

IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "A", HYDERABAD
(Through Virtual Hearing)

BEFORE SHRI A. MOHAN ALANKAMONY, ACCOUNTANT MEMBER
AND
SHRI S.S. GODARA, JUDICIAL MEMBER

ITA No.325/Hyd/2020		
A.Y. 2016-17		
GMR Hospitality and Retail Limited (Successor of Hyderabad Duty Free Retail Limited), Hyderabad. PAN: AADCG 2928 F	VS.	Income Tax Officer, Ward-2(2), Hyderabad.
(Appellant)		(Respondent)
Assessee by	Shri Sunil Jain, AR	
Revenue by	Smt. M. Narmada, DR	
Date of hearing:	02/09/2021	
Date of pronouncement:	16/09/2021	

ORDER

PER A. MOHAN ALANKAMONY, A.M:

This appeal is filed by the assessee with a delay of 65 days before the Tribunal against the order of the Ld. CIT(A)-2, Hyderabad in appeal No. 10341/2018-19/CIT(A)-2, dated 20/02/2020 passed U/s. 143(3) r.w.s 250(6) of the Act for the A.Y. 2016-17. Keeping in view of the Pandemic situation, we hereby condone the delay of 65 days in filing the appeal before the Tribunal and proceed to hear the appeal on merits.

2. The assessee has raised several grounds and alternate grounds in its appeal. However, the crux of the issue is that the Ld. CIT (A) has erred in upholding the order of the ld. AO who had made addition of Rs. 14,48,473/- by disallowing the claim of notional expense incurred towards mark-to-market loss.

3. The brief facts of the case are that the assessee is a private limited company engaged in the business of operating duty-free retail outlets in Rajiv Gandhi International Airport, Shamshabad, Hyderabad. The assessee had filed its return of income for the relevant AY on 30/11/2016 declare income as Rs. 1,37,15,280/-. Subsequently, the case was taken up for scrutiny under CASS. During the course of scrutiny assessment proceedings, it was observed by the ld. AO that the assessee had claimed deduction of Rs. 14,48,473/- towards mark-to-market loss. It was explained by the assessee that that the assessee company had swapped its bank term-loan with cross currency. During the relevant assessment year there was a notional loss due to currency fluctuation and it was recognised in the books of accounts of the assessee as per the accounting standards. However, the Ld. AO was of the view that such notional loss cannot be allowed as deduction as per the provisions of the Act. On appeal, the Ld. CIT (A) confirmed the order of the Ld. AO by relying upon various decisions.

4. At the outset the Ld. AR submitted before us that the issue is squarely covered by the decision of the Hon'ble Apex Court in the case of CIT vs. Woodward Governor India Private Limited reported in 312 ITR 254. The Ld. DR though vehemently argued in support of the order of the Ld. Revenue Authorities she could not controvert to the submission of the Ld. AR.

5. We have heard the rival submissions and carefully perused the materials on record. The gist of the order of the Hon'ble Apex Court is extracted herein below for reference:

“10. *As stated above, on facts in the case of M/s. Woodward Governor India (P.) Ltd., the Department has disallowed the deduction/debit to the P&L account made by the assessee in the sum of Rs. 29,49,088 being unrealized loss due to foreign exchange fluctuation. At the very outset, it may be stated that there is no dispute that in the previous years whenever the dollar rate stood reduced, the Department had taxed the gains which accrued to the assessee on the basis of accrual and it is only in the year in question when the dollar rate stood increased, resulting in loss that the Department has disallowed the deduction/debit. This fact is important. It indicates the double standards adopted by the Department.*

11. *The dispute in this batch of civil appeals centers around the year(s) in which deduction would be admissible for the increased liability under section 37(1).*

12. *We quote hereinbelow section 28(i), section 29, section 37(1) and section 145 of the 1961 Act, which read as follows :*

"Section 28 : Profits and gains of business or profession.—The following income shall be chargeable to income-tax under the head 'Profits and gains of business or profession',—

(i) the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year."

"Section 29 : Income from profits and gains of business or profession, how computed.—The income referred to in section 28 shall be computed in accordance with the provisions contained in sections 30 to 43D."

"Section 37 :General. —(1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or

expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head 'Profits and gains of business or profession'.

Explanation.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure." [Emphasis supplied]

"Section 145 : Method of Accounting.—(1) Income chargeable under the head 'Profits and gains of business or profession' or 'Income from other sources' shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assesseees or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144."

