

**IN THE INCOME TAX APPELLATE TRIBUNAL “K” BENCH, MUMBAI**

**BEFORE SHRI PRASHANT MAHARISHI, AM AND  
MS. KAVITHA RAJAGOPAL, JM**

ITA No. 8029/Mum/2019  
(Assessment Year: 2015-16)

M/s. JBF Industries Ltd. 8 <sup>th</sup> Floor, Express Towers, Nairman Point, Mumbai-400 021	Vs.	Asst. CIT-4(2)(2) Mumbai
PAN/GIR No. AAACJ 2575 J		
<b>(Appellant)</b>	:	<b>(Respondent)</b>
<b>Assessee by</b>	:	Shri K. Gopal
<b>Revenue by</b>	:	Shri Samruddhi Dhananjay Hande
<b>Date of Hearing</b>	:	24.11.2022
<b>Date of Pronouncement</b>	:	17.02.2023

**ORDER**

**Per Kavitha Rajagopal, J M:**

This appeal has been filed by the assessee, challenging the order of the learned Assessing Officer (A.O. for short) passed in pursuance to the proposal of the Id. Dispute Resolution Panel ('DRP' for short) u/s. 144(3) r.w.s. 144C of the Income Tax Act, 1961 ('the Act'), pertaining to the Assessment Year ('A.Y.' for short) 2015-16.

2. The assessee has challenged the upward adjustment of Rs.2,28,62,345/- on account of foreign exchange losses on ECB loan and also the upward adjustment of Rs.29,28,34,962/- on account of 'loss on derivative contracts'.

3. The brief facts are that the assessee company is a limited company engaged in the business of manufacturing and trading in POY, PTY, Bulk drugs, etc. The assessee filed

its return of income on 27.11.2015, declaring total income of Rs.14,61,44,220/- under the normal provisions and book profit of Rs.207,43,63,243/- u/s. 115JB of the Act. The assessee revised its return of income dated 16.05.2016, declaring total income of Rs.14,61,44,220/- under the normal provisions and book profit at Rs.207,42,63,243/- u/s. 115JB of the Act. The assessee's case was selected for scrutiny and the A.O. made a reference u/s. 92CA(1) of the Act to the Transfer Pricing Officer (TPO for short) for computation of arms length price in relation to the international transactions of the assessee and also made an addition on the foreign exchange losses on ECB loan, amounting to Rs.2,28,63,345/-. The A.O. also made an addition of Rs.29,28,34,962/- on account of 'loss on derivative contracts'. The assessee raised an objection before the Id. DRP, challenging the various additions made by the A.O. and after disposing of the objections, the A.O. passed the final assessment order as per the proposal of the Id. DRP. The assessee has challenged the impugned addition before us.

4. Ground no. 1 raised by the assessee is general in nature and ground no. 2 pertains to the disallowance of foreign exchange losses, upward adjustment of Rs.2,28,63,345/- on account of foreign exchange losses on ECB loan. It is observed that the assessee has availed ECB loan from Canara Bank for an amount of USD 40 million (INR Rs.234,54,29,000/-) during FY 2014-15 at an average exchange rate of Rs.58.8 per USD, for the purpose of refinancing the existing rupee borrowings from ICICI Bank, Axis Bank Ltd. and Aditya Birla Group. The assessee has stated that the said loan was not availed for making the payment for imported machineries or for purchase of fixed assets but was only to reduce the cost of borrowings and contended that it was in the nature of 'revenue

expenditure'. The assessee has stated that it had repaid USD 2 million at an average exchange rate of Rs.62.07 per USD and the balance USD 38 million was valued at an exchange rate as on 31.03.2015, thereby arriving at a loss of Rs.14,75,72,500/-. The assessee stated that the same has been amortized to the period of ECB loan and an amount of Rs.2,28,63,345/- has been claimed as an expenditure during the impugned year. The said loss was debited in the P & L account of the assessee.

