

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

श्री महावीर सिंह, उपाध्यक्ष एवं श्री गिरीश अग्रवाल, लेखा सदस्य के समक्ष
BEFORE SHRI MAHAVIR SINGH, VICE PRESIDENT AND
SHRI GIRISH AGRAWAL, ACCOUNTANT MEMBER

आयकर अपील सं./ITA Nos.: **2945 & 2946/CHNY/2018 &**
1209/CHNY/2019

निर्धारण वर्ष /Assessment Years: 2012-13, 2014-15 & 2010-11

M/s. Venture Lighting India Limited,
Plot No.A-30, D5, Phase-II,
Zone-B, MEPZ,
Tambaram,
Chennai – 600 045.

The ACIT / DCIT,
v. Corporate Circle – 3(2),
Chennai.

PAN: AAACA 9284H

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by
प्रत्यर्थी की ओर से/Respondent by

: Shri S. Sridhar, Advocate
: Shri G. Johnson, Addl.CIT

सुनवाई की तारीख/Date of Hearing

: 03.03.2022

घोषणा की तारीख/Date of Pronouncement

: 04.03.2022

आदेश /O R D E R

PER GIRISH AGRAWAL, AM:

The two appeals in ITA Nos. 2945 & 2946/Chny/2018 by the assessee are arising out of common order of learned Commissioner of Income Tax (Appeals)-11, Chennai in ITA Nos.112/16-17 & 160/17-18, dated 29.09.2018. The assessments were framed by the ACIT / DCIT, Corporate Circle 3(2), Chennai for the assessment years 2012-13 &

2014-15 u/s.143(3) & 143(3) r.w.s. 92CA(3) of the Income-tax Act, 1961 (hereinafter 'the Act'), vide orders of different dates i.e. 01.03.2016 & 30.01.2018 respectively.

2. The only common issue in these two appeals of assessee is as regards to the order of CIT(A) confirming the action of AO in disallowing the claim of foreign exchange fluctuation loss to the extent of Rs.3,15,16,252/- in assessment year 2012-13 and Rs.1,84,89,537/- in assessment year 2014-15. For this, assessee has raised various grounds in both the appeals but for the sake of brevity the same are not reproduced.

3. The facts and circumstances are identical in both the assessment years 2012-13 & 2014-15, hence we will take the facts for assessment year 2012-13 in ITA No.2945/Chny/2018 and will decide the issue which will apply *mutatis mutandis* to the other appeal for A.Y. 2014-15 also.

4. Brief facts are that the assessee is engaged in the business of manufacturing and sale of Metal Halide Lamps and exporting the same. The AO during the course of scrutiny assessment proceedings noticed that the assessee has claimed deduction / loss on account of difference between actual exchange amount and exchange amount accounted for in the financial year relevant to assessment year 2012-13 amounting to

Rs.3,15,16,252/-. The AO required the assessee to furnish the details of exchange gain as well as exchange loss. In response to the same, assessee filed a letter dated 18.02.2016 and contended that as and when exports are made, invoices are made and issued in foreign currency and accounted in Indian rupees by converting the foreign currency to Indian rupees on the prevailing market rate of exchange on the date of invoice. When the export proceeds were realized on a later date, the company receives slightly higher or lower amount vis-a-via the invoice value as recorded in the books of accounts as the export value. The assessee follows mercantile system of accounting and in compliance to the Accounting Standard applicable, it translates all the assets and liabilities at the end of the year which are receivable or payable in foreign currency convertible into Indian Rupees at the prevailing conversion rate as on 31st March of every year. The debit or credit arising on account of said reinstatement fluctuations are accounted in the profit & loss account. If the exchange fluctuations arising due to reinstatement pertain to revenue account, the same is treated as business loss or business income depending upon the facts. In the present case, the Id. Counsel for the assessee stated that the assessee from the beginning is following the same method of accounting consistently in respect of accounting for the gain or loss arising due to exchange fluctuations on reinstatement. The AO was not convinced

with the reply of the assessee and thereby disallowed the claim of exchange fluctuation loss and added back to the returned income of the assessee. Aggrieved, assessee preferred appeal before the CIT(A).

