IN THE INCOME TAX APPELLATE TRIBUNAL

"D" BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY, JUDICIAL MEMBER AND

SHRI N.K. PRADHAN, ACCOUNTANT MEMBER

ITA no.220/Mum./2015
(Assessment Year : 2011–12)

Income Tax Officer
Tower no.6, Room no.419
Vashi Railway Station Complex
Vashi, Navi Mumbai 400 703 ……. Appellant

v/s

M/s. Radium Creation
C–32, MIDC TTC Indl. Area
Pawane, Navi Mumbai 400 705
PAN – AAFFR9494N ……. Respondent

ITA no.1161/Mum./2015
(Assessment Year : 2010–11)

M/s. Radium Creation
(Now Radium Creation Ltd.)
C–32, MIDC TTC Indl. Area
Pawane, Navi Mumbai 400 705
PAN – AAFFR9494N ……. Appellant

v/s

Income Tax Officer
Tower no.6, Room no.419
Vashi Railway Station Complex
Vashi, Navi Mumbai 400 703 ……. Respondent

Revenue by : Shri Goli Srinivas Rao
Assessee by : Shri Jitendra Jain

Date of Hearing – 18.08.2016

Date of Order – 16.09.2016

O R D E R

PER SAKTIJIT DEY, J.M.

Aforesaid appeals by the Revenue and assessee pertain to assessment years 2010–11 and 2011–12.

ITA no.220/Mum./2015 – Revenue's Appeal

2. This is an appeal by the Department against the order dated 14th October 2014, passed by the learned Commissioner (Appeals)–33, Mumbai, for the assessment year 2011–12. The effective grounds raised by the Department are as under:–

> *1. On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals) erred in deleting the addition of ₹ 6,94,985 made by the Assessing Officer under section 40(a)(ia) of the Act.*
>
> *2. On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals) erred in deleting the addition of ₹ 42,25,000 made by the Assessing Officer on account of unrealized gain on outstanding forward contracts.*
>
> *3. On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals) erred in holding that the unrealized gain on forward contract is in the nature of profit and gain from business and the entire profit and gain from export is eligible for deduction under section 10B of the Act."*

2. As far as ground no.1 is concerned, brief facts are, the assessee a partnership firm is engaged in the business of manufacturing and export of artificial jewellery. For the assessment year under consideration, the assessee filed its return of income on 29th

September 2011, declaring total income of ₹ 14,31,222. During the assessment proceedings, the Assessing Officer noticed that the assessee had paid interest of ₹ 6,94,985 to Kotak Mahindra Prime Ltd., on the finance received for purchase of machinery. However, the assessee had not deducted tax at source while making such payment. He, therefore, called upon the assessee to explain why payment made should not be disallowed under section 40(a)(ia) for non–deduction of tax at source. Though, the assessee objected to the proposed disallowance by stating that the amount has already been paid during the relevant previous year and nothing remained payable, however, the Assessing Officer disallowed the expenditure by invoking provisions of section 40(a)(ia) of the Act after rejecting the explanation of the assessee. The assessee challenged the disallowance by preferring appeal before the learned Commissioner (Appeals).

3. The learned Commissioner (Appeals), after considering the submissions of the assessee in the context of facts and material on record observed that the assessee being a 100% export oriented unit, the profit from business is eligible for deduction under section 10B. He observed, the disallowance made under section 40(a)(ia) will only increase the business profit derived from the export oriented unit which would again be eligible for deduction under section 10B. He, therefore, directed the Assessing Officer to allow deduction under

section 10B on the enhanced income on account of disallowance under section 40(a)(ia).

4. The learned Departmental Representative relied upon the observations of the Assessing Officer and the first appellate authority.

5. The learned Authorised Representative on the other hand, supported the order of the learned Commissioner (Appeals).

6. We have considered the submissions of the parties and perused the material available on record. At the outset, we must observe that the ground raised by the Department, strictly speaking, does not arise out of the order passed by the learned Commissioner (Appeals) as he has not deleted the disallowance made by the Assessing Officer under section 40(a)(ia) of the Act. Be that as it may, reverting back to the observations of the learned Commissioner (Appeals), it needs to be observed that the Hon'ble Jurisdictional High Court in CIT v/s Gem Plus Jewellery India Pvt. Ltd, 330 ITR 175 (Bom.), has held that any statutory disallowance made of deduction claimed by the assessee only goes to enhance the profit of the assessee, therefore, would be eligible to avail benefit under the provisions of section 10A / 10B. Thus, applying the said principle, the disallowance made under section 40(a)(ia) only enhance the business profit of the assessee which is otherwise eligible for exemption under section 10B. In the aforesaid

view of the matter, we do not find any infirmity in the order of the learned Commissioner (Appeals). The ground no.1, is dismissed.