5. The A.O. held that the same is to be capitalized to the cost of the asset and that the same was not allowable expenditure u/s. 37 of the Act. The A.O. relied on the decision of the Hon'ble Supreme Court in the case of *Sutlej Cotton Mills Ltd. vs. CIT* [1979] 116 ITR 1 (SC) when the foreign currency is used for the business or for trading purpose for transaction on revenue account, the loss on account of depreciation of its value due to the exchange rate will amount to 'trading loss', but if the said amount is held as 'capital asset' then the loss would be a 'capital loss'. The A.O. treated the same to be a 'capital loss'. The A.O. further held that the loss incurred on repayment of capital expenditure loans to be capital loss and the 'marked to market loss' claimed on the same is of notional in nature and held the same to be a 'speculation loss'. The A.O. disallowed the loss claimed in the impugned year, amounting to Rs.14,75,72,500/-, which has been amortized to the entire period of loan, thereby disallowing Rs.2.28 crores for the impugned year.

6. The contention of the assessee is that the interest paid including exchange difference is for the loan, which is not directly linked to the acquisition of the asset and will not be a capital expenditure. The assessee further contended that the losses are

incurred for the business activity of the assessee and had to be allowed as 'expenditure'. The same was not considered by the AO. The assessee further contended that the foreign exchange losses incurred on financial instruments are for the assessee's business and are not akin to that of the forex loans as per section 43A of the Act which is a fictional provision and the assessee further stated that the said expenditure incurred by the assessee are allowable as per section 37 of the Act. The assessee had tabulated the details of the loss on long term monetary item and the amortization of the same which are tabulated as below:

*Loss on Long Term Monetary Item*

<i>Loan Amount – Canara Bank ECB</i>	<i>USD</i>	<i>USD Rate</i>	<i>INR</i>
<i>New Loan Distributed on 19.05.14</i>	<i>3,00,00,000</i>	<i>58.3983</i>	<i>1,75,19,49,000</i>
<i>New Loan Disbursed on 19.05.14</i>	<i>1,00,00,000</i>	<i>59.3380</i>	<i>59,33,80,000</i>
<i>Total loan</i>	<i>4,00,00,000</i>	<i>58.6332</i>	<i>2,34,53,29,000</i>
<i>Repaid on 30.09.2014</i>	<i>10,00,000</i>	<i>61.5775</i>	<i>6,15,77,500</i>
<i>Repaid on 30.03.2015</i>	<i>10,00,000</i>	<i>62.57500</i>	<i>6,25,75,000</i>
<i>Closing balance</i>	<i>3,80,00,000</i>	<i>62.3355</i>	<i>2,36,87,49,000</i>
		<i>Gain /(loss)</i>	<i>(14,75,72,500)</i>

*Amortization of loss on long term monetary item*

<i>Working as AS-11 as on 31.03.2015</i>	
	<i>ECB – Canara Bank</i>
<i>Op. Balance</i>	<i>-</i>
<i>Exchange loss for the period ended 31.03.2015</i>	<i>14,75,72,500</i>
<i>Amount to be capitalised</i>	<i>-</i>
<i>Balance for the period to be amortised</i>	<i>14,75,72,500</i>
<i>Total as on 31.03.2015</i>	<i>14,75,72,500</i>
<i>Total period as on 31.03.2015</i>	<i>71</i>
<i>Remaining period as on 31.03.2015</i>	<i>60</i>
<i>Amortisation in Period ended 31.03.2015</i>	<i>2,28,63,345</i>
<i>Balance as on 31.03.2015</i>	<i>12,47,09,155</i>

7. The AO had rejected the claim of the assessee on the ground that ECB loan was availed by the assessee from Canara bank to refinance the other capital expenditure loans which was obtained in rupees and the foreign exchange loss incurred on repayment was

in the nature of capital loss which has to be capitalized to the cost of the same and hence was not allowable u/s. 37 of the Act.

8. The Id.AR for the assessee contended that loan availed was to save the interest cost as foreign currency loan was arrayed at much lower interest rate than the Indian loan. The Id. AR further stated that the foreign exchange loss was due to the fall in the value of Indian rupee against the US dollar and that there is restatement of outstanding foreign currency loan declared in the P&L account as per the requirement of AS-11. The Id.AR stated that section 43A of the Act was not applicable in assessee's case as the impugned loan was not availed for the purpose of acquiring assets and even otherwise as per the Income Computation and Disclosure Standards (ICDC) notified by CBDT, foreign exchange fluctuation loss was to be charged to the P&L statement. The Id. AR relied on the decision of the Hon'ble Apex Court in the case of *CIT vs. Woodward Governor India (P.) Ltd.* [2009] 312 ITR 254 (SC), wherein it was held that the said foreign exchange fluctuation loss as per mercantile system of accounting was claimed as 'revenue loss'.