5. The CIT(A) after considering submissions of the assessee confirmed the disallowance of exchange fluctuation loss claimed by assessee by observing in para 7 as under:-

“7. The submissions made by the assessee are considered. The assessee has been accounting for the gain in forex difference as on 31st of March in each of the years. This forex gain is accounted in the books of the assessee concern for book profit purposes. Subsequently, the assessee re-values the forex gain as on the date of filing of the return and makes a further correction to the forex gain admitted in the books of accounts. This practice followed by the assessee does not have any sanctity as per accounting policies. The method adopted is both incorrect and uncalled for. The assessee company is expected to close its books as on the last date of the FY. Any forex gain/loss received by it as on the last date of the FY should be accounted. The events subsequent to the end of the FY cannot be captured in the books. This amounts to claiming expenditure or showing income of the future year. This practice is incorrect and cannot be seconded. CBDT Instruction No.03/2010 dated 23.03.2010 is also indicative in this regard. Considering the same, the disallowance of forex loss claimed of Rs.3,15,16,252/-, being reversal of forex gain admitted in the books of accounts, is sustained. The grounds of appeal are rejected.”

Aggrieved, assessee is in appeal before the Tribunal.

6. At the outset, the Id. Counsel for the assessee filed a chart of foreign exchange / loss incurred on year-on-year basis and claimed that the assessee is following this method of accounting consistently. The relevant chart submitted before us reads as under:-

Particulars	AY 2010-11
Actual Exchange Loss/Gain Addition made to Business Income in Computation Memo-Exchange Loss/Gain	Rs.14,42,00,371/- (Loss)
Exchange Loss/Gain accounted: Deduction claimed in Business Income in Computation Memo-Exchange Loss/Gain	Rs.7,33,03,205/- (Loss)

Particulars	AY 2011-12
Actual Exchange Loss/Gain Addition made to Business Income in Computation Memo-Exchange Loss/Gain	Rs.1,79,96,287/- (Gain)
Exchange Loss/Gain accounted: Deduction claimed in Business Income in Computation Memo-Exchange Loss/Gain	Rs.62,48,824/- (Gain)

Particulars	AY 2012-13
Actual Exchange Loss/Gain Addition made to Business Income in Computation Memo-Exchange Loss/Gain	Rs.7,85,75,524/- (Gain)
Exchange Loss/Gain accounted: Deduction claimed in Business Income in Computation Memo-Exchange Loss/Gain	Rs.11,00,91,776/- (Gain)

Particulars	AY 2013-14
Actual Exchange Loss/Gain Addition made to Business Income in Computation Memo-Exchange Loss/Gain	Rs.6,75,12,024/- (Gain)
Exchange Loss/Gain accounted: Deduction claimed in Business Income in Computation Memo-Exchange Loss/Gain	Rs.6,32,60,086/- (Gain)

Particulars	AY 2014-15
Actual Exchange Loss/Gain Addition made to Business Income in Computation Memo-Exchange Loss/Gain	Rs.1,04,38,361/- (Gain)
Exchange Loss/Gain accounted: Deduction claimed in Business Income in Computation Memo-Exchange Loss/Gain	Rs.2,89,27,898/- (Gain)

Particulars	AY 2015-16
Actual Exchange Loss/Gain Addition made to Business Income in Computation Memo-Exchange Loss/Gain	Rs.7,36,83,130/- (Gain)
Exchange Loss/Gain accounted: Deduction claimed in Business Income in Computation Memo-Exchange Loss/Gain	Rs.4,13,00,994/- (Gain)

Particulars	AY 2016-17
Actual Exchange Loss/Gain Addition made to Business Income in Computation Memo-Exchange Loss/Gain	Rs.2,36,76,078/- (Gain)
Exchange Loss/Gain accounted: Deduction claimed in Business Income in Computation Memo-Exchange Loss/Gain	Rs.1,16,42,037/- (Gain)

This chart was also produced before the Id. CIT(A). The Id. Counsel reiterated the same set of arguments as placed before the Id. AO as well as before the Id. CIT(A). He also relied on the decision of Hon'ble Supreme Court in the case of CIT vs. Woodward Governor India P Ltd., reported in [2009] 312 ITR 254 (SC). On the other hand, the Id. Senior DR relied on the orders of the lower authorities.

