

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'G', NEW DELHI**

**BEFORE, SH. CHANDRA MOHAN GARG, JUDICIAL MEMBER
AND
SH. PRADIP KUMAR KEDIA, ACCOUNTANT MEMBER**

ITA No.1175/Del/2019
(Assessment Year : 2012-13)

ACIT(08) New Delhi	Vs.	Sopra India Pvt. Ltd. 190, SFS, Hauz Khas, New Delhi – 110 016
PAN No. AAACM 1762 C		
(APPELLANT)		(RESPONDENT)

Assessee by	Shri Neeraj Jain, Adv. & Shri Himanshu Goel, C.A.
Revenue by	Shri Anuj Garg, Sr. D.R.

Date of hearing:	10.10.2023
Date of Pronouncement:	16.10.2023

ORDER

PER PRADIP KUMAR KEDIA, AM :

The captioned appeal has been filed by the Revenue against the First Appellate Order of the Learned Commissioner of Income Tax (Appeals) – 43, New Delhi ('CIT(A)' in short) dated 28.11.2018 arising from the assessment order dated 31.03.2016 passed by the Assessing Officer (AO) under Section 143(3) of the Income Tax Act, 1961 (the Act) concerning Assessment Year 2012-13.

2. The grounds of appeal raised by the Revenue reads as under:

1. *“Whether on the facts and circumstances of the case and also in law, the ld CIT(A) erred in allowing the claim of the assessee and deleting the disallowance made by the AO amounting to Rs.161.37 lakhs being unrealized foreign exchange forward contract losses, treating it contingent in nature.”*

3. Briefly stated, the assessee is engaged in the business of development of software and providing IT solutions and software engineering services. In the course of assessment under section 143(3) of the Act, the Assessing Officer *inter alia* observed

that assessee has debited and claimed foreign exchange fluctuation expenses of Rs.5,65,36,341/-. The Assessing Officer noted that the aforesaid loss on account of exchange fluctuation on forward cover contracts not crystallised and is in the nature of notional loss. The AO further noted the version of assessee that several foreign exchange forward contracts were entered to hedge its exposure to fluctuation in foreign exchange rates which are entered into on the basis of firm commitments and highly probable future transactions. The Assessing Officer observed that such forward contracts were neither closed nor matured till the end of F.Y. 2011-12 relevant to A.Y. 2012-13. Such forward contracts have been re-valued by the assessee at the exchange rate as on 31.03.2012 and the exchange differences on such contracts has been claimed as foreign exchange fluctuation loss during the year. The Assessing Officer, however, expressed its disagreement with the claim of loss on the ground that such loss are contingent liability and has notionally arisen merely due to assigning closing rate of foreign exchange and creating artificial loss there-from. It was also observed that such forward contracts are in the nature of speculative contracts and loss arising has also not crystallized as the contracts has not matured at the end of the year. For such broad reasons, the Assessing Officer disallowed foreign exchange fluctuation loss claimed.

4. Aggrieved, the assessee preferred appeal before CIT(A).

5. Before CIT(A), the assessee broadly reiterated that such losses has arisen in the ordinarily course of business and the losses incurred on valuation of forward foreign exchange contract are on 'mark to market' (MTM) basis in adherence with recommendation as per the Accounting Standards issued by the ICAI in this regard. The Accounting Standard recognises the difference between the year end exchange rate and the spot rate on the date on which the transactions were entered in respect of forward exchange contracts lying at the end of the year. Consequently, the loss due to fluctuation difference has been recorded in the books of accounts as ordinary business expenditure. It was also pointed out that such 'mark to market' (MTM) gains arising in the subsequent A.Y. 2013-14 has also been offered for taxation in tune with accounting policy. The assessee thus claimed that such fluctuation losses are a fait accompli and

not a notional loss of contingent nature. The MTM method is ultimately a revenue neutral exercise.

5.1 The CIT(A) took note of the detailed submissions made on behalf of the assessee and found merit in the claim of the assessee.

