

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

**INCOME TAX APPEAL NO.1642 OF 2016
WITH
INCOME TAX APPEAL NO.1517 OF 2016
WITH
INCOME TAX APPEAL NO.1545 OF 2016**

Pr.Commissioner of Income Tax-3 ... Appellant

V/s.

M/s Jindal Drugs Ltd. ... Respondent

Mr.A.R.Malhotra with Mr. N.A.Kazi with Ms.Padma Divakar for the Appellant.

Mr.V.Sridharan, Senior counsel with Mr.Jas Sanghavi i/by M/s PDS Legal for the Respondent.

**CORAM : AKIL KURESHI AND
M.S.SANKLECHA, JJ.
DATE : DECEMBER 17, 2018.**

P.C.:-

1. In these appeals filed by the revenue a common question of law has been framed. However, these questions arise from different background in the respective appeals. The broad facts we may record from Income Tax Appeal No.1642 of 2016 and thereafter, to the extent the facts are different in other appeals, we shall notice the same.

2. Tax Appeal No.1642 of 2016 is filed by the revenue. It concerns assessment year 2006-07. Following question has been presented for our consideration :

“Whether on the facts and in the circumstances of the case and in law, the ITAT was justified in holding that the hedging activity of Mentha Oil has a direct nexus with the manufacturing activity and therefore eligible for deduction u/s 80IB of the Income Tax Act, 1961, when hedging profit is not derived from industrial activity?”

3. This question arises in following background. The respondent-assessee is a limited company and is engaged in the business of manufacturing L-Menthol. The assessee has a manufacturing unit at Jammu. The main raw material for the said product is an agro-based product called Crude Menthol Oil (hereinafter referred to as raw material). Since this raw material is subject to high price fluctuation, the assessee entered into forward contracts to hedge itself against such price fluctuation. In the period relevant to the assessment years 2006-07, the assessee earned profit out of such hedging contracts. The assessee's main business of production of L-Menthol was eligible for deduction

under Section 80IB of the Income Tax Act, 1961 (“the Act” for short). In the return the assessee filed for the said year, the assessee claimed deduction of the profit received through the hedging contracts. The Assessing Officer was of the opinion that the same was not allowable, primary on the ground that the profit cannot be stated to have been derived from the assessee's manufacturing activity.

4. The assessee carried the matter in appeal. The CIT (Appeals) allowed the appeal of the assessee by a detailed order, in which he referred to the nature of the hedging contracts and the purpose behind entering into such contracts. The revenue carried the matter in appeal before the Tribunal. The Tribunal by the impugned judgment rejected the revenue's appeal and confirmed the view of the CIT (Appeals).

5. In other two appeals namely Tax Appeal No.1517 of 2016 and 1545 of 2016, we are concerned with the assessment years 2007-08 and 2009-10 respectively. In these years also the assessee had entered into hedging contracts. However, this

resulted in the assessee suffering losses. The assessee therefore, claimed set off of such losses against its business income. The Assessing Officer did not accept the assessee's claim primarily holding that the assessee's losses were speculative in nature. In this case also CIT (Appeals) allowed the assessee's appeals. The Tribunal rejected the revenue's appeals.

6. In this background, counsel for the revenue submitted that the profit arising out of hedging contract cannot be stated to be derived from the assessee's manufacturing activity. He submitted that in order to qualify for deduction the profit had to have direct connection with the assessee's business. He further submitted that the losses also were wrongly recognized by the CIT (Appeals) and the Tribunal; since the same were speculative in nature.

7. On the other hand, learned counsel for the assessee opposed the appeals contending that the main raw material which was used for manufacture of final product was given to high price fluctuations. The assessee had therefore, entered into forward contracts to insulate itself from price fluctuation. The activity was

thus closely connected with the assessee's manufacturing activity. The Tribunal, therefore, committed no error.

8. Having heard learned counsel for the parties and having perused the documents on record what appears to be undisputed is that the product in question is primary raw material for the assessee's final product which is manufactured at its unit at Jammu and income from which qualifies for deduction under Section 80IB of the Act. In this context, the CIT (Appeals) examined the facts at length and noted the nature of the assessee's contract of forward purchase of the commodity and held that the assessee had entered into the contracts in order to protect it from heavy price fluctuations. The Tribunal also confirmed this view of the CIT (Appeals). These authorities thus essentially came to the conclusion that the assessee's forward contracts were part of its business activity of manufacturing an article or thing.

9. We are conscious that Section 80IB of the Act uses expression "profit derived from" and this expression has been seen as restrictive in nature as compared to the expression

“arising out of”. However, in the present case what we find is that the assessee needed high quantity of steady supply of the raw material, which would go into manufacturing its final product. If the assessee did not enter into hedging contract, it would be exposed to wide fluctuation of costs in procuring such material. This would expose the assessee to possible losses since while undertaking contracts for production and sale of the final product, the assessee would have taken into account the procurement price of the raw material at the prevailing rate. In order to avoid such uncertainties, the assessee would enter into hedging contracts. Essentially, the entire exercise was for the purpose of making the profit out of its manufacturing activity more predictable. If the assessee had not entered into such contract and relied on the spot purchase of the product, surely the resultant loss or profit as a case may be, would be part of the assessee's manufacturing activity and thereby, in any case qualify for deduction under Section 80IB of the Act or eligible for carrying forward loss if otherwise permissible under the Act. We do not find any difference in the situation merely because such gain or loss were pursuant to hedging contract of the

assessee.

10. The full bench of Gujarat High Court in case of **Pankaj Oil Mills Vs. Commissioner of Income Tax**¹ had an occasion to deal with the issue of hedging contract and the revenue's contention that the transaction being speculative in nature, the losses resulting from such contract would be hit by Section 43(5) of the Act. It was a case in which the assessee was engaged in the business of manufacturing oil. The assessee had entered into forward transactions of sale of oil tins. When the assessee suffered loss in the process, claimed the same as a business loss to which the revenue had opposed arguing that being speculative in nature, would be hit by section 43(5) of the Act. The contention was negated. We have also noted that the Division Bench of this Court in case of **Commissioner of Income-tax Vs. Badridas Gauridu (P.) Ltd.**² was examining a situation where the assessee was an exporter of cotton and not an agent in foreign exchange. Assessee had booked forward exchange in forward market in order to hedge against losses. The export contract entered into

1 (1978) 115 ITR 824 (Gujarat)

2 (2004) 134 Taxman 376 (Bombay)

by the assessee for export of cotton in some cases failed. The Court held that the deduction in respect of the loss suffered by the assessee in the process was a business loss. It was observed that as per the RBI permission the assessee was entitled to book foreign exchange against export orders received by it. The contracts were incidental to the assessee's business of export of cotton. These judgments in our opinion would sufficiently meet with the revenue's contention in the context of the profit of the assessee's hedging contract not being derived from its manufacturing activity and loss not being allowed being speculative in nature. We may record that the Tribunal in impugned judgment had noted the statement showing month-wise details of quantities of stock and quantities of future sale contract entered into by the assessee which showed that the quantity of future contract entered was less than the available stock. Thus, if the assessee was required to give delivery of the goods, sufficient quantity of goods was available.

11. We are in agreement with the contention of the learned counsel for the revenue that certain observations made by the

Tribunal in the impugned judgment concerning the concept of the profit being derived from a particular business or undertaking, may not lay down to the correct legal preposition. However, when we find that independently of those observations the judgment of the Tribunal can still be confirmed, we do not see any reason to entertain. In the result, tax appeals are dismissed.

(M.S.SANKLECHA,J.)

(AKIL KURESHI,J.)

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