IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved on : 10.12.2025	Pronounced on : 02.02.2026

CORAM

THE HONOURABLE DR. JUSTICE ANITHA SUMANTH
and
THE HONOURABLE MR. JUSTICE MUMMINENI SUDHEER KUMAR

T.C.A.No.465 of 2012

M/s.Assab Sripad Steels Private Limited,
"Padmalaya Towers",
Janaki Avenue, MRC Nagar,
Chennai – 600 028. ... Appellant(s)

Vs.

The Commissioner of Income Tax – 1,
Chennai – 600 034. ... Respondent(s)

Prayer: Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961, against the order dated 20.07.2012 passed in ITA No.2221/Mds/2008.

For Appellant(s) : Mr.R.Meenakshi Sundaram

For Respondent(s) : Mr.D.Prabhu Mukunth Arunkumar,
Senior Standing Counsel

J U D G M E N T

(Judgment of the Court was made by **MUMMINENI SUDHEER KUMAR, J.)**

This is an appeal filed under Section 260A of the Income Tax Act, 1961, by the assessee/ appellant, aggrieved by an order dated 20.07.2012 passed in ITA No.2221/Mds/2008 by the learned Income Tax Appellate Tribunal, 'C' Bench, Chennai, in respect of the assessment for the year 2004-05.

2. The assessee filed its return of income for the assessment year 2004-05 on 30.10.2004, declaring income of Rs.92,91,066/-. The Assessing Officer passed an order, dated 27.12.2006, disallowing expenditure under three heads of account to the tune of Rs.81,63,659/-. The subject matter of the case on hand is only in respect of two heads of account. Firstly, in respect of the amounts paid to M/s.Sterling Matchem Trade (P) Ltd., (for short 'SMTPL') towards the loss suffered by the said SMTPL due to fluctuations in exchange rates for a sum of Rs.45,67,071/-. Secondly, towards the compensation for premature termination of the agreement dated 15.06.2000 entered into between the assessee and the said SMTPL for a sum of Rs.35,00,000/-. Aggrieved by the said order, the petitioner filed an appeal before the Commissioner of Income Tax (Appeals)-III, Chennai, vide ITA

No.815/06-07A-III, and the said appeal was allowed by the Commissioner of Income Tax (Appeals)-III, Chennai by an order dated 19.08.2008. However, the Department filed an appeal against the said order vide ITA No.2221/Mds/2008 before the Income Tax Appellate Tribunal, 'C' Bench, Chennai, and the said Appeal was partly allowed by the Tribunal reversing the order of CIT(A) and upholding the order of Assessing Officer to the extent of the disallowance of a sum of Rs.45,67,071/-, vide order dated 20.07.2012. Aggrieved by the said order, the assessee/ appellant is before us.

3. According to the learned counsel appearing for the appellant, the assessee entered into an agreement dated 15.06.2000 with SMTPL to import all the materials covered by the said agreement on behalf of the assessee and to transport the same to the places specified by the assessee subject to payment of certain amounts in terms of the said agreement. According to learned counsel, the said agreement provides for payment of compensation under certain circumstances and accordingly, on termination of the said agreement prematurely by the assessee, and because of the delay in the payment of the amounts to SMTPL i.e., beyond the time prescribed under the agreement, the assessee is required to compensate the SMTPL. Accordingly, by mutual agreement, the said compensation was finalised and an amount of

Rs.45,67,071/- and Rs.35,00,000/- have been paid to the SMTPL towards the loss suffered by the SMTPL due to fluctuations in the exchange rates and towards compensation for premature termination of the agreement, respectively. He also further submitted that appellant agreed to pay the said amounts as per the Board Meeting held on 18.03.2004 and the said liability was crystallined on 18.03.2004, i.e., during the financial year 2003-04. The said amounts were rightly claimed by the assessee as expenditure under Section 37 of the Income Tax Act, 1961, but the same was erroneously disallowed by the Assessing Officer. He further contended that though the CIT(A) allowed the appeal filed by the assessee, the Income Tax Appellate Tribunal erroneously interfered with the said order and disallowed the expenditure incurred by the assessee for an amount of Rs.45,67,071/- towards the compensation due to fluctuation in the exchange rates while upholding the order of CIT(A) in respect of Rs.35,00,000/-. Thus, he contended that the said amounts were paid in terms of the agreement dated 15.06.2000 and the same is also liable to be admitted as expenditure under Section 37 of the Act, 1961.

