IN THE INCOME TAX APPELLATE TRIBUNAL,
DELHI BENCH: 'D' NEW DELHI

BEFORE SHRI SAKTIJIT DEY, VICE-PRESIDENT
AND
DR. B.R.R. KUMAR, ACCOUNTANT MEMBER

ITA No.1894/Del/2023
Assessment Year: 2020-21

M/s. Petrofac International UAE LLC, Officer 2A, 3rd Floor, Tower-B, Building 9, DLF Cyber City, Phase-2, Gurgaon	**Vs.**	DCIT, International Taxation, Gurgaon
PAN :AAJCP8925H		
(Appellant)		**(Respondent)**

Assessee by	Sh. Ravi Sharma, Advocate
Department by	Sh. Vizay B. Vasanta, CIT-DR

Date of hearing	17.10.2023
Date of pronouncement	10.01.2024

ORDER

PER SAKTIJIT DEY, VICE-PRESIDENT

Captioned appeal has been filed by the assessee challenging the final assessment order dated 29.04.2023 passed under section 143(3) read with section 144C(13) of the Income-tax Act, 1961 (in short 'the Act') in pursuance to the directions of learned Dispute Resolution Panel (DRP) pertaining to assessment year 2020-21.

2. Ground no. 1, being a general ground, does not require adjudication.

3. Insofar as ground 2 is concerned, learned counsel appearing for the assessee, on instructions, did not press it. Accordingly, this ground is dismissed as not pressed.

4. The dispute in ground no. 3 relates to disallowance of Foreign Exchange Fluctuation loss amounting to Rs. 39,92,82,185/-.

5. Briefly the facts relating to this issue are, the assessee is a non-corporate entity incorporated in United Arab Emirates (UAE), is a tax resident of UAE. As stated, the assessee is engaged in the business of engineering design, supply of equipments, construction and project management services for the oil and gas industry. The assessee has established a Project Office (PO) in India on 26.04.2018 after obtaining approval of Reserve Bank of India. For the assessment year under dispute, the assessee filed its return of income on 13.02.2021, declaring income of Rs.6,41,06,770/-. While examining the audited Financial Statements of the assessee, more particularly, profit and loss account, the Assessing Officer noticed that the assessee has

debited foreign exchange loss of Rs.39,92,82,185/- on account of inter-unit revaluation. Being of the view that Foreign Exchange Fluctuation loss has been booked on head office account, which is a capital account, hence, not allowable as expenses, the Assessing Officer issued a show-cause notice calling upon the assessee to explain, as to why the loss claimed should not be disallowed. In response to the show-cause notice, the assessee furnished a detailed submission justifying its claim. Referring to section 43AA of the Act read with Income Computation and Disclosure Standard (ICDS) –VI, assessee submitted that Foreign Exchange Fluctuation loss, being a monetary item, is liable for deduction.

6. The Assessing Officer, however, was not convinced with the submission of the assessee. He observed that the transactions of PO with head office are governed by Principle of Mutuality; hence, receipts/payments from/to PO and HO are transactions with self, as, PO and HO are virtually same for assessment purposes. He observed, because of this, surplus funds are remitted to HO without any taxes. Similarly, funds are received from HO for capital requirement and there is no liability on the PO to repay

the funds of HO, if the projects run on losses. Balances available with PO belong to HO and there cannot be repayment to oneself. He observed that there is no debtor-creditor relationship between PO and HO. Thus, applying the principle of mutuality there cannot be any gain/loss on transactions with oneself. Thus, he held that forex loss cannot be treated as expense. Proceeding further, he observed, even if PO and HO are considered to be distinct, still the deduction is not allowable as head office account is a capital account and receipts/inward remittance from HO are capital receipts in nature.

7. With regard to applicability of section 43AA, AS-11, ICDS-VI, the Assessing Officer observed that the head office account balance is neither a monetary item, nor a non-monetary item. Therefore, computation mechanism of forex gain/loss under ICDS-VI fails resulting in non-applicability of section 43AA of the Act.

8. As regards applicability of Accounting Standard 11, the Assessing Officer, observed that the head office account in the books of PO is not related to its foreign operation as the PO is not executing any project outside in India. Therefore, the HO account

does not represent foreign operation of the PO. Hence, HO account will not come within the ambit of AS-11. He also negated assessee's claim that the balance in HO account is a liability on project. Thus, ultimately, he concluded that forex loss of Rs.39,92,82,185/- is not an allowable expenditure. Accordingly, he proposed the draft assessment order. Against the draft assessment order, the assessee raised objections before learned DRP, however, learned DRP upheld the decision of the Assessing Officer.

9. Before us, learned counsel appearing for the assessee made submissions orally as well as in writing and reiterated the stand taken before the departmental authorities.

