

**IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH : BANGALORE**

**BEFORE SHRI GEORGE GEORGE K, VICE-PRESIDENT
AND
SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER**

ITA No. 394/Bang/2023
Assessment Year : 2012-13

M/s. Bharat Electronics Ltd., Registered Office, Outer Ring Road Nagawara, Bangalore – 560 045. PAN: AAACB5985C	Vs.	The Assistant Commissioner of Income Tax, LTU, Circle – 1, Bangalore.
APPELLANT		RESPONDENT

Assessee by	:	Smt. Richa .B, CA
Revenue by	:	Shri Manoj Kumar, CIT-DR

Date of Hearing	:	20-09-2023
Date of Pronouncement	:	29-09-2023

ORDER

PER LAXMI PRASAD SAHU, ACCOUNTANT MEMBER

This is an appeal filed by the assessee against the order passed by the NFAC, Delhi dated 20.03.2023 DIN & Order No: ITBA/NFAC/S/250/2022-23/1050972174(1) on the following grounds of appeal:

“1. The order of the Ld. CIT (A) is opposed to law, facts and circumstances of the case.

2. *The order is passed against the principle of natural justice and thus, liable to be quashed*

3. *The learned CIT(A) has erred in confirming the disallowance of foreign exchange loss of Rs. 48,23,924.*

4. *The learned CIT(A) has failed to consider that provision of Section 43A of the Act has no application in the instant case as the foreign exchange loss is in respect of advance settlement of payment by letter of credit before receipt of fixed assets from the foreign vendors. Such loss imposed has no direct nexus with the acquisition of the fixed assets.*

5. *The learned CIT (A) erred in considering the advance payments before the acquisition of assets under section 43A of the Act, wherein the fact is that it is not covered under the provisions of the section.*

6. *The Learned CIT(A) erred in not applying the judicial pronouncements relied on by the appellant and further affirmed the additions by relying on other judgments wherein the facts are different.*

7. *The learned CIT(A) failed to appreciate that loss recognized on account of foreign exchange fluctuation as per notified accounting standard is a subsisting liability, eligible for deduction.*

8. *The learned CIT(A) has erred in making the disallowance under Section 14A read with Rule 8D.*

9. *The learned CIT(A) has erred in holding that the Assessing Officer has resorted to Rule 8D after recording his satisfaction that the claim made by the Appellant is incorrect.*

10. *The learned CIT(A) failed to consider that for the purpose of Rule 8D, only those investments relating to exempt income should be considered for the average and not the entire investment.*

11. *The learned CIT(A) failed to consider that the calculation of expenses related to exempt income cannot be on a notional basis, as it would result in the imposition of an artificial method of computation.*

12. The learned CIT(A) erred in assuming that there may be expenses expended for earning such exempt income despite the fact that no fresh investments were made during the year under review.

13. The Appellant craves leave to add, alter, substitute, and delete any or all the grounds of appeal urged above.

14. For the above and other grounds to be urged during the hearing of the appeal, the Appellant prays that the appeal be allowed in the grant of a refund.”

2. Briefly stated the facts of the case are that assessee is engaged in the manufacture and sale of Professional Grade Electronic equipment and components and power generation through wind mills. The assessee filed the original return of income on 18.09.2012 admitting an income of Rs.831,85,31,660/-. Subsequently the return was revised admitting an income of Rs.831,32,80,673/-. The case was selected for scrutiny and statutory notices were issued to the assessee and assessee filed requisite details. During the course of assessment proceedings, from the documents it is noticed from the annual report that a sum of Rs.3,70,63,515/- had been charged to the profit and loss account as foreign exchange differential loss. The details were called for and in response the assessee filed letter dated 15.12.2014 stated that there was a net loss of Rs.3,70,63,515/- and provided the breakup which is as under:

Appendix - VII				
Sharat Electronics Limited				
Assessment Year: 2012-13				
Foreign exchange differential loss break up on account of capital items and revenue items				
Sl. No.	Name of the Unit	FE gain / (Loss) on A/c of Capital - (A)	FE gain / (Loss) on A/c of Revenue - (B)	Total FE Gain/ Loss (A+B)
1	BG COMPLEX	(3,264,044)	24,284,942	21,020,898
2	GHAZIABAD	(602,908)	(58,727,207)	(59,330,115)
3	PUNE	42,004	1,231,954	1,273,958
4	NAVI MUMBAI	-	(19,598,058)	(19,598,058)
5	MACHILIPATNAM	(170,265)	3,861,990	3,691,725
6	PANCHAKULA	(778,420)	(2,970,711)	(3,749,131)
7	KOTDWARA	888,534	(3,930,920)	(3,042,386)
8	HYDERABAD	(8,287)	(11,534,724)	(11,543,011)
9	CHENNAI	-	(6,464,085)	(6,464,085)
10	HEAD OFFICE	86,707	40,589,983	40,676,690
	Total-FE Loss	(3,806,679)	(33,256,836)	(37,063,515)

3. Further, the assessing officer noticed from the significant accounting policy 14 at page no. 52 of the annual report indicated that the resultant exchange difference arising from the settlement of transaction relating to acquisition of fixed assets from place of outside India were recognised in the profit and loss account from 01.04.2007. It was contended that the revised accounting standard 11 issued by the Institute of Chartered Accountants of India was being adhered to. After referring to the accounting standard 11 and Schedule VI to the Companies Act, 1956, & submissions made by the assessee, the assessing officer was not convinced with the submissions of the assessee and he disallowed u/s. 43A to the extent of Rs.48,23,924/- and further the foreign exchange gain of Rs.10,17,445/-.

4. The assessing officer further noted from the financial statements that the assessee has made payments which are capable of generating income which are exempt from tax and has received dividend of Rs.2,60,00,000/- from GE BE Pvt. Ltd. which was claimed as exempt income u/s. 10(34) of the IT Act and the company has also cash credit account for which interest has been paid and charged to the profit and loss account. The assessee itself has disallowed u/s. 14A of Rs.1,30,000/- only. After considering the submissions of the assessee, the assessing officer calculated separately the disallowance u/s. 14A of Rs. 6,16,199/- and after adjusting, the assessee's disallowance he added back of Rs.4,86,199/- to the total income of the assessee.

5. Aggrieved by the order, the assessee filed appeal before the Ld.CIT(A) and made detailed written submissions. The CIT (A) after considering the submissions of the assessee, the disallowance towards foreign exchange loss for purchasing of fixed assets were disallowed by observing that the loss suffered by the assessee is in relation to the purchase of fixed assets and it cannot be treated as a revenue expenditure by relying on the Hon'ble Supreme Court judgment in the case of Woodward Governor Ltd. 80 taxmann.com 285 before AY 2017-18 and introduction of section 43AA from AY 2017-18 provide for the debit of such forex losses on revenue account to the profit & loss account of the assessee. Further the CIT(A) observed that in the case of Sulej Cotton Mills Pvt. Ltd. the Apex Court in 188 ITR 255 (SC), laid down an important observation to decide the fate of

forex gain/loss and dismissed the ground raised by the assessee treating the loss as capital in nature. Further in respect of disallowance u/s. 14A, the Ld.CIT(A) calculated the disallowance under Rule 8D(2)(iii) of Rs.4,69,055/- and directed the Ld.AO to restrict upto this amount.

6. Aggrieved by the above order, the assessee filed appeal before the Income Tax Appellate Tribunal.

7. The Ld.AR of the assessee reiterated the submissions made before the lower authorities and she has also filed a written synopsis which is as under:

“Only the investments yielding non-taxable income have to be considered and not all investments

