



IN THE INCOME TAX APPELLATE TRIBUNAL, PANAJI BENCH, PANAJI



BEFORE HON'BLE SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER

AND

SHRI G. D. PADMAHSHALI, ACCOUNTANT MEMBER

ITA Nos. 114/PAN/2023

Assessment Year : 2010-11

VGM Export

Suvarn Bandekar Building,

Swatantra Path, Vasco, Goa

PAN : AAAPV6197P

..... Applicant

V/s

Joint Commissioner of Income Tax,

Margao Range, Margao.

..... Respondent

Appearances

Assessee by : Mr P B Deshpande ['Ld. AR']

Revenue by : Mr Ravindra Hattalli ['Ld. DR']

सुनवाई की तारीख / Date of conclusive Hearing : 20/02/2025

घोषणा की तारीख / Date of Pronouncement : 25/02/2025

ORDER

PER G. D. PADMAHSHALI;

The captioned appeal of the assessee impugns DIN & Order ITBA/NFAC/S/250/2023-24/1052430696(1) dt. 24/07/2024 passed by the National Faceless Appeal Centre, Delhi ['Ld. NFAC' hereinafter] u/s 250 of the Income-tax Act, 1961 ['the Act' hereinafter] which in turn arisen out of order of assessment dt. 08/03/2013 passed u/s 143(3) of the Act by the Joint Commissioner of Income Tax, Margao Range, Margao ['Ld. AO' hereinafter] anent to assessment year 2010-11 ['AY' hereinafter].



2. Succinctly stated facts of the case are that; the assessee is a registered partnership firm and was engaged in the business of export of iron-ore. For the assessment year under consideration the assessee e-filed its return of income [‘ITR’ hereinafter] on 23/09/2010 declaring therein total income of ₹18,92,20,060/-. The said return in first instance without variation was summarily processed u/s 143(1) of the Act. Later on, by service of statutory notice u/s 143(2) of the Act, the case of the assessee was selected for scrutiny. After considering the assessee’s submission, the resultant assessment in this case was completed by the Ld. AO u/s 143(3) of the Act wherein three bullet additions owing corresponding disallowances were made viz; (a) ₹2,25,000/- disallowance u/s 14A of the Act r.w.r. 8D2(iii) of Income Tax Rules, 1962 [‘IT-Rules’ hereinafter] (b) ₹37,27,447/- disallowance u/s 40(a) r.w.s. 195 of the Act for non-deduction of tax at source from sampling charges paid to Hongkong Party and (c) ₹1,14,11,643/- disallowance of forex fluctuation loss claimed in respect of closing balance of sale proceeds held in Exchange Earners Foreign Currency Account [‘EEFC A/c’ hereinafter] maintained with two IDBI banks and Bank of Maharashtra.



3. Aggrieved assessee filed an appeal before Ld. NFAC which was partly allowed by deleting the addition made on account of non-deduction of taxes on sum paid to Hongkong Party, however confirmed remaining twin additions viz; (a) 14A disallowance and (b) forex fluctuation loss claimed in respect of closing balance held in EEFC A/c. Still aggrieved by the partial relief, the assessee came in present appeal with the following solitary ground;

‘On facts and in the circumstances of case and in law, the ld. Assessing officer and CIT(A) have erred in disallowing Rs 1,14,11,643/- towards loss on balances maintained in EEFC account considering the same as notional and also capital in nature. The ld. AO and the Hon. CIT(A) have incorrectly applied the rationale on the Hon. Delhi HC in the matter of Philips Petroleum International Corp. in the current case.’

4. During the course of hearing the Ld. Senior Counsel Mr Deshpande submitted that, for the year under consideration the assessee was predominantly engaged in export of iron-ore to neighbouring countries. The invoices of export sales were invariably raised in foreign currency more particularly denominated in US



dollars [‘US\$’ hereinafter]. On the date of export sales transaction, such US\$ denominated invoices, for the purpose of recording the sales in books were converted into equivalent INR by applying currency conversion rate prevailing on such transaction date. The proceeds of such export sales and payments from foreign debtors etc., as and when received were directly credited to either any of the two EEFC A/cs maintained with IDBI banks or to an EEFC a/c maintained with Bank of Maharashtra. The accumulated balance of aforesaid EEFC a/cs were utilized either for making foreign currency payment outside India or converted into INR as per the business needs of the assessee. The unutilized balance of sales proceeds lying in EEFC a/cs as at the closure of financial year, for the purpose of closure of books & preparation of financial statement were converted into equivalent INR by applying closing exchange rate in accordance with applicable accounting standard [‘AS’ hereinafter] issued by the Institute of Chartered Accountants of India [‘ICAI’ hereinafter]. The said INR valuation of EEFC a/cs was then compared with the corresponding INR bank ledger accounts maintained by the assessee. The difference between US\$ denominated EEFC a/c’s and