10. The crux of assessee's argument is, in terms of Article 7(3) of India – UAE Double Taxation Avoidance Agreement (DTAA) HO and PO are to be considered as separate and distinct entities. Hence, the principle of mutuality will not apply. It was further submitted that the transaction relating to foreign exchange fluctuation loss, being a monetary item, is squarely covered under section 43AA read with AS-11 read with ICDS-VI. He submitted, assessee's case is squarely covered by the decision of the

Coordinate Bench in case of Cobra Instalaciones & Servicios SA Vs. DCIT [2018] 96 taxmann.com 80 (Delhi Tribunal). In this context, he has furnished the following comparability analysis in a tabular form:

Cobra's case	Assessee's case	Whether any difference the facts of the case
Cobra is a non-resident company and carrying outs its business operations from its project office in Delhi (India)	Assessee is a non-resident company and carrying outs its business operations from its project office in Visakhapatnam, Rajasthan and Kochi (India).	No
Cobra had a PE in India in the form of a project office	The Assessee has a PE in India in form of a project office	No
Cobra is engaged in providing services of consultancy projects, engineering and electrical contractors and suppliers.	The Assessee is engaged in the business of engineering, design, supply of equipment, construction, and project management services	No
Cobra was entitled to raise invoice on customers post reaching certain milestone as per terms of contract. To achieve the milestone, expenses has to be incurred for supply and erection of the project for which funds have been borrowed from head office in Spain.	The Assessee was entitled to raise invoice on customers post reaching certain milestone as per terms of its certain contracts. To achieve the milestone expenses has to be incurred for supply and erection of the project for which funds have been borrowed from head office in UAE.	No

The tax officer held that the transaction of PO with head office is a transaction with oneself. Thus, no profit or loss can arise as no person can enter into a transaction with oneself. The tax officer alleged that the amounts received by Project office is not a loan but a capital contribution and consequent foreign loss on it is capital in nature thus, not allowable	The Ld. AO alleged that transactions of PO with head office are governed by principal of mutuality and receipts/payments from/to PO and head office are transactions with self. Further, alleged that the forex loss incurred by the Assessee is on capital account and thus not deductible as an expense.	No

11. Learned counsel also relied upon the decision of the Bangalore Bench of the Tribunal in case of M/s. Altisource Business Solutions Pvt. Ltd. Vs. DCIT, IT(TP)A No.183/Bang/2022, dated 25.07.2022.

12. Proceeding further, learned counsel submitted that in assessment year 2021-22, foreign exchange gain arising out of similar transaction of revaluation of HO account with reference to working capital loans has been offered to tax and accepted by the Revenue. In this context, he submitted the assessment order dated 27.12.2022 for assessment year 2021-22. He submitted, if the forex gain from similar transaction is treated as revenue item, applying rule of consistency, the loss has to be allowed.

13. Learned Departmental Representative strongly relied upon the observations of the Assessing Officer and learned DRP.

14. We have considered rival submissions and perused the materials on record. Undoubtedly, the assessee has a fixed place Permanent Establishment (PE) in India in the form of PO. The assessee had entered into Engineering Procurement and Construction (EPC) contract with Bharat Petroleum Corporation Limited (BPCL), Hindustan Petroleum Corporation Limited (HPCL) and Vedanta Limited, which were being executed through the PO. For executing such contracts, the PO had received funds from the HO towards working capital requirement. The funds were received in foreign currency, i.e., US Dollar. On the balance sheet date of 31st March, 2020, the amount payable to head office on revaluation of funds received in foreign exchange was recognized and resultant unrealized forex loss was debited to the profit and loss account. It is the case of the assessee that in terms of section 43AA of the Act read with ICDS –VI and AS-11, the forex loss, being a monetary item, is allowable as expense. Whereas, as per the case set up by the Department, forex loss, being in capital account, is not allowable as business expenses. Further, the

Departmental Authorities have held that forex loss not being a monetary or non-monetary item, will not come within the ambit of section 43AA of the Act. It is also the case of the Department that the PO and HO, being self same and having no separate identity, they will be governed by principles of mutuality. Hence, the funds to be paid by PO to HO, being a payment to self cannot be allowed as expenses. Countering the aforesaid reasoning of the Departmental Authorities, the assessee has submitted before us that the PO and HO are to be treated as two distinct and separate entities in terms of Article 7(3) of the tax treaty.

15. On a careful reading of the respective observations of the Departmental Authorities, we find that the aforesaid contention of the assessee has not, at all, been considered. Further, we have observed that in case of Cobra Instalaciones & Servicios SA (supra), the Coordinate Bench has observed that money received from head office, since, did not bring into existence any capital asset and was utilized for incurring the operating cost, it will be of revenue nature. In case of M/s. Altisource Business Solutions Pvt. Ltd. (supra), the Coordinate Bench has held that gain or loss arising out of change in forex rate can be treated as income or

loss provided the same is in accordance with ICDS – VI notified under section 142(2) of the Act. However, in the facts of this case, the Bench has recorded a finding that break-up of forex loss claimed by the assessee indicates that major portion of the loss has arisen out of the year-end restatement of receivables and balance in the EEFC A/c of the assessee, which in terms of ICDS –VI, is a monetary item, hence, would fall within the ambit of section 43AA of the Act.