13. *As stated above, one of the main arguments advanced by the learned Additional Solicitor General on behalf of the Department before us was that the word "expenditure" in section 37(1) connotes "what is paid out" and that which has gone irretrievably. In this connection, heavy reliance was placed on the judgment of this Court in the case of Indian Molasses Co. (P.) Ltd. (supra). Relying on the said judgment, it was sought to be argued that the increase in liability at any point of time prior to the date of payment cannot be said to have gone irretrievably as it can always come back. According to the learned counsel, in the case of increase in liability due to foreign exchange fluctuations, if there is a revaluation of the rupee vis-a-vis foreign exchange at or prior to the point of payment, then there would be no question of money having gone irretrievably and consequently, the requirement of "expenditure" is not met. Consequently, the additional liability arising on account of fluctuation in the rate of foreign exchange was merely a contingent/notional liability which does not crystallize till payment. In that case, the Supreme Court was considering the meaning of the expression "expenditure incurred" while dealing with the question as to whether there was a distinction between the actual liability in praesenti and a liability de futuro. The word "expenditure" is not defined in the 1961 Act. The word "expenditure" is, therefore, required to be understood in the context in which it is used. Section 37 enjoins that any expenditure not being expenditure of the nature described in sections 30 to 36 laid out or expended wholly and exclusively for the purposes of the business should be allowed in computing the income chargeable under the head "Profits and gains of business". In sections 30 to 36, the expressions "expenses incurred" as well as "allowances and*

depreciation" has also been used. For example, depreciation and allowances are dealt with in section 32. Therefore, Parliament has used the expression "any expenditure" in section 37 to cover both. Therefore, the expression "expenditure" as used in section 37 may, in the circumstances of a particular case, cover an amount which is really a "loss" even though the said amount has not gone out from the pocket of the assessee.

14. In the case of *M.P. Financial Corporation v. CIT* [1987] 165 ITR 765 the Madhya Pradesh High Court has held that the expression "expenditure" as used in section 37 may, in the circumstances of a particular case, cover an amount which is a "loss" even though the said amount has not gone out from the pocket of the assessee. This view of the Madhya Pradesh High Court has been approved by this Court in the case of *Madras Industrial Investment Corpn. Ltd. v. CIT* [1977] 225 ITR 802. According to the Law and Practice of Income-tax by Kanga and Palkhivala, section 37(1) is a residuary section extending the allowance to items of business expenditure not covered by sections 30 to 36. This section, according to the learned Author, covers cases of business expenditure only, and not of business losses which are, however, deductible on ordinary principles of commercial accounting. (see page 617 of the eighth edition). It is this principle which attracts the provisions of section 145. That section recognizes the rights of a trader to adopt either the cash system or the mercantile system of accounting. The quantum of allowances permitted to be deducted under diverse heads under sections 30 to 43C from the income, profits and gains of a business would differ according to the system adopted. This is made clear by defining the word "paid" in section 43(2), which is used in several sections 30 to 43C, as meaning actually paid or incurred according to the method of accounting upon the basis on which profits or gains are computed under section 28/29. That is why in deciding the question as to whether the word "expenditure" in section 37(1) includes the word "loss" one has to read section 37(1) with section 28, section 29 and section 145(1). One more principle needs to be kept in mind. Accounts regularly maintained in the course of business are to be taken as correct unless there are strong and sufficient reasons to indicate that they are unreliable. One more aspect needs to be highlighted. 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 P&L 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 needs to be computed. This is one more reason for reading section 37(1) with 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 increase profits before actual realization. This is the theory underlying the Rule that closing 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 years 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. At this stage, we need to emphasise once again that the above system of commercial accounting can be superseded or modified by legislative enactment. This is where section 145(2) comes into play. Under that section, the Central Government is empowered to notify from time to time the Accounting Standards to be followed by any class of assessee or in respect of any class of income. Accordingly, under section 209 of the Companies Act, mercantile system of accounting is made mandatory for companies. In other words, accounting standard which is continuously adopted by an assessee can be superseded or modified by Legislative intervention. However, but for such intervention or in cases falling under section 145(3), the method of accounting undertaken by the assessee continuously is supreme. In the present batch of cases, there is no finding given by the Assessing Officer on the correctness or completeness of the accounts of the assessee. Equally, there is no finding given by the Assessing Officer stating that the assessee has not complied with the accounting standards.

15. *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."*

6. From the above, it is apparent that mark-to-market loss has to be statutorily recognised either as a revenue expenditure or addition to the value of the asset acquired from outside India consequent to the change in rate of exchange during the previous year as per Section 43A of the Act. In the case of the assessee there is nothing on record to suggest that the term-loan was used for acquiring asset from outside India. Therefore, following the ratio laid down by the Hon'ble Apex Court we hereby direct the Ld. AO to grant deduction of Rs. 14,48,473/- being the notional loss due to change in rate of foreign exchange fluctuation on the foreign exchange term-loan granted by the bank.

7. In the result, appeal of the assessee is allowed.

Pronounced in the open Court on the 16th September, 2021.

Sd/-
(S.S. GODARA)
JUDICIAL MEMBER

Sd/-
(A. MOHAN ALANKAMONY)
ACCOUNTANT MEMBER

Hyderabad, Dated: 16th September, 2021.

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Copy to:-

- 1) GMR Hospitality and Retail Limited (Successor to Hyderabad Duty Free Retail Limited), GMR Aero Towers, Rajiv Gandhi International Air Port, Shamshabad, Hyderabad – 500 409.
- 2) Income Tax Officer, Ward-2(2), Signature Towers, Kondapur, Hyderabad – 500 084.
- 3) The Commissioner of Income Tax (Appeals)-2, Hyderabad.
- 4) The Principal Commissioner of Income Tax-2, Hyderabad.
- 5) The DR, ITAT, Hyderabad
- 6) Guard File