

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B", BANGALORE**

Before Shri Chandra Poojari, AM & Shri George George K, JM

ITA No.580/Bang/2019: Asst.Year 2012-2013

M/s.ThoughtWorks Technologies (India) Private Limited 147F, 2 nd Floor, ACR Mansions, 8 th Main Road, 3 rd Block Koramangala Bengaluru – 560 034. PAN : AABCT3936G.	v.	The Deputy Commissioner of Income-tax, Circle 7(1)(1) Bangalore.
(Appellant)		(Respondent)

ITA No.590/Bang/2019: Asst.Year 2012-2013

The Deputy Commissioner of Income-tax, Circle 7(1)(1) Bangalore.	v.	M/s.ThoughtWorks Technologies (India) Private Limited,147F, 2 nd Floor, ACR Mansions, 8 th Main Road, 3 rd Block, Koramangala Bengaluru – 560 034.
(Appellant)		(Respondent)

Assessee by : Sri.V.Sridhar, CA

Revenue by : Sri.Jairam Raipura, CIT-DR

Date of Hearing : 03.01.2022	Date of Pronouncement : 04.01.2022
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ORDER

Per George George K, JM

These cross appeals are directed against CIT(A)'s order dated 07.01.2019. The relevant assessment year is 2012-2013. We shall first adjudicate the assessee's appeal.

ITA No.580/Bang/2019 (Assessee's appeal)

2. The only ground argued by the learned AR is ground No.2, which reads as follows:-

“2. Ground 2 : Disallowance of foreign exchange loss on restatement of Export Earners Foreign Currency (EEFC) account

On the facts and in the circumstances of the case and in law, the learned CIT(A) / learned AO erred in treating the foreign exchange loss of INR 79,27,497 on account of restatement of EEFC account as capital in nature.

On the facts and in the circumstances of the case and in law, the learned CIT(A) / learned AO erred disallowing foreign exchange loss of INR 79,27,497 stating that it is notional in nature without appreciating the fact that the foreign exchange loss is derived on revenue and same has arisen on account of restatement at the year end in accordance with statutory guidelines.

On the facts and in the circumstances of the case and in law, the learned CIT(A) / learned AO erred in disallowing the foreign exchange loss of INR 79,27,497, ignoring the various judicial precedents relied during the course of assessment and appellate proceedings.

On the facts and in the circumstances of the case and in law, the learned CIT(A) / learned AO erred in bringing the foreign exchange loss under the ambit of section 43A of the Act, without appreciating the fact that foreign exchange loss is revenue in nature.

Notwithstanding the above, on the facts and the circumstances of the case and in law, the learned CIT(A) erred in confirming the action of the learned AO in considering INR 79,27,497 as the foreign exchange loss on account of restatement of EEFC account, whereas the actual amount on account of unrealized foreign exchange difference was a gain of INR 24,30,000 which can be traced in the cash flow and the break-up of forex loss, thus resulting in no disallowance.”

2.1 The brief facts of the case are as follows:

The assessee is a private limited company engaged in the business of development and providing custom e-business application and platforms. The assessee is registered as a 100% Export Oriented Unit (EOU) and also registered under the Software Technology Park of India (STPI). For the

assessment year 2012-2013, the return of income was filed on 27.11.2012 disclosing an income of Rs.32,82,55,077. The assessment was selected for scrutiny and the assessment was completed u/s 143(3) r.w.s. 92CA of the I.T.Act vide order dated 28.03.2016 determining the total income at Rs.35,44,70,726. One of the addition made by the A.O. was Rs.79,27,497 on account of foreign exchange loss. During the relevant assessment year, the assessee had recognized net foreign exchange gains at Rs.2,85,85,495. The foreign exchange loss of Rs.79,27,497 which was on account of restatement of Export Earners Foreign Currency (EEFC) at the exchange rate prevailing on the last date of the previous year, namely, 31.03.2012 was adjusted and net gain of Rs.2,85,85,497 was disclosed (the A.O. wrongly mentioned a sum of Rs.31,53,542 in page 4 of the assessment order). The A.O. held that the restatement of EEFC account is in the nature of capital item and hence cannot be allowed. He further held that the amount of Rs.79,27,497 is a notional loss.

