

**IN THE INCOME TAX APPELLATE TRIBUNAL
KOLKATA 'C' BENCH, KOLKATA**

[Before Sri J. Sudhakar Reddy, Accountant Member & Smt. Madhumita Roy, Judicial Member]

I.T.A. No. 1880/Kol/2014
Assessment Year: 2009-10

M/s. Kanoria Chemicals & Industries Ltd.....Appellant
C/o. Salarpuria Jajodia & Co.
7, C.R. Avenue
Kolkata - 700 072
[PAN : AABCK 1291 K]

A.C.I.T., Range-10, Kolkata.....Respondent

I.T.A. No. 2086/Kol/2014
Assessment Year: 2009-10

D.C.I.T., Circle-10, Kolkata.....Appellant
M/s. Kanoria Chemicals & Industries Ltd.....Respondent
C/o. Salarpuria Jajodia & Co.
7, C.R. Avenue
Kolkata - 700 072
[PAN : AABCK 1291 K]

I.T.A. No. 238/Kol/2015
Assessment Year: 2010-11

M/s. Kanoria Chemicals & Industries Ltd.....Appellant
C/o. Salarpuria Jajodia & Co.
7, C.R. Avenue
Kolkata - 700 072
[PAN : AABCK 1291 K]

D.C.I.T., Circle-10, Kolkata.....Respondent

I.T.A. No. 271/Kol/2015
Assessment Year: 2010-11

D.C.I.T., Circle-10(1), Kolkata.....Appellant
M/s. Kanoria Chemicals & Industries Ltd.....Respondent
C/o. Salarpuria Jajodia & Co.
7, C.R. Avenue
Kolkata - 700 072
[PAN : AABCK 1291 K]

Appearances by:

Shri J.P. Khaitan, Sr. Counsel & Shri S. Jhajharia, A/R, appeared on behalf of the assessee.

Shri G. Hangshing, CIT, D/R & Shri Saurabh Kumar, Addl. CIT, D/R, appearing on behalf of the Revenue.

Date of concluding the hearing : September 12th, 2018

Date of pronouncing the order : November 16th, 2018

ORDER

Per J. Sudhakar Reddy :-

I.T.A. No. 1880/Kol/2014 & I.T.A. No. 2086/Kol/2014, are cross-appeals directed against the order of the Id. Commissioner of Income Tax (Appeals)-XII, Kolkata (Id. CIT(A)), passed u/s 250 of the Income Tax Act, 1961 (hereinafter the 'Act'), dt. 27/08/2014 for the Assessment Year 2009-10.

I.T.A. No. 238/Kol/2015 & I.T.A. No. 271/Kol/2015, are cross-appeals directed against the order of the Id. Commissioner of Income Tax (Appeals)-4, Kolkata (Id. CIT(A)), passed u/s 250 of the Income Tax Act, 1961 (hereinafter the 'Act'), dt.15/01/2015, for the Assessment Year 2010-11.

2. There is a delay of 5 days in filing of the appeal by the revenue in I.T.A. No. 2086/Kol/2014 for the Assessment Year 2009-10. After perusing the petition filed for condonation of delay, we are convinced that the revenue was prevented by sufficient cause from filing the appeal in time. Hence the delay is condoned and appeal admitted.

3. As the issues arising in all these appeals are common, for the sake of convenience they are heard together and disposed off by way of this commons order.

4. The assessee is a company engaged in the business of manufacturing of chemicals and generation of power.

5. Grounds of appeal of the Assessment Year 2009-10 are as follows:-

I.T.A. No. 1880/Kol/2014; assessee's appeal

"1. For that in view of the facts and in the circumstances the AO is wholly unjustified in disallowing Foreign Exchange Fluctuation Loss of Rs. 64,99,577/- by wrongly and illegally treating such Foreign Exchange Fluctuation Loss of Rs. 64,99,577/- as notional loss and being contingent in nature and the Ld. CIT(A)-XII, Kolkata is wholly unjustified in confirming the said action of the AO.