7. We have heard rival contentions and gone through facts and circumstances of the case. We noted that the assessee is consistently following a policy and method of accounting admitting foreign exchange gain or loss on year-on-year basis. The assessee before us filed complete chart from assessment year 2010-11 to 2016-17 as noted above. Before us, the Id. Senior DR could not contradict the chart

placed before us. On query from the Bench in respect of treatment of gains in certain years by the Revenue, he could not contradict that it was accepted by the Revenue as part of total income of the assessee. Thus, this factual matrix remained uncontroverted and unchallenged. In the course of hearing, a query was also raised before Id. Counsel of the assessee to demonstrate the accounting procedure adopted for the reversal of reinstatement of assets and liabilities as on 31st March of every year on account of exchange fluctuations, for which the Id. Counsel referred to the paper-book compilation submitted before us and demonstrated the accounting methodology adopted by the assessee for the same. We have also gone through the judgment of Hon'ble Supreme Court in the case of Woodward Governor India P. Ltd., *supra*, wherein it was held that the loss suffered by assessee on account of foreign exchange difference as on the date of balance sheet is an item of expenditure allowable u/s.37(1) of the Act. Further, it was held that the accounting method followed by an assessee continuously for a given period of time needs to be presumed to be correct till AO comes to conclusion for reasons to be given that said systems does not reflect true and correct profits. Hence, in the present case before us also the facts being identical, we respectfully follow the said judgment. The Hon'ble Supreme Court in para 14 & 15 held as under:-

14. In the case of M.P. Financial Corporation v. CIT reported in 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 Corporation Ltd. v. CIT reported in 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 emphasize 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 assesseees 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 AO on the correctness or completeness of the accounts of the assessee. Equally, there is no finding given by the AO 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

In view of the reasoning given by us above and respectfully following the judgment of Hon’ble Supreme Court in the case of Woodward Governor India P. Ltd., *supra*, we allow the claim of the assessee. Accordingly, the orders of the lower authorities are set aside and the appeal of the assessee is allowed.

8. Appeal for assessment year 2014-15 vide ITA No.2946/Chny/2018 have identical factual matrix. Hence, taking a consistent view as held in paragraphs above in ITA No.2945/Chny/2018, the orders of the lower authorities are set aside and the appeal of the assessee for assessment year 2014-15 is allowed.

ITA No.1209/CHNY/2019 FOR A.Y. 2010-11:

9. This appeal by the assessee is arising out of order of learned Commissioner of Income Tax (Appeals)-7 in ITA No.94(T)/CIT(A)-7/2015-16, order dated 13.03.2019. The assessment was framed by DCIT, Corporate Circle 3(2), Chennai for the assessment year 2010-11 u/s.143(3) r.w.s. 147 of the Act vide order dated 20.03.2015.

10. The only issue in this appeal of assessee is against the order of CIT(A) confirming the disallowance of provision made towards stock amounting to Rs.25,00,000/-. For this assessee has raised various grounds, which we need not to reproduce for the sake of brevity.

11. Brief facts are that the AO during the course of assessment proceedings noticed that the assessee has made provision towards stock for an amount of Rs.75,00,000/- out of which provision made for the impugned year was for Rs.25,00,000/-. The AO required the assessee

to explain as to why the claim of provision for stock should not be disallowed. The assessee explained that during the year under consideration, the provision for stock was made for a sum of Rs.25,00,000/- in view of the fact that the assessee is situated in the Madras Export Processing Zone and for removal of some materials which has only negligible value from the Madras Export Processing Zone, it need to pay custom duty on the same. In order to meet that liability, a provision of Rs.25,00,000/- was made during the year. The balance of Rs.50,00,000/- pertains to other assessment years and shown as opening balance for 2010-11. The AO considered the explanation and found it not acceptable for the reason that this provision is only an estimate and it is not based on any scientific method or any working. According to him, the assessee has not produced any supporting evidences and the basis for creation of this provision. Therefore, he disallowed this provision. Aggrieved, assessee preferred appeal before CIT(A). The CIT(A) also confirmed the action of the AO exactly on same reasoning. Aggrieved, assessee came in appeal before Tribunal.

