IN THE INCOME TAX APPELLATE TRIBUNAL
KOLKATA BENCH 'C', KOLKATA
(Before Shri N.V.Vasudevan, J.M. &Dr.A.L.Saini, A.M.)

ITA No. 838/Kol/2009: Asstt. Year : 2004-2005

DCIT, Circle-12, 3,Govt. Place (West), Kolkata-1	Vs	Usha Martin Telematics Limited. 8th Floor, RDB Boulevard, Plot K-1, Block EP & GP, Sector-V, Saltlake City, Kolkata-700091, West Bengal PAN:AAACU3054D
(APPELLANT)		**(RESPONDENT)**

ITA No.815/Kol/2009 : Asstt. Year : 2004-05

Usha Martin Telematics Limited. 8th Floor, RDB Boulevard, Plot K-1, Block EP & GP, Sector-V, Saltlake City, Kolkata-700091, West Bengal PAN:AAACU3054D	Vs	DCIT, Circle-12, 3,Govt. Place (West), Kolkata-1
(APPELLANT)		**(RESPONDENT)**

Department by: G. Mallikarjuna, CIT-DR
Assesseeby : Shri Nageswar Rao, Advocate

Date of Hearing : 10.08.2016		**Date of Pronouncement : 21-09-2016**

ORDER

Per Dr. A.L.Saini, A.M.:

The captioned appeal and cross appeal filed by the Revenue and Assessee respectively, pertaining to assessment year 2004-05,are directed against the order passed by the Ld. Commissioner of Income-Tax (Appeals)-XII, Kolkata, in appeal

No.208/XII/ACIT-12/06-07, dated 25.02.2009, which in turn arises out of an order passed by the ACIT,(Assessing Officer), Circle -12 Kolkata under section 143(3) of the Income Tax Act, 1961 (in short, `the Act`) dated 29/12/2006.

2. The facts relating to the issue are stated in brief. The assessee is a limited company, incorporated under the provisions of Companies Act, 1956 and inter alia engaged in the business of investment and finance activity. The assessee filed its return of income showing a total loss of Rs.8,21,67,180/- The Return of Income was processed U/s 143(1) on 30.03.2006 at the returned income figure. Thereafter, the case was selected for scrutiny U/s 143(3) of the I.T. Act, and the Assessing Officer completed the assessment by making various addition on dated 29.12.2006.

3. The appeal filed by the Revenue and the Cross appeal filed by the assessee relate to the same assessee, same assessment year and common issues involve, therefore these have been clubbed and heard together and a consolidated order is being passed for the sake of convenience and brevity.

4.First we deal with the appeal filed by the Revenue in **ITA No. 838/Kol/2009.** The Revenue took the following grounds of appeal:
"Whether on the facts and in the circumstances of the case, the ld.CIT(A) was correct in deleting the foreign exchange gain amounting to Rs.13,90,00,000/- wherein the same should be chargeable to tax".

4.1 The issue contested in this ground of appeal by Revenue is that foreign exchange gain should be chargeable to tax, whereas the assessee treated it contingent in nature. In the Profit and Loss account, the assessee has credited an

amount of Rs. 13,90,00,000/- on account of foreign exchange gain. In the computation of income, the assessee has not considered this amount as income on the ground that the foreign exchange gain is contingent in nature. The ld Assessing officer treated Rs. 13,90,00,000/- as taxable income of the assessee observing the followings:

"The main ingredient of a contingent liability is that it depends upon happening of a certain event. In the case of the assessee, the "event" i.e. the change in the value of foreign currency in relation to Indian currency, has already taken place in the current year. Therefore, the loss incurred by the assessee is a *fait accompli* and not a notional one. In fact the special bench of the ITAT, Delhi in the case of ONGC Vs. DCIT 83 ITD 151 has held that the loss (or gain) arising as a result of fluctuation in foreign exchange rate on the closing day of the year is a loss incurred by (or gain accruing to) the assessee and is not a notional loss (or gain). It may also be noted here that as per the accounting standard-11, which is mandatory for companies-exchange differences arising on foreign currency transactions should be recognized as income or as expense in the period in which they arise. Since the said accounting standard is mandatory for companies, it has to be followed by the assessee company in letter and spirit. This also makes it amply clear that the exchange gain has to be accounted for as income of the year.