2. For that such Foreign Exchange Fluctuation Loss of Rs. 64,99,577/- being in respect of forward contract against the export of orders for supply of materials and being completely on trading account in respect of export goods, such Foreign Exchange Fluctuation Loss as on the closing date is fully determined and not contingent and is allowable as business expenditure and the AO is wholly unjustified in disallowing such

Foreign Exchange Fluctuation Loss of Rs. 64,99,577/- and in view of the facts and in the circumstances the Ld. CIT(A)-XII, Kol is wholly unjustified in confirming the said action of the AO and in view of the facts and in the circumstances it being a trading loss and being determined on the closing date and not being contingent is fully allowable and in view of the facts and in the circumstances it may kindly be held accordingly.

3. For that your petitioner craves the right to put additional grounds and 1 or to alter / amend/modify the present grounds at the time of hearing.”

I.T.A. No. 2086/Kol/2014; revenue’s appeal

“1. That on the facts and in law of the case and as per law Ld. CIT(A) erred by directing the A.D., to recalculate the disallowance on pro-rata basis i.e., allow amount related to Rs. 71339384/- and restrict the disallowance on pro-rata basis on Rs. 852460616/-.

2. That in the facts and law Ld. CIT(A) erred by deleting the amount of addition of Rs. 852460616/- only by following the principle of res-judicata without assigning any cogent reasoning.

3. That in the facts and law Ld. CIT(A) erred by keeping silent about the nature of claim i.e., capital or revenue in nature. It is pertinent to point out here that the assessee-company itself submitted that the proceeds of the FCCBs were utilized towards funding of capital expenditure and. related issues. The Ld. CIT(A) has himself held that the amount relating to Rs. 852460616/- is not an allowable deduction as per provisions of Section 43A of the I.T., Act, 1961.

4. That in the facts and as per law Ld. CIT(A) erred by deleting the amount of addition of Rs. 8,89,22,446/- after admitting the fact that there was no such claim in the P/L Account, but without any cogent reason.

5. That in the facts and law Ld. CIT(A) erred by deleting the amount of addition of Rs. 2575206/- added under Rule 8D(ii) which is unjustified being contrary to the provisions of Section 14A read with Rule 8D.

6. That the appellant craves for leave to add, delete or modify any of the grounds of appeal before or all the time of hearing.”

Grounds of appeal of the Assessment Year 2010-11 are as follows:-

I.T.A. No. 238/Kol/2015; assessee’s appeal

“1) For that in view of the facts and circumstances of the case the Ld. CIT(A) was wholly wrong and unjustified in not allowing the appellant’s claim of deduction of the notional gain of Rs. 14,31,45,318/- arising due to the fluctuation in the foreign currency exchange rate. The erroneous decision of the Ld. CIT(A) was wholly unreasonable, uncalled for and bad in law.

2) For that in view of the facts and circumstances of the case the Ld. CIT(A) was wholly wrong and unjustified in not allowing the aforesaid claim of deduction of the notional gain of Rs. 14,31,45,318/- and it may kindly be held accordingly.

3) For that in view of the facts and circumstances of the case the Ld. CIT(A) was wholly wrong and unjustified in not allowing the aforesaid claim of deduction of the notional gain of Rs. 14,31,45,318/- on the ground that such claim was not made in the Return/ revised Return without considering the fact that since the time for filing the revised return had unfortunately expired but the deduction was validly claimed in course of and before the completion of the impugned assessment and further that appellate authority is competent to entertain such claim of deduction made before him in case an assessee omits to make a claim before the AO in a Return/ revised Return.

4) For that your petitioner craves the right to put additional grounds and 1 or to alter/ Amend/modify the present grounds before or at the time of hearing.”

I.T.A. No. 271/Kol/2015; revenue's appeal

“1. That in the facts and circumstances and in law, Ld. CIT(A) erred in deleting the addition made by the A.O. of Rs.8,50,27,877/- on account of provision for premium on redemption of FCCBs, without considering the fact that whether the assessee has to repay the said amount on maturity of the bonds.

