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आयकर अपीलीय अधिकरण, मुंबई न्यायपीठ, I ,मुंबई I

IN THE INCOME TAX APPELLATE TRIBUNAL "I" BENCH, MUMBAI

श्री जोगिन्दर सिंह, न्यायिक सदस्य **एवं**

श्री रमित कोचर, लेखा सदस्य, के समक्ष

BEFORE SHRI JOGINDER SINGH, JUDICIAL MEMBER AND SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER

ITA NO 5922/Mum/2013

Assessment year: - 2009-10

Inventurus Knowledge Services Pvt. Ltd. C/o. Seren Properties Pvt. Ltd. (SEZ), Unit No. 204, Build No. 5, Mindspace Airoli Camp, Plot No. 3, Gat No. 95, Kalwa Trans, Thane Creek, MIDC Industrial Area, Thane Belapur Road, Airoli, Navi Mumbai – 400 708. PAN/GIR No. AABCK4601P	v.	Income Tax Officer 5(2)(1), 525, Aaykar Bhavan, M.K. Road, Mumbai - 400 020.
Appellant		Respondent

Assessee By	Shri S.C. Tiwari/Ms.Priyanka J.Maru
Revenue By	Shri Om Prakash Meena

Date of hearing	31.08.2015
Date of pronouncement	21.10.2015

ORDER

Per Ramit Kochar, Accountant Member

This appeal by the assessee company is directed against the order dated 07.02.2013 of Commissioner of Income Tax (Appeals)-

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9,Mumbai(Hereinafter called "the CIT(A)") for assessment year 2009-10. The assessee company has raised following grounds of appeal:-

> *"(A) Disallowance of loss on eligible derivate transactions in foreign exchange Rs.1,09,98,560/-.*
>
> *On the facts and in the circumstances of the case the learned CIT (Appeals) erred in facts and in law in confirming the disallowance of loss in eligible derivate transactions in foreign exchange of Rs.l,09,98,560/- holding them as notional and contingent losses relying on following decisions which are distinguishable on facts :-*
>
> *(i) M/s Sanjiv Woolen Mills V/s. CIT 279 ITR 434 (SC)*
> *(ii) CIT Vs. Oriental Motor Car Co. P. Ltd. (1980) 124 ITR 74*
>
> *And not following the following recent decisions of Honourable Supreme Court and ITAT on similar facts which fully support the contentions of appellant on this issue.*
>
> *(i) CIT V/s. Woodward Governor India Pvt. Ltd. 312 ITR 254 (SC)*
> *(ii) Shree Capital Services Vs. ACIT 318 ITRI (ITAT Kolkatta)*
> *(iii) Oil and Natural Gas Corporation Ltd. Vs. DCIT 261 ITRI (ITAT Delhi).*
> *(iv) DCIT V/s. Bank of Bahrin & Kuwait 132 TT] 550 (ITAT Mumbai Bench 'C')*
>
> *(B) Disallowance of Stamp Duty Rs.2,59,000/- and fees paid to Ministry of Corporate Affairs Rs.7,45,280/-.*
>
> *On the facts and in the- circumstances of the case the learned CIT (Appeals) in confirming the disallowance of stamp duty of Rs.2,59,000/- and fees to Ministry of Corporate Affairs Rs.7,45,280/- holding them as expenses of capital nature although the same have not resulted in any advantage of enduring nature in capital field nor in acquisition of any capital asset to appellant."*

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2. The Brief facts of the case are that the assessee company is a KPO (Knowledge Process Outsourcing Unit) primarily involved in the business of Revenue Cycle Management (RCM) for their clients across US.

3. During the course of scrutiny proceedings, the assessing officer observed that the assessee company has debited Rs. 1,09,98,560/- to the Profit & Loss Account on account of 'loss on derivative transaction' while the gross revenue was Rs. 5,83,80,537/- on account of services rendered to foreign clients. The assessee company was asked to explain such dis-proportionate loss as compared to gross revenue and the outstanding debtors as on 31-03-2009. The assessee company submitted that the assessee company is engaged in the business of providing business processing outsourcing services to its customers located in US and other countries and the income is received in foreign currency. The assessee company submitted that during the financial year it has entered into foreign exchange derivative contracts on the National Stock Exchange of India Limited to hedge itself against foreign exchange fluctuations on account of underlying account receivables which are denominated in US Dollars. The assessee submitted that the loss on account of derivative transaction of Rs. 1,09,98,560/- representing loss arising out of restatement of foreign currency forward

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contract in accordance with Accounting Standard (AS-11) issued by the Institute of Chartered Accountant of India(ICAI) and mark to market losses on such foreign exchange derivative transactions as at the end of assessment year are booked in the books of accounts which are neither speculative nor contingent loss. The assessee company relied upon the following judgments :

1. ***Shree Capital Services V. ACIT 318 ITR 1***
2. ***CIT V. Woodward Governor India Pvt. Ltd. 312 ITR 254***
3. ***Oil and Natural Gas Corporation Ltd. V. DCIT 261 ITR 1***
4. ***DCIT V Bank of Bahrain & Kuwait 132 TTJ 505***

The assessing officer held that these are speculative transactions and loss arising is in the nature of speculative loss. The assessing officer held that the turnover of the assessee company is only Rs. 5.83 crores for the assessment year and the receivables are Rs. 2.23 crores as at the end of the assessment year and the assessee company has incurred huge loss of Rs. 1.10 crores, which is totally disproportionate as compared to turnover and the accounts receivables and has not been entered into by the assessee company to hedge its foreign exchange positions . The assessing officer held these transactions of foreign exchange as speculative in nature and held that it falls within the ambit of section 43(5) of the Income Tax Act,1961(Hereinafter called "the Act") and does not enjoys the benefit of provisio to section 43(5) of the Act . The assessing officer held that it is for the assessee company to bring on record that this transaction is an 'eligible

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transaction' provided under Explanation 1 to section 43(5) of the Act and the same being a beneficial provision the onus is on the assessee company to bring on record cogent material to prove that its case falls with in the four corners of the beneficial provisions. The assessing officer relied upon the Judgments of Hon'ble Supreme Court in the cases of **Bacha F. Guzdar v. CIT 27 ITR 1 (SC) & CIT v. Ramkrishna Deo 35 ITR 312 (SC).** Relying upon the Judgment of Hon'ble Supreme Court in the case of Tuticorin Alkali Chemicals & Fertilizers Ltd v. CIT 227 ITR 172 (SC), the assessing officer held that accounting standard prescribed by ICAI cannot override the Act, and thus, rejected the contention of the assessee company by considering the loss as speculation loss and not allowed the set off against the income from business other than speculation business. The assessing officer also held the said mark to market loss on the forward contracts of foreign exchange as contingent and notional loss and hence dis-allowable under the Act.

The assessing officer also noted that the assessee company has debited Rs. 10,31,096/- as Rates & Taxes out of which Rs. 2,59,000/- was paid as stamp duty and Rs. 7,45,286/- was paid to Ministry of Corporate Affairs, New Delhi as fees for increase in authorized capital. The assessing officer disallowed the said expenses u/s 37 of the Act being capital in nature and added back the same to the total income of the assessee.

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4. Aggrieved by the orders of the assessing officer, the assessee company carried the matter in appeal before the CIT(A) and reiterated its submissions, as made before the assessing officer also before the CIT(A) regarding disallowance of the foreign exchange loss of Rs. 1,09,98,560/-. The assessee company submitted that the assessee company is a domestic company registered with the Development Commissioner, Vishakhapatnam Special Economic Zone as an approved SEZ and is a KPO primarily involved in the revenue cycle management for the clients across America. The assessee company submitted the loss on account of derivative transactions amounting to Rs.1,09,98,560/- represents loss arising on account of restatement of foreign currency forward contracts in accordance with Accounting Standard-11 issued by ICAI and accordingly the assessee company has booked a marked to market loss of such foreign exchange derivative transaction. The assessee company submitted that it had done hedging by way of derivative transactions to protect against the loss arising on account of fluctuation between Indian Rupee and United States Dollar as its revenue are earned in US Dollars which are to be converted into Rupees, keeping in view its long term goals and achieved the turnover of Rs. 5.83 crores in the assessment year under consideration and Rs 35 crores in the succeeding assessment year. Through hedging it covered the anticipated receipts of not only the outstanding debtors but also the expected volumes. The assessee company submitted that loss was

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neither speculative nor contingent and relied upon the following decisions:-

1. ***Shree Capital Services v. ACIT 318 ITR 1***
2. ***CIT v.. Woodword Governor India Pvt. Ltd. 312 ITR 254***
3. ***Oil and Natural Gas Corpn Ltd. v. DCIT 261 ITR 1***
4. ***DCIT v.Bank of Bahrain & Kuwait 132 TTJ 505***

The assessee company further submitted that these transactions are hedging transactions against the foreign currency loss on account of receivables in foreign currency and are not speculative transactions and they are mainly marked to market loss on these foreign exchange derivative contracts as on 31.03.2009. The assessee company submitted that the said loss is not speculative as the same is carried on the recognized stock exchange and are not deemed to be speculative in view of provisio (d) to Section 43(5) of the Act . The CIT(A) held that these mark to market losses are notional losses as the amount of loss will not be known till the forward contract of foreign currency expires and hence the same cannot be allowed as deduction for the purpose of Income Tax Act even though the same may have to be provided in the books of accounts as per prescribed accounting standards. The CIT(A) further held the same to be contingent in nature and not allowable in view of CBDT instruction no. 17/2008 dated 26.11.2008.Thus, the CIT(A) disallowed the assessee company claim of Rs. 1,09,98,560/- on account of marked to market losses on forward contact entered into by the assessee company in foreign exchange .