In view of the reasoning as outlined above and the accepted principle of revenue recognition affirmed by the apex court, the assessee was required to account for the foreign exchange gain as income of the year. It is also highly pertinent to remark at this juncture that the assessee has paid MAT U/s 115JB on the foreign exchange gain of Rs. 13,90,00,000/-. The question therefore naturally arises as to why the assessee should credit the foreign exchange gain to the profit and loss account and take the same into account for calculating MAT. In view of the above,

discussions the foreign exchange gain of Rs.13,90,00,000/- is held to be taxable income of the assessee. Hence, an amount of Rs.13,90,00,000/- is added to the total income of the assessee."

4.2.Aggrieved from the order of the Assessing Officer, the assessee filed an appeal before the ld Commissioner of Income Tax (Appeals)-XII, Kolkata, who has deleted the addition observing the following:

"To sum up, I am of the opinion that the addition made on account of notional foreign exchange gain due to restatement of liability at the year end is not correct and to be deleted for the following reasons:

- Appellant`s action of crediting the "gain" to P & L A/c is not the decisive test to decide the true nature of the transaction. This has to be decided as per principles of law.
- Even borrowed funds to be treated as business liabilities as observed by A.O; there is no real accretion to the capital/loan and the liability is outstanding and not settled.
- Reference to Rule 115 of I.T. Rules read with section 145 (2) of I.T. Act and drawing inferences with reference to accrual of income is not in agreement with the legislative intent. What is to be taxed is 'real income' and not the 'notional income' as held by judicial forums.
- With regard to case laws (viz. Indian overseas Bank Ltd. 246 ITR 206 and CIT Vs. IOB 151 ITR 446) relied upon by the appellant, the AO wrongly distinguished the cases with the present case on the subject of estimated profit/anticipated loss on unsettled contracts. In fact the referred cases are in favour of the appellant. On the other hand, the case law relied by the A.O. (viz.Coca cola Exp. Corp. 158 ITR 446) is in favour of the appellant.

- The case on which reliance placed by the AO on the principle of revenue recognition (CITVs.Mysore 63 ITR 328) can be distinguished on facts.
- Sutlej Cotton Mills Ltd. 116 ITR 1, the case on which A.O. placed reliance to distinguish capital account with that of revenue account, the Apex Court only laid down the general principles for deciding the nature of 'gain' and the facts can be distinguished.
- Foreign exchange gain is on account of fixed capital and not circulating capital.
- The gain is only contingent and notional as held by Uttarakhand High Court in the case of CIT Vs.ONGC 301 ITR 415, and hence can not be taxed. This view is further supported by Hon`ble Kolkata ITAT [EIH Hotels Ltd, 16 DTR 181.
- Foreign exchange gain is only hypothetical in nature and no real income to the appellant.
- Treatment given by the appellant for calculating MAT does not alter the 'nature of gain'. It remains as notional and hypothetical.

Decision

In view of the discussion held and relying on the decision of jurisdictional ITAT in the case of EIH Associated Hotels Ltd (16 DTR 181), decision of Uttarakhand High Court in the case of CIT Vs. Oil & Natural Gas Corporation Ltd (301 ITR 415) and decisions of Madras High Court in the case of Indian Overseas Bank Ltd (212 ITR 206) & California Software Co. Ltd. (118 TTJ 842-2008), I hold that the notional foreign exchange gain added amounting to Rs. 13,90,00,000/- on account of restatement of liability is not a 'gain' and it is only notional and hypothetical in nature. Accordingly, I direct the AO to delete the above said addition of Rs.13,90,00,000/-

Not being satisfied from the order of the ld CIT (A), the Revenue is in appeal before us.