4. On the other hand, Mr.D.Prabhu Mukunth Arunkumar, the learned Senior Standing Counsel appearing for the Revenue contended that an amount

of Rs.45,67,071/- paid by the assessee to the SMTPL towards the alleged loss due to fluctuations in the exchange rates is not supported by any of the clauses contained in the agreement dated 15.06.2000 and therefore, the same cannot be admitted under Section 37 of the Act, 1961. He also further contended that the said amount is not an amount liable to be paid by the assessee to the SMTPL as a consequence of premature termination of the agreement and therefore, the same was rightly disallowed by the Assessing Officer and the same was confirmed by the Appellate Tribunal rightly.

5. The appeal was admitted on 02.01.2013 on the following substantial questions of law:-.

> *"1. Whether on the facts and in the circumstances of the case, the Tribunal is right in law in interpreting the provisions of Section 37 of the 'Act' which permits all business loss as an allowable expenditure ?*
>
> *2. In the absence of any specific prohibition relating to payment of compensation for exchange loss on termination of contract in advance, whether the Tribunal is right in law in upholding the disallowance of compensation for exchange loss?*
>
> *3. Whether on the facts and in the circumstances of the case the Tribunal has erred in disallowing the expenditure which is fully supported by the agreement entered into by the*

parties while terminating the agreement in advance?

4. Whether on the facts and in the circumstances of the case the Tribunal should have appreciated the facts that liability arose on quasi contract and inference by law that the given circumstances, the business liability shall be inflicted on the termination of contract and therefore the same should be allowed as a business expenditure under the provisions of the Act ?"

6. We have carefully considered the submissions made on either side and also perused the entire material on record.

7. It is not in dispute that the assessee paid an amout of Rs.45,67,071/- to the SMTPL and the same was claimed as expenditure while filing its return of income for the assessment year 2004-05. The notes to accounts in respect of the disputed amount as furnished by the assessee reads as under:-

"i. As in the previous years, the company has been making imports through Sterling Metchem Trade (P) Ltd (SMTPL). During the year, due to violent fluctuations in exchange rates, SMTPL had to suffer huge losses on this account. These losses had occured mainly because the company could not make payments within the contracted period for the purchases made. It was then mutually agreed that the Company had to reimburse this loss amounting to Rs.45,67,071 to Sterling Metchem Trade (P) Ltd."

8. From the above, it is evident that there were certain delays on the part of the assessee in making payments to the SMTPL beyond the agreed timeline for the purchases made by the assessee and because of the same, the SMTPL suffered losses due to violent fluctuations in exchange rates, and therefore as per the mutual agreement between the assessee and the SMTPL an amount of Rs.45,67,071/- was agreed to be paid. However, the Assessing Officer, having taken note of the notes to accounts which is extracted herein above, has taken into consideration the recitals mentioned in the agreement dated 15.06.2000 and came to the conclusion that there is no provision in the agreement for payment of compensation on account of exchange fluctuation and accordingly, disallowed the said expenditure.

9. When the matter went before the Commissioner of Income Tax (Appeals), the First Appellate Authority, having taken note of the contentions raised by the assessee, came to the conclusion that disallowance of the said deduction/ expenditure claimed towards loss for a sum of Rs.45,67,071/- by the Assessing Officer is liable to be deleted. In this connection, it would be appropriate to take note of contention raised on behalf of the assessee before the First Appellate Authority which reads as under:-

"Firstly the AR submits that the assessing officer was not correct in assuming that the appellant is not required to pay any compensation for exchange loss since the agreement provides for credit for six months and therefore any loss on account of exchange fluctuation was agreed to be borne by SMTPL, because in the present case the losses on account of exchange fluctuation has arisen in cases where the payment were delayed beyond the period of six months envisaged in the agreement, which delay in some cases extend to more than one year. He further point out that in working out the loss on exchange fluctuation while claiming compensation, SMTPL set off the gains made on exchange fluctuation and claimed compensation only on the net loss amounting to Rs. 1,02,73,693/-. In this connection the AR furnished a statement giving details of invoices raised from 1997 to 2004, the bill amount and rate of exchange on date of bill, date of payment and rate of exchange on the date of payment and resultant loss or gain consequent to exchange fluctuation. For example on invoice No.170648 dated 28-10-1997 the exchange rate on the date of the bill was Rs.5, whereas on 9-4-1999 when this bill was settled the rate of exchange rate was Rs.5.18, which is the rate at which SMTPL was required to purchase foreign exchange to settle the bill of its supplier, which was delayed because of the delay in the settlement of the bill by the appellant to SMTPL, thus resulting in a loss of Rs.51,785.40/-. Similarly the delay of more than one and half years in settling invoice No. 170685 resulted in a loss Rs. 109187.60 and so on. The AR on the above facts submitted, that the loss so incurred by SMTPL due to delay on the part of the appellant in settling the bills beyond the period of six months envisaged in the agreement, resulted in SMTPL suffering a loss on account of fluctuation amounting to Rs. 1,39,97,964.88. However, the AR pointed out that occasionally in spite of the delay on the part of the appellant in settling its bills within reasonable time, SMTPL did manage to make some gains on account of