2.2 Aggrieved by the order of assessment, the assessee filed an appeal before the first appellate authority. The CIT(A) affirmed the addition of Rs.79,27,497. The CIT(A) by relying on section 43A of the I.T.Act as amended by Finance Act, 2002 held that the loss on account of fluctuation in foreign exchange can be adjusted at the time of making payment but not on notional basis. The relevant finding of the CIT(A) reads as follows:-

“6.4 In the present case, there is no dispute regarding the facts of the case that the restatement in EEFC account has been made at the end of the year and the loss claimed is in relation to the same account for fluctuation in foreign exchange rate. However, as per provisions of section 43A, this loss can be adjusted at the time of making payment but not on notional basis. In view of the above position, the loss being a notional loss cannot be allowed. Hence, the contentions of the appellant cannot be accepted. The disallowance of foreign exchange loss of Rs.79,27,497/- made by the AO is confirmed. The ground of appeal is dismissed.”

2.3 Aggrieved by the order of the CIT(A), the assessee has raised this issue before the Tribunal. The learned AR reiterated the submissions made before the Income Tax Authorities.

2.4 The learned Departmental Representative strongly supported the orders of the Assessing Officer and the CIT(A).

2.5 We have heard rival submissions and perused the material on record. The restatement of EEFC account as on 31.03.2012 is in accordance with foreign exchange management regulation 2015. The EEFC account is an account maintained in foreign currency by foreign exchange earners. The assessee had followed account standard -11, which requires that foreign currency monetary item should be reported using the closing rate at each balance sheet date. Accordingly, the resultant gain on account of such restatement in the case of assessee was credited to the profit and loss account. Further, the transaction in EEFC account undertaken during the year are trading in nature in order to facilitate to regular business operation of the company. As per

the mercantile system of accounting followed by the assessee, the foreign exchange loss arising on account of restatement of EEFC account cannot by any stretch of imagination can be termed as notional or contingent in nature.

2.6 The CIT(A) by referring to section 43A of the I.T.Act had decided the issue against the assessee. The relevant provisions of section 43A of the Act as amended by Finance Act, 2002 reads as follows:-

“Special provisions consequential to changes in rate of exchange of currency.

43A. Notwithstanding anything contained in any other provision of this Act, where an assessee has acquired any asset in any previous year from a country outside India for the purposes of his business or profession and, in consequence of a change in the rate of exchange during any previous year after the acquisition of such asset, there is an increase or reduction in the liability of the assessee as expressed in Indian currency (as compared to the liability existing at the time of acquisition of the asset) at the time of making payment—

(a) towards the whole or a part of the cost of the asset; or

(b) towards repayment of the whole or a part of the moneys borrowed by him from any person, directly or indirectly, in any foreign currency specifically for the purpose of acquiring the asset along with interest, if any,

the amount by which the liability as aforesaid is so increased or reduced during such previous year and which is taken into account at the time of making the payment, irrespective of the method of accounting adopted by the assessee, shall be added to, or, as the case may be, deducted from—

(i) the actual cost of the asset as defined in clause (1) of [section 43](#); or

(ii) the amount of expenditure of a capital nature referred to in clause (iv) of sub-section (1) of [section 35](#); or

(iii) the amount of expenditure of a capital nature referred to in [section 35A](#); or

(iv) the amount of expenditure of a capital nature referred to in clause (ix) of sub-section (1) of [section 36](#); or

(v) the cost of acquisition of a capital asset (not being a capital asset referred to in [section 50](#)) for the purposes of [section 48](#),

and the amount arrived at after such addition or deduction shall be taken to be the actual cost of the asset or the amount of expenditure of a capital

nature or, as the case may be, the cost of acquisition of the capital asset as aforesaid.”

2.7 It is clear from the above provision that section 43A of the I.T.Act applies where an assessee acquires an asset in a previous year. The EEFC account was maintained by the assessee to facilitate regular business operation and not for acquiring any asset. The Hon'ble Apex Court in the case of Oil and Natural Gas Corporation Limited v CIT reported in (2010) 322 ITR 180 (SC) had observed as under:-

“10. 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 AO 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 s. 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?