2. That in the facts and circumstances and in law, Ld. CIT(A) erred in deleting the addition just following the previous order of Id. CIT(A) of assessee's case for the A.Y-2009-10 without going into merit, that the said order has been contested before the Id. ITAT.

3. That in the facts and circumstances and in law, Ld. CIT(A) erred in deleting the amount of addition of Rs.20,19,830/- added under Rule 8D(ii) without considering the fact that the assessee has failed to substantiate the utilization of borrowed fund toward earning of exempted income.

4. That the appellant craves for leave to add, delete or modify any of the grounds of appeal before or all the time of hearing.”

The assessee raised an additional ground of appeal in ITA No. 238/Kol/2015, for Assessment Year 2010-11, which is as follows:-

“Further in any event and without prejudice to Ground Nos. 1, 2 & 3 raised originally, the said sum of Rs.14,31,45,318/- is on Capital Account and is liable to be treated as capital receipt and as such outside the purview of taxation and in view of the facts and in the circumstances it may be held accordingly.”

6. We first take up the issue of foreign exchange fluctuations on Foreign Currency Convertible Bonds (FCCB). The assessee has issued 200 FCCBs at a face value of US\$ 1,00,000/- each on 31st May, 2006. This aggregated to US\$ 20 Millions, which is equivalent to Rs.92.38 Crores. These FCCBs were listed on the Luxemborg Stock Exchange and were redeemable on 7th June, 2011 at 144.715% of the principle amount of the FCCBs, which is based on an yield of 7.5% compounded semi-annually. The FCCB holders had the option, at any point of time on or after 5th June, 2006, but before 28th May, 2011, to convert the bonds into equity shares at Rs.5/- each, at a conversion price of Rs.44.67/- per share.

The assessee admits that the proceeds from these FCCBs were utilized for acquiring capital assets before 31st March, 2008. An amount of Rs.8,89,22,446/- was brought into India and utilized towards acquisition of fixed assets. The remaining sum of Rs.7,39,39,384/-, was utilized for acquisition of fixed assets outside India.

6.1. Due to adverse fluctuations of foreign exchange rates on 31st March, 2009, the assessee's liability towards redemption of the said bonds went up substantially. The net loss on account of effective change in foreign exchange rates on re-valuation of currency as on 31st March, 2009, was Rs.24,34,29,255/-. For the year ending 31st March, 2010, the assessee earned net gain on account of foreign exchange fluctuation of Rs.14,31,45,318/-. The Assessing Officer disallowed the claim of the assessee of loss on account of foreign exchange fluctuations on redemption of bonds along with premium thereon on the following grounds:-

- a) The FCCBs could be converted into equity shares at the option of the bond holders and hence the claim of the assessee is a contingent liability.
- b) The assessee has utilized the proceeds of FCCBs for acquisition of fixed assets and thus, the amount was utilized towards capital expenditure and hence the loss in question is in capital field.
- c) Section 43A of the Act, is applicable in the case of the assessee.

The Id. CIT(A), called for a remand report and in this remand report, the Assessing Officer raised yet another contentions that the assessee has not deducted tax at source and hence the claim should be disallowed u/s 40(a)(i) of the Act.

The Id. CIT(A) held as follows:-

- a) The assessee was liable to redeem the said bonds and hence the liability in question is not a contingent liability.
- b) Section 43A of the Act, was applicable only in respect of the assets acquired outside India. This Section cannot be applied where the assets were acquired within the country.