exchange fluctuation amounting to Rs.37,24,271.41/- which is smaller as compared to the losses suffered by it, and after setting off this gain against the loss Rs.1,39,97,96.88/-, SMTPL suffered a net loss of Rs.1,02,73,693.47/- and it is for this loss SMTPL sought compensation from the appellant. Based on these facts the AR submits that in order to maintain amicable relationship with SMTPL and in the light of the decision of the appellant to terminate the agreement with SMTPL prematurely, when the agreement had about 1½ years remaining, the appellant on grounds of commercial expediency decided to compensate the loss suffered by SMTPL, due to delay on the part of the appellant, in settling the bills, beyond the period of credit permitted under the agreernent. therefore submits that in the circumstances, the assessing officer was not justified in disallowing the compensation of Rs. 45,67,071/- paid by the appellant to SMTPL on account of exchange fluctuation loss. He submits that even though there is no specific provision in the agreement, to compensate for loss on exchange fluctuation, there is no prohibition either. Further according to the AR the officer erred in relying on the clause in the agreement providing for 6 months' credit, ignoring the fact that in the present case the losses were suffered by SMTPL on account of delay of more than 6 months on the part of the appellant in settling the bills and if SMTPL had insisted on being compensated by way of interest for the period of delay, the appellant would have been required to pay a substantially higher amount as interest as compared to the compensation of Rs.45,67,071/-paid by it and which in fact resulted, in substantial savings, in the form of interest saved by the appellant"

10. Having taken note of the above contentions, the First Appellate Authority passed a reasoned order allowing the said expenditure. The same reads as under:-

> *"I have carefully considered the submission of the AR and gone through the order of the assessing officer setting out the reasons for making the two disallowances as also various materials and information available in the records. Having perused the same and having given my careful consideration to the facts of the case, I find that in so far as the termination fee of Rs.35,00,000 is concerned, the assessing officer has not correctly understood the legal implication of the letter of the appellant dated 18-3-2004 addressed to SMTPL agreed to pay them a consolidated compensation of Rs. 80,67,071 both for premature termination of the agreement as also for the loss on account of exchange fluctuation due to enormous delay on the part of the appellant to settle the bills of SMTPL. The letter of the SMTPL dated 10-3-2004 addressed to the appellant clearly establishes the fact the claim for compensation was initiated by SMTPL and the same was accepted and quantified on 19-3-2004, the date on which the appellant informed SMTPL of its acceptance of the claim for compensation and also the quantum of the compensation. The letter of SMTPL dated 14-9-2005 relied on by the assessing officer to disallow the appellant's claim was not about acceptance and conclusion of a contract for payment of compensation which has been concluded as early as 19-3-2004 but represents only the acceptance of SMTPL as to the time of the payment of an amount which has already become due to it as early as 18-3-2004, well before the end of the previous year relevant to assessment year 2004-2005. The reliance placed by the assessing officer on the letter of the SMTPL to disallow the claim of the appellant, in my view is misconceived*

and not borne out by the facts of the case, as set out above. As regards the compensation of Rs.45, 67,071/-also, the assessing officer erred in making the disallowance on the reasons set out by him. In the first place as long as there is no prohibition against a particular act in the agreement, the non-existence of such provision cannot be the sole criteria to disallow such claim. In such cases, the allowability or otherwise of any such claim should be considered solely on the basis of commercial expediency and from the point of view of businessmen"