7. In grounds no.2 and 3, the Revenue has raised the issue relating to relief granted by the learned Commissioner (Appeals) in respect of addition made by the Assessing Officer on account of unrealised gain on outstanding forward contracts.

8. Brief facts are, during the assessment proceedings, the Assessing Officer while verifying the financial statement of the assessee noticed that during the relevant previous year, the assessee has accounted for ₹ 56,56,222 as foreign exchange contract gain. However, in the computation of income, the assessee has reduced an amount of ₹ 42,25,000 from the total income on account of unrealised forward exchange contract gain. The Assessing Officer, therefore, called upon the assessee to explain the reason for excluding unrealised forward foreign exchange contract gin of ₹ 42,25,000 from the total income when the assessee is following mercantile system of accounting. In response to the query raised by the Assessing Officer, it was submitted by the assessee that it has passed entries in the books of account for profit on un–matured forward contract on the basis of rates notified by the foreign exchange dealers association. It was submitted, in such case, entries in the books of account merely represent hypothetical

income. Further, income from unsettled contract will fall in the category of contingent income. Assessee submitted, even though the profit have been booked by adopting exclusive value of a foreign exchange contract with the foreign exchange rate on the last date of accounting year, if it is unsettled it is only in the class of contingent income, hence, not taxable. In support of its claim, assessee relied upon some judicial precedents also. After considering the submissions of the assessee, the Assessing Officer, however, did not find merit in the same. He added back the unrealised foreign exchange gain of ₹ 42,25,000 to the income of the assessee holding that the exchange difference arising on foreign currency transactions should be recognised as income in the period in which it arises. The assessee challenged the addition in appeal preferred before the learned Commissioner (Appeals). In the course of hearing before the first appellate authority, contention of the assessee was twofold. It was submitted by the assessee, the unrealised gain was neither actually received nor it has any right to receive. It is merely a contingent income not necessarily receivable by the assessee. Thus, it is a mere book entry which will not create any taxable income to the assessee. It was submitted under the Act only the real income can be taxed and not any notional income. The assessee referring to CBDT circular no.3 dated 23rd March 2010 submitted, in a case where no sale has actually

taken place and gain on mark to market has resulted in increase in book profit, then such gain on marked to market would be a notional gain and cannot be subject to tax. The assessee further submitted, it has been following the same accounting policy of excluding the unrealised gain / loss as taxable / deductible over the years and the department has accepted it. Therefore, no addition should be made in the impugned assessment year. The second contention of the assessee was, the assessee is engaged in manufacturing and export of artificial jewellery. Due to wide fluctuation in currency, the assessee enters into forward contract to hedge its current currency. It was contended that the forward contract entered into has a direct nexus with goods exported by the assessee and amount receivable from its debtors. Thus, the unrealised gain of forward contract is in the nature of business income and will form part of profits and gains of the business, hence, eligible for exemption under section 10B.

9. The learned Commissioner (Appeals) after considering the submissions of the assessee observed that the addition made by the Assessing Officer of unrealised gain as per the prudent accounting practice is not recognised as income at the year end by making enhancement since AS–11 does not permit upward revision on prudential norms. He observed, even otherwise also, the unrealised foreign exchange gain is directly relatable to business profit which is

eligible for deduction under section 10B. He accordingly directed the Assessing Officer to allow exemption under section 10B on the income increased on account of addition made of unrealised foreign exchange gain.

10. Having considered the submissions of the parties and perused the material on record, we do not find any infirmity in the order of the learned Commissioner (Appeals) as far as it relates to his direction to the Assessing Officer to allow exemption under section 10B on the income increased on account of addition of unrealised foreign exchange gain. As could be seen, the forward foreign exchange contract has been entered into by the assessee for the purpose of its export business. Therefore, any gain arising out of such contract has a direct nexus with the business activity of the assessee thereby constitute a part of the business income of the assessee. That being the case, applying the ratio laid down by the Hon'ble Jurisdictional High Court in Gem Plus Jewellery (supra), we uphold the decision of the learned Commissioner (Appeals) for allowing exemption under section 10B of the Act, on the increased income on account of addition of unrealised foreign exchange gain. In view of our aforesaid decision, we refrain from deciding the issue as to whether the unrealised gain from unexpired forward foreign exchange contract can at all be considered as income. However, it is open for both the parties to

agitate the issue in an appropriate case in future. Thus, grounds no.2 and 3 are dismissed.

11. In the result, Department's appeal stands dismissed.

ITA no.1161/Mum./2015

12. In this appeal, the assessee has challenged the order passed by the learned Commissioner under section 263 of the Income Tax Act, 1961 (for short *"the Act"*) setting aside the assessment order passed under section 143(3) for the assessment year 2011–12.

