

**IN THE INCOME TAX APPELLATE TRIBUNAL  
"J" BENCH, MUMBAI**

**SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER  
SHRI RAHUL CHAUDHARY, JUDICIAL MEMBER**

**ITA No. 2019/MUM/2016  
(Assessment Year: 2011-12)**

**M/s Oetiker India Private Limited,**  
Business World Centre, St. Martin Road,  
Off Turner Road, Bandra,  
Mumbai - 400050  
[PAN:AAACO8083G]

..... **Appellant**

**Deputy Commissioner of Income Tax,  
Circle 13(1)(1), Mumbai**

Vs

..... **Respondent**

**Appearance**

For the Appellant/Assessee : Shri Ketan Ved  
For the Respondent/Department : Shri Samuel Pitta

**Date**

Conclusion of hearing : 01.06.2023  
Pronouncement of order : 25.08.2023

**ORDER**

**Per Rahul Chaudhary, Judicial Member:**

1. The present appeal is directed against Assessment Order dated, 29/01/2016, passed under Section 143(3) read with Section 144C(13) of the Income Tax Act, 1961 [hereinafter referred to as 'the Act'] for the Assessment Year 2011-12, as per directions issued by Dispute Resolution Panel-2, Mumbai- [hereinafter referred to as 'the DRP'] under Section 144C(5) of the Act.
2. The Appellant has raised following grounds of appeal:
  - (a) Ground No. 1 to 1.9 pertain to transfer pricing adjustment of INR 3,19,07,773/- in respect of international transaction of imports of goods

- (b) Ground No. 2 to 2.8 pertain to transfer pricing adjustment of INR 53,66,329/- related to payments of royalty
  - (c) Ground No. 3 to 3.8 pertain to transfer pricing adjustment of INR 41,75,987/- in respect of IT Service Charges and Other Expenses (for short 'IT Charges')
  - (d) Ground No. 4, 5 and 6 pertain to disallowance of foreign exchange loss of INR 4,04,64,260/-, INR 51,04,230/- (incorrectly mentioned as INR 39,18,016/-) and INR 26,65,991/- on account of restatement of External Commercial Borrowing (ECB) liability, interest payable on ECB and Other Expenses, respectively, in view of foreign exchange rate prevailing on the last day of the relevant previous year.
3. The relevant facts in brief are that the Appellant is a company incorporated during the Financial Year 2005-06 which commenced commercial operation during the Financial Year 2009-2010. The appeal before us pertains to Assessment Year 2011-12 which is the second year of commercial operations.
4. During the previous year 2010-11 relevant to the Assessment Year 2011-12, the Appellant was engaged in the business of, both, trading as well as manufacture and sale of steel clamps which are used for clamping hoses. For the Assessment Year 2011-12, the Appellant has filed its return of income on 29/09/2011 declaring 'Nil' income and claiming carry forward loss of INR 12,13,21,068/-.
5. The case of the Appellant was selected for regular scrutiny. During the assessment proceedings, the Assessing Officer noted that the Appellant has entered into the international transactions with its Associated Enterprises (AEs) and therefore, reference was made to the Transfer Pricing Officer (TPO) under Section 92CA(1) of the Act on 21.09.2010. The TPO, vide order, dated 19/01/2015, passed

under Section 92CA(3) of the Act, proposed aggregate transfer pricing adjustment of INR 5,07,98,566/- consisting of the following:

S.No.	International Transaction	Amount (INR)
1	Imports of goods	4,12,56,250/-
2	IT Service Charges	41,75,987/-
3	Royalty Payment	53,66,329/-
Total		5,07,98,566/-

6. The above Transfer Pricing Adjustments were incorporated in the Draft Assessment Order, dated 23/03/2015, by the Assessing Officer. In addition, the Assessing Officer also proposed following additions/disallowances in relation to the deduction claimed by the Appellant for loss arising from foreign currency fluctuation:

S.No.	Particulars	Amount (INR)
1	Loss on restatement of External Commercial Borrowing (ECB) Liability outstanding as on balance sheet date on account of foreign currency fluctuation	4,04,64,260/-
2	Loss on restatement of the amount of interest payable on ECB on account of foreign currency fluctuation	39,18,016/-
3	Other losses arising on account of foreign currency fluctuation	26,65,991/-