11. However, when the matter went before the Income Tax Appellate Tribunal at the instance of the Department, the learned Tribunal, having taken note of some of the clauses from the agreement dated 15.06.2000 and having extracted the same in its order as Clauses (a) to (j), has taken into consideration only Clause (g) and (j) and came to the conclusion that the deduction/ expenditure claimed by the assessee to SMTPL towards the loss suffered due to fluctuation in exchange rates is absent in the agreement, and in the absence of any written covenant with regard to the same, it cannot be construed that, either parties is liable to compensate for the loss on account of fluctuation in the exchange rates. Thus, concluded that the said amount cannot be held to be an allowable expenses in the hands of the Assessee. The relevant portion from the said order is extracted hereunder for the sake of convenience:-

6. We have heard the submissions made by the respective parties and have gone through the documents on record as well as the orders of the lower authorities. A perusal of the relevant terms & conditions of the agreement between the assessee and M/s. SMTPL would show that there is no clause for compensation on account of loss suffered due to fluctuation in exchange rates. The clauses relating to the compensation are 'g' & 'j'. As per clause 'g', the compensation would be paid for the current period of six months from the date of despatch of material for remittance of payment and as per clause 'j', compensation was to be paid by either of the parties on account of premature termination of the agreement. Since both the parties were bound by the terms and conditions of the agreement, no covenant, which is not part of the agreement, could not be interpreted for the sake of convenience of either of the parties. The agreement is silent with regard to compensation suffered on account of loss of exchange rates. Since there is no written covenant with regard to the same, it cannot be construed that either of the parties are liable to compensate for loss on account of fluctuation in exchange rates. Therefore, the amount paid by the assessee to M/s.SMTPL on account of compensation for loss suffered due to exchange rates cannot be held to be an allowable expenses in the hands of the assessee

12. For the sake of convenience and for better appreciation, the relevant Clauses namely (a) to (j) are extracted hereunder for better appreciation:-

"a. SMTPL shall import all materials on behalf of the assessee on its account, after complying with all legal formalities and after payment of customs duty and other port and handling charges from its own funds and will not receive any advance from the assessee.

b. SMTPL shall transport the goods to its warehouse, store it at its risk and dispatch as and when required by the assesse

c. SMTPL shall make remittance in foreign exchange to associated Swedish Steels AB within six months from the date of dispatch of the material from Sweden.

d. SMTPL is not entitled to any advance from the assessee for making such remittances.

e. SMTPL shall bear the cost of transportation of the material from its warehouse to any location specified by the assessee.

f. SMTPL shall raise an invoice on the assessee for the materials despatched. invoice so raised shall include the rupee cost of material as supplied by the Swedish company, the customs duty and port and the charges incurred by it besides including a fee mutually agreed upon as compensation for services rendered.

g. SMTPL shail allow a credit period of six months from the date of despatch of the material for remittance of payment for the material for which separate compensation will be paid on mutual agreement.

h. SMTPL shall not be entitled to advance payment from the assessee for making any forex remittance to M/s. Associated Swedish Steels AB.

i. Assessee reserves the right at its option to import material directly, in case of urgent need or as circumstances warrant. No compensation shall be paid to SMTPL in such cases.

j. Either party shall compensate the other in

the event of loss of profits due to premature termination of the agreement. The quantum of compensation shall be mutually agreed upon."

13. No doubt, as rightly concluded by the learned Tribunal, the loss due to fluctuation in the exchange rates is not covered by the Clauses (g) or (j), but in our considered view, the same would fall within the scope of Clause (f) above, and the reasons for the same are as under.

14. It is the specific case of the assessee that in terms of the agreement, the assessee is entitled for a credit period of six months from the date of dispatch of the material, for remittance of the payment (as is evident from Clause (g)). But the assessee could not make the payment within the stipulated six-month period and on certain instances there is a delay beyond a period of one year and because of the same, SMTPL suffered loss due to fluctuation in the exchange rates and because of the same, it became necessary for the assessee to compensate the SMTPL and accordingly a sum of Rs.45,67,071/- was agreed to be paid. The said Clause (f) provides for raising of an invoice by the SMTPL which shall include the rupee cost of the material as supplied by the Swedish Company, the Customs Duty, and the cost and the charges incurred by SMTPL including a fee mutually agreed upon as compensation for services rendered by the SMTPL.