9. The learned Departmental Representative (Id. DR for short) for the Revenue, on the other hand, contended that the said loan was obtained for refinancing the already existing capital expenditure loans received in rupees from 3 other banks. The Id. DR further contended that the said foreign exchange loss is to be a capital loss, which has to be capitalized to the cost of the asset and relied on the decision of *Sutlej Cotton Mills Ltd.* (supra). The Id. DR relied on the decision of the lower authorities.

10. Heard the rival submissions and perused the material on record. It is observed that the assessee has incurred a loss of Rs.147,572,500/- on foreign exchange loss and the same was amortized for the term period of the loan. The assessee company had stated that the said loan was not for the purpose of acquisition of assets or for expansion of the project, as the same was completed before the conversion of the loans and the capital asset was also put to use, prior to the said conversion.

11. From the submission made by both sides, it is evident that the assessee has not utilised the said loan for the purpose of acquisition of the assets and was only for the purpose of saving in interest costs. The AO has not controverted this fact and has merely stated that the assessee has availed loan for the purpose of acquisition of capital assets. There is no material evidence to prove this fact. In the absence of the said proof, we can conclude that the purpose of the loan availed by the assessee was to save the interest costs for the loan received from the banks. On perusal of the decisions cited by the Id. AR, it can be observed that the Hon'ble Apex Court has held that a profit or loss on account of fluctuation in foreign currency held by the assessee would ordinarily be a 'trading loss' or a circulating capital for the purpose of the business activity of the assessing. The Hon'ble Apex Court has also held that for the purpose of allowing any expenditure, it is essential to consider whether the accounting system followed by the assessee is Mercantile system that and whether the said system has been followed by the assessee without any change in the system and whether the assessee has treated the loss and gain in the same manner and has followed a consistent and definite methodology for maintaining its books of accounts along with various other criteria.

12. From the facts of the case, it can be concluded that section 42A of the Act is not applicable for the present case where the assessee is not said to have accrued any asset in foreign currency and the only object of refinancing the loan was to pay the earlier debts for the purpose of reducing the cost of interest. We would also like to place our reliance on the decision of the co-ordinate bench in the case of *Cooper Corporation (P.) Ltd. vs. Dy. CIT, Satara* [2016] 69 taxmann.com 244 (Pune-Trib.), where similar issue has been dealt with extensively in favour of the assessee and the relevant extract of the said decision is cited hereunder for ease of reference :

11. For the aforesaid reasons, in the absence of applicability of section 43A of the Act to the facts of the case and in the absence of any other provision of the Income Tax Act dealing with the issue, claim of exchange fluctuation loss in revenue account by the assessee in accordance with generally accepted accounting practices and mandatory accounting standards notified by the ICAI and also in conformity with CBDT notification cannot be faulted. No inconsistency with any provision of Act or with any accounting practices been brought to our notice. Otherwise also, in the light of fact that the conversion in foreign currency loans which led to impugned loss, were dictated by revenue considerations towards savings interest costs etc. we have no hesitation in coming to the conclusion that loss being on revenue account is an allowable expenditure under s. 37(1) of the Act. The order of the CIT(A) sustaining the disallowance is not called for and is thus reversed. In the result, the ground no. 1 is allowed.

13. From the above observation, and by respectfully following the decisions cited herein above, we are of the view that the loss incurred by the assessee in foreign currency exchange is allowable as 'revenue expenditure' and is a 'revenue loss' for which the assessee is entitled to deduction as 'revenue expenditure'. In the absence of any finding that the loan obtained by the assessee is utilized for the purpose of accruing assets, we hold that the said loan was availed for the purpose of reducing the cost of interest, which is an allowable expenditure u/s. 37(1) of the Act. The addition made on account of the

same is directed to be deleted and, therefore, ground no. 2 and its relevant grounds raised by the assessee are allowed.