7. The Appellant filed objections before the DRP against the additions/disallowances proposed in the Draft Assessment Order. In order to support the contentions the Appellant also filed additional evidence. The DRP sought remand report from the Assessing Officer on additional evidence. In response the Assessing Officer filed Remand Report, dated 14/12/2015, which was provided to the Appellant by the DRP and in reply thereto the Appellant filed letter dated 15/12/2015 & 21/12/2015. The Appellant also filed

submission before DRP. After taking into consideration the aforesaid, the DRP disposed off the objections vide order dated 29/12/2015 passed under Section 144C(5) of the Act. Thereafter, as per the directions issued by the DRP, vide order dated 29/12/2015, the Assessing Officer passed the Final Assessment Order, dated 29/01/2016, under Section 143(3) read with Section 144C(13) of the Act making the following additions/disallowances:

S.No.	Particulars	Amount (INR)
1	Transfer Pricing Adjustment	4,14,50,089/-
	- Import from AE – INR 3,19,07,773	
	- IT Services Charge – INR 41,75,987	
	- Royalty Payment – INR 53,66,329	
2	Loss on restatement of External Commercial Borrowing (ECB) Liability outstanding as on balance sheet date on account of foreign currency fluctuation	4,04,64,260/-
3	Loss on restatement of the amount of interest payable on ECB on account of foreign currency fluctuation	39,18,016/-
4	Other Losses arising on account of foreign currency fluctuation	26,65,991/-

8. Being aggrieved, the Appellant has preferred the present appeal against the Final Assessment Order, dated 29/01/2016.
9. We have heard both the sides on the grounds raised by the Appellant (specified in paragraph 2 above), perused the material on record including the orders passed by the income tax authorities.

Ground No. 1 to 1.9

10. Ground No. 1 to 1.9 are directed against the transfer pricing adjustment of INR 3,19,07,773/- made in relation to the international transaction of import of goods.

11. The Learned Authorised Representative for the Appellant appearing before us had, at the outset, challenged the approach adopted by TPO/DRP of aggregating the manufacturing and trading segments and determining the ALP by benchmarking the transactions by applying the TNMM at the entity level. He submitted that the functions performed by the Appellant for trading and manufacturing activities are completely different. The aforesaid two segments are neither inter-connected nor inter-linked and hence, the same can never be benchmarked together. Ld. Authorised Representative for the Appellant submitted that the Trading Segment had earned a Gross Margin of 31.17% on sales and 45.29% on costs from the trading activities. This aspect of the matter has been completely lost sight of by the TPO. This aspect was also brought to the notice of the DRP as it was argued that the transactions of trading in clamping tools, pneumatic and hydraulic connections and manufacturing of steel clamps undertaken by the Appellant cannot be aggregated, since both the activities are neither inter-connected nor inter-linked, and the same have to be benchmarked separately. However, the DRP also rejected the submission of the Appellant.
12. Per contra the Learned Departmental Representative pointed out that TPO was constrained to adopt the aggregation approach as the Appellant had not provided segmental profitability statement. All that was submitted by the Appellant was computation of Gross Margins and on the basis of the same the TPO could not have proceeded to carry out transfer pricing analysis.
13. In rejoinder, the Learned Authorised Representative for Appellant submitted that the Appellant was never confronted with this fact. He

submitted that the Segmental Profitability Statement was available with the Appellant, however, the Appellant was never asked to furnish the same.

14. We have given thoughtful consideration to the rival submission and peruse the material on record.
15. The Indian transfer pricing regulations provide that each transaction or class of transactions must be benchmarked separately having regard to the arm's length principle by applying the most appropriate method. Thus, as per Indian transfer pricing regulations aggregation of separate, distinct and distinguishable transactions is not permissible. In the facts of the present case, in absence of any material on record to show that the trading segment is inter-linked or inter-related to manufacturing segment, the trading segment cannot be aggregated with the manufacturing segment for the purpose of benchmarking. The TPO was constrained to adopt aggregation approach since the correct segmental profitability statement was not placed on record. The Appellant has now filed Segmental Profitability Statement. Therefore, we deem it appropriate to set aside the transfer pricing addition of INR 3,19,07,773/- and remand the issue back to the file of TPO/Assessing Officer for determination of ALP and transfer pricing addition, if any. The Appellant is directed to co-operate and furnish all the information and details requisitioned by the TPO/Assessing Officer without inordinate delay. Thus, Ground No. 1.1 to 1.3 raised by the Appellant are allowed for statistical purposes while Ground No. 1.4 raised by the Appellant is dismissed.
16. In relation to Ground No. 1.5, the Ld. Authorised Representative for