15. As seen from the 'notes on account', the said amount of Rs.45,67,071/- is the amount mutually agreed by the assessee and the SMTPL and paid by the assessee to the SMTPL during the subsequent financial year. No doubt, the assessee had not made a specific reference to clause (f) of the agreement but we, after having gone through, are convinced that the said amount of Rs.45,67,071/- paid by the assessee would fall within the meaning of compensation contemplated under Clause (f) of the agreement. Therefore, in our considered view, the learned Tribunal is not right in concluding that the said compensation amount paid by the assessee is not covered by clauses in the agreement.

16. Be that as it may, in the absence of any dispute on the actual payment of the said amount by the assessee to the SMTPL, the disallowance of the said amount by the Assessing Officer cannot be said to be in accordance with law, unless the Assessing Officer comes to the conclusion that the same is an expenditure of the nature prescribed in Sections 30 to 36 of the Act, 1961 and does not fall within the scope and ambit of Section 37 of the Act, 1961. As seen from the assessment order as well as the order passed by the learned Appellate Tribunal, there is nothing to indicate that the said

expenditure incurred by the appellant would fall either under Sections 30 to 36 or to say that the same does not fall under Section 37 of the Income Tax Act, 1961, except saying that the same is not covered by agreement. When the CIT(A) had considered the matter elaborately and furnished detailed reasons for his conclusion, the learned Tribunal with not even finding fault with the order of CIT(A) passed a cryptic order simply referring to Clauses (g) and (j) of the Agreement. Insofar as the fact that the assessee paid the said amount of Rs.45,67,071/- during the subsequent financial year is concerned, the stand of the assessee by placing reliance on the decision of the Hon'ble Apex Court in the case of "***Bharat Earth Movers -vs- Commissioner Of Income Tax, Karnataka***" reported in **(245) ITR 428 (SC)** in respect of Rs.35,00,000/- paid by the assessee during the subsequent financial year was accepted by the Tribunal. The same would equally applicable in respect of Rs.45,65,071/- as well, especially in the context of the fact that there is no dispute on the actual payment of the said amount by the assessee during the subsequent financial year. The said amount of Rs.45,67,071/- was crystallized on 18.03.2004 itself and therefore, the same cannot either be called as contingent amount or otherwise.

17. In the order of assessment, there is a finding that the expenditure has been incurred in the financial year ending 31.03.2006. This finding is arrived at on the basis of the fact that FMTPL had not accounted for the said expenditure either in years ending 31.03.2004 or 31.03.2005. It was only in year ending 31.03.2006, relevant to AY 2006-07, that a ledger of SMTPL was produced, accounting for compensation received from the assessee. This payment was pursuant to a Board Resolution, that was communicated to SMTPL by the assessee on 14.09.2005.

18. Based on the above, the Assessing Authority concludes that the expenditure would be relevant only to AY 2006-07 and disallows the same for AY 2004-05, being the subject assessment year. It is relevant to note that he has not questioned the genuinity of the expenditure incurred.

19. The Commissioner of Income Tax (Appeals) has accepted the assessee's challenge to the disallowance on the ground of commercial expediency, being of the view that the disallowance of the expenditure must be tested from the view point of a business man. He does not go into the year of claim. The Tribunal reverses the order of the Commissioner of Income Tax

(Appeals) on the ground that the agreement did not contain a clause for compensation. The Tribunal too, does not refer to the year of claim.

20. We have, in the paragraphs supra, found that the contract contained a categoric clause providing for the payment of compensation. As we have noted earlier, genuinity of the expenses is not in question, as the Assessing Authority has not doubted either the need or the incurrence of the same.

21. In the light of the above, we are of the considered view that the learned Appellate Tribunal is not right in interfering with the well-considered order dated 20.07.2012 passed by the Commissioner of Income Tax (Appeals) insofar as the disallowance of Rs.45,67,071/- is concerned.

22. In the aforesaid circumstances, while we answer the substantial questions of law in favour of the assessee, we direct that as the claim relates to a subsequent assessment year, the assessment of the assessee for AY 2006-07 shall be revised to the extent of the subject expenditure.

23. Accordingly, the appeal is allowed. No costs.

(Dr.A.S.M.,J.) **(M.S.K.,J.)**
02.02.2026

skr
Index : Yes / No
Speaking order / Non-speaking order
Neutral Citation : Yes / No

To

The Commissioner of Income Tax – 1,
Chennai – 600 034.

Dr.ANITHA SUMANTH, J.
and
MUMMINENI SUDHEER KUMAR, J.

skr

Pre-Delivery Order made in
T.C.A.No.465 of 2012

02.02.2026