, since security deposits to get electricity connection was integral part of business of assessee, so as to run its manufacturing activity, impugned interest earned on such security deposits was to be included in business profits of assessee undertaking for purpose of computing deduction under section 10AA

INCOME TAX : Where Assessing Officer disallowed deduction under section 10AA in respect of miscellaneous income earned by assessee, since assessee had not advanced any argument as to why disallowance of deduction under section 10AA in respect of miscellaneous income was not justified, there was no reason to interfere with orders of Assessing Officer

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IN THE ITAT JAIPUR BENCH 'B'

Gallant Jewellery

v.

Deputy commissioner of Income Tax, Circle 2, Jaipur*

RAMESH C. SHARMA, ACCOUNTANT MEMBER

AND VIJAY PAL RAO, JUDICIAL MEMBER

IT APPEAL NOS. 632 & 633 (JP) 2018

[ASSESSMENT YEARS 2011-12 & 2012-13]

SEPTEMBER 23, 2019

I. Section [10AA](#), read with section [43\(5\)](#), of the Income-tax Act, 1961 - Special Economic Zones - Newly established Units in (Profits earned on forward contracts) - Assessment years 2011-12 and 2012-13 - Whether if forward contract is entered into as integral or incidental to activity of actual export of goods then as per exceptions provided under proviso to section 43(5), same would not be treated as speculative transaction - Held, yes - Assessee partnership firm was engaged in business of manufacturing and trading of jewellery - Assessee claimed that to hedge against fluctuation of price in gold and silver, it entered into a commodity derivative transaction to minimise risk on account of fluctuation of prices in future - Assessee further claimed that since profit was earned on these forward contracts, said hedging profit was to be treated as business income of assessee for purpose of availing deduction under section 10AA - Whether, however, since assessee had entered into forward contract only in respect of price of gold and silver and not in respect of foreign exchange rate which was directly affecting export

proceeds or import outgo in foreign exchange, profit or loss arising from such forward contracts could not be treated as integral or incidental to export activity but it was certainly an integral part of business activity of assessee - Held, yes - Whether, however, since facts remained unverified as to whether forward contracts entered into by assessee during year were covering only actual transaction of purchase and sale, issue was to be set aside to record of Assessing Officer for re-adjudication - Held, yes [Para 7][In favour of assessee/Matter remanded]

II. Section [10AA](#) of the Income-tax Act, 1961 - Special Economic Zones - Newly established Units in (Interest) - Assessment year 2011-12 - Assessee had made security deposit with Jaipur Vidyut Vitaran Nigam Limited (JVVNL) towards its factory's electricity connection and earned interest on such security deposit - Assessee claimed that such interest income was to be considered for deduction under section 10AA - Assessing Officer disallowed same - Whether security deposits made by assessee for getting electricity connection was integral part of business of assessee so as to run its manufacturing activity, therefore, interest received on such security deposit would be included in business profits of undertaking for purpose of computing deduction under section 10AA - Held, yes [Para 11][In favour of assessee]

III. Section [10AA](#) of the Income-tax Act, 1961 - Special Economic Zones - Newly established Units in (Miscellaneous income) - Assessment year 2011-12 - Whether where Assessing Officer disallowed deduction under section 10AA in respect of miscellaneous income earned by assessee, since assessee had not advanced any argument as to why disallowance of deduction under section 10AA in respect of miscellaneous income was not justified, there was no reason to interfere with order of Assessing Officer - Held, yes [Para 13] [In favour of revenue]

FACTS-I

- The assessee was a partnership firm engaged in the business of manufacturing and trading of jewellery. The assessee had 100 per cent Export Oriented Unit (EOU) at SEZ. To hedge against fluctuation of price in gold and silver, the assessee entered into a commodity derivative transaction. The assessee claimed that since there was a profit earned on these forward contracts entered into so as to hedge against the fluctuation in the price of gold and silver, the said hedging profit was to be adjusted against the cost of purchase of gold and silver or to be treated as business income of the assessee for the purpose of deduction under section 10AA. In the return of income, the assessee had claimed entire income under the head 'business and profession' and claimed exemption under section 10AA.
- The Assessing Officer had disallowed the claim of deduction under section 10AA in respect of the profits derived from the forward contracts by treating same as speculative in nature.
- On appeal, the Commissioner (Appeals) held that the assessee had failed to establish the direct nexus of forward contract to the actual transaction of purchase and sale of gold and silver. He had confirmed the disallowance made by the Assessing Officer by holding that the profit earned in the derivative segment was speculative in nature and liable to be taxed as income from other sources.
- On appeal:

HELD-I

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- There is no dispute that the forward contracts entered into by the assessee in respect of the purchase of gold and silver are without actual delivery of goods and, therefore, except to the extent of such contracts are entered into so as to cover or safeguard the future loss due to price fluctuation in respect of actual transaction of sales/export, the same would be speculative transaction in terms of section 43(5). Thus, if the forward contract is entered into as an integral or incidental to the activity of actual export of goods then as per the exceptions provided under proviso to section 43(5), the same would not be treated as speculative transaction.
 - Thus, the transaction in which the contract for purchase or sale of any commodity settled otherwise than by actual delivery or transfer of commodity is treated as speculative transaction. However, there are exceptions as provided under the proviso and the relevant clause for the purpose which is applicable in the case of the assessee is clause (a) which reads that a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him, shall not be deemed to be speculative transaction. A forward contract is regarded as hedging transaction only when it is entered into with a view to safeguard the losses in respect of a contract for actual sales or purchase of goods in future and any profit or loss arising from such hedging transaction will be treated as business profit or allowable business loss. Since in the case in hand, the assessee has entered into forward contract only in respect of price of the gold and silver and not in respect of foreign exchange rate which is directly affecting the export proceeds or import outgo in foreign exchange, therefore, the profit or loss arising from such forward contracts cannot be treated as integral or incidental to the export activity but it is certainly an integral part of business activity of the assessee. Since the assessee is purchasing raw material in local market, therefore, such profit or loss shall have a bearing on the cost of raw material and consequently the profits and gain from the export of the jewellery is directly affected by the profit or loss of forward contract. In order to hold that the forward contracts entered into by the assessee are hedging transaction to hedge the loss due to fluctuation of the price of gold and silver it is required to ascertain whether the forward contracts are covering the quantity to the extent of the order for export in hand of the assessee during the year under consideration.
 - Since the purpose of hedging transaction was to minimize the assessee's risk on account of fluctuation of prices in future and covered by these contracts was limited to the extent of actual exposure in respect of purchase of raw material and export of finished goods. The assessee has claimed that the total quantity under the forward contract during the year never exceeds the quantity of export or purchases made by the assessee. Though it appears that the assessee has entered into the forward contracts for purchase as well as sale of gold and silver, however, the exact details are required to be verified which has not been considered either by the Assessing Officer or by the Commissioner (Appeals) but the deduction under section 10AA has been denied by the authorities below only on the observation that the assessee has failed to demonstrate that the transactions which have yielded profit were hedging transactions. It is the duty of the Assessing Officer to first ascertain whether the forward contracts are only in respect of covering the actual transaction of purchase and sale and not beyond actual transaction of purchase and sale then such forward

contracts would be regarded as hedging transaction and cannot be treated as speculative transaction. But the facts remained unverified whether the forward contracts entered into by the assessee during the year are covering only actual transaction of purchase and sale so as to refer the hedging transaction to safeguard the future loss due to fluctuation of prices, Accordingly, this issue is set aside to the record of the Assessing Officer to verify the actual details of forward contract as well as the actual transaction of purchase and sale made by the assessee during the year. [Para 7]

FACTS-II

- The assessee had received interest on deposit made with Jaipur Vidyut Vitaran Nigam Limited (JVVNL) towards factory electric connection. The assessee claimed deduction under section 10AA on the interest received from JVVNL. The Assessing Officer disallowed the same.
- On appeal, the Commissioner (Appeals) had confirmed the action of the Assessing Officer.
- On second appeal:

HELD-II

- There is no dispute that the interest was earned by the assessee from the security deposits with JVVNL for getting the electricity connection, therefore, the said interest income is integral part of the business of the assessee for availing the electricity connection for its manufacturing activity. Hence, the interest received on security deposit with JVVNL will be included in the business profits of undertaking for the purpose of computing the deduction under section 10AA in terms of sub-section (7) of the said provision. Consequently, the deduction will be computed as per the formulae given in sub-section (7) of section 10AA and the profits of the business undertaking includes said interest income and the profits derived from the export of the articles or things of services shall be computed in proportionate to the export turnover to total turnover. This amount will be part of the business profits undertaking but shall not be part of the export turnover. The Assessing Officer is directed to recompute the deduction as per the formulae given in sub-section (7) of section 10AA. [Para 11]

CASE REVIEW-I

Pankaj Oil Mills v. CIT [\[1978\] 115 ITR 824 \(Guj.\) \(FB\)](#) (para 7) followed.