the Appellant had submitted that the Appellant was operating at 34% capacity level during the relevant previous year, and therefore, had claimed low capacity utilization adjustment. The Learned Authorised Representative for Appellant contended that the Appellant was entitled to capacity utilization adjustment and submitted that capacity utilization adjustment was claimed on the basis of the data/information related to capacity utilization reflected in the financial statements of the Appellant wherein details production capacity and actual production were available. Though relevant material was placed before DRP, the DRP rejected the objection by simply reproducing the relevant extract of the remand report without giving its own findings. However, Learned Departmental Representative contested the veracity and the availability of data on record on the basis of which capacity utilization was claimed before the DRP. He submitted that the Appellant had failed to establish before the TPO/Assessing Officer why the Appellant was entitled to capacity utilization adjustment. Having considered the rival submission and on perusal of record we are of the view that the material facts on the basis of which the Appellant has set up the claim for adjustment for capacity utilization needs to be examined as the same do not clearly flow from the documents/material placed before us. Further, we have already remanded the issue of determination of ALP/transfer pricing adjustment for trading and manufacturing segment back to the file of Assessing Officer afresh in terms of paragraph 15 above. Therefore, we deem it appropriate to remand the issue relating to capacity utilization adjustment back to the file of TPO/Assessing Officer. The Appellant is directed to provide necessary information/details to establish his case for claiming low capacity

utilization adjustment before the TPO/Assessing Officer who shall decide the same as per law. It is clarified that the onus would be on the Appellant that low capacity utilization adjustment is to be granted in the facts and circumstances of the present case. In terms of the aforesaid, Ground No. 1.5 raised by the Appellant is allowed for statistical purposes.

17. In Ground No. 1.8 the Appellant has claimed that non-operational, abnormal and extraordinary expenses should be excluded while calculating the operating margins of the comparable. It was submitted by the Ld. Authorised Representative for the Appellant that this issue may also be remitted back to the file of the Assessing Officer/TPO to be decided keeping in view the findings/adjudication by the Tribunal in relation to Ground No. 4 to 6 dealing with claim of deduction for foreign exchange fluctuation loss. In our view, no prejudice to be caused to the Revenue in case the aforesaid submission of the Ld. Authorised Representative for the Appellant are accepted. Accordingly, issues raised in Ground No. 1.8 are remanded to the file of Assessing Officer/TPO. All rights and contentions are left open. In terms of the aforesaid, Ground No. 1.8 raised by the Appellant is allowed for statistical purposes.
18. As regards Ground No. 1.6, 1.7 and 1.9, no submissions were advanced in relation to the same during the course of hearing and therefore, the same are dismissed.

Ground No. 2 to 2.8

19. Ground No. 2 to 2.8 are directed against the transfer pricing adjustment of INR 53,66,329/- pertaining to the international transaction of payment of royalty by the Appellant to its AE.

20. During the year under consideration the Appellant had paid a royalty of INR 81,76,051 computed at the rate of 12% of the net invoice amount of all products manufactured and/or sold containing the AE's trademark and other services as per the terms of the Agreement, dated 05.12.2009. However, the TPO restricted the rate of royalty payment to 5% holding the same to be the arm's length royalty rate for determination of ALP by placing reliance on the Guidelines issued by the Reserve Bank of India (RBI) which provided automatic approval for remittance of royalty payments outside India, and proposed additional of the differential amount of INR 53,66,329/-. Before the DRP Appellant filed additional evidence. The Assessing Officer submitted Remand Report, 14/12/2015 in relation to the additional evidence and a response to the same was filed by the Appellant vide letter, dated 15/12/2015 and 21/12/2015. It was contended on behalf of the Appellant is that the DRP rejected the objections of the Appellant on this issue by simply making reference to the aforesaid Remand Report without giving any findings. Further, the DRP failed to appreciate that the TPO had not applied any of the prescribed methods for determining the ALP for royalty transactions. Alternatively, it was also contended that even after considering the royalty payment, the gross profit margin of the Appellant compared favorably and hence, the same can be considered at arm's length price.
21. Per contra, it was contended by the Learned Departmental Representative that the Appellant was making various payments to its AEs for use of trademark, for services etc. However, the Appellant had failed to establish the benefit drawn from the same. In the Remand Report, the Assessing Officer has pointed out that