5.2 The relevant operative para of the appellate order is reproduced hereunder for ready reference:

5.2.6 The submissions of appellant have been examined. The arguments given by the AO have also been seen. It is seen that the aforesaid issue was clearly examined by the jurisdictional High Court in the matter of Munjan Showa Ltd. vs DCIT. The Instruction no.3 used by the AO against the assessee has also been discussed in this jurisdictional judgement. Relevant extracts from the aforesaid judgement is as under:

“44. This has to be also appreciated in the context of the Assessee following the mercantile system of accounting and Section 145 of the Act. The income of the Assessee is to be computed consistent with the regular method of accounting followed by the Assessee. The Assessee has been following AS- 11 and AS-30 issued by the ICAI, in terms of which the loss/gains on outstanding derivatives contracts are to be recognized on mark to market basis. The Assessee is right in contending that CBDT Instruction No. 3 of 2010 cannot possibly override the existing decisions of the Supreme Court/ High Court on similar issues. The legal position in this regard has been explained in Ratan Melting (supra) and has been reiterated in CIT t NageshKnitwears (P) Ltd. [2012] 345 ITR 135 (Delhi) and CIT v. Indian Oil Co. Ltd., (2012) 254 CTR 113 (Bom).”

5.2.7.1 It is also seen from the submissions that a Special Bench of the Tribunal in the case of DCIT vs Bank of Bahrain has discussed the issue in detail in the said order. The Special Bench has clearly held that loss arising on unmatured derivative contracts is allowable to the assessee. Relevant extracts from the order are as under:

"32. Ground No.2 for the AY 1998-99 and Ground No.3 for the AY 1999-2000 in regard to which reference has been made to the Special Bench reads as under:

“Whether on facts and circumstances of the case, can it be said that where a forward contract is entered into by the assessee to sell the foreign currency at an agreed price at a future date falling beyond the last date of accounting period, the loss is incurred to the assessee on account of evaluation of the contract on the last date of the accounting period i.e. before the date of maturity of the forward contract.”

33. *Facts in brief are that the AO noticed that the assessee had booked a loss on revaluation of forward foreign exchange contracts, which were unmatured on the date of balance sheet, of an amount of Rs.12,42,648/-. He noted that the assessee enters into forward contracts with clients to buy or sell foreign exchange at an agreed price on a future date. This future price was estimated according to certain norms such as forward premium rates for certain currencies. He noted that when such contract was entered into, the bank normally booked loss or profit depending upon the difference between the prevailing exchange rate on that date and contract rate. On the maturity Bank of Bahrain & Kuwait BSE of contract, the same profit or loss booked earlier was reversed and the actual profit or loss incurred based on the difference between the exchange rate on that date and the contract rate was booked. He pointed out that for transactions which mature during the year, the notional profit or loss gets replaced by actual profit or loss. There is no dispute in this regard and the same has been treated as revenues profits/loss. However, since in the forward contracts, the liability to purchase or sale of foreign exchange arises only on the date of maturity of the contract, therefore, the loss or gain depends upon the rate prevailing on that date and the contracted rate. Thus, he was of the opinion that the date of maturity of the contract is the relevant date for determining the profit or loss, accruing to an assessee, in pursuance to the forward foreign exchange contract. The assessee pointed out that as per RBI's guidelines, the banks were required to revalue unmatured contracts as per rates of exchange notified by Foreign Exchange Dealer's Association of India (FEDAI). Accordingly, on the balance sheet date, based on the exchange rate on that date, provision of profit/loss substitutes the figures booked at the time of contract. Thus, revalued loss/profit was debited to the profit and loss account. Further, this treatment was as per principles of accounting which required the current assets to be marked to the market rate. The AO did not agree with this modus operandi in regard to unmatured forward contracts. He further pointed out that in case foreign exchange is current asset, the easier method of accounting would be to book the sale when it was done and the purchase when it was executed, which will determine gain or loss of the transaction. He further observed that the method followed by the assessee may be fair accounting principle to estimate the net worth but the principles of taxation required that actual profit or loss was brought to the He also observed that there are number of provisions in the I.T. Act which require the assessee to follow a different method than followed in its books of account. In this regard, the Assessing Officer referred to the decision in the case of CIT v. Motor Industries Company Limited (229 ITR 137), wherein, it has been held that the income tax law does not allow as expenses all the deductions a prudent trader would make in computing his profits. It is only the actual liability in present which is allowable and not liability in future which for the time being, is only contingent. It was also held that what a prudent trader sets apart to meet a liability, not actually present but only contingent, cannot bear the*