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Similarly for ground no. B regarding disallowance of payment to Ministry of Corporate Affairs of fee of Rs. Rs. 7,45,286/- and Stamp duty of Rs.2,59,000/- towards increase in authorized capital of the company , the CIT(A) rejected the contention of the assessee in view of the decision of Hon'ble Supreme Court in the case of **Brooke Bond India Ltd. v. CIT (1997) 225 ITR 798 (SC), Punjab State Ind. Corp. Ltd. v. CIT (1997) 225 ITR 792 (SC) and CIT v.Kodak India Ltd. (2002) 253 ITR 445 (SC)** and held the same expenditure to be capital in nature as the expenditure for expansion of capital retains the character of capital expenditure since it is directly related to the expansion of the capital base of the appellant**.**

5. Aggrieved by the order of CIT(A), the assessee company is in appeal before us.

6. The assessee company reiterated its submissions before us which were made before the authorities below . The assessee company submitted that the assessee company is a domestic company registered with the Development Commissioner, Vishakhapatnam Special Economic Zone as an approved SEZ and is a KPO primarily involved in the revenue cycle management for the clients across America. The assessee company submitted that the loss on account of derivative transactions amounting to Rs.1,09,98,560/- represents loss arising on account of restatement of foreign currency forward contracts in derivative segment in accordance

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with Accounting Standard-11 issued by ICAI and accordingly the assessee company has booked a marked to market loss of such foreign exchange derivative transaction. The assessee company submitted that it had done hedging by way of derivative transactions to protect against the loss arising on account of fluctuation between Indian Rupee and United States Dollar as its revenue are earned in US Dollars which are to be converted into Rupees, keeping in view its long term goals and achieved the turnover of Rs. 5.83 crores in the assessment year under consideration and Rs 35 crores in the succeeding assessment year. Through hedging it covered the anticipated receipts of not only the outstanding debtors but also the expected volumes of business. The assessee company submitted that loss was neither speculative nor contingent and relied upon the following decisions:-

1. ***Shree Capital Services v.. ACIT 318 ITR 1***
2. ***CIT v. Woodword Governor India Pvt. Ltd. 312 ITR 254***
3. ***Oil and Natural Gas Corpn Ltd. v. DCIT 261 ITR 1***
4. ***DCIT v. Bank of Bahrain & Kuwait 132 TTJ 505***

The assessee company further submitted that these transactions are hedging transactions against the foreign currency loss on account of receivables in foreign currency and are not speculative and they are mainly marked to market loss on these foreign exchange derivative contracts as on 31.03.2009. The assessee company submitted that the said loss is not speculative as the same is carried on the recognized stock exchange and

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are not deemed to be speculative in view of proviso (d) to Section 43(5) of the Act and also having complied with explanation 1 to section 43(5) of the Act. The assessee company contended that these forward foreign exchange derivative contract were made to hedge against the possibility of foreign exchange losses arising from the fluctuation in the conversion rate of United States Dollars vis-à-vis in relation to Indian Rupee on account of amount receivables which are for services rendered to the clients in USA for which payments are received in United States Dollars . The assessee company submitted that his case is covered in favour of the assessee company by the decision of Special Bench of the Tribunal in the case of **DCIT v. Bank of Bahrain & Kuwait (supra)**. The assessee company submitted that these transactions of foreign exchange contracts are duly covered u/s 43(5) of the Act and are eligible transactions as per Section 43(5) of the Act read with proviso (d) and explanation 1 to Section 43(5) of the Act and stated that these are not speculative transactions but they are being entered into to hedge against the possibility of foreign exchange losses due to fluctuation in currency on the amount receivables for services rendered to clients in USA for which payments are receivable in United States Dollars. These are marked to market losses on account of foreign exchange fluctuation as on 31.03.2009 for un-expired derivative transactions in foreign currency. The assessee company showed us the foreign currency contract notes and the statement of account of broker which are placed at the paper book pages 16-23 filed before us. The

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assessee company submitted that these contract notes are of currency derivative segments of National Stock Exchange of India Limited and are derivative transactions in currency futures in United States Dollars entered into through MF Global Sify Securities India Private Limited who are Member, National Stock Exchange of India Limited holding SEBI Registration No. INE231250335, NSE TM Code No. 12503 , CM 51102. The assessee company submitted that these transactions of currency derivatives are covered under proviso (d) to Section 43(5) of the Act and are eligible transactions as per explanation 1 to Section 43(5) of the Act as these derivative transactions are entered into through National Stock Exchange of India Limited which is a recognized stock exchange, these contract carried out electronically on screen based system through a SEBI registered broker who is a member of National Stock Exchange of India and these contract notes are time stamped contract notes issued by the above broker indicating the unique client identity number and PAN allotted under the Act as per mandate of Section 43(5) of the Act. The assessee company also relied upon the decision of Hon'ble Supreme Court in the case of **CIT v. Woodword Governor India Pvt. Ltd. (supra)** and contended that these losses should be allowed to be set off against non-speculative business income being on revenue account as derivative contracts have foreign currency as underlying asset and these contracts are in the nature of stock-in-trade.

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7. Ld. DR on the other hand relied upon the orders of the authorities below . The Ld. DR submitted that these forward foreign exchange contracts are not backed by any business transactions and these are not hedging transactions and marked to market transaction cannot be allowed as per Instruction of CBDT no. 3/2010 dated 23th March 2010. The Ld DR relied upon the orders of Tribunal Mumbai in ITA no. 5631/Mum/2012 in Araska Diamond Private Limited to contend that these losses are speculative in nature and cannot be allowed to be set off against business income other than speculative income .

8. We have heard the rival submissions and carefully perused the relevant material on record and case laws relied upon by the parties.We have observed that the assessee company is a domestic company registered with the Development Commissioner, Vishakhapatnam Special Economic Zone as an approved SEZ and is a KPO primarily involved in the revenue cycle management for the clients across America and the assessee company is billing its overseas clients in foreign currency. The assessee company has a turnover of Rs. 5.83 crores during the assessment year under consideration. We have observed that assessee company has entered into forward foreign exchange contracts and the contract worth USD 4 Million were outstanding as un-expired as on 31st March 2009 on which the assessee company has booked marked to market loss of Rs.1,09,98,560/- on the date of Balance Sheet as at 31st March 2009 based

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on the movement of value of United States Dollar vis-à-vis in relation to Indian Rupees based on prevailing rate as on 31-03-2009 .

Before we proceed further , it would be relevant to analyse the provisions of Section 43(5) of the Act read with proviso (d) and explanation 1 to Section 43(5) of the Act which reads as under:

"Definitions of certain terms relevant to income from profits and gains of business or profession.

43. In sections 28 to 41 and in this section, unless the context otherwise requires—

…………

…………

[80](*5*)[81] "speculative transaction"[82] means a transaction in which a contract[82] for the purchase or sale of any commodity[82], including stocks and shares[82], is periodically or ultimately[82] settled[82] otherwise than by the actual delivery[82] or transfer of the commodity or scrips:

Provided that for the purposes of this clause—

(*a*) ……….

(*b*) ……….

(*c*) ……….

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[83][(*d*) an eligible transaction in respect of trading in derivatives[84] referred to in clause [85][(*ac*)] of section 2[86] of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) carried out in a recognised stock exchange; [87][or]]

[87][(*e*) ……….

shall not be deemed to be a speculative transaction.

[89][[90][*Explanation 1*].—For the purposes of [91][clause (*d*)], the expressions—

(*i*) "eligible transaction" means any transaction,—

(*A*) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) or the Securities and Exchange Board of India Act, 1992 (15 of 1992) or the Depositories Act, 1996 (22 of 1996) and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and

(*B*) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-

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clause (*A*) and permanent account number allotted under this Act;

(*ii*) "recognised stock exchange" means a recognised stock exchange as referred to in clause (*f*) of section 2[92] of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and which fulfils such conditions as may be prescribed and notified[93] by the Central Government for this purpose;] "

Section 43(5) of the Act provides that 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 actual delivery or transfer of the commodity or scrips while proviso(d) to Section 43(5) of the Act inter-alia provides that an eligible transaction in respect of trading in derivatives referred to in clause (ac) of Section 2 of the Securities Contracts(Regulation) Act,1956 carried out in a recognized stock exchange shall not be deemed to be a speculative transaction.

We would also like to refer to the relevant definitions as contained in the Securities Contract (Regulation)Act,1956 as under:

Section 2(ac) of the Securities Contract (Regulation)Act,1956 reads as under:

Section 2 in The Securities Contracts (Regulation) Act,

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1956

2 Definitions. —In this Act, unless the context otherwise requires,—

....

[2] [(ac) "derivative" includes—

(A) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;

(B) a contract which derives its value from the prices, or index of prices, of underlying securities;]

Section 2(h) of the Securities Contract (Regulation)Act,1956 reads as under:

Section 2 in The Securities Contracts (Regulation) Act, 1956

2 Definitions. —In this Act, unless the context otherwise requires,—

(h) "securities" include—

....

[4] [(ia) derivative;

.... "

From the above , it is clear that speculative transaction is a

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transaction in which contract for purchase and sale of any commodity is settled otherwise than by actual delivery. It is not in dispute that in case of transaction in derivatives, the transaction is always settled otherwise than by actual delivery. The derivative derives its value from underlying asset which can be securities, commodities, bullion, currency etc and in this instant case , the derivative transaction undertaken by the assessee company, the underlying asset of derivative transaction is foreign currency. The word 'commodity' is used in broadest sense in Section 43(5) of the Act as it mentions in the Section 43(5) of the Act that the commodity includes stock and shares . Thus, derivative will be included in the definition of the word 'commodity' as held in Shree Capital Services Limited v. ACIT (2009)124 TTJ 0740(SB-ITAT Kol.). Hence, derivative transactions in foreign currency shall be exempted from purview of speculative transactions u/s 43(5) of the Act provided other conditions as contained in proviso (d) read with explanation 1 to Section 43(5) of the Act are fulfilled. Our view is fortified by the Memorandum explaining the provisions in the Finance Bill, 2005 which introduced clause (d) ((2005) 194 CTR(St.) 147 , the purpose of introduction of clause (d) has been explained, which reads as under:

" Measures to rationalize the tax treatment of derivative transaction

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Under the existing provisions (cl.(5) of s.43) a transaction for the purchase and sale of any commodity including stocks and shares is deemed to be a 'speculative transaction', if it is settled otherwise than by actual delivery. However, certain categories of transactions are excluded from the purview of said provision. Further, the unabsorbed speculation losses are allowed to be carried forward for eight years for set-off against speculation profits in subsequent years. These restrictions were essentially designed as an anti-evasion measure to prevent claims of artificially generated losses in the absence of an appropriate institutional infrastructure.