14. Ground no. 3 pertains to the adjustment of Rs.29,28,34,962/- on account of loss on derivative contracts. It is observed that the assessee has entered into two derivative contracts amounting to Rs.100 crores (Rs.50 crores each) in the nature of interest and principal currency swap transaction where Rs.100 crores was converted into dollar loan at a fixed rate of USD/INR with ICICI Bank. As per the contract, the assessee has converted three months floating libor into the fixed libor rate pertaining to ECB loan of 20 million dollars from the DBS Bank during the financial year 2011-12. The said loan was to be repaid in 16 quarterly installments after moratorium period of 24 months. As per the accounting standards, the derivative contracts are to be valued at the yearend as and when the interest settlement is made. The resultant impact has to be transferred to the profit and loss account and the necessary provision entries are made in the books of accounts to provide for 'Marked to Market losses'. The assessee is said to have reversed the provision of section of Rs.32,17,21,685/- reflected at the beginning of financial year and adjusted the actual losses and gains to the said derivative account. The assessee passed an entry by debiting Rs.14,34,05,142/- as closing provision for 'marked to market losses' at the year end and balance of Rs.2,47,52,748/- was treated as 'net gain' offered as 'income'. The A.O. relied on the CBDT Board Instruction No.3/2010 dated 23.03.2010 for treatment of these two losses as being the difference between the purchase price and the value as on the valuation date, being a notional loss and is contingent in nature and thereby disallowing to be set off against the taxable income. The assessee

contended that the A.O. has not considered the reversal of the opening provision and treated the closing provision of Rs.14,34,05,142/- as 'loss' and disallowed the same as 'capital loss'. The assessee submits that the A.O. also had not considered the actual crystallized payment of Rs.15,36,34,919/- being the actual payment and held it to be a 'capital loss' thereby disallowing Rs.14,94,29,820/- after reducing 0.42 crores from payments made. The assessee contended that the derivative contracts are to be valued at the yearend in accordance with the accounting standards and the provision is made by recognizing 'marked to market losses'. The assessee has relied on the decision of the Hon'ble Apex Court in the case of *CIT vs. Woodward Governor India (P.) Ltd.* (supra) *Dy. CIT vs. Kotak Mahindra Investment Ltd.* [2013 35 taxmann.com 225 vide order dated 03.05.2013, wherein it was held that 'marked to market losses' arising out of derivative contract is allowable even in case where there is no actual loss. It also held that the derivative contracts are not merely contingent in nature where the profit or loss is computed as per the day to day market value. The assessee also relied on the assessee's case for A.Ys. 2011-12 and 2012-13 in ITA No. 701 & 702/Mum/2018 vide order dated 16.11.2018. The A.O., on the other hand, relied on the decision of the Hon'ble Apex Court in the case of *Sutlej Cotton Mills Ltd.* (supra), which held that the foreign currency exchange whether profit or loss is of capital nature. It is to be noted that the said decision relied on by the A.O. is distinguishable on facts and is not applicable to the present case in hand. We would also like to place our reliance on the decision of *Reliance Industries Ltd.* wherein it was held that the forex loss incurred during fluctuation in foreign currency exchange is not a notional loss and was allowable as 'deduction'.

15. From the above observation and by respectfully following the said decision, we hold that the 'marked to market loss' is not a notional loss and is, therefore, allowable expenditure. We also hold that the said transaction is not a speculative transaction as per section 43(5) of the act and is merely a hedging transaction and thereby the same would fall under the exception to section 43(5) of the Act. We hereby direct the A.O. to allow the said loss while computing the income of the assessee.

16. In the result, the appeal filed by the assessee is allowed.

*Order pronounced in the open court on 17.02.2023*

Sd/-

(Prashant Maharishi)  
Accountant Member

Mumbai; Dated : 17.02.2023  
Roshani, Sr. PS

Sd/-

(Kavitha Rajagopal)  
Judicial Member

**Copy of the Order forwarded to :**

1. The Appellant
2. The Respondent
3. The CIT(A)
4. CIT - concerned
5. DR, ITAT, Mumbai
6. Guard File

BY ORDER,

(Dy./Asstt. Registrar)  
ITAT, Mumbai