CASES REFERRED TO

Sopropa S.A., Inre [\[2004\] 138 Taxman 75/268 ITR 37 \(AAR\)](#) (para 5) and *Pankaj Oil Mills v. CIT* [\[1978\] 115 ITR 824 \(Guj.\) \(FB\)](#) (para 5).

Manish Aggarwal, (CA) *for the Appellant*. **Ms. Anuradha** (JCIT) *for the Respondent*.

ORDER

Vijay Pal Rao, Judicial Member. - These two appeals by the assessee are directed against the two separate orders Id. CIT(A)-1, Jaipur both dated 28/03/2018 for the A.Ys. 2011-12 and 2012-13

respectively. The assessee has raised common grounds in both these appeals. Grounds raised by the assessee for the A.Y. 2011-12 are reproduced as under:

"1. On the facts and in the circumstances of the case and in law, Id.CIT(A) erred in confirming the disallowance of deduction u/s 10AA in respect of income to the tune of Rs. 4,99,376/-. Appellant prays that income of Rs. 4,99,376/- is earned by assessee incidental to the business of the assessee and is thus eligible for deduction u/s 10AA.

1.1 That, Id.CIT(A) has erred in confirming the disallowance of deduction u/s 10AA in respect of Profit of Rs. 4,80,871/- earned from derivative transactions by completely ignoring the submission of assessee that such contracts were entered into by assessee to hedge against the fluctuation in the price of gold and silver. Appellant prays that profit or loss as the case may be arising due to fluctuation in prices is directly related to the business of assessee and deserves to be considered as "Business profit" for computing deduction u/s 10AA.

1.2 That, Id.CIT(A) erred in confirming the action of Id.AO in not allowing deduction u/s 10AA in respect of Interest from RSEB to the tune of Rs. 17,622/- by grossly ignoring the submission of the assessee that such deposit is made in normal course of business and thus interest received therefrom is in the nature of Business Receipt and eligible for deduction u/s 10AA.

1.3 That, Id. C(T(A) erred in confirming the action of Id.AO in not allowing deduction u/s 10AA in respect of Miscellaneous income amounting to Rs. 883/- by grossly ignoring the fact that such income was incidental to the business and thus deduction u/s 10AA deserves to be allowed on the same.

2. That the appellant craves the right to add, delete, amend or abandon any of the grounds of appeal either before or at the time of hearing of appeal."

2. Ground No. 1 of the appeal is general regarding disallowing deduction U/s 10AA of the Income Tax Act, 1961 (in short, the Act) in respect of income which comprising the different components which are specified in the other grounds, therefore, no specific adjudication is required in respect of ground No. 1 of the appeal.

3. Ground No. 1.1 of the appeal is regarding the disallowance of deduction U/s 10AA of the Act in respect of the profit earned from derivative transactions claimed as hedging transactions by way of forward contracts. The assessee is a partnership firm and engaged in the business of manufacturing and trading of jewellery. The assessee having 100% export oriented unit (EOU) at SEZ, Sitapura, Jaipur. In the return of income, the assessee has claimed entire income under the head "business and profession" and claimed exemption/deduction U/s 10AA of the Act. The A.O. while passing the assessment in pursuant to the revision order U/s 263 of the Act, has disallowed the claim of deduction U/s 10AA of the Act in respect of the profits derives from the forward contracts by treating the same as speculative in nature.

4. The assessee has challenged the action of the A.O. before the Id. CIT(A) and contended that the forward contract entered into by the assessee are with a view to hedge the future loss due to price fluctuation of gold and silver. The Id. CIT(A) did not accept this contention of the assessee and held that the assessee has failed to establish the direct nexus of forward contract to the actual transaction of purchase and sale of gold and silver.

5. Before us, the Id AR of the assessee has submitted that the assessee deals in export of gold and silver jewellery and to hedge against fluctuation of price in gold and silver, the assessee entered into a commodity derivative transaction. Since there was a profit earned on these forward contracts entered into to hedge against the fluctuation in the price of gold and silver, the said hedging profit is to be