even from non-AE sales, the Appellant has not made substantial profits and the suggest that purchase made from the AEs are on a higher side. Further, the payment of royalty over and above the purchase price has resulted in losses to the Appellant. In the immediately preceding financial year 2009-10 no royalty was paid by the Appellant to its AE. Further, the reliance placed by the Appellant on the royalty payments paid by other related parties to the AE cannot be accepted as the aforesaid transactions are controlled transactions. The Ld. Departmental Representative further submitted that even the alternative contention of the Appellant cannot be accepted as the same would render otiose the entire transfer pricing provisions. Favorable entity level margins cannot be taken as the sole basis to conclude that all the international transactions undertaken by such entity were at arm's length.

22. We have given thoughtful consideration to the rival submissions and perused the material on record. In our view, the approach adopted by the TPO/DRP cannot be countenanced. Rate of 5% specified by RBI as the rate upto which remittances of royalty payments outside India was adopted as arm's length rate of royalty by the TPO/DRP without examining whether the royalty payments were for use of trademark or for technical services. On the other hand, we note that the Appellant has also benchmarked the royalty payments on the basis of royalty payments charged from other group companies. We concur with the Ld. Departmental Representative that controlled transactions cannot form the basis of benchmarking the royalty payments. Therefore, even the approached adopted by the Appellant cannot be accepted. In view of the aforesaid, we set aside transfer pricing addition of INR 53,66,329/- made by the Assessing

Officer/TPO in respect of royalty payments and remand this issue back to the file of Assessing Officer/TPO for fresh adjudication as per law. As regards alternative contention raised by the Appellant is concerned, the same has become infructuous at this stage in view of our adjudication of Ground No. 1 to 1.8 above as we have set aside the ALP determined by the TPO/Assessing Officer. However, the Appellant would be free to raise the same before the TPO/Assessing Officer in the remitted proceedings. In terms of the aforesaid, Ground No. 2.6 raised by the Appellant is allowed for statistical purposes, while Ground No. 2 to 2.8 (except Ground No. 2.6) are dismissed as being infructuous.

Ground No. 3 to 3.8

23. Ground No. 3 to 3.8 challenges the transfer pricing adjustment of INR 41,75,987/- made in relation to the payment of IT Services Charges.
24. During the relevant assessment year, the Appellant paid INR 40,01,635/- to its AE towards amount charged for Intra-Group Services (for short 'IGS'). According to the Appellant IGS represent allocation of actual cost incurred by the Appellant increased by the mark-up of 10 percent.
25. We note that the TPO had concluded that no services were rendered by the AE and therefore, the ALP of the intra-group services was determined at 'NIL'. While disposing off the objections filed by the Appellant, the DRP also concluded that the Appellant had failed to satisfy the need-purpose-benefit test. By placing reliance on the Remand Report furnished by the Assessing Officer, the DRP had observed that the Appellant was not under obligation to make

payment for intra-group services as the agreement was not applicable for the relevant previous year as it came into effect later on.

26. During the course of the appellate proceedings before us, the Learned Authorised Representative for Appellant vehemently contended that the services were actually rendered to the Appellant. He submitted that although IT Service Agreement (*filed before TPO, vide submission dated 03/01/2015,*) pertained to the Financial Year 2012-13, the terms of the services stated therein as well as the method of charge had continued to be the same since the Financial Year 2010-11 relevant to the Assessment Year 2011-12. It was also contended by the Appellant that the DRP rejected the objections raised by the Appellant without returning independent findings and that the TPO had failed to use one of the prescribed methods for determining ALP as 'Nil'. Per Contra, the Learned Departmental Representative submitted placed reliance on the order passed by the TPO/DRP and submitted that the Appellant had failed to establish that the services were actually rendered. No independent party would have paid the IT Service Charges without receiving any services and therefore, the TPO/DRP were correct in concluding that the ALP of IT Service Charges was 'Nil' by applying CUP Method.
27. We have heard the rival submissions. There is nothing on record to show that the terms and conditions stated in the IT Service Agreement applicable for the Financial Year 2012-13 were identical to the terms and conditions as applicable during the Financial Year 2011-12. Therefore, the IT Service Agreement by itself does not advance the case of the Appellant as regards the fulfillment of the need-purpose-benefit test is concerned. During the course of the