1. *While, the Appellant had disallowed Rs. 1,30,000 in its return of income, as aforementioned, the learned Assessing Officer made the disallowance under Rule 8D(2)(ii) in addition to disallowance under Rule 8D(2)(iii) of Rs. 2,194/- and Rs. 6,14,005 respectively by holding that disallowance of expenditure made by Appellant is inadequate.*
2. *Nonetheless, the learned CIT(A) restricted the disallowance only under Rule 8D(2)(iii) 5,99,055/- and made the addition of Rs. 4,69,055/- (Rs. 5,99,055- Rs. 130,000). It is imperative to note that the learned CIT(A) deleted the addition under Rule 8(2)(ii) by holding that interest expenditure is mostly towards the trade payables and finance lease cost, since there are no other borrowings in the books of the Appellant for the year under consideration and therefore, no unattributable interest expenditure is there in case of the Appellant and hence, no liability arose under Rule 8D(2)(ii).*
3. *However, it is humbly submitted that the learned CIT(A) has incorrectly calculated the disallowance under Rule 8D(2)(iii). It is reiterated that Rule 8D(2)(iii) postulated that in the calculation of the disallowance amount, "an amount equal to one-half percent of the value of the investment, income from which does not or shall not form part of the total income" should be taken into consideration. Thus, it is not all investment but only that which is expressly spelled out in rule 8D(2)(iii) read with section 14A is to be reckoned for the purpose of calculation of the required average percentage. Having said this, learned CIT(A) ought to have considered Rs. 1,30,000 i.e. 0.5% of Rs. 2,60,00,000/- (investments made in GE BE Private Ltd. on which exempt dividend income was received) instead of considering Rs. Rs. 5,99,055/- i.e. 0.5% of Rs. 11,98,11,000/- for calculating disallowance under Rule 8D(2)(iii).*

4. In other words, in the instant case, the learned CIT(A) instead of adopting the average value of investment of which income is not part of the total income i.e., the value of tax-exempt investment, chose to factor in the total investment itself.
5. In this regard, the Appellant wishes to place reliance on the judicial pronouncement of Delhi High Court in the case of **ACB India Ltd. v. Asstt. CIT [2015] 62 taxmann.com 71/235 Taxman 22/374 ITR 108 (Delhi)** wherein it was held that for the purpose of Section 14A, instead of taking into account total investment, investment attributable to dividend (exempt income) was required to be adopted and thereafter disallowance was to be arrived. A similar issue came in the case of **Pr. CIT v. Indiabulls Capital Services Ltd [2020] 114 taxmann.com 647** wherein the SLP of revenue was dismissed upholding the validity of judgment in ACB India Ltd's (supra) stating that where the assessee in his return has himself apportioned expenditure but the AO was not accepting the said apportionment, in that eventuality, the Assessing Officer will have to record its satisfaction to this effect. We find that no such satisfaction has been recorded by the AO to come to the conclusion to invoke the provisions of Section 14A(2) and the disallowance is directed to be deleted.
6. Further, various courts on different occasions have also held that **investments which not yielded income cannot be considered and investments that yielded income only be considered for computing the disallowance:**
 - **Welspun India Ltd. v. Dy. CIT (2019) 69 ITR 617 (Mum) (Trib.)**
 - **PTC India Ltd. v. DCIT (2019) 69 ITR 37(SN.) (Delhi) (Trib.)**
 - **ACIT v. Paras Buildtech (India) (P.) Ltd. (2018)62 ITR 284 (Delhi) (Trib.)**
 - **ACIT v. Vireet Investment Pvt. Ltd. (2017) 165 ITD 27 / 58 ITR 313 / 154 DTR 241 / 188 TTJ 1 (SB) (Delhi) (Trib.)**
 - **Dy.CIT v. Diamond Co. Ltd. (2017) 162 ITD 131 (Kol.) (Trib.)**
 - **Yashoda Health Care Services P. Ltd. v. DCIT (2017) 54 ITR 26 (Hyd.) (Trib.)**
 - **Electrosteel Castings Ltd. v. DCIT (2017) 53 ITR 5 (Kol.) (Trib.)**
7. While calculating the disallowance under section 14A, only the investments that have generated exempt income should be taken into consideration. In other words, if an investment has not yielded any exempt income during a given period, the associated expenses or deductions related to that investment may not be eligible for disallowance. Therefore, the investments which are not capable of yielding the dividend income needs to be excluded while calculating the exact disallowance under section 14A of the Act.
Effect of Explanation inserted in section 14A by Finance Act 2022
8. Further, the learned CIT (A) has wrongly alleged that even if there is no exempt income disallowances required to be made. In this regard, the learned CIT (A) drew the support from the amendment to Section 14A of the Act by Finance Act 2022 by way of insertion of an Explanation. The Notes on clauses explaining the intention behind insertion of Explanation to Section 14A states as under-
"It is also proposed to insert an Explanation to the said section to clarify that notwithstanding anything to the contrary contained in this Act, the provisions of the said section shall apply and shall be deemed to have been always applied in a case where the income, not forming part of the total income, has not accrued or arisen or has not been

received during the previous year relevant to an assessment year and the expenditure has been incurred during the said previous year in relation to such income not form part of the total income. This amendment will take effect from 1st April, 2022.”