character of expenses till the liability becomes real. He also referred to the decision of Bank of Bahrain & Kuwait BSE the Hon'ble Supreme Court in the case of Indian Molasses' case (37 ITR 66), wherein also, it was held that where the liability is contingent, the same is not allowable. The Hon'ble Supreme Court observed as under:-

"The expenditure which is deductible for income tax purposes is one which is towards a liability actually existing at the time, but the putting aside of money which may become expenditure on the happening of an event is not expenditure."

5.2.7.1 As regards the assessee's contention that bank was recording its income and expenditure on accrual basis, which was as per the provisions of Section 145 and the same could be disputed only if the profits or gains were not properly deducible from the same, the AO pointed out that the accounting method followed does not have much relation to the accrual basis of accounting. He observed that in forward contracts, liability arises only on the date contract matures. He pointed out that before the sale, it is only a contingent liability as the assessee could not foresee the rate of exchange which would prevail on the date of maturity of the contract. The AO referred to the decision of the Hon'ble Madras High Court in the case of Indian Overseas Bank (183 ITR 200), wherein, similar issue was examined and it was held that before settlement of contracts in foreign currency, no actual profit could accrue. It was held that the amounts in question represented notional profits only. Drawing analogy from this decision, the AO disallowed the loss of Rs.12,42,648/- treating the same as notional loss. The AO, however, allowed the amount which was disallowed on this count in earlier years.

Thus, in sum and sub stance, the arguments of Ld CIT D.R. are as under:-

- i) Unsettled forward foreign exchange contracts does not constitute stock-in-trade and, therefore, there is no question of its valuation.*
- ii) No transaction has been recorded in the books of account in regard to unsettled forward foreign exchange contracts and, therefore, there is no question of its valuation being done at the end of the accounting year.*

Bank of Bahrain & Kuwait BSE

- iii) The anticipated loss is primarily in the nature of notional liability and, therefore, does not accrue/arise at the end of the previous year and hence, not allowable.*
- iv) The liability accrues or arise only on the date of maturity of the contract and prior to that purely on the basis of estimated liability as per FEDAL guidelines it cannot be allowed under I.T.Act.*

- v) *Various decisions relied upon by ld CIT (A) relate to stock-in-trade and not to unsettled forward foreign exchange contract.*
- vi) *The issue is squarely covered by the following decisions:-*
 - a) *Indian Overseas Bank Ltd., 246 ITR 206(Mad)*
 - b) *Indian Overseas Bank Ltd., 151 ITR 446 (Mad)*
 - c) *Kamani Metals & Alloys Ltd., 208 ITR 1017 (Bom)*
 - d) *Bank of India, 218 ITR 371 (Bom)*
 - e) *Eveready Industries (1) Ltd., 78 ITD175 (Cal) 1) Indian Molasses Co. Ltd., 37 ITR 66 (SC)*

5.2.7.2 *The Special Bench thereafter, has discussed in detail the entire set of arguments put forth by the Revenue. In the concluding part of the judgment the special bench has held:*

"In view of the above discussion, we allow the assessee's appeal for the following reasons:-

