IN THE INCOME TAX APPELLATE TRIBUNAL,
BANGALORE BENCH 'A'

BEFORE SHRI N.V VASUDEVAN, JUDICIAL MEMBER
AND
SHRI A.K GARODIA, ACCOUNTANT MEMBER

IT(TP)A Nos.1431 & 1415/Bang/2013
(Asst. Year – 2008-09)

Toshiba Embedded Software (India)
Pvt. Ltd.,
Bengaluru. . Appellant
PAN – AAGCS4693C
Vs.
The Dy. Commissioner of Income-tax,
Circle-12(4),
Bengaluru. . Respondent

Appellant by : Shri K.R Vasudevan, Advocate
Respondent by : Shri B.R Ramesh, JCIT

Date of Hearing : 27-03-2018
Date of Pronouncement : 06-04-2018

O R D E R

PER SHRI N.V VASUDEVAN, JUDICIAL MEMBER :

IT(TP)A.No.1415/Bang/2013 is an appeal by the Revenue, while IT(TP)A.No.1431/Bang/13 is an appeal by the Assessee. Both the appeals are directed against the order dated 16.7.2013 of CIT(A)-III, Bangalore, relating to AY 2008-09.

2. In the appeal by the Revenue, the only issue that arises for consideration is as to whether the CIT(A) was justified in directing the AO to exclude from the export turnover

and total turnover reimbursement of telecommunication expenses and Insurance expenses incurred in foreign currency while computing deduction u/s.10A of the Act.

3. The Assessee is a company engaged in the business of development of computer software and is eligible for deduction u/s.10A of the Income Tax Act, 1961 (Act) on profits and gains as are derived from the export of computer software. Sec.10A(4) provides the methodology of computation of deduction u/s.10A of the Act and it lays down that the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking. Export turnover has been defined under Explanation 2 (iv) to Sec.10A as:

> *"export turnover" means the consideration in respect of export by the undertaking of articles or things or computer software received in, or brought into, India by the assessee in convertible foreign exchange in accordance with sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India."*

4. The AO noticed that while computing export turnover for the purpose of deduction u/s.10A, the Assessee had included a sum of Rs.91,25,480/- being telecommunication expenses and Rs.8,07,429 being Insurance expenses. Both the aforesaid expenses had been incurred in foreign currency. The AO therefore excluded the aforesaid sum from the export turnover without excluding them from the total turnover. As a result, the deduction claimed u/s.10A of the Act by the Assessee was allowed at a lesser sum than what was claimed by the Assessee.

5. It was the plea of the Assessee in the appeal against the assessment order before the *CIT(A)* that at all times during the relevant previous year, it was engaged in development of computer software and not in rendering any technical services. Communication

expenses were incurred not for export of computer software outside India and therefore the exclusion from export turnover as done by the AO was not correct . Without prejudice to its contention that the aforesaid sums should not be excluded from the export turnover while computing deduction u/s.10A of the Act, the Assessee has also made an alternate prayer that expenses that are reduced from the export turnover should also be reduced from the total turnover and in this regard has placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)* wherein it was held that while computing deduction u/s.10A of the Act expenses that are reduced from the export turnover should also be reduced from the total turnover.

6. The CIT(A) accepted the alternate prayer of the Assessee and directed that the expenses reduced from the export turnover should also be reduced from the total turnover. As a result, the deduction as claimed by the Assessee u/s.10A of the Act stood allowed. Aggrieved by the relief allowed by the CIT(A), the revenue has preferred the present appeal before the Tribunal.

7. We have heard the ld. counsel for the assessee who relied on the order of the CIT(A) and the ld. DR who relied on the order of the CIT(A). Taking into consideration the decision rendered by the Hon'ble High Court of Karnataka in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*, we are of the view that the order of the CIT(A) directing the Assessing Officer to exclude communication charges and travelling and conveyance expenses both from export turnover and total turnover, is just and proper and calls for no interference. The only grievance of the Revenue is that the decision of Hon'ble High Court of Karnataka in *Tata Elxsi (supra)* has not attained finality and a SLP by the department is pending before the Hon'ble Supreme Court. We are of the view that as of today, law declared by the Hon'ble High Court of Karnataka which is the jurisdictional High Court is binding on us. We therefore hold that the order of CIT(A) does not call for any interference and accordingly the same is confirmed.