Thus, he held that only the loss on account of fluctuations referable to the sum of Rs.7,13,39,384/-, which was utilized by the assessee outside the country for the purchase of its assets has to be dealt with as per Section 43A of the Act. He observed that the assessee had offered to tax the foreign exchange fluctuation gain for the Assessment Year 2008-09 and for the Assessment Year 2010-11. Hence applying the principle of consistency, he held that the assessee would be entitled for deduction in respect of such Exchange fluctuations loss as revenue expenditure for the Assessment Year 2009-10. That the provisions of Section 40(a)(i) of the Act, would not be applicable before the maturity of the FCCBs. He relied on certain case-law, in this regard.

6.2. For the Assessment Year 2010-11, the assessee claimed that the foreign exchange fluctuation gain of Rs.14,31,45,318/- cannot be subjected to tax. The Assessing Officer relied on the judgment of the Hon'ble Supreme Court in the case of *Goetze (India) Ltd. vs CIT 284 ITR 323 SC* and rejected the claim of the assessee. He also held that the provisions of Section 43A of the Act, are applicable.

6.3. On appeal the Id. CIT(A) followed his view for the Assessment Year 2009-10 and dismissed the assessee's appeal.

7. Aggrieved the revenue is in appeal for the Assessment Year 2009-10 and the assessee is in appeal for the Assessment Year 2010-11.

8. We have heard rival contentions. On careful consideration of the facts and circumstances of the case, perusal of the papers on record, orders of the authorities below as well as case law cited, we hold as follows:-

We find that the assessee has an obligation to redeem the FCCBs on 7th June, 2011 at 144.715% of the principal amount of the bonds. This liability, in our view cannot be considered a contingent one, merely because the FCCB holders have an option to convert the bonds into equity shares. It should be realized that the option is not with the assessee and the assessee has the liability to redeem the bonds. Only when an application is made, the bonds are converted into equity shares by the bond holders, the instrument remains to be "bonds" which have to be redeemed at 144.75% of the principal amount.

This view of ours is supported by the decision of the Bangalore Bench of the Tribunal in the case of *Crane Software International Ltd. vs. DCIT in ITA Nos.741, 742, 774 and 775/Bang/2010, order dt. 8th February, 2011* and the decision of the ITAT Mumbai Bench of the Tribunal in the case of *Mahindra & Mahindra Limited vs. DCIT (2012) 24 taxmann.com 267 (Mum)*.

8.1. As regards applicability of Section 43A of the Act, we find that the Id. CIT(A) was right in stating that it is applicable to the assets acquired out of the country, which is to the tune of Rs.7,13,39,384/-. This issue is covered by the decision of the Hon'ble Supreme Court in the case of *CIT vs. Woodward Governor India P. Ltd. (2009) 312 ITR 254 SC*.

8.2. Hence in respect of the exchange fluctuation relating to Rs.85,24,60,616/-, utilized by the assessee for acquisition of fixed assets within the country the provision of Section 43A of the Act, does not apply. For the balance amount of Rs.7,13,39,384/-,

utilized for acquisition of assets outside India, the provision of Section 43A of the Act would apply.

9. Now the question is, whether the foreign exchange fluctuation gain/loss on foreign currency loan borrowed to acquire indigenous fixed assets and/or imported fixed assets is chargeable to income tax or is not allowable as a revenue loss.

9.1. In case of *Sutlej Cotton Mills Ltd. vs. CIT* – 116 ITR 1, it was observed by the Hon'ble Apex court that:

“Whether the loss suffered by the assessee was a trading loss or not would depend on the answer to the question, whether the loss was in respect of a trading asset or a capital asset. In the former case, it would be a trading loss but not so in the latter. The test may also be formulated in another way by asking the question whether the loss was in respect of circulating capital or in respect of fixed capital”

Further observation made in above case that if the amount in foreign currency is utilised or intended to be utilised in the course of business or for a trading purpose or for effecting a transaction on revenue account, loss arising from depreciation in its value on account of alteration in the rate of exchange would be a trading loss, but if the amount is held as a capital asset, loss arising from depreciation would be a capital loss.