11. 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 brings into credits, what is due, immediately it becomes due and 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."

12. 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 s. 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.

13. 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 s. 37(1) of the Act."

2.8 Further, the ITAT Ahmedabad in the case of DCIT v. Shree Swati Texdyes Private Limited in ITA No.2016/Ahd/2013 (order dated 11.04.2017) on identical facts, has observed as under:-

7. In ground no. 2, the assessee has raised the following grievance: The Ld. Commissioner of Income-tax (Appeals)-XIV, Ahmedabad has erred in law and on facts in deleting the addition of Rs.1,15,37,454/- made on account of EEFC account, on account of forex loss claimed by Assessee

when these were proved to be not pertaining to import payable or export receivable.

8. The assessee was maintaining a US Dollar denominated bank account, in the nature of EEFC (Exchange Earner's Foreign Currency) account, with Citibank. During the course of scrutiny assessment proceedings, the Assessing Officer noticed that the assessee has credited foreign exchange gain of Rs 43,94,762, as on 31st March, the assessee has also debited foreign exchange loss of Rs 28,24,686 on the same date. When the matter was probed further, it was explained by the assessee that the assessee maintains the above account in US Dollars, and every time a transaction takes place, the difference between US Dollar rate then prevailing and the rate at which the account was earlier credited, is taken a foreign exchange gain or loss. As on the year end, since again the value of US Dollar balance is to be taken in the balance sheet at the applicable conversion rate, the loss or gain between the amount so computed vis-à-vis the amount already taken to books is taken as foreign exchange loss or gain. The Assessing Officer did not agree with the stand of the assessee.

He was of the view that the contentions of the assessee are factually as also legally incorrect. He noted that the amount of Rs 43,94,762 is not in respect of day to day transactions but an year end entry "by cumulatively considering all the transactions in EEFC account". As for the references to the Accounting Standards referred to by the assessee, the AO was of the view that these submissions are irrelevant as the amounts are not deductible under the Income Tax Act. As regards Hon'ble Supreme Court's judgment in the case of CIT Vs Woodward Governor India Pvt Ltd [(2009) 312 ITR 254 (SC)], the Assessing Officer was of the view that this decision does not apply to the facts of the case. It was held that "no doubt, foreign exchange loss in respect of import payable and export receivable is an allowable expenditure" but in the present case the transactions are not in respect of exports and imports and "therefore, these expenses are capital in nature". As regards the adjustment of Rs 28,24,686 in respect of year end balance, the AO observed that "the loss of Rs 28,24,686 does not pertain to any deposit/ withdrawal in the EEFC account" and "therefore, the entry of Rs 28,24,686 is a notional entry". The amounts of Rs 87,12,768 and Rs 28,24,686 were thus disallowed. Aggrieved, assessee carried the matter in appeal before the CIT(A) who deleted these disallowances by following Hon'ble Supreme Court's decision in the case of Woodward Governor (supra). The Assessing Officer is aggrieved and is in appeal before us.

9. Having heard the rival contentions, and having perusal the material on record, we see no reasons to interfere in the conclusions arrived at by the CIT(A). As regards the amount of Rs 87,12,768 all it represents is the difference in conversion rate, of US Dollars into Indian rupees, at the point of time when the EEFC account was originally credited vis-à-vis the point of time when subsequent debit entry, or vice versa, is made. As a matter of fact, these entries, truly speaking, do not even represent losses but merely deal with corrections in the conversion rate with respect to the