adjusted against the cost of purchase of gold and silver or to be treated as business income of the assessee for the purpose of deduction U/s 10AA of the Act. The Id AR has contended that the Id. CIT(A) has confirmed the disallowance made by the A.O. by holding that the profit earned in the derivative segment was speculative in nature and liable to be taxed as income from other sources. The Id AR has submitted that the said finding of the Id. CIT(A) is slightly misplaced as speculative transaction has been defined U/s 43(5) subject to the exception in explanation to the said provision and therefore, once the contract has been entered into by the assessee to guard against the loss through future price fluctuation in respect of his contract for actual delivery of goods or goods manufactured or merchandise sold by him, the same cannot be treated as speculative transaction. In support of his contention, the Id AR has relied upon the ruling of authority for advance ruling in the case of *Soprophya S.A.*, Inre [\[2004\] 138 Taxman 75/268 ITR 37](#). He has then submitted that authority for advance ruling has relied upon the decision of Full Bench of the Hon'ble Gujarat High Court in the case of *Pankaj Oil Mills v. CIT* [\[1978\] 115 ITR 824](#). Thus, the Id AR has submitted that the assessee has entered into forward contract for purchase as well as sale of goods. The contracts were against the orders in hand as the assessee received orders in advance at least 3-4 months. He has referred to the details of forward contract and submitted that on a particular date outstanding hedging contract of gold and silver during the year under consideration was not exceeding the actual sale/export of gold and silver jewellery. Therefore, when the forward contract quantity of gold and silver was always less than the actual quantity of export of gold and silver jewellery then the said forward contract cannot be held as speculative but it is only in hedging transaction and profit or loss arising from such contract will be treated as business profit or loss.

6. On the other hand, the Id DR has submitted that the Id. CIT(A) has given a specific finding that the assessee has failed to produce supporting evidence to show that the transactions which have earned the profit were hedging transactions hence in absence of necessary details to establish the direct nexus between the forward contract and actual transaction of sale/export, the assessee has failed to discharge its onus. He has relied upon the orders of the authorities below.

7. We have considered the rival submissions as well as relevant material on record. There is no dispute that the forward contracts entered into by the assessee in respect of the purchase of gold and silver are without actual delivery of goods and therefore, except to the extent of such contracts are entered into to cover or safeguard the future loss due to price fluctuation in respect of actual transaction of sales/export, the same would be speculative transaction in terms of Section 43(5) of the Act. Thus, if the forward contract is entered into as an integral or incidental to the activity of actual export of goods then as per the exceptions provided under proviso to Section 43(5) of the Act, the same would not be treated as speculative transaction. For ready reference, we quote Section 43(5) and proviso thereto as under;

'43(5) "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips:

Provided that for the purposes of this clause—

- (a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or
- (b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or
- (c) a contract entered into by a member of a forward market or a stock exchange

in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member; [or]

[(d) an eligible transaction in respect of trading in derivatives referred to in clause [(ac)] of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) carried out in a recognised stock exchange; [or]]

[(e) an eligible transaction in respect of trading in commodity derivatives carried out in a recognised association [,which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013 (17 of 2013),]]

shall not be deemed to be a speculative transaction.

Following second proviso shall be inserted after the existing proviso to clause (5) of section 43 by the Finance Act, 2018, w.e.f. 1-4-2019 :

Provided further that for the purposes of clause (e) of the first proviso, in respect of trading in agricultural commodity derivatives, the requirement of chargeability of commodity transaction tax under Chapter VII of the Finance Act, 2013 (17 of 2013) shall not apply.'

Thus, the transaction in which the contract for purchase or sale of any commodity settled otherwise than by actual delivery or transfer of commodity is treated as speculative transaction. However, there are exceptions as provided under the proviso and the relevant clause for the purpose which is applicable in the case of the assessee is clause (a) which reads that a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him, shall not be deemed to be speculative transaction. A forward contract is regarded as hedging transaction only when it is entered into with a view to safeguard the losses in respect of a contract for actual sales or purchase of goods in future. Any profit or loss arising from such hedging transaction will be treated as business profit or allowable business loss. Since in the case in hand, the assessee has entered into forward contract only in respect of price of the gold and silver and not in respect of foreign exchange rate which is directly affecting the export proceeds or import outgo in foreign exchange. Therefore, the profit or loss arising from such forward contracts cannot be treated as integral or incidental to the export activity but it is certainly an integral part of business activity of the assessee. Since the assessee is purchasing raw material in local market, therefore, such profit or loss shall have a bearing on the cost of raw material and consequently the profits and gain from the export of the jewellery is directly affected by the profit or loss of forward contract. In order to hold that the forward contracts entered into by the assessee are hedging transaction to hedge the loss due to fluctuation of the price of gold and silver it is required to ascertain whether the forward contracts are covering the quantity to the extent of the order for export in hand of the assessee during the year under consideration. Since the purpose of hedging transaction was to minimize the assessee's risk on account of fluctuation of prices in future and covered by these contracts was limited to the extent of actual exposure in respect of purchase of raw material and export of finished goods. The assessee has claimed that the total quantity under the forward contract during the year never exceeds the quantity of export or purchases made by the assessee. Though it appears that the assessee has entered into the forward contracts for purchase as well as sale of gold and silver, however, the exact details are required to be verified which has not been considered either by the A.O. or by the Id. CIT(A) but the deduction U/s 10AA has been denied by the authorities below only on the observation that the assessee has failed to demonstrate that the transactions which have yielded profit were hedging transactions. It is the duty of the A.O. to first ascertain whether the forward contracts are only in respect of covering the actual transaction of purchase and sale and not beyond actual transaction of purchase and sale then such