13. Brief facts are, as stated earlier, assessee is engaged in the business of manufacturing and export of artificial jewellery. For the assessment year under consideration assessee filed its return of income on 8th October 2010, declaring total income of ₹ 60,51,184. The assessment in assessee's case was completed under section 143(3) vide order dated 28th February 2013 by determining the total income at ₹ 60,65,127. The learned Commissioner in exercise of power under section 263, called for and examined the assessment record pertaining to the assessee for the impugned assessment year and after verifying the same, he found that the assessee has accounted an amount of ₹ 69,62,240 as forward exchange contract gain, however, in the computation of income, assessee has reduced an amount of ₹

9,11,056 from such forward exchange contract gain. The learned Commissioner observed, as the assessee is following mercantile system of accounting, as per the Accounting Standard, if the transaction is not settled in the same period, then the effect of exchange itself has to be recorded on 31st March. The learned Commissioner observed by reducing the amount of ₹ 9,11,056 from the total income, the assessee deviated from the accounting principle which is not allowable as per the provisions of the Act. Observing that the Assessing Officer during the assessment proceedings has not examined this aspect nor investigated into the matter properly, he was of the view that the assessment order passed is erroneous and prejudicial to the interest of revenue. Accordingly, he issued a show cause notice to the assessee to explain why the assessment order should not be revised. In response to the said notice, the assessee, though, vehemently objected to the exercise of power under section 263 and stated that it has accounted exchange rate difference on outstanding forward contract as per AS–11 and in this regard also drew attention to CBDT instruction no.3 of 2010 dated 23rd March 2010, however, the learned Commissioner rejecting the objections of the assessee held that as the Assessing Officer has passed the assessment order without verifying the facts, such order is erroneous and prejudicial to the interests of revenue. The learned Commissioner

observed that in the assessment order, the Assessing Officer has not recorded any finding on the issue and also the fact whether he examined the issue in the context of CBDT instruction. The learned Commissioner observed, when the Assessing Officer has made similar addition in assessment year 2011–12 on account of unrealised exchange gain failure to make such addition in the impugned assessment year shows that the Assessing Officer has failed to examine the issue in detail. Accordingly, he set aside the assessment order with a direction to the Assessing Officer to examine the issue in detail.

14. The learned Authorised Representative challenging the order passed under section 263, submitted that the learned Commissioner has no jurisdiction to exercise power under section 263 as basic condition of the said provisions are not fulfilled. He submitted, the assessment order passed cannot be considered to be either erroneous or prejudicial to revise it under section 263. Referring to the computation of income filed for the impugned assessment year, the learned Authorised Representative submitted, the assessee has offered forward exchange contract gain of ₹ 60,51,184. The learned Authorised Representative submitted, in the financial statements also, the assessee has disclosed full particulars of the forward foreign exchange contract gain. During the assessment proceedings, the

Assessing Officer enquired into the matter by raising queries and calling for necessary details from the assessee. The learned Authorised Representative submitted, in response to the query raised the assessee also furnished all necessary and relevant details relating to foreign exchange contract gain. In this context, he drew the attention of the bench to letter dated 28th January 2013, submitted before the Assessing Officer during the assessment proceedings as well as the other details submitted before the Assessing Officer in respect of forward foreign exchange contract and gain received therefrom. The learned Authorised Representative submitted, in the course of assessment proceedings, the Assessing Officer has not only enquired into the matter relating to forward foreign exchange contract gain but has also examined the materials on record thoroughly while completing the assessment. He submitted, only because there is no discussion in the assessment order, it will not lead to the conclusion that the Assessing Officer has not examined the issue. Learned Authorised Representative submitted, in fact, during the assessment proceedings, the assessee specifically brought instruction no.3 of 2000 dated 23rd March 2010 to the notice of the Assessing Officer which is nothing but a direction to the Assessing Officer on the issue of foreign exchange contract gain / loss. He submitted, unrealised gain from

foreign exchange forward contract being a notional income is not taxable. In this context, he relied upon the following decisions:–

i) Indian Overseas Bank v/s CIT, [2002] 250 ITR 146 (Mad.);
ii) Indian Overseas Bank v/s CIT, [990] 183 ITR 200 (Mad.);
iii) Indian Overseas Bank Ltd. v/s CIT, [2002] 246 ITR 206 (Mad.);
iv) CIT v/s Wipro Finance Ltd. [2013] 351 ITR 153; and
v) CIT vs. Woodward Governor India (P) Ltd. [1992] 312 ITR 254 (SC).

