

आयकर अपीलीय अधिकरण, 'सी' न्यायपीठ, चेन्नई।
**IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH: CHENNAI**

श्री इंटूरी रामा राव, लेखा सदस्य एवं
श्री धुव्वुरु आर.एल. रेड्डी, न्यायिक सदस्य के समक्ष

**BEFORE SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER AND
SHRI DUVVURU R.L.REDDY, JUDICIAL MEMBER**

आयकर अपील सं./ITA No.2427/Chny/2007

निर्धारण वर्ष /Assessment Year: 2003-04

The Asst. Commissioner-
of Income Tax,
Company Circle-III(2),
Chennai-600 034.

Vs. M/s.Teledata Informatics-
Ltd.,
2AB Gee Gee Emerald,
151, Village Road,
Nungambakkam,
Chennai-600 034.

[PAN: AAAC 2976 K]

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

Department by

: Mrs.Vijaya Prabha, JCIT

Assessee by

: Mr.R.Vijayaraghavan, Adv.

सुनवाई की तारीख/Date of Hearing

: 19.02.2020

घोषणा की तारीख /Date of Pronouncement

: 26.02.2020

आदेश / O R D E R

PER INTURI RAMA RAO, ACCOUNTANT MEMBER:

This is a matter remanded back by the Hon'ble High Court of
judicature at Madras vide order dated 09.04.2019 in TCA No.981 of 2009.

2. Briefly, the facts of the case are as under:

The appellant is a company duly incorporated under the provisions
of Companies Act, 1956, which is engaged in the business of development
and export of software. The return of income for the AY 2003-04 was filed

on 01.12.2003 showing a loss of ₹6,70,90,209/-. Against the said return of income, the assessment was completed by the Asst. Commissioner of Income Tax, Company Circle-III (2), Chennai-34, hereinafter called as "the AO") vide order dated 29.03.2006 passed u/s.143(3) of the Income Tax Act, 1961, at a total income of ₹6,35,53,935/-. While doing so, the AO made several disallowances which includes, inter alia, following additions with which we are concerned:

1. *Notional loss due to foreign exchange fluctuation of ₹24,54,725/-.*
2. *Restricting the deduction u/s.10B in respect of export of sale proceeds not received within the due date.*
3. *Re-calculation of the business profit eligible for deduction u/s.10B of the Act by allocating the common expenditure between the STP and non-STP divisions.*

3. Being aggrieved by the above Assessment Order, an appeal was preferred before the Ld.CIT(A), who vide impugned order dated 02.08.2007 in Appeal No.CIT(A)-VIII/CHE/280/06-07 allowed the loss on account of the exchange rate fluctuation, as regards, to the re-calculation of profit eligible for deduction u/s.10B of the Act, the Ld.CIT(A) following the decision of the Hon'ble Madras High Court in the case of CIT vs. Sundaram Clayton Ltd., reported in 281 ITR 425 and also in the case of IT vs. MM Forgings Ltd., reported in 257 ITR 60 and also the Hon'ble Kerala High Court in the case of CIT vs. Abad Fisheries Ltd., reported in 258 ITR 641 held that the export turnover in respect of the sale proceeds were not received within the stipulated period, should be reduced from both export turnover as well as the total turnover. Similarly, as regards to the allocation of depreciation between the STP Units and non-STP Units, the Commissioner held that the depreciation on the imported software, which

was exclusively used in the domestic sales cannot be allocated to STP Units and accordingly, directed the AO to exclude the depreciation on the cost of the imported software for the purpose of calculating the eligible profits for deduction u/s.10B of the Act. Thus, the Ld.CIT(A) partly allowed.

4. The Revenue challenged the correctness of the order of the Ld.CIT(A) before this Tribunal in ITA No.2427/Chny/2007.

5. This Tribunal vide order dated 14.08.2008 while confirming the decision of the Ld.CIT(A) in reducing the value of export turnover in respect of which the sale proceeds were not received in convertible foreign exchange within the stipulated period confirming the action of the Ld.CIT(A) in directing to reduce the same from export turnover and total turnover, reversed the findings of the Ld.CIT(A) in respect of reducing the depreciation on cost of imported software, which is claimed to have been used for domestic sale purpose, while calculating the eligible profit for deduction u/s.10B by holding that the Commissioner had ignored the findings of the AO that the assessee was not objected before the AO. As regards to the disallowance loss on account of the foreign exchange fluctuation, the Tribunal reversed the findings of the Ld.CIT(A) and restored the addition by following the judgment of the Hon'ble Uttarakhand High Court in the case of CIT v ONGC reported in (2008) 301 ITR 415 challenging the decision of the Tribunal, the assessee carried the

matter before the Hon'ble Madras High Court. The Hon'ble High Court framed the following questions of law vide order dated 09.04.2019 in TCA No.981 of 2009:

"1. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the expenses between the STP and Non-STP divisions should be distributed on turnover basis ?

2. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the depreciation on software used in domestic sales should be set off against the export profits for the purpose of computing deduction u/s.10B ?

3. Whether the Tribunal failed to appreciate that Section 10B provides for deduction of such profits and gains derived by an undertaking from the export of computer software and therefore the setting off of depreciation on software used in domestic sales against export profits would not result in profits derived from exports but reduce the profits on account of inappropriate adjustment ?"

6. Thus, the Hon'ble High Court restored the entire matter filed by the Revenue before the Tribunal for fresh adjudication in accordance with law. That is how; the matter had arisen before us in the present appeal.

7. The Ld.DR submitted that the loss on account of foreign exchange fluctuation rate is only notional. Further, he submitted that the loss should be computed in accordance with the provisions of Rule 115 of IT Rules, 1962. As regards to, the exclusion of depreciation on the cost of imported software, she submitted that the assessee had not raised any objection before the AO and therefore, the assessee is barred from agitating the same before the appellate authorities.

8. On the other hand, the Counsel for the assessee, Mr. R.Vijayaraghavan, submitted that the sale proceeds which were not received in and convertible foreign exchange within the stipulated period

should be reduced from both export turnover and total turnover by following the judgments:

- CIT vs. Abad Fisheries Ltd., reported in 258 ITR 641
- CIT vs. M/s.Maars Software International Ltd in TCA No.390 of 2009 dated 05.12.2018.

9. As regards to the disallowance of loss on account of foreign exchange fluctuation, the Ld.Counsel submitted that the decision of the Hon'ble Uttarakhand High Court in the case of ONGC was reversed by the Hon'ble Supreme Court, which was reported in (2010) 322 ITR 0180 regarding the exclusion of depreciation from the eligible profits for the purpose of calculating eligible profits for deduction u/s.10B. He submitted that no new material on imported software was considered by the Ld.CIT(A), the AO also agreed on allowability in principle in the remand proceedings, however, the AO only objected that the assessee had not objected during the course of assessment proceedings.

10. We have heard the rival submissions and perused the material placed on record.

11. Ground Nos.1 & 5 are general in nature.

12. Ground No.2 challenges the decision of the Ld.CIT(A) disallowing the loss on account of the exchange rate fluctuation in respect of sale proceeds holding to be a notional. The decision of the Hon'ble

Uttarakhand High Court was reversed by the Hon'ble Supreme Court in the case of Oil & Natural Gas Corpn. Ltd. vs. CIT reported in (2010) 322 ITR 0180 by holding as under:

9. Thus, the questions surviving for determination are :- (i) that when the Assessee maintained their accounts on mercantile system of accounting and there was no finding by the Assessing Officer on the correctness or completeness of the account and that the Assessee had complied with the accounting standards, laid down by the Central Government, can the "loss" suffered by it on account of fluctuation in the rate of foreign exchange as on the date of balance-sheet be allowed as expenditure under Section 37(1) of the Act notwithstanding the fact that the liability had not been actually discharged in the year in which the fluctuation in the rate of foreign exchange had occurred and (ii) whether on account of fluctuation in the rate of exchange at the end of the previous year, the Assessee is entitled to adjust the actual cost of imported assets acquired in foreign currency?

10. Having carefully perused the decision of this Court in Woodward's case (supra), we are of the opinion that both the issues stand concluded by the said decision. Dealing with the said issues extensively, speaking for the Bench, S.H. Kapadia, J. summarised the following factors which should be taken into account in order to find out if an expenditure on account of fluctuation in the foreign currency rates, when the Assessee is following mercantile system of accounting, is deductible:

(i) whether the system of accounting followed by the assessee is the mercantile system, which brings in the debits of the amount of expenditure for which a legal liability has been incurred even before it is actually disbursed and credits, what is due, immediately it becomes due even before it is actually received;

(ii) whether the same system is followed by the assessee from the very beginning and if there was a change in the system, whether the change was bona fide;

(iii) whether the assessee has given the same treatment to losses claimed to have accrued and to the gains that may accrue to it;

(iv) whether the assessee has been consistent and definite in making entries in the account books in respect of losses and gains;

(v) whether the method adopted by the assessee for making entries in the books both in respect of losses and gains is as per nationally accepted accounting standards;

(vi) whether the system adopted by the assessee is fair and reasonable or is adopted only with a view to reducing the incidence of taxation.