hearing the Learned Authorised Representative had vehemently contended that the Appellant was, at the relevant time, still in the start-up phase and hence needed assistance to set up the business. Thus, in order to reduce its expenditure, it was not feasible for the Appellant to own its own software/IT license due to which it used the license provided by the AE and additionally purchases IT equipments from third parties in India. Further, the electro mechanic machines of the Appellant were IT enabled and require a robust set of IT setup for operation, maintenance & trouble shooting. The Appellant had submitted documents such as email correspondence before TPO/DRP. However, the TPO/DRP failed to consider the same. On the other hand, the Learned Departmental Representative relied on the order passed by the TPO and DRP wherein it was stated that the Appellant had failed to establish that the services were actually rendered and failed to satisfy the need, purpose and benefit test. Therefore, the TPO was correct in applying CUP Method to benchmark the transaction at 'Nil' as no independent party would have made payment of IT Charges. However, we also note that the Learned Departmental Representative had, while advancing arguments in relation to Ground No. 2 to 2.8 pertaining to transfer pricing adjustment related to royalty payments, submitted that the Appellant made multiple payments to its AEs and that there was need to examine the overlapping of scope of services and related payments. We note that Appellant had claimed that the IT Service Charges paid to AE are in the nature of cost allocation charges on which mark-up of 10% has been charged by the AE to the Appellant. The Appellant has filed invoices related to the IT Charge payments. Keeping in view the submissions advanced by both the sides and overall facts and circumstances of the case, we

deem it appropriate to grant another opportunity to the Appellant and remand the issue back to the file of the Assessing Officer to establish and substantiate the need, purpose and benefit of the IT Service Charges. Accordingly, the addition of INR 41,75,987/- in respect of IT Charge is set aside and Ground No. 3 to 3.8 are allowed for statistical purposes.

Ground No. 4

28. Ground No. 4 raised by the Assessee is directed against the disallowance of INR 4,04,64,260/- being the foreign exchange loss on account of External Commercial Borrowings.
29. The Assessee had entered into The External Commercial Borrowings Agreements, dated 22/01/2007 (Amendment Agreement dated 20/11/2008) and 30/03/2009 with its holding company, Inter Clamp Holding AG. Based on these ECB Agreements, the Appellant had raised the ECBs from Inter Clamp Holding AG:

S.No.	Date of Receipt of ECB Funds	ECB Amount [ CHF]	ECB Amount [INR]
1	26.10.2007	1,000,000	3,30,70,000
2	28.01.2008	5,00,000	1,77,24,714
3	23.06.2008	20,00,000	8,22,35,800
4	01.12.2008	5,00,000	2,32,99,160
5	22.03.2009	22,50,000	9,70,72,898
Total		62,50,000	25,34,02,572

Note: Out of the above 62,50,000 CHF was converted into equity share capital as per RBI approval.

30. On the last day of the relevant previous year (i.e. 31.03.2011), the outstanding ECB amount was restated at the prevailing foreign exchange rate and the difference on account of foreign exchange

rate was debited to the Profit & Loss Account, being foreign exchange loss amounting to INR 4,04,64,260/- in terms of Accounting Standard - 11 [for Short 'AS-11'] issued by the Institute of Chartered Accountants of India (ICAI). The AO disallowed the amount of INR 4,04,64,260/-. According to the Assessing Officer the ECB amount outstanding represents a capital expenditure. Further, the ECB proceeds were also utilised for discharging liability towards capital goods. Expenditure on account of capital nature was not allowable as a deduction under Section 37(1) of the Act. Further, the Appellant had only made a provision for contingent liability. Giving the aforesaid reasoning, the Assessing Officer disallowed the aforesaid deduction of INR 4,04,64,260/- being loss of account of foreign exchange fluctuation debited to the Profit & Loss Account on account of restatement of outstanding ECB liability as on the last day of the relevant previous year.