amounts utilized from EEFC account. These corrections are to be taken into account in computing the correct profits and losses. Be that as it may, whether these losses are treated as losses or corrections, the effect is the same- i.e. accounting for foreign exchange at the right rates. Quite interestingly, similar entries resulting in gains have been accepted by the Assessing Officer. These entries are admittedly in accordance with the Accounting Standards which are binding on the assessee. The method of accounting has been consistently followed by the assessee, it is fair and reasonable, and, as a result of the losses so booked, the accounts of the assessee show true and fair picture of the transactions. It is also noted that similar approach, when it resulted in net gains in subsequent assessment years i.e. 2011-12 and 2012-13, was accepted by the revenue authorities. In the light of Woodward Governor decision (supra) of Hon'ble Supreme Court, as the CIT(A) correctly concludes, the foreign exchange loss was indeed admissible. As regards the loss of Rs 28,24,686 in respect of US Dollar balance in the EEFC account, if these US Dollars are credited in the books of accounts at x value, whereas the present value is lower amount of y, the loss to the extent of x-y is required to be accounted for due to lower realizable value of these foreign exchange balance. it is one of the most fundamental principles of accounting that while all anticipated losses are taken into account in computing the profits and losses of business, even though such losses may not have crystallized, as long as these losses can be reasonably quantified. This approach can be contrasted with the anticipated profits being ignored, in the computation of profits and losses of an enterprise, unless the profits are actually realized. To that extent, there is a dichotomy in accounting approach but then this is what is the sound accounting policy and it has the sanction of law. As a matter of fact, it is this principle, as recognized by Hon'ble Supreme Court in the case of Chainrup Sampatram Vs CIT [(1953) 24 ITR 481 (SC)], which explains the valuation of closing stock on market price or cost price whichever is less. There is thus, in principle, no difficulty in seeking a deduction in respect of a reasonably anticipated loss, even though it may not have actually fructified, in computation of profits and gains of business. To this extent, the Assessing Officer was clearly in error in treating the loss on foreign exchange as a notional loss not deductible in computation of business income. Learned CIT(A) rightly reversed the action of the Assessing Officer in this regard.

2.9 Since the transaction in EEFC account undertaken during the year are trading in nature in order to facilitate the regular business operation of the assessee-company, we hold that the AO has erred in making an addition of Rs.79,27,497 to the income returned and the CIT(A) was not justified in sustaining the same. Therefore, we delete the addition. It is ordered accordingly.

2.10 In the result, ground No.2 is allowed.

ITA No.590/Bang/2019 (Revenue's appeal)

3. The grounds raised read as follows:-

a. Whether the CIT(A) not erred in considering the finance lease rentals as being revenue in nature, in view of the fact that the majority of the economic life of the assets would be consumed by the assessee company?

b. The CIT(A) erred in not considering that the expenses incurred towards assets which have enduring benefit should be treated as capital expenditure.

c. The CIT(A) erred in treating the leased rentals expenses as revenue in nature and dismissing assessee's appeal only in view of contravention of provisions of section 194-I of the IT Act.

d. For these and other grounds that may be urged at the time of hearing, it is prayed that the order of the CIT(A) in so far as it relates to the above grounds may be reversed and that of the Assessing Officer may be restored.

e. The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above."

3.1 During the relevant assessment year, the assessee had paid a sum of Rs.2,36,70,370 to M/s.First Lease Company India Limited towards equipment leasing. Out of R.2,36,70,317, the principal repayment was Rs.1,77,95,992, the interest and VAT aggregated to Rs.58,74,325. The assessee had claimed Rs.2,36,70,317 as a deduction. The A.O. in the impugned order held that the sum of RS.1,77,95,992 (i.e. Rs.2,36,70,317 – Rs.58,74,325), which was paid towards principal as an expenditure of capital in nature and accordingly added back to the returned income.

3.2 Aggrieved, the assessee preferred an appeal before the first appellate authority. The CIT(A) following his order for assessment year 2007-2008 in assessee's own case, directed the A.O. to verify whether there was violation of TDS provisions u/s 194-I of the I.T.Act and to make necessary disallowance u/s 40(a)(ia) of the I.T.Act. Further, the CIT(A) directed the A.O. to verify whether the assessee had claimed depreciation on the leased asset and if so, add back the same to the total income. The relevant finding of the CIT(A) reads as follows:-