Applying these factors on the facts of that case, it was held that the "loss" suffered by the Assessee, maintaining accounts regularly on mercantile system and following accounting standards prescribed by the Institute of Chartered Accountants of India (ICAI), on account of fluctuation in the rate of foreign exchange as on the date of balance-sheet was an item of expenditure under Section 37(1) of the Act, notwithstanding that the liability had not been discharged in the year in which the fluctuation in the rate of foreign exchange occurred.

11. We are of the opinion that the ratio of the said decision, with which we are in respectful agreement, squarely applies to the facts at hand and, therefore, the loss claimed by the Assessee on account of fluctuation in the rate of foreign exchange as on the date of balance-sheet is allowable as expenditure under Section 37(1) of the Act.

Respectfully following the decision of the Hon'ble Supreme Court, the issue stands covered in favour of the assessee against the Revenue. The argument of the Ld.DR that the calculation should be done in accordance with Rule 115. From the perusal of the Assessment Order, it is clear that the AO had not doubted the correctness of the computation of the loss, the AO disallowed on the principle that it is a notional loss. Under the facts and circumstances, Ground No.2 stands dismissed.

13. Ground No.3 challenges the decision of the Ld.CIT(A) in directing the AO to deduct the export sale proceeds not received within the stipulated period from both the export turnover as well as the total turnover. Thus, the decision of the Ld.CIT(A) is inconsonance with the decision of the Hon'ble Supreme Court in the case of CIT v. HCL Technologies Ltd. reported in 404 ITR 719 and also the decision of the Hon'ble Jurisdictional High Court in the case of CIT v. M/s.Maars Software International Ltd., wherein the Hon'ble Madras High Court has held as under:

22. Learned Counsel for the Revenue seeks to distinguish the above judgment stating that the rationale thereof would be applicable only to the items of exclusion at issue before the Supreme Court and cannot be extended to the question of unrealised sale proceeds, which is the issue in the present case.

23. We see no valid distinction as sought to be pointed out before us. The components of the total turnover/denominator in the formula would be the

quantum of export turnover/numerator plus proceeds from domestic sales. Thus what is 'export turnover' for the purpose of the numerator would have to be the 'export turnover' for the purpose of denominator as well and 'export turnover' cannot assume two different characteristics for two parts of the same formula.

14. In the light of the above legal position and facts, we do not find any reason to interfere with the order of the Ld.CIT(A). Accordingly, Ground No.3 stands dismissed

15. Ground No.4 challenges the decision of the Ld.CIT(A) to exclude the depreciation on the cost of the imported software from the eligible profits for the deduction u/s.10A of the Act. The principle is well settled that what can be allocated between the STP Unit and the non-STP Units is only indirect expenditure. The expenditure which can be directly be identified with a particular unit cannot be apportioned between the two units. Admittedly, the AO apportioned the depreciation between the STP units and the non-STP units, but the contention of the assessee is that the depreciation on imported software cannot be apportioned to STP Unit, because it was exclusively used in the domestic sales, is required to be adjudicated with reference to the evidence on record as it is a question of fact. But, it appears that the Ld.CIT(A) had not gone into the evidence whether the imported software was used exclusively in the domestic sales or not. In these circumstances, we are of the considered opinion that the matter should go back to the AO to adjudicate the issue in the light of the following directions:

Whether the imported software was used exclusively in the domestic sales? If so, to exclude the same from the eligible profit for deduction

u/s.10A of the Act. Accordingly, Ground No.4 stands partly allowed for statistical purposes.

16. In the result, the appeal filed by the Revenue is partly allowed for statistical purposes.

Order pronounced on the 26th day of February, 2020 in Chennai.

Sd/-

(धुव्वुरु आर.एल. रेड्डी)

(DUVVURU R.L.REDDY)

न्यायिक सदस्य/**JUDICIAL MEMBER**

Sd/-

(इंटूरी रामा राव)

(INTURI RAMA RAO)

लेखा सदस्य/**ACCOUNTANT MEMBER**

चेन्नई/Chennai,

दिनांक/Dated: 26th February, 2020.

TLN

आदेश की प्रतिलिपि अग्रेषित/**Copy to:**

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकर आयुक्त (अपील)/CIT(A)
4. आयकर आयुक्त/CIT
5. विभागीय प्रतिनिधि/DR
6. गार्ड फाईल/GF