Clauses 4, 5, 6 & 7 of the Memorandum of Finance Bill, 2022 reproduced hereinbelow provide following guidelines:

"4. In order to make the intention of the legislation clear and to make it free from any misinterpretation, it is proposed to insert an Explanation to section 14A of the Act to clarify that notwithstanding anything to the contrary contained in this Act, the provisions of this section shall apply and shall be deemed to have always applied in a case where exempt income has not accrued or arisen or has not been received during the previous year relevant to an assessment year and the expenditure has been incurred during the said previous year in relation to such exempt income.

5. This amendment will take effect from 1st April, 2022.

6. It is also proposed to amend sub-section (1) of the said section, so as to include a non-obstante clause in respect of other provisions of the Income-tax Act and provide that no deduction shall be allowed in relation to exempt income, notwithstanding anything to the contrary contained in this Act.

7. This amendment will take effect from 1st April, 2022 and will accordingly apply in relation to the assessment year 2022-23 and subsequent assessment years."

9. Thus, Memorandum of the Finance Bill, 2022 reveals that **it explicitly stipulates that the amendment made to Section 14A will take effect from 1st April, 2022 and will apply in relation to the assessment year 2022- 23 and subsequent assessment years.**
10. The learned CIT (A) in its order relied on the decision of Williamson Financial Services Ltd. [2022] 140 taxmann.com 164/196 ITD 422 (Guwahati ITAT Guwahati Bench in ACIT v. - Trib.), which observed as under –

“In order to remove the prevailing doubts about the interpretation of the provisions of section 14A and to overcome the interpretation given by the various High Courts regarding the applicability of provisions of section 14A and to make the intention of the legislation clear and to make it free from any misinterpretation, the Parliament has brought in an Explanation to section 14A. Further, sub-section (1) of section 14 has been amended so as to include a non obstante clause to provide that no direction shall be allowed in relation to exempt income, notwithstanding anything contrary contained in the Act.”
11. It was held in this decision of ITAT Guwahati Bench that this explanation is clarificatory in nature and will therefore, be applicable retrospectively as it effective from 01-04-2022. **However, it is pertinent to mention that the view held by ITAT Guwahati Bench in the above case is not approved by Hon'ble Delhi High Court in Pr. CIT v. Era Infrastructure (India) Ltd. [2022] 141 taxmann.com 289/288 Taxman 384 where it was held, following the judgment of Hon'ble Supreme Court in Sedco Forex International Drill Inc. v. CIT [2005] 149 Taxman 352/12 SCC 717 (SC), that the amendment of Section 14A, which is "for removal of doubts" cannot be presumed to be retrospective, even where such language is used, if it alters or changes the law as it earlier stood. Therefore, the Explanation is held prospective. The decision of Hon'ble Delhi High Court in Era Infrastructure Ltd. (supra) was followed in following cases –**