- i) *A binding obligation accrued against the assessee the minute it entered into forward foreign exchange contracts.*
- ii) *A consistent method of accounting followed by assessee cannot be disregarded only on the ground that a better method could be adopted.*
- iii) *The assessee has consistently followed the same method of accounting in regard to recognition of profit or loss both, in respect of forward foreign exchange contract as per the rate prevailing on March 31.*
- iv) *A liability is said to have crystallized when a pending obligation on the balance sheet date is determinable with reasonable certainty. The considerations for accounting the income are entirely on different footing.*
- v) *As per AS-11, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period.*
- vi) *The forward foreign exchange contracts have all the trappings of stock-in-trade.*
- vii) *In view of the decision of Hon'ble Supreme Court in the case of Woodward Governor India (1) P. Ltd., the assessee's claim is allowable.*
- viii) *In the ultimate analysis, there is no revenue effect and it is only the timing of taxation of loss/profit.*

59. *We, accordingly, hold that where a forward contract is entered into by the assessee to sell the foreign currency at an agreed price at a future date falling beyond the last date of accounting period, the loss is incurred to the assessee on account of Bank of Bahrain & Kuwait BSE evaluation of the contract on the last date of the accounting period i.e. before the date of maturity of the forward contract.”*

5.2.8 *It is clear from the observation of the Hon'ble Supreme Court in Woodward Governor's on a similar matter, the decision of the jurisdictional High Court as well as the Special Bench it is seen that loss on revaluation of unmatured forward contracts is allowable (if any arises on such revaluation). It is further seen that the judgment of the Hon'ble High Court in CIT vs ONGC relied upon by the AO has been over ruled by the Supreme Court in 322 ITR 180. The relevant extract of the judgment in the case of ONGC vs CIT of the Hon'ble Supreme Court vide their order dated 15.03.2010:322 ITR 180 is as under:*

“10. Having carefully perused the decision of this Court in Woodward's case (supra), we are of the opinion that both the issues stand concluded by the said decision. Dealing with the said issues extensively, speaking for the Bench. S.H. Kavadia. J. summarised the following factors which should be taken into account in order to find out if an expenditure on account of fluctuation in the foreign currency rates, when the assessee is following mercantile system of accounting, is deductible:

- (i) whether the system of accounting followed by the assessee is the mercantile system, which brings in the debits of the amount of expenditure for which a legal liability has been incurred even before it is actually disbursed and credits, what is due, immediately it becomes due even 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 bonafide;*
- (iii) whether the assessee has given the same treatment to losses claimed to have accrued and to the gains that may accrue to it; whether the assessee has been consistent and definite in making*
- (iv) entries in the account books in respect of losses and gains; 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.*

Applying these factors on the facts of that case, it was held that the "loss" suffered by the Assessee, maintaining accounts regularly on mercantile system and following accounting standards prescribed by the Institute of Chartered Accountants of India (ICAI), on account of fluctuation in the rate of foreign exchange as on the date of balance-sheet was an item of expenditure under section 37(1) of the Act, notwithstanding that the liability had not been discharged in the year in which the fluctuation in the rate of foreign exchange occurred.

We are of the opinion that the ratio of the said decision, with which we are in respectful agreement, squarely applies to the facts at hand and. therefore, the loss claimed by the assessee on account of fluctuation in the rate of foreign exchange as on the date of balance-sheet is allowable as expenditure under section 37(1) of the Act."

5.2.9 *The other judgements quoted by the AO were discussed in detail in the order and the Special Bench in DCIT vs Bank of Bahrain. In view of the aforesaid legal position, the loss on uncompleted contract is treated to allowable expenditure u/s 37 of the Income Tax Act. It is further seen that the basic issue in question here is only on account of the year of allowability or the time of allowability of the said deduction. In principle, it is accepted that loss arising from a completed contract is allowable. The profit arising from completed contract as well as uncompleted contract has been offered to tax by the appellant. The timing of the taxability does not have a cumulative effect on revenue. In fact, the Hon'ble Delhi High Court in DCIT vs Triveni Engineering had observed:*

"12. We are reminded of the classic observations made by Justice Tendolkar in the case of the Commissioner of Income-tax, Delhi, Ajmer, Rajasthan and Madhya Bharat Vs. Nagri Mills Co. Ltd. 133 ITR 681], which reads as under:

"We have often wondered why the Income-tax authorities, in a matter such as this where the deduction is obviously a permissible deduction under the Income-tax Act, raise disputes as to the year in which the deduction should be allowed. The question as to the year in which a deduction is allowable may be material when the rate of tax chargeable on the assessee in two different years is different; but in the case of income of a company, tax is attracted at a uniform rate, and whether the deduction in respect of bonus was granted in the assessment year 1952-53 or in the assessment year corresponding to the accounting year 1952, that is in the assessment year 1953-54, should be a matter of no consequence to the Department....."