forward contracts would be regarded as hedging transaction and cannot be treated as speculative transaction. Accordingly, the ruling relied upon by the Id. AR of the assessee is not in dispute as far as the principle laid down by the Hon'ble Gujarat High Court in the case of *Pankaj Oil Mills (supra)* but the facts remained unverified whether the forward contracts entered into by the assessee during the year are covering only actual transaction of purchase and sale so as to refer the hedging transaction to safeguard the future loss due to fluctuation of prices. Accordingly, this issue is set aside to the record of the A.O. to verify the actual details of forward contract as well as the actual transaction of purchase and sale made by the assessee during the year.

8. Ground No. 1.2 of the appeal is regarding denial of deduction U/s 10AA of the Act on the interest received from JVVNL/RESB. The assessee has received interest on deposit made with JVVNL towards factory electric connection. The assessee paid bill after having adjusted the interest on security and therefore, the assessee claimed deduction U/s 10AA of the Act on the profits computed which includes the interest received from JVVNL being reduced from the electricity bills. The A.O. denied the deduction by holding that the same is not eligible for deduction U/s 10AA of the Act. The Id. CIT(A) has confirmed the action of the A.O.

9. Before us, the Id AR of the assessee has submitted that the interest earned on the deposit made with the JVVNL for the supply of electricity to the appellant's industrial undertaking should be treated as income derived from the industrial undertaking. It is submitted that without the supply of electricity the industrial undertaking could not run and since electricity was an essential requirement of the industrial undertaking, the industrial undertaking could not survive without it. It is further pointed out that for the purpose of getting this essential input, the statutory requirement was that the deposit must be made as a precondition for the supply of electricity. Consequently, according to the appellant, the interest on the deposit should be treated as income derived from the industrial undertaking. The Id. AR relied on the order of the ITAT Mumbai Benches in the case of *Dania Oro Jewellery (P.) Ltd. v. ITO* (ITAT Mumbai). From the above submission, it is clear beyond doubt that the Interest earned on electricity deposit of Rs. 16,949/- should be eligible for the purpose of calculation under section 10AA of the Act.

10. On the other hand, the Id DR has relied on the orders of the authorities below.

11. We have considered the rival submissions as well as relevant material on record. There is no dispute that the interest was earned by the assessee from the security deposits with JVVNL for getting the electricity connection, therefore, the said interest income is integral part of the business of the assessee for availing the electricity connection for its manufacturing activity. Hence, the interest received on security deposit with JVVNL will be included in the business profits of undertaking for the purpose of computing the deduction U/s 10AA of the Act in terms of sub-Section (7) of the said provision. Consequently, the deduction will be computed as per the formulae given in sub-Section (7) of Section 10AA of the Act and the profits of the business undertaking includes said interest income and the profits derived from the export of the articles or things of services shall be computed in proportionate to the export turnover to total turnover. This amount will be part of the business profits undertaking but shall not be part of the export turnover. The A.O. is directed to recompute the deduction as per the formulae given in sub-section (7) of Section 10AA of the Act.

12. Ground No. 1.3 of the appeal is regarding disallowance of deduction U/s 10AA of the Act in respect of miscellaneous income of Rs. 883/-.

13. At the outset, we note that the Id. CIT(A) has decided this issue as under:

"The appellant has not stated anything about the deduction not allowed by the A.O. U/s 10AA of the Act in respect of Misc. income of Rs. 883/- and thus, it is held that action of the A.O. was justified."

14. Before us also, the assessee has not advanced any argument as to why the disallowance of deduction U/s 10AA of the Act in respect of Misc. income is not justified. In absence of any explanation or argument on this issue, we do not find any reason to interfere with the orders of the authorities below qua this issue. Hence, this ground of appeal is dismissed.

15. In the appeal for the A.Y. 2012-13, ground No. 1.1 to 1.2 are common, accordingly, in view of our finding for the A.Y. 2011-12, the ground No. 1.1 stands decided being remitted to the A.O. in the same terms whereas ground No. 1.2 is also stands disposed off in the same terms as for the A.Y. 2011-12.

16. In the result, both the appeals of the assessee are allowed in part.

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*Partly in favour of assessee/Matter remanded.