- *Dy. CIT v. Lodha Developers Ltd. [2022] 143 taxmann.com 442 (Mum. - Trib.);*
 - *Asstt. CIT v. Bajaj Capital Ventures (P.) Ltd.[2022] 140 taxmann.com 1/196 ITD 24 (Mum. - Trib.)*
12. Thus, in view of the submissions made above, it is humbly submitted that if there is no exempt income, naturally, there cannot be any disallowance under Section 14A of the Act because no expenditure has been incurred on any exempt income during the year. Further, the reliance placed by the learned CIT (A) on the amendment made by the Finance Act 2022 applies prospectively as held by the Hon'ble Delhi High Court in *CIT v. Era Infrastructure (P.) Ltd. [2022] 141 taxmann.com 289/288 Taxman 384/448 ITR 674*. Therefore, for the assessment year 2012-13, no disallowance could be made under Section 14A if no exempt income was earned by the Appellant.
 13. Alternatively, it is submitted that the Assessing Officer has stated the reason for making the disallowance under section 14A of the Act that
 14. "It is pertinent to note that the investments flow from a common pool of funds, viz., the current or cash credit accounts. The business receipts and payments as well as investments are made from these accounts. Therefore, it cannot be assumed that the investments were made exclusively out of non-interest bearing or surplus funds."
 15. The learned assessing officer himself has stated that the only such expenses that cannot be allocated to any specific head of income and are non-identifiable can be considered for invoking Rule 8D. In this regard, it is humbly submitted that the learned Assessing Officer, hence, has failed to demonstrate the correct reason for invoking Rule 8D. The reason stated by the Assessing Officer itself is invalid and non-existent as the Appellant has not incurred any interest expenditure which is unattributable. The interest expenditure is clearly identifiable and is mostly towards the trade payables and finance lease costs since there are no other borrowings held by the Appellant. It is reiterated that the Appellant does not have any long-term or short-term borrowed funds for the said year.
 16. In a nutshell, it is humbly submitted that where the assessing officer gets jurisdiction to make disallowance, he has to compute the disallowance in accordance with the prescribed method under rule 8D and while applying rule 8D, the assessing officer has to consider only such investments which yielded tax-free income and not the entire investments. Additionally, the learned Assessing Officer has failed to demonstrate the correct reason for invoking Rule 8D.
 17. Given the above, it is submitted that the Appellant has rightly made the disallowance of Rs. 1,30,000/- under Section 14A of the Act r.w. Rule 8D in its return of income and it is humbly submitted that disallowance to the tune of Rs. 4,69,055/- (5,99,055-1,30,000) on total investments is unjustified.

B. Disallowance of Foreign exchange loss of Rs. 48,23,924/- under Section 43A of the Act.

Grounds as per Form 36

- III. The learned CIT(A) has erred in confirming the disallowance of foreign exchange loss of Rs. 48,23,924.
- IV. The learned CIT(A) has failed to consider that provision of Section 43A of the Act has no application in the instant case as the foreign exchange loss is in respect of advance settlement of payment by letter of credit before receipt of fixed assets from the foreign vendors. Such loss imposed has no direct nexus with the acquisition of the fixed assets.

- V. *The learned CIT (A) erred in considering the advance payments before the acquisition of assets under Section 43 A of the Act wherein fact it is not covered under the provisions of the Section.*
- VI. *The learned CIT(A) erred in not applying the judicial pronouncements relied on by the Appellant and further affirmed the additions by relying on other judgments wherein the facts are different.*
- VII. *The learned CIT(A) failed to appreciate that loss recognized on account of foreign exchange fluctuation as per notified accounting standard is a subsisting liability, eligible for deduction.*