31. While disposing objections filed by the Assessee against above disallowance in the Draft Assessment Order, the DRP upheld the action of the Assessing Officer holding as under:

*"13.2.3: From the fact of the case it is evident that the assessee has revalued the ECB loan and claimed it as expenses for the current year. In the first place, a revaluation is of a loan is capital in nature and should not impact the P/L account. Secondly, it is only a book/notional loss and would not qualify as an allowable expense under the provisions of the Act. Under such circumstance, the contentions of the assessee are rejected."*

32. Being aggrieved, the Appellant is now in appeal before us.
33. We have heard the rival submission, perused the material on record and considered the position in law.

34. We find that the Appellant had borrowed funds by way of External Commercial Borrowings (ECBs) from its AE. As per the RBI Guidelines, ECBs can be raised either under automatic route or after obtaining necessary approval. However, the ECBs raised, whether under automatic route or approval route, are subject to end-use restrictions. At the relevant time, the ECBs could be raised for investment such as import of capital goods and the use of ECBs for the purpose of working capital purposes, general corporate purposes and for repayment of existing rupee loan was not permitted [*Refer to as per the Master Circular on External Commercial Borrowings and Trade Credits, dated July 1, 2011*]. We note that the Appellant had, in the written submission (@ page 14 of 18), stated that INR 12,03,72,058/- was used for purchase of imported goods. However, it is not clear whether the goods were purchased within India or from outside India which is to be considered for determining the applicability or otherwise of Section 43A of the Act. Accordingly, this issue is remanded back to the file of the Assessing Officer for fresh adjudication after verifying the correct fact and keeping in view the applicable ECB Regulations, Section 43A or 37 of the Act, the provisions of AS-11 and the accounting policy actually followed by the Appellant. Ground No. 4 raised by the Assessee is allowed for statistical purposes.

Ground No.5

35. Ground No. 5 raised by the Appellant are directed against the disallowance of loss on account of foreign exchange currency fluctuation related to interest payable on ECB.
36. We have considered the rival submissions and perused the material on record. Admittedly, the Appellant has claimed deduction of loss

on restatement of interest payable on ECB. In our view the aforesaid loss is not in the nature of contingent liability and is allowable as deduction under Section 37 of the Act in terms of the judgment of the Hon'ble Supreme Court in the case of Commissioner of Income Tax, Delhi Vs. Woodward Governor India Pvt. Ltd. : [2009] 312 ITR 254 (SC), wherein it has been held as under:

"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.

16. xx        xx

17. xx        xx

18. AS-11 deals with giving of accounting treatment for the effects of changes in foreign exchange rates. AS-11 deals with effects of Exchange Differences. Under para 2, reporting currency is defined to mean the currency used in presenting the financial statements. Similarly, the words "monetary items" are defined to mean money held and assets and liabilities to be received or paid in fixed amounts, e.g., cash, receivables and payables. The word "paid" is defined under section 43(2). This has been discussed earlier. Similarly, it is important to note that foreign currency notes, balance in bank accounts denominated in a foreign currency, and receivables/payables and loans denominated in a foreign currency as well as sundry creditors are all monetary items which have to be valued at the closing rate under AS-11. Under para 5, a transaction in a foreign currency has to be recorded in the reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. This is known as recording of transaction on Initial Recognition. Para 7 of AS-11 deals with reporting of the effects of changes in exchange rates subsequent to initial recognition. Para 7(a) inter alia states that on each balance sheet date monetary items, enumerated above, denominated in a foreign currency should be reported using the closing rate. In case of revenue items falling under section 37(1), para 9 of AS-11 which deals with recognition of exchange differences, needs to be considered. Under that para, exchange differences arising on foreign currency transactions have to

be recognized as income or as expense in the period in which they arise, except as stated in para 10 and para 11 which deals with exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which topic falls under section 43A of the 1961 Act. At this stage, we are concerned only with para 9 which deals with revenue items. Para 9 of AS-11 recognises exchange differences as income or expense. In cases where, e.g., the rate of dollar rises vis-a-vis the Indian rupee, there is an expense during that period. The important point to be noted is that AS-11 stipulates effect of changes in exchange rate vis-a-vis monetary items denominated in a foreign currency to be taken into account for giving accounting treatment on the balance sheet date. Therefore, an enterprise has to report the outstanding liability relating to import of raw materials using closing rate of exchange. Any difference, loss or gain, arising on conversion of the said liability at the closing rate, should be recognized in the P&L account for the reporting period.