12. Before us, the Id. Counsel for the assessee stated that raw materials are imported and some raw materials become obsolete. Further, he stated that all the lamps manufactured by it cannot be sold due to quality issues and other reasons and have to be rejected.

Further, when these materials are sold from the Export Processing Zone, the payer has to pay Custom duty, Additional duty, VAT, etc., and because of these taxes, the value of material gets reduced substantially. Therefore, provision for stock was made. On query from the Bench, whether the provision is based on scientific method adopted for accounting this provision, the nature of the business, nature of sale, nature of product manufactured and sold and historical trend and number of articles produced and whether the assessee has submitted any such details before the lower authorities, the Id. Counsel could not answer and could not demonstrate before us by corroborative and cogent material on record that the provision is created on the basis of above factors. On the other hand, the Id. Senior DR supported the orders of the lower authorities.

13. We have heard rival contentions, perused the records and gone through facts and circumstances of the case. We noted that the assessee before us made a statement that the provision was based on scientific principles and proper working. However, on perusal of records and on specific query to the Id. Counsel of the assessee, we noted that provision for stock made by assessee is totally on adhoc basis, contingent in nature and that there is no historic trend explained before us. We noted that the Hon'ble Supreme Court in the case of Rotork

Controls India P. Ltd., vs. CIT, reported in [2009] 314 ITR 62 (SC) has noted the issue regarding contingent liability like warranty provision and held that the value of contingent liability, like the warranty expenses, if properly ascertained and discounted on accrual basis can be claimed as item of deduction u/s.37(1) of the Act. But, Hon'ble Supreme Court stated that the principle of estimation of contingent liability is not the normal rule. It would depend on the nature of the business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting adopted by the assessee. It would also depend upon the historical trend and upon the number of articles produced. All the parameters indicated by the Hon'ble Supreme Court while dealing with accounting for similar aspects like warranty provisions are not at all satisfied in the present case.

14. Further, the Hon'ble Supreme Court explained that a provision is a liability which can be measured only by using a substantial degree of estimation. But a provision is recognized when -

- a) an enterprise has a present obligation as a result of a past event;
- b) it is probable that an outflow of resources will be required to settle the obligation, and
- c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision can be recognized. Accounting Standard 29 (AS 29) issued by the Institute of Chartered Accountants of India (ICAI) relating to "Provisions, Contingent Liabilities and Contingent Assets" also enumerates the above three parameters for recognizing a "provision" in the books of account. A careful perusal of the above parameters on the recognition of provision listed above and dealt by AS 29 would show that there should exist a 'present obligation' as a result of 'past event'. The question here is whether 'provision for stock' claimed by the assessee as an allowable expense u/s. 37(1) of the Act would satisfy the above said requirements? The present obligation as a result of past event contemplates that there has occurred some event in the past and the same would give rise to some obligation to the assessee and further the said obligation should exist as on the Balance Sheet date.

15. However, we notice that the fact available in the instant case do not qualify the fulfillment of above parameters for the claim of assessee towards provision for stock of Rs. 25,00,000/-.

16. In the result, considering the factual matrix in the instant case, material available on record and the judicial precedence discussed above, the appeals filed by the assessee in ITA Nos.2945 &

2946/Chny/2018 are allowed and the appeal vide ITA No.1209/Chny/2019 is dismissed.

Order pronounced in the court on 4th March, 2022 at Chennai.

Sd/-

(महावीर सिंह)

(MAHAVIR SINGH)

उपाध्यक्ष /VICE PRESIDENT

Sd/-

(गिरीश अग्रवाल)

(GIRISH AGRAWAL)

लेखा सदस्य /ACCOUNTANT MEMBER

चेन्नई/Chennai,

दिनांक/Dated, the 4th March, 2022

RSR

आदेश की प्रतिलिपि अग्रेषित/Copy to:

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