Submissions

1. *During the year under consideration, the Appellant has claimed the foreign exchange loss on capital items as per the 'Significant Accounting Policy' followed by the Appellant.*
2. *It may be noted that there was a net loss of Rs. 3,70,63,515/- on account of foreign exchange, which was duly accounted for in the profit and loss account of the Appellant. Out of the net loss of Rs. 3,70,63,515/-, the net foreign exchange loss on account of capital items is Rs. 38,06,679/-, and the balance pertains to the revenue items. It is imperative to note that the net foreign exchange loss on capital items is calculated after taking the exchange gain of Rs. 10,70,445/- into consideration. Thus, there was a foreign exchange loss of Rs. 48,23,924/-*
3. *The learned Assessing Officer disallowed the entire foreign exchange loss of Rs. Rs. 48,23,924/- holding that the foreign exchange loss is attributable to the cost of capital assets acquired by the Appellant, and necessary adjustment towards depreciation shall be allowed on furnishing the requisite details. It is humbly submitted that the CIT(A) also, without appreciating the facts in hand, upheld the order of learned A.O. held that forex loss in the present case is on account of capital account and cannot be debited to the P/L account.*
4. *It is humbly submitted that the learned Assessing Officer and learned CIT (A) has failed to appreciate the fact that the Appellant had obtained a letter of credit in the process of buying the capital asset as detailed in **Annexure 1** and not for the acquisition of the capital asset.*
5. *In trade parlance, the buyer and vendor negotiate on several terms as per the common prevalent practices. Having said this, at the outset, it is imperative to understand the nature of a Letter of Credit ('LC') and the mechanism generally followed in international trade vis a vis LC.*
6. *LC is a very common document used in international trade. It is a letter issued by the buyer's bank, guaranteeing payment to the seller upon fulfillment of the conditions mentioned therein. Generally, these conditions are with respect to the presentation of certain documents evidencing the transportation/ shipping of goods.*
7. *The structure of a typical documentary LC transaction can be best understood as under:*
 - a. *The Seller and the Buyer enter into an agreement to buy and sell goods with the condition that payment will be made through LC;*
 - b. *The Buyer thereafter files an application with his bank ("Issuing Bank") to issue LC against pledge over document related to the transaction for which LC is to be issued;*
 - c. *The Issuing Bank issues LC and sends it to the Seller's Bank ("Advising Bank");*
 - d. *The Advising Bank subsequently examines the LC and informs the Seller;*
 - e. *The Seller thereafter dispatches the goods to Buyer;*
 - f. *The Seller presents documents under LC to the Advising Bank;*

- g. (i) The documents are checked, and forwarded to the Issuing Bank; (ii) If the documents are in place, payment is processed by the Advising Bank;
- h. The documents are then verified by the Issuing Bank and accordingly reimbursement is made to the Advising Bank;
- i. The Buyer then makes payment to the Issuing Bank and documents related to transaction are release

8. Thus, it is apparent that in the instant case, the Appellant, following the common practice of obtaining LC in the process of buying of the capital asset, has made the advance payments, and accounted for impugned foreign exchange loss on such payments. It has no relation or connection with the acquisition of any capital asset. Moreover, all these payments were concluded well before the acquisition of the capital asset. In other words, such foreign exchange loss has no direct nexus with the acquisition of the capital asset. Thus, it is humbly submitted that impugned foreign exchange loss, by no stretch of the imagination, would fall under the four corners of Section 43A of the Act. In order to illustrate the same, the provisions as contained in Section 43A of the Act is reproduced here-in-below for ready reference

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:

Provided that where an addition to or deduction from the actual cost or expenditure or cost of acquisition has been made under this section, as it stood immediately before its substitution by the Finance Act, 2002, on account of an increase or reduction in the liability as aforesaid, the amount to be added to, or, as the case may be, deducted under this

section from, the actual cost or expenditure or cost of acquisition at the time of making the payment shall be so adjusted that the total amount added to, or, as the case may be, deducted from, the actual cost or expenditure or cost of acquisition, is equal to the increase or reduction in the aforesaid liability taken into account at the time of making payment.

9. From the plain reading of Section 43A of the Act, one can infer that it deals with a situation where any asset is acquired from a country outside India for the purposes of business and if there is an increase or reduction in liability 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 towards the whole or part of the cost of the asset or towards repayment of whole or part of money borrowed by him from any person directly or indirectly, in any foreign currency specifically for the purposes 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 payment, irrespective of method of accounting adopted by the assessee, shall be added to, or as the case may be deducted from the actual cost of asset and the amount arrived at after such addition or deduction shall be taken as actual cost of the asset.
10. It is apparent that Section 43A of the Act shall be applicable **only if an asset is acquired** from a country outside India and **at the time of payment, there is a difference in liability**, instead of treating the same as income or loss, the same shall be adjusted to the actual cost of the asset and the balance shall be taken as actual cost.
11. It is reiterated that Section 43A of the Act is applicable only in consonance of the acquisition of capital asset and not otherwise and in the instant case, impugned foreign exchange loss has no relation with the acquisition of capital asset. It is humbly submitted that as explained above, the Appellant had obtained Letter of Credit following the common practice of international trade and made the advance payment against such letter of credit, way before acquisition of the capital asset. The impugned foreign exchange fluctuation on such advance payment has no connection with acquisition of capital asset per se. Such payments utmost can be considered to be made to initiate the process of buying and not for acquisition of capital asset.
12. In this regard, reliance is placed on the following judicial pronouncements –
Cooper Corporation (P.) Ltd. vs. Deputy Commissioner of Income-tax [2016] 69 taxmann.com 244 (Pune - Trib.)
 “Thus, it is evident the variation in the loan amount has no bearing on the cost of the asset as the loan is a distinct and independent transaction in comparison with the acquisition of assets out of said loan amount borrowed. The actual cost of the corresponding fixed asset acquired earlier by utilizing the aforesaid loan will not undergo any change owing to such fluctuation.”
13. Further, it is humbly submitted that nothing can be added or reduced to the actual cost of assets except a situation that is envisaged in Section 43A of the Act because of its non-obstinate clause. The activity of repayment of LC and the actual cost of the asset are two different things and cannot be read from one to another.
14. The impugned fluctuation loss has a direct nexus to only providing a guarantee to the vendor, and it has no direct nexus or relation to bringing new capital asset into existence. Since, the business exigencies are implicit as well as explicit in the action of the Appellant