INR bank ledger a/c's was finally recognised in the books as '*loss on conversion of forex closing balance held in EEFC a/cs*'. The losses arisen upon conversion of closing forex balance held in EEFC a/cs are incurred & being a monetary item, is claimed as allowable business deduction u/s 37(1) of the Act. This claim of the assessee for deduction finds support in the decision of Hon'ble Apex Court rendered in the case of '*CIT Vs M/s Woodward Governor India Pvt Ltd.*' [2009, 179 Taxman 326 (SC) & 312 ITR 254 (SC)].

5. To brace the allowability of deduction the Ld. Mr Deshpande further submitted that, it must be noted that, there was no explicit provision in the Act for deductibility of exchange loss, until following settled position of law laid in '*M/s Woodward Governor India Pvt Ltd.*' (supra), the legislature by Finance Act 2018 brought in a novel provision u/s 43AA of the Act. This newly inserted section provided for taxing the foreign exchange fluctuations which *inter-alia* provides that, all gains or losses arising on account change in foreign exchange rates are treated as incomes or losses. In relation to monetary items being cash and cash equivalents, receivables & payables etc., all gains



arising upon conversion are treated as revenue income and conversely all losses are deductible as business revenue expenditure in accordance with income computation & disclosure standards [‘ICDS’ hereinafter] notified u/s 145(2) of the Act. To reinforce assessee’s entitlement for deduction of exchange loss relating to monetary items, the Ld. Deshpande at the cost of repetition also expounded the corresponding text of ICDS-VI placed on page 57-59 of paper books and the adjudication of the Ld. Co-ordinate bench in the case of *‘Altisource Business Solution Pvt Ltd. Vs DCIT’* [TS-8000-ITAT-(Bangalore)-O]. It is further argued that, though section 43AA of the Act and ICDS-VI came into play at a later stage, the assessee’s claim for deduction of exchange loss as business expenditure is indispensable in view of the binding judicial precedents laid in *‘CIT Vs Woodward Governor India Pvt Ltd.’* (Supra). The explicit provision brought in subsequently hint sites that law never intended to disentitle the assessee from claiming any foreign exchanges fluctuation losses relating to circulating capital. For the reasons the assessee prays to set-aside the impugned order on this score and delete the disallowance made by the Ld. AO in very terms.



6. *Au contraire*, in refuting the claim for deduction the Ld. DR Hattalli contended that; the instant case anent to AY 2010-11 whereas the provisions of section 43AA of the Act and the ICDS-VI at the outset came into effect from AY 2017-18, therefore by no stretch of imagination these provisions can be made applicable to present case. So is the decision of Tribunal rendered in '*Altisource Business Solutions Pvt Ltd.*' (supra). Now coming to forex fluctuation loss debited to profit & loss account ['P&L' hereinafter]; it is much less disputed by the assessee that, such loss was arrived notionally for preparation & presentation of financial statements in accordance with method accounting employed vis-à-vis compliance with applicable (if any) AS issued by the ICAI. What is taxable & deductible under the provisions of law is real income & the real expenditure. The notional income since cannot be brought to tax unless specifically & expressly provided in the Act, so is the notional expenditure or loss.

7. The Ld. DR continued on board to state that; the receivables from export sales already realised & received in EEFC a/cs and the assessee was not under obligation to keep such export sale proceeds



in such EEFC a/cs. Once income is received in cash or cash equivalents, it partakes the character of capital and any loss on such account cannot be claimed to be revenue in nature. Moreover, such forex fluctuation loss on sale proceeds kept on EEFC a/cs represents a notional loss being contingent in nature.

8. The Ld. DR also drew our attention towards CBDT Circular No. 3/2010 dt 23/03/2010 which states that the notional loss/contingent loss which are worked out basing on the market closing date are not allowable losses. Therefore, the notional loss worked out by the assessee on account of foreign exchange fluctuations was correctly disallowed by the Ld. AO. The real loss or real profit/gain can arise only when such closing forex balances are actually converted into absolute INR without their alternate utilization for payment. Trusting the orders of tax authorities below in nutshell the Ld. DR cemented the action of disallowance of forex loss on twofold reasons that; (a) losses are purely notional in nature and (b) forex balance being a cash equivalents represents an item of capital therefore losses even if assumed to have arisen, are of capital nature, hence the resultant loss.