Recent systemic and technological changes introduced by stock markets have resulted in sufficient transparency to prevent generating fictitious losses through artificial transactions or shifting of incidence of loss from one person to another. The screen based computerized trading provides for an excellent audit trail. Therefore, the present distinction between speculative and non-speculative transactions, particularly relating to derivatives is no more required.

The proposed amendment therefore, seeks to provide that an eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange shall not be deemed to be a speculative transaction. The proposed amendment also seeks to notify relevant rules etc. regarding conditions to be fulfilled by

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recognized exchanges in this regard. Further it is also proposed to amend sub-s. (4) of s.73 so as to reduce the period of carry forward of speculation losses from eight assessment years to four assessment years.

These amendments will take effect from 1st April 2006 and will, accordingly, apply in relation to asst. ys 2006-07 and subsequent years."

From the above it is evident that the eligible transactions in derivatives carried out through recognized stock exchanges are exempted from the purview of speculation transactions u/s 43(5) of the Act provided other conditions are satisfied because of recent and systemic and technological changes introduced by stock exchanges.

We have observed that the assessee company has entered into derivative transactions in foreign currency through SEBI registered broker who is a member National Stock Exchange of India Limited and these derivative transactions are carried on through National Stock Exchange of India which is a recognized stock exchange and these transactions are backed by time stamped contract notes carrying unique client identity number and PAN allotted under the Act. The reliance of the Ld. DR on the case of Araska Diamond Pvt. Ltd. is misconceived as in this case the assessee did not fulfill the conditions as stipulated under

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section 43(5) of the Act read with proviso and explanation thereto to entitle the assessee to bring forward contract in foreign currency within four corners of exemption from being treated as non-speculative transaction as per mandate of Section 43(5) of the Act.

Thus, we hold that these derivative transactions in foreign currency as entered into by the assessee company duly fulfill all the conditions as specified u/s 43(5) of the Act read with proviso (d) and explanation 1 to Section 43(5) of the Act. We further hold that these transactions are covered by the exception as contained in proviso (d) to Section 43(5) of the Act and hence are not speculative transactions as defined under Section 43(5) of the Act. Thus, we hold that loss of Rs.1,09,98,560/- incurred by the company on derivative transactions in foreign currency in the instant appeal is not a speculative loss within the definition as contained in Section 43(5) of the Act.

Regarding contention of the Revenue that , these marked to market loss of Rs.1,09,98,560/- as at 31st March 2009 is a notional or contingent loss and cannot be allowed as revenue expenditure as in view of Revenue the assessee company has claimed the losses on unexpired derivative transactions in foreign currency based on the prevailing exchange rates of United States Dollar vis-à-vis in relation to Indian Rupee as on the date of Balance Sheet as

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at 31st March 2009 while the actual loss has not yet crystallized in the view of revenue because the derivative transactions had not yet been squared/settled as on the date of Balance Sheet as at 31st March 2009 , we are guided by the decision of Tribunal Special Bench , Mumbai in DCIT v. Bank of Bahrain and Kuwait (2010) 132 TTJ 0505(SB) as detailed here in under:

"***32.*** *Ground No.2 for the assessment year 1998-99 and Ground No.3 for the assessment year 1999-2000 in regard to which reference has been made to the Special Bench reads as under:*

"Whether on facts and circumstances of the case, can it be said that where a forward contract is entered into by the assessee to sell the foreign currency at an agreed price at a future date falling beyond the last date of accounting period, the loss is incurred to the assessee on account of evaluation of the contract on the last date of the accounting period i.e. before the date of maturity of the forward contract."

33. *Facts in brief are that the assessing officer noticed that the assessee had booked a loss on revaluation of forward foreign exchange contracts, which were unmatured on the date of balance sheet, of an amount of Rs.12,42,648/-. He noted that the assessee enters into forward contracts with clients to buy or sell foreign exchange at an agreed price on a future date. This future price was estimated according to certain norms such as forward premium rates for certain currencies. He noted that when such contract was entered into, the bank normally booked loss or profit depending upon the difference between the prevailing exchange rate on that date and contract rate. On the maturity of contract, the same profit or loss booked earlier was reversed and the actual profit or loss incurred based on the difference between the exchange rate on that date and the contract rate was booked. He pointed out that for transactions which mature during the year, the notional profit or loss gets replaced by actual profit or loss. There is no dispute in this regard and the same has been treated as revenues profits/loss. However, since in the forward contracts, the liability to purchase or sale of foreign exchange arises only on the date of maturity of the contract, therefore, the loss or gain depends upon the rate prevailing on that date and the contracted rate. Thus, he was of the opinion that the date of maturity of the contract is the relevant date for determining the profit or loss, accruing to an assessee, in pursuance to the forward foreign exchange contract. The assessee pointed out that as per RBI's guidelines, the banks were required to revalue unmatured contracts as per rates of exchange notified by Foreign Exchange Dealer's*

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Association of India (FEDAI). Accordingly, on the balance sheet date, based on the exchange rate on that date, provision of profit/loss substitutes the figures booked at the time of contract. Thus, revalued loss/profit was debited to the profit and loss account. Further, this treatment was as per principles of accounting which required the current assets to be marked to the market rate. The assessing officer did not agree with this modus operandi in regard to unmatured forward contracts. He further pointed out that in case foreign exchange is a current asset, the easier method of accounting would be to book the sale when it was done and the purchase when it was executed, which will determine gain or loss of the transaction. He further observed that the method followed by the assessee may be fair accounting principle to estimate the net worth but the principles of taxation required that actual profit or loss was brought to tax. He also observed that there are number of provisions in the I.T. Act which require the assessee to follow a different method than followed in its books of account. In this regard, the assessing officer referred to the decision in the case of CIT v. Motor Industries Company Limited (229 ITR 137), wherein, it has been held that the income tax law does not allow as expenses all the deductions a prudent trader would make in computing his profits. It is only the actual liability in present which is allowable and not liability in future which for the time being, is only contingent. It was also held that what a prudent trader sets apart to meet a liability, not actually present but only contingent, cannot bear the character of expenses till the liability becomes real. He also referred to the decision of the Hon'ble Supreme Court in the case of Indian Molasses' case (37 ITR 66), wherein also, it was held that where the liability is contingent, the same is not allowable. The Hon'ble Supreme Court observed as under:-

> *"The expenditure which is deductible for income tax purposes is one which is towards a liability actually existing at the time, but the putting aside of money which may become expenditure on the happening of an event is not expenditure."*

As regards the assessee's contention that bank was recording its income and expenditure on accrual basis, which was as per the provisions of section 145 and the same could be disputed only if the profits or gains were not properly deducible from the same, the assessing officer pointed out that the accounting method followed does not have much relation to the accrual basis of accounting. He observed that in forward contracts, liability arises only on the date contract matures. He pointed out that before the sale, it is only a contingent liability as the assessee could not foresee the rate of exchange which would prevail on the date of maturity of the contract. The assessing officer referred to the decision of the Hon'ble Madras High Court in the case of Indian Overseas Bank(183 ITR 200) , wherein, similar issue was examined and it was held that before settlement of contracts in foreign currency, no actual profit could accrue. It was held that the amounts in question represented notional profits only. Drawing analogy from this decision, the assessing officer disallowed the loss of Rs.12,42,648/- treating the same as notional loss. The assessing officer, however, allowed the amount which was disallowed on this count in earlier years.

***34.** Before ld Commissioner (Appeals), it was contended that the assessee was required to revalue its outstanding forward foreign exchange contracts as per the rates of exchange notified by the Foreign Exchange Dealer's Association of India on March 31, every year as per RBI guidelines. The gain or loss on revaluation of the outstanding contracts was booked in the profit and loss account as per the mandatory requirements of RBI guidelines. The assessee relied on the decision*

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of the Hon'ble Supreme Court in the case of United Commercial bank v CIT,240 ITR 355 and also on following decisions:-

1. Bank of Tokyo v Inspecting Assistant Commissioner, 13 ITD 32

2. State bank of Mysore v CIT, 114 ITR 704 (Kerala)

3. CIT v. Canara Bank, 63 ITR 328 (sc)

4. ONGC v DCIT, 83 ITD 151 (Delhi)

Ld Commissioner (Appeals) allowed the assessee's appeal, inter alia, observing that the assessee was offering profits resulting from such revaluation as and when they so arise and the assessing officer had never objected to the profits which was shown on revaluation of outstanding foreign exchange forward contracts. In this regard, ld Commissioner (Appeals) relied on the decision of ITAT Mumbai in the case of Deutsche bank A.G v DCIT, 86 ITD 431, wherein, it has been held that income/loss on revaluation of forward foreign exchange contracts is not notional in nature and, therefore, needs to be considered in preparing computation of total income of the assessee. He also pointed out that in this case the decision of the Hon'ble Madras High Court in the case of Indian Overseas bank (supra) has been distinguished.