and the LC was only obtained to provide the comfort of the guarantee to the vendor and therefore, it portrays commercial expediency, thereby it is eligible for deduction under the Act.

15. *It is pertinent to note that the Appellant has inter alia followed its accounting policy in line with AS-11 dealing with the effects of the changes in the exchange rate to record the losses incurred owing to fluctuation in the foreign exchange. AS-11 enjoins reporting of monetary items denominated foreign currency using the closing rate at the end of the accounting year. It also requires that any difference, loss or gain, arising from such conversion of the liability at the closing rate should be recognized in the profit & loss account for the reporting period.*
16. *Also, the Appellant wishes to place the reliance in the case of **Sutlej Cotton Mills Ltd. v. CIT [1979] 116 ITR 1** held as under: "The law may, therefore, now be taken to be well-settled that where profit or loss arises to an assessee on account of appreciation or depreciation in the value of foreign currency held by it, on conversion into another currency, such profit or loss would ordinarily be a trading profit or loss if the foreign currency is held by the assessee on revenue account or as a trading asset or as a part of circulating capital embarked in the business. But; if on the other hand, the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital nature. . . ." (p. 13) [Emphasis supplied]*
17. *Thus, in light of the above submissions, it is contended that the Section 43A of the Act is not applicable in the case of the Appellant as the foreign exchange loss/gain pertains to the advance payment by Letter of Credit (i.e., before acquiring the assets) but not on the actual cost of the assets.*

Prayer:

In light of the submission made hereto above, the Appellant pleads your learned Authority to:

- a. *Delete the addition made by the learned Assessing Officer on account of disallowance of expenditure under Section 14A read with rule 8D and disallowance of the foreign exchange loss passing such order as your learned Authority deems fit.*
- b. *hear and dispose of the appeal in accordance with law and the merits of the case, and*
- c. *set aside the order of assessment by passing such order as your Authority deems fit and proper."*

8. In addition to the above, the Ld.AR vehemently argued that in the case of the assessee, disallowance of foreign exchange loss u/s. 43A is not applicable. Therefore the assessing officer is not justified. The loss suffered by the assessee was only towards arrangement for the payments made through Letter of Credit (LoC).

9. On the other hand, the Ld.DR relied on the order of the lower authorities.

10. After hearing the rival contentions, we noted that the assessee has incurred foreign exchange loss towards arrangement of the LoC on purchase of fixed assets which has been disallowed by the Assessing Officer u/s. 43A however the Ld.CIT(A) has treated it as a capital expenditure and not to be treated as a revenue expenditure, relying on the judgment of the Hon'ble Apex Court in the case of Woodward Governor Ltd. reported in 81 taxmann.com 285, Tata Locomotive and Engineering Co. Ltd. reported in 60 ITR 405 and Sutlej Cotton Mills Pvt. Ltd. reported in 188 ITR 255 (SC). The loss suffered by the assessee is directly linked with the purchase of fixed assets which is capital in nature. Though forex gain/ loss is arising on account of assurance for payments of capital assets are capital in nature which cannot be charged to the profit and loss account. Further the Hon'ble Apex Court has held in the case of Tata Locomotive and Engineering Co. Ltd. reported in 60 ITR 405 that the forex gain on money accumulated to purchase capital asset being the first step for acquisition of capital asset is capital in nature and cannot be taxed. The assessee made advance payments through Letter of Credit is the first step for acquisition of capital asset because there was a direct link of LOC towards purchase of the fixed assets, therefore it will be treated as capital in nature. Section 43(1) has defined the actual cost of the assets. Therefore the actual loss suffered by the assessee cannot be charged to the profit and loss account. The CIT(A) has rightly