15. The learned Authorised Representative submitted, as the unrealised gain being a notional income is not taxable, the assessment order cannot be held to be erroneous for not bringing to tax the unrealised foreign exchange gain. In this context, he relied upon the decision of the Hon'ble Supreme Court in UCO Bank v/s CIT, [1991] 237 ITR 889 (SC). Further, he submitted, there is also no prejudice caused to the Revenue as even in the event of addition of the amount of ₹ 9,11,056, to the income of the assessee there will be no tax implication as the assessee would be eligible for exemption under section 10B of the Act on such enhanced income. Therefore, the conditions of section 263 are not satisfied. Learned Authorised Representative submitted, the Assessing Officer having examined the issue and accepted assessee’s claim only because it is not reflected in the assessment order for that reason alone the assessment order cannot be held to be erroneous or prejudicial to the interest of revenue unless it is established on record that the Assessing Officer has not

made any enquiry at all. For such proposition, learned Authorised Representative relied upon the following decisions:–

i) CIT v/s Fine Jewellery India Ltd., [2015] 372 ITR 303; and

ii) CIT v/s Nirab Mody, [2016] 138 TTR 81 (Bom.)

16. Learned Departmental Representative relied upon the observations of the learned Commissioner.

17. We have considered the submissions of the parties and perused the material available on record. It is well settled principle of law that power under section 263 of the Act can be exercised on fulfillment of two conditions viz. the order sought to be revised must be erroneous and secondly it must be prejudicial to the interests of Revenue. Both these conditions have to be fulfilled cumulatively for exercising jurisdiction under section 263 of the Act. Keeping in view the aforesaid legal position, we have to examine the issue at hand. As could be seen, the issue in dispute involving the exercise of power under section 263 is taxability of unrealised forward exchange contract gain of ₹ 9,11,056. As could be seen from the computation of income filed along with the return of income for assessment year 2010–11 during the relevant previous year it has shown total forward exchange contract gain of ₹ 69,62,240 and after reducing therefrom unrealised forward exchange contract gain of ₹ 9,11,056 has shown net forward

exchange contract gain of ₹ 60,51,184. As per the material on record, it is evident that during the assessment proceedings, the Assessing Officer has enquired into the issue of forward exchange contract gain and in response to the query raised the assessee had not only submitted his explanation in letter dated 28th January 2013, but has also submitted all necessary and relevant details relating to the forward foreign exchange contract gain. On a perusal of assessee's reply, it is observed, the assessee has specifically stated that the amount of ₹ 9,11,056 being unrealised gain for outstanding / pending contract though, is accounted under the head *"Foreign Exchange Contract Gain"* but is excluded while computing the taxable income for the year under consideration. Thus, from the aforesaid facts, it is very much evident that during the assessment proceedings, the Assessing Officer has enquired into the issue of foreign exchange contract gain and after examining the information and details submitted by the assessee has completed the assessment. That being the case, only because there is no discussion by the Assessing Officer in the assessment order on the issue, it cannot be said that there is a lack of enquiry by the Assessing Officer. On the contrary, the Assessing Officer after verifying the details along with the assessee's explanation having found the claim allowable it was not necessary for him to discuss the issue again in the assessment order. Moreover, the view

taken by the Assessing Officer in allowing assessee's claim cannot be considered to be a totally illegal or impossible view. That being the case, the assessment order cannot be held to be erroneous. As far as the other condition of *"prejudicial to the interests of Revenue"* is concerned, undisputedly, the assessee is a 100% export oriented unit and the profit derived by it is exempt under section 10B. Therefore, even assuming that the unrealised foreign exchange gain of ₹ 9,11,056 is taxable at the hands of the assessee it will only result in enhancing the business profit of the assessee as the forward foreign exchange gain has a direct nexus with the assessee's manufacturing and export activities. In that event also, the assessee would be eligible for exemption under section 10B, on the income enhanced by virtue of addition of unrealised foreign exchange gain. Therefore, there will be no prejudice caused to the Revenue. Thus, in view of the aforesaid facts, the assessment order passed by the Assessing Officer cannot be considered to be either erroneous or prejudicial to the interest of Revenue. That being the case, the exercise of jurisdiction under section 263 by the learned Commissioner in the instant case is not proper and valid. Accordingly, we set aside the impugned order passed by the learned Commissioner under section 263 of the Act and restore the order of the Assessing Officer.

18. In the result, Revenue's appeal is dismissed and assessee's appeal stands allowed.

Order pronounced in the open Court on 16.09.2016

Sd/-	**Sd/-**
N.K. PRADHAN	**SAKTIJIT DEY**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

MUMBAI, DATED: 16.09.2016

Copy of the order forwarded to:

(1) The Assessee;

(2) The Revenue;

(3) The CIT(A);

(4) The CIT, Mumbai City concerned;

(5) The DR, ITAT, Mumbai;

(6) Guard file.

True Copy
By Order

Pradeep J. Chowdhury
Sr. Private Secretary

(Dy./Asstt. Registrar)
ITAT, Mumbai