8. In the result, the appeal by the revenue is dismissed.

9. As far as the appeal by the Assessee is concerned, there are two issues that arise for consideration. The first issue is as to whether the CIT(A) was justified in excluding interest income derived from fixed deposits from “income from business” while computing deduction u/s.10A of the Act. As far as this issue is considered the Tribunal in Assessee’s own case in AY 2011-12 in ITA No.1717/Bang/2017 order dated 2.3.2018, on identical issue held that interest income arose from fixed deposits that were made out of profits generated from export business and therefore the Assessee was entitled to deduction u/s.10A of the Act on interest income treating the same as part of business income. The finding in that year was that the source of fixed deposit was export realization and advances received in the normal course of business. In fact for AY 2010-11 also the tribunal in ITA No.748/Bang/2016 taken the same view in Assessee’s own case and the appeal against that order of the Tribunal was dismissed by the Hon’ble Karnataka High Court in ITA No.761/2017 order dated 23.1.2018. We are of the view that the source of fixed deposit has to be examined in this AY and since this exercise has not been done by the revenue authorities, we deem it fit to remand the issue to the AO for fresh consideration in the light of the decisions of the Tribunal referred to above.

10. The second issue that arises for consideration in this appeal by the Assessee is as to whether the revenue authorities were justified in not allowing the claim for deduction of loss on account of foreign exchange fluctuation as on the last date of the previous year on the ground that the loss in question was only contingent and hence cannot be allowed. On this issue the admitted factual position is that the Assessee entered into forward contracts in foreign exchange currency to safe guard against earnings from export on account of exchange fluctuation. The export earnings of the Assessee are received in foreign exchange currency. As a result of fluctuation in exchange rate of foreign currency, the Assessee might receive something less or more than the price at which it had exported its software. To safeguard against adverse fluctuation in foreign exchange and consequent loss, the Assessee entered into forward contracts in foreign exchange. As on the last date of the relevant previous year, the forward contract was subsisting and was

not settled. The Assessee as on the last date of the relevant previous year noticed that there was a fluctuation in the foreign exchange rates and consequently as on that date there would be a loss on account of forward contract in foreign exchange and claimed the said loss as a deduction while computing income from business. The AO held that the loss was speculative in nature and cannot be allowed as a deduction. On appeal by the Assessee, the CIT(A) held that the loss is notional and cannot be allowed as a deduction. Aggrieved by the order of the CIT(A), the Assessee is in appeal before the Tribunal.

11. We have heard the rival submissions. The learned DR relied on the order of the CIT(A). The learned counsel for the Assessee reiterated stand of the Assessee as was put forth before the Revenue authorities. He relied on several judicial pronouncements in support of his claim. In particular it was submitted that identical issue was decided by the ITAT Bangalore Benches in the case of Quality Engineering & Software Technologies (P) Ltd. Vs. DCIT (2014) 52 taxmann.com 515 (Bangalore-Tribunal) in favour of the Assessee.

12. We have carefully considered the rival submissions. The facts of the present case is that the Assessee entered into forward contracts in foreign exchange currency to safe guard against earnings from export on account of exchange fluctuation. The export earnings of the Assessee are received in foreign exchange currency. As a result of fluctuation in exchange rate of foreign currency, the Assessee might receive something less or more than the price at which it had exported its software. To safeguard against adverse fluctuation in foreign exchange and consequent loss, the Assessee entered into forward contracts in foreign exchange. As on the last date of the relevant previous year, the forward contract was subsisting and was not settled. The Assessee as on the last date of the relevant previous year noticed that there was a fluctuation in the foreign exchange rates and consequently as on that date there would be a loss on account of forward contract in foreign exchange and claimed the said loss as a deduction while computing income from business. The AO held that the loss was speculative in nature and cannot be

allowed as a deduction. On appeal by the Assessee, the CIT(A) held that the loss is notional and cannot be allowed as a deduction.