decided the issue in favour of the revenue. However, the AO is directed to give benefit of depreciation as per section 32 of the IT Act in the current year as well as in following years if there is effect on the following years. This issue is partly allowed for statistical purposes.

11. Disallowance u/s. 14A

The Ld.CIT(A) has dealt with this issue in detail however he has not considered the issue completely as per Rule 8D(2)(iii). The disallowance should be calculated as per Rule 8D(2)(iii) considering only the investments in which the assessee has received exempt income. In similar issue in the assessee's own case for the AY 2014-15 in ITA NO. 395/Bang/2023 order dated 30.08.2023 the co-ordinate bench has decided as under:-

7. We have heard the rival submissions and perused the material on record. We are of the view that only investment yielding non-taxable income has to be considered and not all the investments. This proposition has been held correct by the Hon'ble Delhi High Court in the case of ACB India Ltd., Vs. ACIT (supra). The Hon'ble Delhi High Court had held that for the purpose of section 14A, instead of taking into account total investment, the investment attributable to dividend (exempt income) was only required to be adopted and thereafter the disallowance was to be arrived. The relevant finding of the Hon'ble Delhi High Court in the case of ACB India Ltd., Vs. ACIT (supra) reads as follows:

"8. The Assessing Officer, instead of adopting the average value of investment of which income is not part of the total income, i.e., the value of tax exempt investment, chose to factor in the total investment itself. Even though the Commissioner of Income-tax (Appeals) noticed the exact value of the investment which yielded taxable income he did not correct the error but chose to apply his own equity. Given the record that had to be done so to substitute the figure of Rs. 38,61,09,287 with the figure of Rs. 3,53,26,800 and, thereafter, arrive at the exact disallowance of .05 per cent."

8. A similar view was taken by the Hon'ble Delhi High Court in the case of PCIT Vs. Indiabulls Capital Services Ltd., in ITA No.181/2019 (judgment dated 26.02.2019). The SLP filed by the Revenue against Hon'ble Delhi High Court's judgment in the case of PCIT Vs. Indiabulls

Capital Services Ltd., (supra) was dismissed by the Hon'ble Apex Court [reported in (2020)] 114 taxmann.com 647. In view of the aforesaid judicial pronouncement, we hold that while calculating disallowance under section 14A of the Act, only investment that have generated exempt income should be taken into consideration.

9. Before concluding, it is also to be mentioned that explanation inserted by Finance Act, 2022, has been held to be prospective by the judgment of the Hon'ble Delhi High Court in the case of PCIT Vs. Era Infrastructure (India) Ltd., (2022) 141 taxmann.com 289. In light of the aforesaid reasoning and judicial pronouncements, we delete the disallowance made under section 14A of the Act, amounting to Rs.4,69,055/-. It is ordered accordingly.

12. Respectfully following the above judgement in assessee's own case, we order accordingly. This issue is allowed for statistical purposes.

13. In the result, the appeal filed by the assessee is allowed for statistical purposes.

Order pronounced in the open court on 29th September, 2023.

Sd/-
(GEORGE GEORGE K)
Vice-President

Sd/-
(LAXMI PRASAD SAHU)
Accountant Member

Bangalore,
Dated, the 29th September, 2023.
/MS /

Copy to:

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|---------------|------------------------|
| 1. Appellant | 2. Respondent |
| 3. CIT | 4. DR, ITAT, Bangalore |
| 5. Guard file | |

By order

Assistant Registrar,
ITAT, Bangalore