9. We have heard the rival party's submission and subject to rule 18 of ITAT-Rules, perused the material placed on records and considered the facts in the light of settled position of law, which are forewarned to the respective opposing party. From pg 1-13 of paper book we note that; the assessee had three EEFC a/cs viz; (1) Bank of Maharashtra-Panaji a/c which had a closing balance of US\$ 775.37 equal to opening balance and there were no transaction for the year under consideration. The differential rate of forex standing at respective dates glided the valuation and resulted into loss of ₹4730/- (2)IDBI-Vasco a/c had no opening balance but net of receipts and withdrawals arising out of monetary items / trading activities left with a closing balance of 1047878.96US\$. Difference of INR valuation of closing EEFC balance with that of books resulted into a loss of ₹13,69,821.60/- (3)IDBI-Panaji a/c had no closing balance as at 31/03/2010 but the difference on account of total receipts & withdrawals relating to transactions of monetary items resulted into a loss of ₹1,00,37,093.93/-. These losses are recognised in the books by passing journal entries at the closure of the year and resultantly claimed as deduction u/s 37(1) of the Act as revenue in nature.



10. Before we hit the ground of adjudication on aforesaid factual matrix, let us set the dispute in clear terms. There is much less dispute that the impugned disallowance relates to forex fluctuation loss which is computed and relates to closing cash equivalent held in EEFC a/c as at the closure of financial year. There is also no dispute that, for the year under consideration there was complete absence of explicit provision in the law by which such loss could have been claimed & allowed as deduction. The rival parties are also in complete agreement that, neither section 43AA nor ICDS-VI can be made applicable to the present case. The sole dispute hinges around nature of forex fluctuation loss as to 'notional or real' & 'capital or revenue'. The Revenue setup its disallowance on twofold reasoning viz; (a) the forex fluctuation loss is notional in nature and (b) since it relates to cash equivalents, hence capital in nature. *Per contra*, the appellant pleads that; (a) cash equivalent being monetary item is a circulating capital hence forex fluctuation loss is revenue in nature (b) though notional but recognised consistently in accordance with method of accounting regularly employed and in compliance of AS-11 issued by the ICAI r.w.s. 145(2) of the Act.



11. It is well settled principle that, what follows for taxation is real income theory unless expressly provided otherwise in the law. The notional income like deemed annual value of a house property where assessee holds more than allowed number of units is brought to tax by expressed deeming fiction. Likewise, a notional expenditure in the form of depreciation is also allowed be charged to profits, but only by explicit provisions of law. Thus, in the absence of explicit provision of law, whenever a question as to the taxability of notional income or allowability of notional expenditure arises, what needs to be proved in common is 'accrual' thereof. If the notional income although following applicable AS is credited to P&L a/c but in reality, if not accrued to assessee at all, then such action of credit *per-se* does not change the very character of it to real for taxability, so is the notional expenditure. That is to say, any notional expenditure although recognised & debited to P&L a/c as per accounting method regularly employed or in compliance of applicable AS, unless such expenditure proved to have been incurred, the character in the absence of explicit provision of the Act would continue to be notional one and thus disentitles from claim for deduction u/s 37(1) of the Act.



12. Now first coming to determination of nature of forex fluctuation loss as to capital or revenue, one can find an answer in the landmark decision of Hon'ble Apex Court rendered in 'Sutlej Cotton Mills Ltd. Vs CIT' [1979, 116 ITR 1 (SC)] wherein their Hon'ble lordship while settling the issue regarding nature of loss as revenue or capital has first formulated the question as; '*Whether the loss suffered by the assessee was a trading loss or not would depend on whether the loss was in respect of a trading asset or a capital asset. In the former case, it would be a trading loss but not so in the latter*'. And then answered it in subsequent paragraph [requoted to the extent relevant] as;

The law is 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 trading profit or loss if the foreign currency is held by the assessee on revenue account or as a trading asset or as 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

(Emphasis supplied)



13. Now coming to instant case, the appellant is an export earner which was allowed to open EEFC a/c to receive 100% credit of its export's realisation in foreign currency without the compulsion of converting into INR and vice-versa. It shall apt to note here that, this EEFC a/c is operated with an inherent restriction which allows all inward remittances through normal banking channels, other than remittances received on account of foreign currency loan or investment received from abroad or received for meeting specific obligations by the a/c holder. The appellant strictly complied with mandatory operational norms of EEFC a/c and operated solitarily for the purpose of receipt of sales proceeds from its export's sale and their utilization either for current account transaction or withdrawal therefore in INR. This in our considered view is sufficient to establishes that, the very character of closing balance held as trading receipts. The said closing balance remained unutilized thus represents noting other than a circulating capital more precisely the working capital. On the other hand, the Revenue could hardly bring any deprecative evidence on records to dismantle the appellant's claim and these findings emerged in the course of physical hearing.