***35.** Ld CIT D.R. Shri Ajit Kumar Sinha submitted that the assessee is carrying on banking business in India and it is not the assessee's business to deal in forward contracts. It entered into forward contracts with its clients to buy or sell foreign currency at an agreed price on a future date in order to protect the interest of the bank. He submitted that it is a tool to safeguard the assessee's interest. Ld CIT D.R. submitted that these contracts are entered into in order to avoid wide fluctuation in foreign currency. He submitted that there is no dispute in regard to contracts which matured during the year in which they were entered into and the loss/profit was claimed as deduction/income, had been allowed/taxed, accordingly. The dispute is only in regard to those forward contracts, date of maturity of which fall after the end of the accounting year. The assessee revalued its profit/loss on notional basis as per rate of exchange prevailing on the balance sheet date and claimed the same. Ld CIT D.R. submitted that the reference to the Special Bench has been made because the decision of ITAT in the case of Deutsche bank A.G., 86 ITD 431 (supra) and that of the decision of the Hon'ble Bombay High Court in the case of bank of India, 218 ITR 371 relied upon by the assessee proceeded on the footing that the securities were stock-in-trade but as far as the forward contract is concerned, the same is not stock-in-trade and, therefore, those decisions are not applicable. He pointed out that there is no material to prove that forward contract to buy or sell foreign currency itself constitutes the stock-in-trade as the assessee does not trade in such forward contract. He, therefore, submitted that the decision which proceeded on the basis of foreign currency being stock-in-trade cannot be relied upon in the present set of facts. He further pointed out that these transactions are not recorded in the books of account and hence, there cannot be any liability from income tax point of view. Thus, there cannot be any question of computing any notional loss for the purposes of income tax. He submitted that the foreign exchange contract cannot be considered on the same footing on which foreign exchange currency being stock-in-trade is considered. In this regard, Ld CIT D.R. referred to the decision of the Hon'ble Supreme Court in the case of CIT v. Woodward Governor of India, 312 ITR 254 (SC) and pointed out that in para 18, while considering the applicability of AS-11, the Hon'ble Supreme Court noted that exchange difference arising on*

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foreign currency transaction have to be recognized as income or as expenses in the period for which they arise, except as stated in paras 10 & 11, which deals with exchange difference on repayment of liabilities incurred for the purpose of acquiring fixed asset. It was, inter alia, observed that AS-11 stipulates effect of changes in exchange rate vis-a-vis monetary items denominated in a foreign currency to be taken into account for giving accounting treatment on the balance sheet date. Ld CIT D.R. pointed out that in the present case, since no transaction has been entered into in the books of account, there was no monetary item requiring adjustment of exchange rate difference. Ld CIT D.R. thus, submitted that the manner of holding foreign currency is relevant and if the same is held as stock-in-trade then in view of the decision of the Hon'ble Supreme Court in the case of Woodward Governor of India (supra), the exchange rate difference on the balance sheet date has to be considered for tax purposes. Ld CIT D.R. referred to the decision of the Hon'ble Bombay High Court in the case of CIT v. Kamani Metals and Alloys Ltd, 208 ITR 1017(Bom), wherein, the facts were that the assessee had entered into a contract with MMTC on 27-8-1974 for purchase of 49,981 kgs copper cathodes at the rate of Rs.33,825/- per M.T. The assessee had opened an irrevocable letter of credit on 28-9-1974. However, till the end of the relevant accounting year, no material was received by the assessee. The MMTC announced price of copper cathodes at Rs.25,461/- per M.T. for the quarter January to March, 1975. The assessee received the material on 12.3.1975. In the backdrop of these facts, the assessee made a provision amounting to Rs.4,18,021/- for the anticipated loss in the purchase account representing the difference between the contract price and the market price on the date of receipt of the material as the market price of the copper cathodes was less than the contract price. The assessee's claim was allowed by the Tribunal . However, when the matter traveled before the Hon'ble High Court, it was held that under the contract in question, no raw material was in fact purchased by the assessee during the relevant accounting year. The material was received in the next accounting period on 12-3-1975. The Hon'ble High Court held that since there was no closing stock of the material in the hands of the assessee and only contract with MMTC was there, therefore, the material contracted to be purchased could not be regarded as assessee's stock-in-trade and hence, could not be valued in the accounts as such. Accordingly, the anticipated loss was disallowed by the Hon'ble High Court. Ld CIT D.R. relying on this decision submitted that this covers the issue before us and on same parity of reasoning; the forward foreign exchange contract remaining unsettled at the closing balance sheet date could not be treated as stock-in-trade.

36. *Ld CIT D.R. further submitted that the decision in the case of Deutsche Bank A.G. (supra) relied upon by ld Commissioner (Appeals) is not applicable as the same proceeds on a wrong premise that unsettled forward foreign exchange contracts as on balance sheet date constitute the stock-in-trade. Thus, the very premise is wrong on which the decision was delivered. He submitted that the circular No.664 dated 5-10-1993 referred to in the case of Deutsche bank (supra) talks only about securities and not forward contracts. Therefore, the said circular is not applicable in the present facts. Ld CIT D.R. further referred to the decision of the Hon'ble Supreme Court in the case of Indian Molasses Co. Ltd v CIT, 37 ITR 66 (SC), wherein, the Hon'ble Supreme Court, inter alia, observed that income tax law does not allow as expenses all the deductions a prudent trader would make in computing his profits. It was further held that in finding out what profits there be, the normal accountancy practice may be to allow as expense any sum in respect of liabilities which have accrued over the accounting period and to deduct such sums from profits. He, therefore,*

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submitted that unless the liability actually accrued on maturity of the contracts, there could not be any allowable expense on account of variation in the rate of exchange as compared to contracted rate at the end of the financial year.

37.*As regards the assessee's submissions that the valuation was done as per the guidelines of FEDAI, Ld CIT D.R. submitted that the income or expense is to be determined as per the requirements of Income tax Act and as per the guidelines prescribed for preparation of accounts.*

38. *Ld CIT D.R. further referred to the decision of the ITAT Calcutta Bench Third Member in the case of Eveready Industries India Ltd v. DCIT, 78 ITD 175 (Cal)',wherein, it was held that exchange fluctuation loss of un-matured forward covers (i.e. forward contract) could not be allowed on accrual basis. However, since the assessee claimed that such contract got settled during the year and only remittance was made, the issue was set aside to the assessing officer to ascertain the fact and reconsider the claim of the assessee in accordance with law. Ld CIT D.R. referred to section 145 of the I.T. Act and pointed out that as per sub-section (3), if the assessing officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting or accounting standard have not been regularly followed, then the assessing officer can make assessment u/s.144. He submitted that the main object of section 145 is to compute the correct profits and if the correct profits cannot be deduced from the accounts then he has to compute the profits on his own. Ld CIT D.R. further referred to the decision of the Hon'ble Calcutta High Court in the case of Bestobell India Ltd, 117 ITR 789 (Cal),wherein, the facts were that the loan of 37,500, being about Rs.5 lakhs was taken by the assessee from its subsidiary company to be repaid at the expiry of one year or earlier. However, the loan could not be repaid within the stipulated period and on account of devaluation of Rupee, there was increase in loan liability on account of sterling loan. It was held that increase in liability was inextricably connected with assessee's indebtedness and was capital in nature. Thus, in sum and sub stance, the arguments of Ld CIT D.R. are as under:-*

(i) Unsettled forward foreign exchange contracts does not constitute stock-in-trade and, therefore, there is no question of its valuation.

(ii) No transaction has been recorded in the books of account in regard to unsettled forward foreign exchange contracts and, therefore, there is no question of its valuation being done at the end of the accounting year.

(iii) The anticipated loss is primarily in the nature of notional liability and, therefore, does not accrue/arise at the end of the previous year and hence, not allowable.

(iv) The liability accrues or arise only on the date of maturity of the contract and prior to that purely on the basis of estimated liability as per FEDAI guidelines it cannot be allowed under I.T.Act.

(v) Various decisions relied upon by ld Commissioner (Appeals) relate to stock-in-trade and not to unsettled forward foreign exchange contract.

(vi) The issue is squarely covered by the following decisions:-

(a) Indian Overseas bank Ltd., 246 ITR 206(Mad)

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(b) Indian Overseas bank Ltd., 151 ITR 446 (Mad)

(c) Kamani Metals & Alloys Ltd., 208 ITR 1017 (Bom)

(d) Bank of India, 218 ITR 371 (Bom)

(e) Eveready Industries (I) Ltd., 78 ITD175 (Cal)

(f) Indian Molasses Co. Ltd., 37 ITR 66 (SC)

***39.** Shri F.V.Irani, ld counsel for the assessee submitted that there is no dispute regarding allowability of assessee's claim and the only dispute is regarding timing i.e. year of allowability. The whole controversy is whether on the balance sheet date the estimated loss as per the FEDAI notification as per RBI guidelines is accrued loss or notional loss. Ld counsel for the assessee referred to page 8 para 5.3 of ld Commissioner (Appeals)'s order for A.Y. 1998-99 and pointed out that he has taken note of the fact that as per the RBI guidelines, the assessee was required to revalue its outstanding foreign exchange forward contract as per the rates notified by the FEDAI on March 31st every year. Ld counsel submitted that the assessee had to re-assess the anticipated loss at the end of the year in accordance with the method of accounting consistently followed by it. Therefore, it was allowable. Ld counsel submitted that now the issue stands settled by the decision of the Hon'ble Supreme Court in the case of Woodward Governor of India Ltd., 312 ITR 254(SC). Ld counsel pointed out that the Hon'ble Supreme Court has affirmed the decision of the Hon'ble Delhi High Court in the case of CIT v. Woodward Governor of India Ltd., 294 ITR 451 (Del). In this regard, ld counsel referred to page 469 and pointed out that in regard to revenue account cases, the Hon'ble Delhi High Court has, inter alia, observed in para 32 that the liability stands accrued the minute the contract was entered into. In support of his contention, ld counsel has advanced various propositions before us which are discussed herein-below.*

1. The loss claimed by the assessee is in accordance with a recognized method of accounting. The assessing officer, admittedly, not having invoked the provisions of section 145(3) of the Act, is bound by the assessee's aforesaid method and, therefore, is obliged to allow the loss.