13. In the case of Quality Engineering & Software Technologies (P) Ltd., (Supra), the facts were The assessee-company engaged in the business of providing computer aided engineering analysis and software services. It is filed its return and claimed provision for loss on derivative contracts. The Assessee claimed loss on account of fluctuation in foreign exchange as deduction in computing income from business. The assessee contended that in order to hedge against foreign exchange fluctuations and to limit the diminution in the value of export proceeds on services provided to overseas customers, the assessee entered into forward contracts. The AO disallowed the claim for deduction made by the Assessee on the ground that the loss reported was not on account of re-statement of existing liabilities and assets. Future sales were uncertain and hedging such future sales through forward contracts was purely a speculative transaction. Loss not arising out of regular business transactions and also not on account of re-statement of assets and liabilities was only speculative loss and could not be allowed as expenditure. On appeal, the Commissioner (Appeals) upheld the decision of the Assessing Officer. On second appeal, the ITAT held that it was not in dispute that the forward contracts have been entered into by the assessee in order to protect its interest against fluctuations in foreign currency, in respect of consideration for export proceeds, which is a revenue item. Therefore, in sum and substance, it has the trappings of stock-in-trade and the assessee has to restate or revalue the same as on the balance sheet date. The consequent effect of this accounting treatment was to recognize the exchange fluctuation gain or loss in the profit and loss account as on the valuation date. In view of the facts and circumstances of the case, the appeal of the assessee on this issue, succeeds for the following reasons:

- A binding obligation accrued against the assessee when it entered into foreign exchange forward contracts;

- The forward contracts are in respect of consideration for export proceeds, which are revenue items;

- The liability is determinable with reasonable certainty when an obligation is pending on the balance sheet date and such a liability cannot be said to be a contingent liability.
- The accounting treatment is as per Accounting Standards and the ICAI Guidelines.

- The principles enunciated by the Apex Court in the case of CIT Vs. Woodward Governor India (P.) Ltd. [2009] 312 ITR 254/179 taxman 326/312 ITR 254 are applicable to the facts of the case on hand.

14. The Tribunal held that a contract has been concluded and a liability has crystallized. In this factual matrix, from the wordings of the Instruction of CBDT, it follows that the loss arising out of the forward contract is not notional. In such a case, the CBDT Instruction requires the Assessing Officer to examine whether such a loss is on account of a speculative transaction as contemplated in section 43(5). As discussed earlier, in the case on hand there has been an existing contract with a binding obligation accrued against the assessee when it entered into for ex forward contracts. The forward contracts are in respect of consideration for exports proceeds, which are revenue items. There is an actual contract for sale of merchandise. In this factual matrix, it is clear that the transaction in question will not qualify to be called as speculative transaction. In view of the facts and circumstances of the case on hand, as discussed above, the provision for losses on derivative contracts is allowable as expenditure.

15. The facts of the case before the Tribunal and the facts of the case in the case of Quality Engineering & Software Technologies (P) Ltd. (supra) are identical. We are therefore of the view that the decision rendered in the said decision will be applicable to the facts of the present case also. Respectfully following the said decision, we hold that the loss in question should be allowed as a deduction.

16. In the result, appeal by the Assessee is partly allowed.

17. In the result, appeal by the Revenue is dismissed while the Appeal by the Assessee is partly allowed.

Order pronounced in the open court on **6th April, 2018**.

Sd/-	**Sd/-**
(A.K GARODIA)	**(N.V VASUDEVAN)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Bangalore
Dated : 6/4/2018
Vms

Copy to :1. The Assessee
2. The Revenue
3.The CIT concerned.
4.The CIT(A) concerned.
5.DR
6.GF

By order

Sr. Private Secretary, ITAT, Bangalore

1. Date of Dictation ……………………………
2. Date on which the typed draft is placed
   before the dictating Member ……………………
3. Date on which the approved draft comes to Sr. P.
   S………………………..
4. Date on which the fair order is placed
   before the dictating Member ………………..
5. Date on which the fair order comes back to the Sr. P.S.
   …………………..
6. Date of uploading the order on website……………………………..
7. If not uploaded, furnish the reason for doing so
   …………………………..
8. Date on which the file goes to the Bench Clerk ………………..
9. Date on which order goes for Xerox &
   endorsement…………………..
10. Date on which the file goes to the Head Clerk …………….
11. The date on which the file goes to the Assistant Registrar
    for signature on the order ……………………………….
12. The date on which the file goes to dispatch section for
    dispatch of the Tribunal Order ………………………….
13. Date of Despatch of Order. ……………………………………………..