14. Having determined the character of balance held in EEFC a/c, now turning to deductibility of losses arising therefore. The issue of deductibility of fluctuation of forex loss arising out of trading transactions came for consideration before the Hon'ble jurisdictional High Court in '*CIT Vs Vinergy International Pvt. Ltd.*' [2016, 96 CCH 154 MumHC] wherein their lordship following the decision of Apex Court rendered in '*Woodward Governor*' (supra) upheld the adjudication of Ld. Co-ordinate bench in allowing deduction for forex fluctuation losses in relation to monetary items u/s 37(1) of the Act.

15. Subsequently an indistinguishable issue also came on board for reconsideration in '*Sociedade De Fomento Industrial Pvt Ltd*' wherein the Ld. Co-ordinate bench deleted the disallowance of forex fluctuation loss in relation to sale proceeds which were already received by assessee and held in EEFC a/c, clearly holding that such balance represent the circulating capital thus loss arising therefrom is revenue in nature irrespective of the fact whether or not the assessee was under obligation to keep sale proceeds under EEFC a/c. The said matter travelled to jurisdictional High Court in '*CIT Vs Sociedade De*



Fomento Industrial Pvt Ltd [2024, (4) TMI 317] wherein their Hon'ble lordships have upheld the Tribunals decision and dismissed the appeal of the Revenue on the ground that no substantial question of law arises as the issue raised therein stands already answered against the Revenue by the decisions of the Hon'ble Supreme Court in the case of '*CIT Vs Woodward Governor India (P) Ltd*' [2009 (4) TMI 4 - SC] wherein it was categorically held that; the loss suffered by assessee due to fluctuation of foreign exchange as on the date of the balance sheet is in respect of the purchase and sale of goods (payments have to be made/received) is an item of expenditure u/s 37(1) of the Income Tax Act. It shall not be out of the box to state that similarly in '*PCIT Vs Suzlon Energy Ltd*' [2020, 121 taxman.com 137] wherein the SLP filed by the Revenue is dismissed and decision of Hon'ble High Court of Gujrat which in turn upheld the adjudication of Ld. Co-ordinate bench in allowing the claim for forex fluctuation loss in adjusting the EEFC a/c to mark to market basis [2020, 120 taxmann.com 459 (Ahd-Tribunal)].



16. The appellant recognised the losses on forex fluctuation in relation to closing balance held in EEFC a/c on a regular basis in accordance with the AS-11 and method of accounting regularly employed u/s 145 of the Act. The same was consistently followed by the appellant in all immediate proceeding & later years which the Revenue accepted in regular scrutiny assessments. Thus, there was no scope for the Revenue to take a swap to treat the same as ‘notional’ now and outdo the aforesaid binding judicial precedents. Accordingly, guided precedentially by aforesaid decisions whereby the Revenue has already accepted the claim of fluctuation loss as the ‘real & revenue in nature’, hence deductible u/s 37(1) of the Act, so must be here. *Per contra* in the absence of compelling reasons, it much less necessitates a diversion from the settled position of law.

17. The appeal of the assessee in result stands ALLOWED.

In terms of rule 34 of ITAT Rules, 1963 the order pronounced in the open court on date mentioned herein before.

-S/d-

PAVAN KUMAR GADALE
JUDICIAL MEMBER

-S/d-

G. D. PADMAHSHALI
ACCOUNTANT MEMBER

Panaji/Dt: 25 th February, 2025.

Copy of the Order forwarded to :

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|-------------------|-----------------------------------|------------------------------|
| 1. The Appellant. | 2. The Respondent. | 3. The CIT(A)/NFAC Concerned |
| 4. PCIT Concerned | 5. DR, ITAT, Panaji Bench, Panaji | 6. Guard File |

By Order,
Sr. Private Secretary / AR ITAT, Panaji.