***40.** In this regard, ld counsel for the assessee referred to the assessment order for the assessment year 1998-99 and pointed out that in para 5.2 at page 5, the assessing officer observed as under:*

> *"In case foreign exchange is a current asset, the easier method of accounting would be to book the sale when this is done and the purchase when it is executed."*

Ld counsel further referred to page 1 of the assessment order and pointed out that the assessing officer has taken note of the fact that the assessee was following mercantile system of accounting. He further pointed out that the assessment has been completed u/s.143(3) and, thus, it is clear that the assessee's books of account have not been rejected. Ld counsel for the assessee referred to the decision of the Hon'ble Supreme Court in the case of Investment Ltd v. CIT, 77 ITR 533 (SC), wherein, it has been held at pages 537 to 538 that the method of accounting consistently and regularly followed by the assessee cannot be discarded by the departmental authorities on the view that he should have adopted a different method of keeping account or of valuation. The method of accounting regularly employed may be discarded only if, in the opinion of the taxing authorities, income of the trade cannot be properly deduced therefrom. He further referred to the decision of the Hon'ble Bombay High Court in the case of CIT v. TISCO, 106 ITR 363 (Bom), wherein also,

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similar view was taken. In support of this proposition, he also relied on the decision of the Hon'ble Supreme Court in the case of CIT v. Woodward Governor India P. Ltd., 312 ITR 254 (SC), wherein, the Hon'ble Supreme Court has, inter alia, observed as under:-

> *""For the reasons given hereinabove, we hold that, in the present case, the "loss" suffered by the assessee on account of the exchange difference as on the date of the balance sheet is an item of expenditure under section 37(1) of the 1961 Act.*
>
> *In the light of what is stated hereinabove, it is clear that profits and gains of the previous year required to be computed in accordance with the relevant Accounting Standard. It is important bear in mind that the basis on which stock-in-trade is valued is part of the method of accounting. It is well established, that, on general principles of commercial accounting, in the P&L account, the values of the stock-in-trade at the beginning and at the end of the accounting year should be entered at cost or market value, whichever is lower- the market value being ascertained on the last date of the accounting year and not as on any intermediate date between the commencement and the closing of the year, failing which it would not be possible to ascertain the true and correct state of affairs. No gain or profit can arise until a balance is struck between the cost of acquisition and the proceeds of sale. The word "profit" implies a comparison between the state of business at two specific dates, usually separated by an interval of twelve months. Stock-in- trade is an asset. It is a trading asset. Therefore, the concept of profit and gains made by business during the year can only materialize when a comparison of the assets of the business at two different dates is taken into account. Sec. 145(1) enacts that for the purpose of section 28 and section 56 alone, income, profits and gains must be computed in accordance with the method of accounting regularly employed by the assessee. In this case, we are concerned with section 28. Therefore, section 145 is attracted to the facts of the present case. Under the mercantile system of accounting, what is due is brought into credit before it is actually received; it brings into debit an expenditure for which legal liability has been incurred before it is actually disbursed. (See judgment of this court in the case of United Commercial bank v. CIT (1999) 240 ITR 355 (SC). Therefore, the accounting method followed by an assessee continuously for a given period of time needs to be presumed to be correct till the assessing officer comes to the conclusion for reasons to be given that system does not reflect true and correct profits. As stated, there is no finding given by the assessing officer the correctness of the Accounting Standard followed by the assessee(s) in this batch of civil appeals."*

40.1 *Ld counsel also relied on the decision of the ITAT Delhi Bench in the case of DCIT v Maruti Udyog Ltd., 99 ITD 666 (Del) and ONGC v DCIT, 83 ITD 151 (Del)(SB), wherein also, it was, inter alia, held that additional liability incurred by the assessee on account of variation in foreign exchange rate was an allowable trading liability where borrowed foreign currency was utilized to meet need of working capital. Ld counsel for the assessee submitted that there is no distinction between the loan transaction and foreign contract and these decisions are squarely applicable to the present set of facts because the contract had already been entered into in the relevant previous year.*

(2) The loss claimed by the assessee is not a notional/contingent loss, but is an actual loss which it is entitled to as a deduction.

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40.2 *Ld counsel for the assessee pointed out this aspect is evident from the fact that the loss of Rs.1,52,20,000/- disallowed by the assessing officer in A.Y. 1998-99 has been allowed by the assessing officer as a revenue deduction in assessment year 1999-2000. Ld counsel for the assessee referred to the written submissions filed by ld CIT (DR) and pointed out that one of the definitions of forward foreign exchange contract is as under:-*

> *"Agreement to exchange at a given future date currencies of different countries at a specified rate (forward rate). A forward contract is a foreign currency transaction. The gain or loss on the contract is typically included in determining net income. The amount of gain or loss, except on a speculative forward contract (designed as a risky investment rather than as a hedge), is computed by multiplying the foreign currency amount of the forward contract by the difference between the spot rate at the balance sheet date and the spot rate at the date of inception of the contract."*
>
> *"Agreement that obligates an investor to deliver a specified quantity of one currency in return for a specified amount of another currency.*
>
> *Forward exchange contracts.*
>
> *A forward exchange contract (or forward contract) is a binding obligation to buy or sell a certain amount of foreign currency at a pre-agreed rate of exchange, on a certain future date.*
>
> *Summary*
>
> *A forward contract is an obligation to buy or sell a certain amount of foreign currency at a pre-determined date. Even if your requirements change over the term of the forward contract, you are still obliged to deal.*
>
> *A forward contract obliges you to deal at a specific rate - you are not in a position to benefit from any favourable movements in exchange rates between booking the contract and completing the deal.*
>
> *No premium is payable."*

He submitted therefore, the minute forward exchange contract is entered into; the bank becomes liable to honour the same. A binding obligation arises against the bank which it is required to discharge. He, therefore, submitted that the physical delivery of foreign currency on the date of maturity does not wipe out the present liability incurred by the bank. He relied on the decision in the case of ONGC (supra), wherein, it was, inter alia, observed as under:-

> *"Before concluding, we would like to point out that the assessee's claim for loss arising as a result of fluctuation in foreign exchange rates on the closing day of the year has been disallowed by the assessing officer, inter alia, on the ground that this liability was a contingent liability and the loss was a notional one. The main ingredient of a contingent liability is that it depends upon happening of a certain event. We are of the considered opinion that in the case of the assessee, the "event" i.e. the change in the value of foreign currency in relation to Indian currency has already taken place in the current year. Therefore, the loss incurred by the assessee is a fait accompli and not a notional one."*

40.3 *Ld counsel for the assessee pointed out that in these cases also, the loans were payable at some future date but the liability was allowed on the basis of revaluation of foreign exchange on the date of balance sheet. Ld counsel pointed out that the decision in the case of ONGC (supra) and Maruti Udyog (supra) was affirmed by the Hon'ble Delhi High Court in the case of Woodward Governor India (P)Ltd. (supra) and it has been held that the additional liability on account fluctuation in foreign currency as on 31st March,1991 of foreign currency loans outstanding on that date was an allowable revenue loss and was not notional or contingent one. He further submitted that the decision of the Hon'ble Delhi High Court stands affirmed by the Hon'ble Supreme Court and, therefore, it has to be followed, particularly, because the Hon'ble Delhi High Court has considered the decision in the case of Indian Molasses and also in the case of Indian Overseas bank (supra). Ld counsel for the assessee also pointed out that similar view has been taken in the case of Silcon Graphics v ACIT, 105 TTJ 591 (Delhi) and CIT v. Brockhoven BV, (Mumbai ITAT). Ld counsel for the assessee submitted that from the above decisions, it is evident that the additional liability arisen on account of foreign exchange fluctuation as at the end of the year, is not a contingent or notional liability and hence, allowable. Further, it is not necessary for such additional liability to be allowable, that it must relate to stock-in-trade because all the above cases were cases of loans and not stock-in-trade. The only requirement is that it must be on revenue account, which is not disputed in assessee's own case.*

(3) The loss on the revaluation of the outstanding forward exchange contracts is allowable on the well recognized principle that an assessee's stock/circulating capital has to be valued at cost or market price, wherever is lower.

40.4 *Ld counsel for the assessee submitted that in any event, forward foreign exchange contracts are in the nature of stock-in-trade and on this count also they have to be valued at cost or market price, whichever is lower and, therefore, any resultant loss on fluctuation of Indian Rupee has to be allowed as a deduction on normal principles of commercial accounting. In this regard, he relied on the following decisions:-*

(i) Bank of Tokyo v Inspecting Assistant Commissioner, 13 ITD 32(Cal) affirmed by Hon'ble Calcutta High Court.

(ii) Deutsche bank A G v. DCIT, Spl. Range (ITA No.7251/B/91 & C.O.924/B/92), wherein, in para 26, the Tribunal has taken note of the fact that the Hon'ble Calcutta High Court refused to direct the Tribunal to refer a question with reference to the decision of the Tribunal.

(iii) Deutsche bank A.G. v. ACIT (ITA No.5327/M/01). In this case, the Tribunal taking note of the fact that in assessee's own case the addition on account of notional profit on unsettled forward exchange contract had been taxed the loss claimed by the assessee on the same count was held allowable.

(iv) Deutsche bank A.G. v DCIT, 86 ITD 431(Mum), wherein also, similar view was taken.

(v) Shree Capital Services Limited, 121 ITD 498(Kol)(SB), wherein, it has been observed that the derivative derives its value from the underlying assets. In other words, the underlying assets are represented by derivatives. When the underlying asset of any derivative is share or stock for

all practical purposes, the treatment given to such derivatives should be similar to stock and securities.

Ld counsel for the assessee, therefore, pointed out that as there is no dispute that foreign currency is bank's stock-in-trade and since in the forward foreign exchange contract, the underlying security is foreign currency, therefore, it should be taken as stock-in-trade.

(4) The loss has to be allowed on the matching principle laid down by the Supreme Court in the case of Madras Industrial Investment Corporation.