9.2. In case of *CIT vs. V.S. Dempo & Co Pvt. Ltd* (206 ITR 291) which has specifically laid down principles in order to decide whether loss/gain arising out of foreign exchange fluctuations is in nature of revenue or capital, of which at para 5 of said principles which says as follow:

“Loss resulting from depreciation of the foreign currency which is utilised or intended to be utilised in business and is part of the circulating capital, would be a trading loss, but depreciation of fixed capital on account of alteration in exchange rate would be capital loss”

9.3. Applying the principles of law laid down in the above case-law to the facts of this case, we hold that such exchange gain or loss is on capital account and hence it is neither taxable nor a deduction from profits can be allowed on the same. The Ld. Senior Counsel, Mr. J.P. Khaitan was fair enough to submit that the revenue's ground for the Assessment Year 2009-10 has to be allowed in view of this legal position.

10. In view of the above discussion, we reverse the order of the Id. First Appellate Authority and uphold the finding of the Assessing Officer for the Assessment Year 2009-10 that the assessee is not eligible for claim of deduction on account of exchange fluctuation loss. Similarly, the exchange fluctuation gain for the Assessment Year 2010-11, cannot be brought to tax as the same is on capital account, by applying the same principles of law. This claim of the assessee can be entertained by the ITAT in view of the judgment of the Hon'ble Supreme Court in the case of *National Thermal Power Co. Ltd. vs Commissioner Of Income Tax 1998 229 ITR 383 SC*. Hence this additional ground of the assessee is allowed.

11. The next issue is disallowance of foreign exchange loss of Rs.64,99,577/- for the Assessment Year 2009-10. These are Ground Nos. 1 & 2 of the assessee's appeal for the Assessment Year 2009-10.

The assessee entered into a Forward Contract against its export orders in order to arbitrage loss due to exchange rate fluctuations. It made a provision of Rs.64,99,577/- , on 31st March, 2009 for market to market losses on such contracts. The Assessing Officer disallowed the provision on the ground that it is a notional loss and contingent in nature by applying CBDT's Instruction No. 3/2010, dt. 23rd March, 2010.

11.1. We find that this issue is covered in favour of the assessee by the decision of the ITAT, Kolkata 'B' Bench of the Tribunal in *ITA No. 462 & 752/Kol/2014 and C.O. No. 63/Kol/2014, in the case of Hindustan Gum & Chemicals Pvt. Ltd., order dt. 8th March, 2017*.

11.2. Respectfully following the principles of law laid down in the decision of the Tribunal, we allow these grounds of the assessee.

12. Coming to the issue of applicability of Section 40(a)(i) of the Act, as we have held that the gains/loss is on capital account and no deduction is admissible for the Assessment Year 2009-10, the question of disallowance u/s 40(a)(i) of the Act, does not arise.

13. In the result, the grounds of the assessee for the Assessment Year 2009-10 are dismissed and the ground for the Assessment Year 2010-11, is allowed.

14. Ground No. 4 of the departmental appeal for the Assessment Year 2009-10 and the Ground No. 2 for the Assessment Year 2010-11, are on the issue of allowability of the claim of the assessee for deduction of premium payable on redemption of FCCB bonds, which the assessee have been claiming on *pro rata* basis based on over the terms (i.e. Time Period) of the bond. The Assessing Officer disallowed this claim on the ground that:-

- a) The assessee has not debited its profit and loss account.
- b) That the liability was contingent in nature.
- c) And that the bonds are convertible and hence no deduction is allowed.

During the course of remand proceedings, the Assessing Officer raised another point regarding tax deduction at source. On appeal the Id. First Appellate Authority held that the liability to pay premium on FCCBs is not a contingent one. He further held that, the actual payment need to be done on the redemption of these FCCBs and entries need not be made every year. He applied the decision of the Hon'ble Supreme Court in the case of *Madras Industrial Investment Corpn. Ltd. v. Commissioner of Income-tax 225 ITR 802 SC* and upheld the claim of the assessee. He pointed out that tax has been deducted at source in the year of redemption of bonds and hence was of the view that no tax need be deducted every year. He held that the assessee was entitled to deduction of the premium on yearly basis by relying on the order of the Bangalore Bench of the Tribunal in the case of *Crane Softwares Internation Ltd. vs. DCIT (supra)* and the decision in the case of *Mahindra & Mahindra Ltd. vs. DCIT (supra)*. He held that the assessee was entitled to

deduction of the premium, subject to disallowance made u/s 43A of the Act. The issues are the same for both the Assessment Years.