19. xx        xx

20. xx        xx

21. In conclusion, we may state that in order to find out if an expenditure is deductible the following have to be taken into account (i) whether the system of accounting followed by the assessee is mercantile system, which brings into debit the expenditure amount for which a legal liability has been incurred before it is actually disbursed and brings into credit 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."

37. As per the judgment of the Hon'ble Supreme Court the loss/gain arising on account of foreign exchange fluctuation is to be recognized in the Profit & Loss Account for the relevant previous

year. Accordingly, the loss arising on account of restatement of interest payable thereon on the last day of the previous year as on account of foreign currency fluctuation per the provisions of Accounting Standard 11 would have to be recognized as loss of the relevant previous year.

38. In view of the above, we delete the disallowance of INR 39,18,016/- made by the Assessing Officer. Ground No. 5 raised by the Assessee, therefore, allowed.

Ground No.6

39. Ground No. 6 raised by the Appellant are directed against the disallowance of loss on account of foreign exchange currency fluctuation related to Other Expenses.
40. On perusal of record we find that the Assessing Officer disallowed INR 26,65,991/- holding the same to be foreign exchange loss debited to the Profit & Loss Account under the sub-head 'Others'.
41. Before DRP, it was contended on behalf of the Appellant that the foreign exchange loss under consideration arose on restatement of the amounts payable in foreign currency to the vendors for supply of raw materials, production consumables and services due to foreign exchange fluctuations. It was claimed on behalf of the Assessee that the expenses and the corresponding foreign exchange loss were a revenue nature and therefore, the Assessing Officer ought to have allowed deduction for the foreign exchange loss. It was further submitted that while disallowance of INR 26,65,991/- was made by the Assessing Officer, the correct amount was INR 8,24,190/- only. In view of the aforesaid submissions, the DRP

directed the Assessing Officer to verify the claim of the Assessee and provide appropriate relief.

42. In the Final Assessment Order, dated 29/01/2016, the Assessing Officer denied deduction claiming that the Assessee had failed to provide necessary documents and supporting evidences.
43. The Ld. Authorised Representative for the Assessee reiterated the submissions made before DRP and submitted that the Assessing Officer had failed to take into consideration the break-up of foreign exchange loss submitted by the Assessee and therefore, failed to implement the directions issued by DRP. Per contra, the Ld. Departmental Representative relied upon the Final Assessment Order and submitted that even after the directions given by the DRP the Assessee had failed to substantiate it's claim for deduction. In rejoinder, the Ld. Authorised Representative for the Assessee submitted that, even if for the sake of arguments the contention of the Ld. Departmental Representative was to be accepted, the amount of disallowance could not have being more than INR 8,24,190/-.
44. Keeping in view the facts and circumstances stated hereinabove, we deem it appropriate to remand this issue back to the file of Assessing Officer for fresh adjudication. The Assessing Officer is directed to verify the correct amount foreign exchange loss debited to the Profit & Loss Account under the sub-head 'Others' in respect of which deduction has been claimed by the Assessee while adjudicating the claim afresh. In terms of the aforesaid, the addition of INR 26,65,991/- made by the Assessing Officer is set aside and Ground No. 6 raised by the Appellant is treated as being

allowed for statistical purposes.

45. In terms of the above, the present appeal by the Assessee is partly allowed.

Order pronounced on 25.08.2023.

**Sd/-**  
**(S. Rifaur Rahman)**  
**Accountant Member**

**Sd/-**  
**(Rahul Chaudhary)**  
**Judicial Member**

मुंबई Mumbai; दिनांक Dated : 25.08.2023  
Alindra, PS

**आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :**

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त/ The CIT
4. प्रधान आयकर आयुक्त / Pr.CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT,  
Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

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