“5.3 Facts involved are identical in the year under consideration as that for AY 2007-08. The appellant was required (order sheet dated 19.11.2018) to furnish the details and evidence of TDS if made by the assessee on payment of lease rental of Rs.2,36,70,317/- for the year. The appellant has filed copies of Form 16A in 10 numbers on next date of hearing on 17.12.2018 which contain large number of deduction entries u/s 194C and 194-I in respect of First leasing company of India Ltd. In view of this, the ARs were asked to file a reconciliation of lease rental paid and the TDS amount as per Form 16A by 24.12.2018. Though the appellant filed a copy of Form 3CD on 21.12.2018, no reconciliation of TDS was filed. The assessee never claimed before the AO that there was TDS effected on payment of lease rentals to First Leasing Company. At the other hand, the Form 3CD filed by the appellant mentions that an amount of Rs.53,89,970 is disallowable u/s 40(a)(ia) will get attracted if the same is violated. Therefore, the AO is directed to verify the details of TDS in respect of lease rentals of Rs.2,36,70,317/- paid by the assessee and disallow the amount which has been paid without TDS. The AO is also directed to verify the claim of the appellant that the depreciation amount relating to leased assets debited to P&L account has been added back in the computation of income and if this claim is found to be not true then to disallow such depreciation amount debited to P&L account.”

3.3 Aggrieved by the order of the CIT(A), the Revenue has filed this appeal before the Tribunal. The learned DR relied on the grounds of appeal.

3.4 The learned AR, on the other hand, relied on the findings of the CIT(A) and the judgment of the Hon'ble Apex Court in the case of I.C.D.S.Ltd. v. CIT & Anr. reported in (2013) 350 ITR 527 (SC).

3.5 We have heard rival submissions and perused the material on record. On a query from the Bench, both the learned Counsels submitted that they are not aware of the proceedings subsequent to the assessment orders for assessment years 2010-2011, 2011-2012 and the appellate proceedings for assessment year 2007-2008 (wherein similar additions were made).

3.6 As per clause 4 of the agreement between the assessee and the First Leasing (lessor) the asset shall remain the exclusive property of the lessor (First Leasing) at all times. It further provides that the lessee at no time during the lease period can capitalize the assets in its books of account since the ownership of the asset lies with the lessor. Further, as per clause 19 of the said agreement, the assessee company (lessee) shall surrender the leased assets to First Leasing in good condition and working order on expiration of agreement. It is also mentioned that the lessee shall reimburse all the cost to the lessor for replacing, missing components and repairing of non working components. From reading of the

agreement between the assessee and First Leasing, it is clear that the actual owner of the leased asset is the lessor and First Leasing, the lessor, is entitled to claim depreciation. The assessee-company has merely taken the assets on lease from the owner and it is accordingly eligible to claim actual rental expenses in the return of income. The Hon'ble Rajasthan High Court in the case of Rajshree Roadways v. Union of India reported in (2003) 263 ITR 206 (Raj.) had held that the lessor being the owner of the trucks, would be eligible for the benefit of depreciation. Further, it was held by the Hon'ble Court that the lessee having not the right to transfer or alienate the vehicle to other parties in any form, the lease rent paid by the assessee in that case (lessee) would be revenue expenditure. Further, the Hon'ble Karnataka High Court in the case of Banashankari Medical & Oncology Research Centre Ltd. v. JCIT reported in (2009) 316 ITR 407 (Kar.) had held that when equipments are not owned by the assessee, hire charges paid for leasing of the equipment is a revenue expenditure and is to be allowed as a deduction. As regards the CIT(A)'s directions to the A.O. to verify whether there was TDS made by the assessee while making payment for lease rentals and adding back the depreciation claim, the directions are to protect the interest of revenue. Therefore, the order of the CIT(A) is in accordance with law and we uphold the same.

4. In the result, the appeal filed by the assessee is partly allowed and the appeal filed by the Revenue is dismissed.

Order pronounced on this 04th day of January, 2022.

Sd/-
(Chandra Poojari)
ACCOUNTANT MEMBER

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 04th January, 2022.
Devadas G*

Copy to :

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2. The Respondent.
3. The CIT(A)-7, Bengaluru.
4. The Pr.CIT-7, Bengaluru.
5. The DR, ITAT, Bengaluru.
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Asst.Registrar/ITAT, Bangalore