As stated earlier, in our view, the liability is not a contingent liability. Deduction is liable on yearly basis as the liability accrues on time basis. The Hon'ble Calcutta High Court in the case of *National Engg. Industries Ltd. v. Commissioner of Income-tax [1999] 236 ITR 577 (Calcutta)* is relied in this regard. The Hon'ble Supreme Court in the case of *Madras Industrial Investment Corpn. Ltd. (supra)*, laid down the principle that, deduction should be allowed on pro-rata basis over the terms of the bond.

14.1. Applying the propositions of law in these case-law to the facts of this case, we hold that the deduction in question is allowable.

15. Coming to the applicability of provision of Section 40(a)(i) of the Act, the same is not applicable as only a provision has been claimed as a deduction during the year. The provisions relating to tax deduction at source apply only in the year of redemption. On the issue of applicability of Section 43A of the Act, the assessee submits that the imported assets were put to use by March 31st, 2008. The pro-rata premium for the period up to 31st March, 2008, was capitalized by the assessee. The premium relating to the period after the imported assets were put to use did not form part of the actual cost. Hence Section 43A of the Act, does not apply.

16. Ground No. 5 of the revenue's appeal for the Assessment Year 2009-10 regarding disallowance u/s 14A r.w.r. 8D(2)(ii) of the Income Tax Rules, 1962 (Rules).

The assessee's case is that it has sufficient interest free funds in the form of share capital in its reserves. The figure of interest free funds for the Assessment Year 2009-10 was Rs. 232 Crores and whereas the investments were only Rs.5.68 Crores. Similarly, for the Assessment Year 2010-11 interest free funds in the form of share capital reserves aggregated to Rs.235 Crores and whereas the investments were only Rs.6.92 Crores. On these facts, no disallowance can be made u/s 14A r.w.r. 8D(2)(ii) of the Rules, as the presumption is that interest free funds have been utilized for making investments.

These principles were laid down by the Hon'ble Bombay High Court in the case of *CIT vs. HDFC Bank Ltd. 366 ITR 505 (Bom)*. The Jurisdictional High Court in the case of *Principal Commissioner Of Income vs Rasoi Limited, G.A no. 633 of 2016 ITAT No.109 of 2016, order dt. 15th February, 2017*, took the same view.

16.1. In view of the above discussion, we uphold the order of the ld. CIT(A) and dismiss Ground No. 5 of the revenue's appeal for the Assessment Year 2009-10.

17. **In, the result appeal of the assessee for the Assessment Year 2009-10 & 2010-11 are allowed in part.**

The appeal of the revenue for the Assessment Years 2009-10 & 2010-11 are dismissed.

Kolkata, the 16th day of November, 2018.

Sd/-

[Madhumita Roy]
Judicial Member

Dated : 16.11.2018
{SC SPS}

Sd/-

[J. Sudhakar Reddy]
Accountant Member

Copy of the order forwarded to:

1. M/s. Kanoria Chemicals & Industries Ltd

C/o. Salarpuria Jajodia & Co.
7, C.R. Avenue
Kolkata – 700 072

2. A.C.I.T., Range-10, Kolkata

3. D.C.I.T., Circle-10, Kolkata

4. D.C.I.T., Circle-10, Kolkata

5. D.C.I.T., Circle-10(1), Kolkata

6. CIT(A)-

7. CIT- ,

8. CIT(DR), Kolkata Benches, Kolkata.

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Assistant Registrar
. ITAT, Kolkata Benches