16. In our view, assessee's case also requires examination in the light of ratio laid down in the aforesaid decision. Further, it has been submitted before us by learned counsel for the assessee that in assessment year 2021-22, the Assessing Officer has assessed foreign exchange gain arising out of similar transaction relating to recasting of accounts with reference to working capital loans received from the head office. In case, gain derived from similar nature of transaction has been treated as revenue item and brought to tax, in our considered opinion, the loss arising from such type of transaction also has to be treated as revenue item and allowed as deduction.

17. Since, all these aspects have not been examined either by the Assessing Officer or by learned DRP, for whatever may the reason, we are inclined to restore the issue to the file of Assessing Officer for fresh adjudication, keeping in view our observations above, in the light of submissions made by the assessee and the ratio laid down in the judicial precedents discussed above. Needless to mention, the Assessing Officer must provide a reasonable opportunity of being heard to the assessee before deciding the issue. Ground is allowed for statistical purposes.

18. In ground no. 4, the assessee has challenged addition of Rs. 36,55,722/- under section 41(1) of the Act. Briefly the facts are, in course of assessment proceeding, the Assessing Officer noticed that one of the creditors of the assessee, namely, M/s. Indcon Project & Equipment Ltd. has written-off an amount of Rs. 36,55,722/-, being balance relating to the assessee in its books of account. Noticing these facts, the Assessing Officer called upon the assessee to explain why write-off of the account should not be treated as cessation of liability under section 41(1) of the Act and added to the income. In response, the assessee submitted that liability still exists in its books of account and the provisions of

section 41 of the Act cannot be invoked on the basis of unilateral action of third party in its books of account. Not being convinced with the submissions of the assessee, the Assessing Officer added back the amount of Rs.36,55,722/- to the income of the assessee, while framing the draft assessment order. Though, the assessee raised objections against the aforesaid addition before learned DRP, however, it was unsuccessful.

19. We have considered rival submissions and perused the materials on record. Before us, learned counsel for the assessee submitted that no addition under section 41(1) of the Act can be made as the liability has not ceased and it has subsequently been paid to the concerned party. In this context, learned counsel drew our attention to the bank statement placed in the paper-book.

20. Learned Departmental Representative relied upon the observations of the Assessing Officer and learned DRP.

21. We have considered rival submissions and perused the materials on record. The crux of the issue is, whether the liability is a trading liability and whether it has ceased to exist in the year under consideration and the assessee has received the benefit in terms of money or kind. The Assessing Officer has made the

addition under section 41(1) of the Act by simply relying upon the fact that the trade creditor has written-off the amount in its books of account. However, it is the specific contention of the assessee before us that the amount in dispute has subsequently been paid back to the concerned party. In case, the assessee has paid back the amount to the concerned party, in our view, the provisions of section 41(1) of the Act will not apply as it cannot be treated as cessation of liability. Therefore, we direct the Assessing Officer to factually verify assessee's claim that the amount in dispute has been paid back to the concerned party and if it is found to be so, then delete the addition.

22. Ground no. 5 with sub-grounds read as under:

Other grounds

5.1. That, on the facts and in the circumstances of the case and in law, the Ld. DRP/Ld. AO have erred in reducing the interest computed under section 244A of the Act due to above impugned additions.

5.2. That, on the facts and in the circumstances of the case and in law, the Ld. AO have incorrectly levied interest and fee amounting to INR 70,71,592.

5.3. That, on the facts and in the circumstances of the case and in law, the Ld. AO have incorrectly mentioned in the computation sheet that refund of INR 2,55,84,901 was issued to the Appellant, without appreciating that no such refund have been received by the Appellant.

5.4. That, on the facts and in the circumstances of the case and in law, the Ld. AO erred in initiating penalty proceedings under section 270A of the Act against the Appellant on account of the above adjustments made in the Impugned Order.

23. Qua ground nos. 5.1 to 5.3, having considered rival submissions, we direct the Assessing Officer to factually verify assessee's claim and correct the computational error, if any, in accordance with law. Ground no. 5.4, being premature at this stage, is dismissed.

24. In the result, the appeal is partly allowed.

Order pronounced in the open court on 10th January, 2024

Sd/-	***Sd/-***
(DR. B.R.R. KUMAR)	**(SAKTIJIT DEY)**
ACCOUNTANT MEMBER	**VICE-PRESIDENT**

Dated: 10th January, 2024.
RK/-
Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, New Delhi