Ld counsel for the assessee referred to the following hypothetical example which is reproduced herein-below:

"A" the Bank's method "matches" the total profit of Rs.300 to the respective periods to which it relates viz

Rs.100 to the year ended 31-3-1998

Rs.200 to the period ended 31 March, 1999"

***40.5** In the last leg of his argument, ld counsel submitted that if at all a conclusion is reached that there is a cleavage of judicial opinions, the view favouring the assessee has to be adopted. In this regard, he referred to the decision of the 5 Members Special Bench in the case of Narang Overseas v ACIT, 114 ITJ (Mum) 433.*

***41.** In the rejoinder, Ld CIT D.R. submitted that the decision in the case of Woodward Governor of India Ltd, 312 ITR 254 (SC) and 294 ITR 541 (Del) and ONGC (supra) has to be considered in the context in which the same is delivered. He pointed out that the Hon'ble Supreme Court in the case of Woodward Governor (supra) held that the foreign currency notes, balance in bank accounts denominated in foreign currency and receivables/payables and loans denominated in foreign currency as well as sundry creditors are all 'monetary items', which have to be valued at closing rate at the end of the accounting year as per AS-11. He pointed out that this judgment is mainly with reference to stock-in-trade and applies to foreign exchange liabilities in respect of raw materials or stock-in-trade and at the most it can be extended to monetary items noted above. But in the present case, forward foreign exchange contracts are not similar to this specified item. He submitted that in forward foreign exchange contract, no investment of foreign currency was made at any time prior to the date of its maturity and, therefore, it cannot even be said that such contracts indirectly represent stock-in-trade or trading assets of the assessee. Further, no accounting entry had been made before the settlement of contract. He submitted that the following decisions relied upon by ld counsel for the assessee proceeded on the assumptions that there was stock-in-trade:*

(i) Bank of India, 218 ITR 371 (Bom) - Here foreign exchange held in its foreign branches constituted stock-in-trade.

(ii) Bank of Tokyo, 13 ITD 32 (Cal) - Proceeded on the assumption that foreign exchange contract constitute stock-in-trade which is not correct.

(iii) State bank of Mysore, 114 ITR 704 (Kar) - delivered in respect of foreign currency held by bank.

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(iv) Nedungadi bank ltd., 264 ITR 545 (Ker)- delivered in the context whether Government securities can be treated as stock-in-trade or not.

(v) Mashreque bank, 18 SOT 233 (Mum). This case proceeded on wrong assumption that forward foreign exchange contracts constitute stock- in-trade.

(vi) United Commercial Bank, 240 ITR 355 (SC). The question was whether government securities held by bank are stock- in- trade or not.

(vii) Brockhoven BV (ITA No.8344/B/90. In this case, the question before the Hon'ble Bombay High Court was loss on account of difference in foreign exchange rate in respect of amount due by the assessee to its head office, which was held to be allowable.

42. *We have considered the rival submissions and perused the record of the case. There is no dispute that if the date of maturity of the contract falls within the same financial year then the difference between the exchange rate as prevailing on the balance sheet date and contracted rate is an allowable deduction. The moot point for consideration is whether keeping in view the nature of contract, can it be said that a liability accrued on 31st March in respect of unmatured forward foreign exchange contract on account of fluctuation in rate of foreign currency or not. Therefore, it is necessary to first examine the nature of contract entered into by the assessee. Forward Foreign exchange contract means an agreement to exchange different currencies at a forward rate. Forward rate is a specified rate for exchange of currency at a specified date. The assessee enters into forward contract with clients to buy or sell foreign exchange at an agreed price at a future date in order to hedge against the possible future financial loss on account of wide fluctuation in the rate of foreign currency. Thus, firstly, forward foreign exchange contract creates a continuing binding obligation on the date of contract against the assessee to fulfill the same on the date of maturity and secondly, it is in the nature of hedging contract because it is a contract entered into against possible financial losses . Let us take a hypothetical example. Suppose 'X & Co.' is assessee's client. It entered into a contract with 'Y & Co.' on 15.2.2010 for supply of goods at 1,00,000 $, for which payment was to be made after three months on 15-5-2010. Suppose, on the date of contract, the value of Dollar vis-a-vis Rupee was Rs.45. After three months, 'X & Co.', keeping in view the prevailing economic conditions etc., anticipated wide fluctuation in exchange rate. Therefore, it entered into with its bank (assessee) to purchase 1,00,000 $ on 15.5.2010 at say Rs.47/-. Thus 'X & Co.' had hedged the loss at Rs.2/- which it distributed over two periods. However, as far as the assessee was concerned, it came to know of actual loss/profit only on 15.5.2010 and not prior to that date. However, at the same time it could anticipate the loss on 31stMarch with reasonable accuracy, keeping in view the day to day fluctuation in the foreign currency rates and also that as prevailing on 31st march. The assessee-bank, accordingly, makes provision in its accounts on 31st March in line with the prudent commercial accounting principles, which requires that all accrued losses have to betaken into consideration on 31st March. Having considered the nature of contract, we will examine whether on account of existing obligation, a liability accrues as per I.T. provisions on 31st March or not. In order to find answer to this intricate issue, we have to keep in mind certain settled accounting propositions which have received judicial recognition. They can briefly be summed up as under:-*

(i) The income is to be accounted for only when right to receive the same has accrued in favour of a person thereby creating realizable debt in his favour. A legally enforceable right should have accrued in favour of assessee.

(ii) All the anticipated losses though not ascertainable with precise accuracy, which have accrued on the date of balance sheet, have to be accounted for as per prudent accounting policy.

(iii) Stock-in-trade is valued at the end of the previous year in accordance with the principle of matching in order to find out true profit/loss accruing to the assessee.

(iv) The method of accounting consistently followed by the assessee should not be discarded casually without giving strong reasons for the same. Merely because the assessing officer feels that other method of accounting would be better, the assessee's method of accounting cannot be rejected.

***43.** The assessee's contention is that this contract has to be revalued in accordance with FEDAI guidelines as notified by RBI and, therefore, the assessee had no option but to determine the profit/loss in regard to unmatured forward foreign exchange contracts in accordance with the currency rate prevailing on 31st March. Further, a binding obligation had also accrued against the assessee . Ld CIT D.R. has rightly submitted that this treatment in books of account per se does not give right to the assessee to claim the loss under Income tax Act. However, ld CIT D.R.'s contention needs to be examined having regard to fundamental commercial principles which have received judicial recognition. It is settled principle that deduction is allowable under the Income Tax Act in respect of those liabilities which crystalise during the previous year. Therefore, the concept of crystalisation of liability under Income Tax Act assumes significance vis-'-vis commercial principles in vogue. As per the commercial principles of policy of prudence, all anticipated liabilities have to be accounted for but as per I.T.Act, only that liability will be allowed which has actually accrued. As a matter of fact, Courts have time and again given due weightage to commercial principles in deciding such issues. However, those anticipated liabilities are not allowable which are contingent in nature but, if an anticipated liability is coupled with present obligation and only quantification can vary depending upon the terms of contract, then a liability is said to have crystalised on the balance sheet date. It is in conformity with the principles of prudence also. A contingent liability depends purely on the happening or not happening of an event whereas if an event has already taken place, which, in the present case, is of entering into the contract and undertaking of obligation to meet the liability, and only consequential effect of the same is to be determined, then, it cannot be said that it is in the nature of contingent liability*

***43.1** We have to bear in mind that the issues relating to accrual of income cannot be decided on the same footing and considerations on which the issues relating to loss/expense is to be decided. In case of loss/expense, it is the concept of reasonable certainty to meet an existing obligation which comes into play which in legal terminology is said to be 'crystalisation of liability'. When outflow of economic resources in settlement of present obligation can be anticipated with reasonable accuracy then it is to be recognized as crystalised liability. This is in consonance with the principle of prudence as considered by the Hon'ble Supreme Court in the case of Woodward Governor of India Pvt.Ltd. (supra). The revenue's main contention is that liability can arise only when the contract*

matures. This plea, in our humble opinion, is completely divorce of the principles of commercial accounting and, therefore, cannot be accepted. Both legal obligation and commercial principles have to be taken into consideration for deciding such issues.

44. *From the above discussion, it is evident that the anticipated losses on account of existing obligation as on 31st March, determinable with reasonable accuracy, being in the nature of expenditure/accrued liability, have to be taken into account while preparing financial statements. In this regard we may refer to the observations of Hon'ble Supreme Court in the case of Bharat Earth Movers, 245 ITR 428 (SC):*

> *"'.. The law is settled; if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain. 5. In Metal Box Co. of India Ltd. v. Their Workmen (1969) 73 ITR 53 (SC) the appellant company estimated its liability under two gratuity schemes framed by the company and the amount of liability was deducted from the gross receipts in the P&L a/c. The company had worked out on an actuarial valuation its estimated liability and made provision for such liability not all at once but spread over a number of years. The practice followed by the company was that every year the company worked out the additional liability incurred by it on the employees putting in every additional year of service. The gratuity was payable on the termination of an employee ' s service either due to retirement, death or termination of service--the exact time of occurrence of the latter two events being not determinable with exactitude beforehand. A few principles were laid down by this Court, the relevant of which for our purpose are extracted and reproduced as under : (i) For an assessee maintaining his accounts on mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid; (ii) Just as receipts, though not actual receipts but accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business; (iii) A condition subsequent, the fulfilment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability. (iv) A trader computing his taxable profits for a particular year may properly deduct not only the payments actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated. So is the view taken in Calcutta Co. Ltd. v. CIT (1959) 37 ITR 1 (SC) : TC 16R.197 wherein this court has held that the liability on the assessee having been imported, the liability would be an accrued liability and would not convert into a conditional one merely because the liability was to be discharged at a future date. There may be some difficulty in the estimation thereof but that would not convert the accrued liability into a conditional one; it was always open to the tax authorities concerned to arrive at a proper estimate of the liability having regard to all the circumstances of the case."*

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45. *One more aspect which needs to be discussed with reference to commercial accounting principles is with reference to the arguments of Ld CIT D.R. that no transaction has been recorded in the books of account before the date of maturity of contract and, therefore, there is no question of any liability accruing on 31st March. The elements of financial statement can be broadly divided into following five groups, viz; assets, liabilities, equity, income/gains & expenses/loss. These items are recognized in a financial statement if both the following criteria are met:*

(a) Future economic benefit will be there from the said events,

(b) The event can be measured in monetary terms.