13. *The aforesaid observations of the Bombay High Court were reiterated by this Court in the case of Commissioner of Income Tax Vs. Shri Ram Pistons and Rings Ltd. [220 CTR 404], as under:*

"Finally, we may only mention what has been articulated by the Bombay High Court in Commissioner of Income Tax, Delhi, Ajmer, Rajasthan and Madhya Pradesh vs, Nagri Mills Co. Ltd. [1958] 33 ITR 681 as follows:

In the reference that is before us there is no doubt that the Assessee had incurred an expenditure. The only dispute is regarding the date on which the liability had crystallized. It appears that there was no change in the rate of tax for the Assessment Year 1983-84 with which we are concerned. The question, therefore, is only with regard to the year of deduction and it is a pity that all of us have to expend so much time and energy only to determine the year of taxability of the amount."

14. In such circumstances, we are of the view that insofar as present appeal is concerned, substantial questions of law that need to be answered does not arise. We, therefore, dismiss this appeal on this ground alone."

5.2.10 In the present case the issue at hand is only with reference to the year of allowability of the loss from forward contracts. The time of taxability is in fact tax neutral. The decisions of the H'ble Delhi High Court and the special bench also substantively suggest that a liability which can be reasonable ascertained at the close of the year is required to be allowed. The addition made is therefore not sustainable in the present case."

The CIT(A) accordingly reversed the disallowance carried out in the assessment order on the point in issue.

6. Aggrieved by relief granted by the CIT(A), the Revenue is in appeal before the Tribunal.

7. We have heard the rival submissions and perused the assessment order and the first appellate order and also the documents referred to relying upon and case laws cited. The grievance of the Revenue concerns disallowance of 'mark to market' losses of Rs.161.37 lakhs being unrealized losses arising from foreign exchange forward contract owing to foreign exchange fluctuation.

8. We straight away observe that the issue is squarely covered in favour of the assessee by plethora of judgments which in unequivocal terms have held that 'mark to market' loss on such future and forward contracts are not a notional loss of contingent nature and the loss stands crystallized at the end of the year notwithstanding the continuance and spilling over of the contract to next year. We also simultaneously take note of the plea of the assessee that the claim has been made in consonance with Accounting Standards prescribed by ICAI. Besides, the gains arising in A.Y. 2013-14 due to devaluation of foreign exchange has also been similarly offered for taxation.

9. The Supreme Court in the case of CIT vs. Woodward Governor India Pvt. Ltd., 179 taxman 326 (SC) has considered such losses as allowable and not of contingent in nature. Similar view has been taken by the Co-ordinate Bench in the case of Investmentor Securities Limited vs. JCIT, ITA No.1724/Ahd/2015 order dated 01.05.2018 and DCIT vs. M/s. SAL Steel Ltd. in ITA No.2013/Ahd/2013 order dated 18.01.2017.

10. We thus concur with the view taken by the CIT(A) that loss occurred due to such fluctuation in forward contract is a ordinary business loss and not merely a notional loss of provisional nature. We thus decline to interfere with the first appellate order.

11. In the result, appeal of the Revenue thus is dismissed.

Order was pronounced in the open court on 16.10.2023

Sd/-

(CHANDRA MOHAN GARG)
JUDICIAL MEMBER

Date:- 16.10.2023

*Priti Yadav, Sr. PS**

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Sd/-

(PRADIP KUMAR KEDIA)
ACCOUNTANT MEMBER

ASSISTANT REGISTRAR
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