In the present case, the assessing officer himself has observed in the assessment order that at the time of entering into the contract, the assessee has recorded the income/loss on the basis of difference between the contracted rate and the spot rate. Thus, to say that the contract was incapable of being recognized in the books of account, is not correct. The assessee recorded only the net effect of the transaction and not the entire transaction. Whether the deduction is allowable or not, therefore, cannot be guided by this factor.

46. *With regard to observations of the assessing officer regarding method of accounting, we may observe that it is well settled law that a method of accounting regularly employed by the assessee cannot be disregarded unless assessing officer is of the opinion that profits are not correctly deductible from such method of accounting as per the provisions of section 145(3) of the Act. The assessing officer cannot reject the method of accounting followed by the assessee merely on the ground that a better method of accounting could be the alternate one. However, in the present case, though observations have been made by the assessing officer to this effect but actual disallowance has been made by treating the impugned amount as contingent liability.*

47. *Now, we will consider the issue with reference to Accounting Standard -11 (AS-11). The Hon'ble Supreme Court in the case of Chellapali Sugar Mills, 98 ITR 167 and the Hon'ble Delhi High Court in the case of Woodward Governor of India P. Ltd.(supra)observed that the accounting standards issued by the Institute of Chartered Accountants of India required that accounting policies must be governed by the principle of prudence. Accounting Standards are prepared by ICAI keeping in view of the principle of prudence and this principle has received judicial recognition. In other words, provisions should be made for loan liabilities and losses even though the amount cannot be determined with certainty and represents only the basic estimate in the light of available information. The Accounting Standard issued by ICAI which are mandatory for preparation of financial statements and have to be followed inasmuch as the deviation from the same is to be reported in the audit report. Section 145(2) gives power to the Central Government to notify the accounting standards to be followed by any class of assesses or in respect of any class of income.*

48. *The Hon'ble Supreme Court in the case of Woodward Governor of India (P) Ltd.,((supra) has observed at page 265 para 17 that the Central Government has made AS-11 mandatory. Therefore, compliance with this has to be made.*

49. *We find that in AS-11 in paras 9 to 12, it has been observed as under:*

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"9. Exchange differences arising on foreign currency transactions should be recognized as income or as expense in the period in which they arise, except as stated in paras 10 and 11 below.

10. Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which are carried in terms of historical cost, should be adjusted in the carrying amount of the fixed assets. The carrying amount of such fixed assets should, to the extent not already so adjusted or otherwise accounted for, also be adjusted to account for any increase or decrease in the liability of the enterprise, as expressed in the reporting currency by applying the closing rate, for making payment towards the whole or a part of the cost of the assets or for repayment of the whole or a part of the monies borrowed by the enterprise from any person, directly or indirectly, in foreign currency specifically for the purpose of acquiring those assets.

11. The carrying amount of fixed assets which are carried in terms of revalued amounts should also be adjusted in the manner described in para 10 above. However, such adjustment should not result in the net book value of a class of revalued fixed assets exceeding the recoverable amount of assets of that class, the remaining amount of the increase in liability, if any, being debited to the revaluation reserve, or to the profit and loss statement in the event of inadequacy or absence of the revaluation reserve.

12. 12.An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, the entire exchange difference arises in that period. However, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period."

50. *Therefore, this Accounting Standard mandates that in a situation like in the present case, since the transaction is not settled in the same accounting period, the effect of exchange difference has to be recorded on 31st March. Ld CIT D.R. has rightly pointed out that the expenses required to be charged against revenue as per accounting standard do not ipso facto imply that the same are always deductible for Income-tax purposes but at the same time its relevance does not, in any manner, gets mitigated. The Hon'ble Supreme Court in the case of Woodward Governor of India (P) Ltd.,((supra) with reference to working capital loan, which was also repayable after the end of accounting period, has held that loss occurred to the assessee, on account of fluctuation in the rate of foreign exchange, as on the date of the balance sheet, is an item of expenditure u/s.28(i) of the I.T. Act. Hon'ble Supreme Court observes as under:-*

"Under section 28(i), one needs to decide the profits and gains of any business which is carried on by the assessee during the previous year. Therefore, one has to take into account stock-in-trade for determination of profits. The 1961 Act makes no provision with regard to valuation of stock. But the ordinary principle of commercial accounting requires that in the profit and loss account the value of the stock-in-trade at the beginning and at the end of the year should be entered at cost or market price, whichever is the lower. This is how business profits arising during the year need to be computed. This is one more reason for reading section 37(1) with

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section 145. For valuing the closing stock at the end of a particular year, the value prevailing on the last date is relevant. This is because profits/loss is embedded in the closing stock. While anticipated loss is taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into account, as no prudent trader would care to show increased profits before actual realization. This is the theory underlying the rule that closings stock is to be valued at cost or market price, whichever is the lower. As profits for income tax purposes are to be computed in accordance with ordinary principles of commercial accounting, unless such principles stand superseded or modified by legislative enactments, unrealized profits in the shape of appreciated value of goods remaining unsold at the end of the accounting year and carried over to the following year's account in a continuing business are not brought to the charge as a matter of practice, though, as stated above, loss due to fall in the price below cost is allowed even though such loss has not been realized actually."

Ld CIT D.R.'s submission is that this decision is with reference to monetary items as referred to in AS-11 and since forward foreign exchange contracts do not come within the monetary items, therefore, the said decision cannot be applied. However, we have already discussed in the concept of recognition of various events in financial statements and have noted that the assessee , in fact, has recorded net effect in its profit and loss account. Therefore, on this count, the department's plea cannot be accepted. Thus, in view of the decision of the Supreme Court in the case of Chellapali Sugar Mills (supra), and also in view of decision of the the Hon'ble Supreme Court in the case of Woodward Governor India (P)Ltd., (supra), assessee's plea deserves to be accepted.

***51.** Now, coming to the objection of ld CIT D.R. with reference to various decisions relied upon by ld counsel for the assessee on the ground that in the said decisions, the issue was relating to stock-in-trade but in the present case, there is no stock-in-trade. Admittedly, the assessee has not shown any closing stock of unmatured forward foreign exchange contracts as on balance sheet date and has only booked the profit and loss in that regard. There is no dispute that the foreign exchange currency held by the assessee bank is its stock-in-trade and as is evident from the hypothetical example considered earlier, the assessee had entered into forward foreign exchange contracts in order to protect its interest against the wide fluctuation in the foreign currency itself. Therefore, this contract was incidental to assessee's holding of the foreign currency as current asset. Therefore, in substance, it cannot be said that the forward contract had no trappings of the stock-in-trade. Ld counsel has rightly relied upon the decision of the Calcutta ITAT (SB) in the case of Shree Capital Services Limited (supra) in this regard and, therefore, the various decisions relied upon by ld counsel for the assessee as discussed in his submissions are applicable to the facts of the case.*

***52.** Now coming to the argument of ld CIT (DR) with reference to the decision in the case of Indian Overseas bank (supra), we find that the said decision was rendered with reference to taxing of notional profits and not with reference to anticipated losses, as is the case before us. The department is trying to draw analogy from the said decision but the said decision cannot be applied as the considerations are entirely different in regard to the issue relating to notional profits vis-'-vis anticipated losses. Profits are considered only when actual debt is created in favour of assessee but in case of anticipated losses, if an existing binding obligation, though dischargeable at a future date, is determinable with reasonable certainty, then the same is allowable.*

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53. *Ld CIT D.R. has also heavily relied on the decision of the Hon'ble Bombay High Court in the case of CIT v. Kamani Metals and Alloys Ltd. (supra). This decision, in our opinion, is of little help to the department inasmuch as the same has been rendered with reference to contract for purchase of raw material. The contracted price was more than the market price as the price went down and the material had not been received at the end of the accounting year. Under these facts, the Hon'ble High Court held that notional loss claimed by the assessee on the balance sheet date was not allowable because there was merely the contract to purchase the material at a future date. Neither any payment was made by the assessee nor any material was received. This case, in our opinion, cannot be applied to the facts of the present case as in the present case, we are concerned about the anticipated loss booked by the assessee on account of foreign exchange rate fluctuation as on balance sheet date, which was in accordance with RBI guidelines as well as in accordance with AS-11. Moreover, a binding obligation arose the minute the contract was entered into. However, now the decision of the Hon'ble Supreme Court in the case of Woodward Governor India P. Ltd. (supra) covers the issue on account of variation in foreign exchange rate with reference to current assets. The facts in the case of CIT v. Kamani Metals and Alloys Ltd. (supra) are more akin to such a situation where the assessee has simply ordered for purchase of material at a particular rate but the material has not been supplied by the seller by the end of the accounting period. No liability is accounted for in respect of such ordered goods because the basic elements of contract have not been fulfilled. In the present case, we have already observed that the forward contract is incidental to the foreign currency held by the assessee as stock-in-trade and, therefore, the decision in the case of CIT v. Kamani Metals and Alloys Ltd (supra) is clearly distinguishable on facts.*

54. *Ld CIT D.R. has also relied on the decision in the case of Eveready Industries (supra). The view expressed in the said decision also cannot be upheld in view of the decision of the Hon'ble Supreme Court in the case of Woodward Governor India P. Ltd (supra). The facts in the case of Indian Molasses' case(supra) are entirely different. The said decision proceeded on the premise that till the date of retirement of Managing Director, the assessee company itself had dominion over the sum paid through trustees and insurance society and there was no irrecoverable liability created. Thus, the impugned amounts were treated as part of profits set apart to meet a contingency by the assessee without any corresponding liability being there as the liability was only contingent in nature. There cannot be any quarrel with the proposition that the liability in praesenti is an allowable deduction but a liability in futuro, which for the time being is only contingent, is not allowable. As already pointed out this principle is to be applied keeping in view the principles of prudence and applicable Accounting Standards. In our opinion, the complete answer has been given long back by the Hon'ble Supreme Court in the case of Bharat Earth Movers Ltd, 245 ITR 428 (SC), wherein, it was held that the provision made by the assessee for meeting the liability incurred by it under the leave encashment scheme proportionate with the entitlement earned by the employees of the company was entitled to deduction out of the gross receipts of the accounting year in which the provisions were made.*

55. *Ld CIT D.R. has also relied on the decision of the Hon'ble Calcutta High Court in the case of Bestobell India Ltd ((supra), which decision has been considered in detail by the Hon'ble Delhi High Court in the case of Woodward Governor India (P)Ltd (supra), wherein, it has been observed as under:-*

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"The revenue relied upon the decision of the Calcutta High Court in Bestobell (India) Ltd.,(1979) 117 ITR 789 in support of the submission that the increased liability on repayment of a loan borrowed in foreign exchange for business purposes as a result of exchange rate fluctuation would be a capital loss and not a trading loss. What weighed with the Calcutta High Court there appears to be that there was no outflow of funds during the year, as has been urged by the revenue before us. However, a closer scrutiny of the said decision indicates that the Calcutta High Court in this case relied upon its earlier judgment in Sutlej Cottons Mills Ltd v CIT (1971) 81 ITR 641. It will be recalled that the Hon'ble Supreme Court in Sutlej Cotton Mills Ltd v CIT(1979) 116 ITR 1 reversed the aforesaid decision of the Calcutta High Court on this point and held that such liability would be treated as a trading loss. In that view of the matter, the reliance placed by the revenue on the judgment of the Calcutta High Court in Bestobell (India Ltd., (1979) 117 ITR 789 appears misplaced."

56. *The controversy stands now resolved in view of the decision of the Supreme Court in the case of Sutlej Cotton Mills Ltd., 116 ITR 1 (SC), wherein, it has been held that fluctuation on account of foreign exchange rate is an allowable deduction and is not capital in nature. The observation of the Hon'ble Supreme Court is as under:-*

"The law may, therefore, now be taken to be well settled that where profit or loss arises to an assessee on account of appreciation or depreciation in the value of foreign currency held by it, on conversion into another currency, such profit or loss would ordinarily be a trading profit or loss if the foreign currency is held by the assessee on revenue account or as a trading asset or as a part of circulating capital embarked in the business. But, if on the other hand, the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital nature(Emphasis, here italicized in print, supplied)"

57. *At the end we may further observe that when profits are being taxed by the department in respect of such unmatured forward foreign exchange contracts then there was no reason to disallow the loss as claimed by assessee in respect of same contracts on the same footing. In this regard, we may refer to the details furnished by assessee vide their letter dated August 05, 2010 to establish that the department has assessed the B ank in respect of the profit shown by the bank on restatement of outstanding forward foreign exchange contracts for A.Ys.2002-03 and 2003-04. There is no dispute on this count and, therefore, we refrain from referring the details.*

58. *In view of the above discussion, we allow the assessee's appeal for the following reasons:-*

(i) A binding obligation accrued against the assessee the minute it entered into forward foreign exchange contracts.

(ii) A consistent method of accounting followed by assessee cannot be disregarded only on the ground that a better method could be adopted.

(iii) The assessee has consistently followed the same method of accounting in regard to recognition of profit or loss both, in respect of forward foreign exchange contract as per the rate prevailing on March 31.

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(iv) A liability is said to have crystalised when a pending obligation on the balance sheet date is determinable with reasonable certainity. The considerations for accounting the income are entirely on different footing.

(v) As per AS-11, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period.

(vi) The forward foreign exchange contracts have all the trappings of stock-in-trade.

(vii) In view of the decision of Hon'ble Supreme Court in the case of Woodward Governor India (I) P.Ltd., the assessee's claim is allowable.

(viii) In the ultimate analysis, there is no revenue effect and it is only the timing of taxation of loss/profit.

***59.** We, accordingly, hold that where a forward contract is entered into by the assessee to sell the foreign currency at an agreed price at a future date falling beyond the last date of accounting period, the loss is incurred to the assessee on account of evaluation of the contract on the last date of the accounting period i.e. before the date of maturity of the forward contract."*

The transaction in derivatives in foreign currency as entered into by the assessee company are similar to forward contract in foreign currency as discussed in the decision of Bank of Bahrain and Kuwait(supra). Respectfully following the decision of Tribunal, Special Bench , Mumbai in Bank of Bahrain and Kuwait (supra) we hold that the marked to market losses of Rs.1,09,98,560/- determined by the assessee company due to the movement in the prevailing exchange rate of foreign currency i.e. United States Dollar vis-à-vis in relation to Indian Rupee as on the date of Balance Sheet viz 31st March 2009 is not a notional or contingent loss rather it is an ascertained liability which has crystallized whereby a pending obligation of derivative contract on the balance sheet date i.e 31st March 2009 is determinable with reasonable certainty and accuracy . The Accounting Standard-11 prescribed by ICAI also stipulate that in situation like this when the

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derivative transaction in foreign currency has not been settled/squared during the accounting period , the effect of exchange rate difference on the un-expired foreign currency contracts as at the end of accounting period is to be accounted for in the books of accounts prepared for the afore-stated accounting period. The reliance of the DR on instruction no 17/2008 dated 26th November 2008 is misconceived as in the instant case under appeal it is not a contingent or notional liability rather it is an ascertained liability which has crystallized and can be determined with reasonable certainty based upon the adverse exchange rate prevailing between United States Dollars vis-à-vis in relation to Indian Rupees as on the date of Balance Sheet as at 31st March 2009. Hence , We hold that the said loss of Rs.1,09,98,560/- incurred by the assesee company on account of marked to market loss arising on the date of Balance Sheet as at 31st March 2009 on account of un-expired derivative transactions in foreign currency entered by the assessee company arising due to the adverse movement in the exchange rate prevailing between United State Dollar vis-à-vis in relation to Indian Rupee as on the date of Balance Sheet as at 31st March 2009 can not be considered as notional or contingent loss rather it is an ascertained loss which has already occurred during the assessment year which can be computed with reasonable certainty and accuracy and is a fait accompli as held in ONGC v. DCIT 261 ITR 1 –Delhi ITAT.

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9. Thus in view of our above foregoing discussions, we allow the appeal of the assessee company on following reasons:-

1 That the assessee company has entered into derivative transactions in foreign currency through recognised stock exchange and has complied with the other conditions as stipulated in Section 43(5) read with proviso(d) and explanation 1 to the said Section 43(5) of the Act for which cogent material is brought on record.

2. That the contract for derivatives in foreign currency are commodity as defined u/s 43(5) of the Act , the underlying asset being foreign currency and are hence entitled for exemption from being treated as speculative provided all other conditions as stipulated u/s 43(5) are complied with.

3. A binding obligation accrued against the assessee the minute it entered into contract for derivative in foreign currency

4. A liability is said to have crystallized when a pending obligation on the balance sheet date is determinable with reasonable certainty. The considerations for accounting the income are entirely on different footing.

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5. As per AS-11, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period.

6. The contract for derivative in foreign currency have all the trappings of stock-in-trade.

7 In the ultimate analysis, there is no revenue effect and it is only the timing of taxation of loss/profit and in case the derivative contract is squared off/settled in the succeeding year, the difference in loss/profit will be brought to tax in the succeeding assessment year and hence its allowability in the current year is tax neutral.

Hence, We order that loss of Rs.1,09,98,560/- incurred by the assessee company on the contract for transaction in un-expired contracts as on the date of Balance Sheet as at 31st March 2009 in derivatives in foreign currency complies with the provisions of Section 43(5) of the Act read with proviso (d) and explanation 1 of the Section 43(5) of the Act and is exempt to be categorised as speculation loss and further hold that the said loss as at the date of financial statement as at 31st March 2009 arising due to adverse movement in exchange rate between United States Dollars vis-a-vis in relation to Indian Rupee as on the date of Balance Sheet as at 31st

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March 2009 is not a notional or contingent loss rather it is a ascertained liability which has crystallized on the date of Balance Sheet as at 31st March 2009 and can be computed with reasonable certainty and accuracy, hence allowable as non-speculation loss.We order accordingly.

10. Insofar as, ground no. B is concerned. We observe that assessee company has paid Rs. 10,31,096/- towards stamp duty and fee to Ministry of Corporate Affairs, New Delhi towards increase in authorized capital of the assessee company which was held to be capital expenditure and disallowed as revenue expenditure as claimed by the assessee company by the authorities below . We have observed that Hon'ble Supreme Court in the case of **Brooke Bond India Ltd. v. CIT** (Supra) and **Punjab State Ind. Corp. Ltd. v. CIT** (supra) has clearly held that these stamp duties/fees to Ministry of Corporate Affairs , GOI paid towards the increase in authorized capital of the company is held to be for expansion of capital base of the company and hence these are capital expenditure and cannot be allowed. Respectfully following the above decisions of the Hon'ble Supreme Court, we uphold the orders of assessing officer as confirmed by the CIT(A) and decide this issue against the assessee company and in favour of the Revenue by holding that payment of Rs. 10,31,096/- by assessee company towards stamp duty and fee to Ministry of Corporate Affairs, New Delhi towards increase in authorized capital of the assessee company is capital

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expenditure and disallowed as revenue expenditure as claimed by the assessee company . We order accordingly.

11. In the result appeal of the assessee company is partly allowed.

Order pronounced in the open court on this 21st day of October 2015.

Sd/-	Sd/-
(Joginder Singh)	(Ramit Kochar)
न्यायिक सदस्य / JUDICIAL MEMBER	**लेखा सदस्य** / ACCOUNTANT MEMBER

मुंबई Mumbai; दिनांक Dated : 21./10/2015

S.K.S., *Sr.P.S/.*नि.स.

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT, Mumbai.
4. आयकर आयुक्त / CIT(A)- , Mumbai
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

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उप/सहायक पंजीकार (Dy./Asst. Registrar)
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