4.3 The ld Departmental Representative (DR) assailed the impugned issue on several counts and the various arguments of the ld. DR could be summarized as under:

a. Ld. DR pointed out that in order to find out whether an expenditure is deductible or not, the following principles have to be taken into account:

i. Whether the system of accounting followed by the assessee is mercantile system, which brings into debit the expenditure amount for which a legal liability has been incurred before it is actually disbursed and brings into credit what is due, immediately it becomes due and before it is actually received;

ii. Whether the same system is followed by the assessee from the very beginning and if there was a change in the system, whether the change was bona fide;

iii. Whether the assessee has given the same treatment to losses claimed to have accrued and to the gains that may accrue to it.

iv. Whether the assessee has been consistent and define in making entries in the account books in respect of losses and gains.

v. Whether the method adopted by the assessee for making entries in the books both in respect of losses and gains is as per nationally accepted accounting standards.

vi. Whether the system adopted by the assessee is fair and reasonable or is adopted only with a view to reducing the incidence of taxation.

b.Ld DR further argued that it can be seen from the assessee`s record that the assessee is following mercantile system of accounting, there is no chane in the method of accounting, assessee is giving same treatment for losses and gains accrued on account of foreign exchange depreciation or appreciation,theassessee has credited the gain in profit and loss account and such recognition of income is as per AS-11.

c.Ld. DR also relied on the following judgments where similar issues have been decided in favour of Revenue: 1)Hon`ble C Bench ITAT, Kolkata in case of ITO ward 12(3) Kolkata Vs. UMT Investments Ltd. in ITA No.554/Kol/2009 dated 30.12.2015. and 2) Woodward Governor case (312 ITR 254-SC).

4.4 On the other hand, the ld Authorized Representative (AR) for the assessee has primarily reiterated the stand taken by the Ld.CIT (Appeal), which we have already noted in our earlier para No.4.2 and the same is not being repeated for the sake of brevity.

4.5 Having heard the rival submissions, we are of the view that there is merit in the submissions of the ld DR, since the proposition canvassed by ld. DR is supported by the decision of ITAT Kolkata and decision of Hon`ble Supreme Court , as referred above. As has been pointed out by ld DR that once the utilization of borrowings are held to be on revenue account and mercantile system followed, then the resultant exchange gain or loss at the end of the year due to restatement of foreign currency loan would automatically take the revenue receipt/expenditure as the case may be. Accordingly, we allow the appeal filed by the Revenue on this issue. However, we find in the order of the ld CIT (A) that the assessee had incurred exchange loss of Rs. 18,000,000/- for the assessment year 2005-06 but not

claimed as deduction treating it notional in nature in line with the consistent stand taken by the assessee. In this regard, we deem it fit and appropriate in the interest of justice, to give direction to the Learned AO to grant deduction of exchange loss in the subsequent assessment years to be in consonance with our findings hereinabove. Otherwise, it would only result in Revenue trying to blow hot and cold simultaneously. Accordingly, the ground raised by the Revenue is allowed subject to the direction given above.

4.6 In the result, the appeal of the Revenue is allowed subject to the direction contained hereinabove.

5. The Assessee has taken the following grounds in cross appeal filed by him, in ITA No. 815/Kol/2009, which read as under:

Ground No. 1-Disallowance of interest on borrowings of Rs. 254,473,131/-

The learned CIT (A) has erred in not accepting the contention of the appellant that interest expenditure on borrowings amounting to Rs.254,473,131/- should be allowed as a deduction under section 36 (1) (iii) and /or Section 37(1) of the Act.

Your appellant respectfully prays that the learned Assessing Officer be directed to delete the disallowance of Rs.254,473,131/- in respect of interest expenditure incurred by the appellant.

Ground No.2 Non-taxability of income from service fees of Rs.168,500,000/-

Without prejudice to the above ground of appeal in relation to allowability of interest expenditure as being revenue in nature, the ld CIT (A) has erred in not accepting the alternative contention of the appellant that in case interest on borrowing from investment is held as capital in nature ,income from service fees in

respect of put option (also being in relation to acquisition of shares) should be held as capital receipt and accordingly not liable to tax.

Your appellant respectfully prays, in case interest on borrowings from investment is held as capital in nature, income from service fees in respect of put options(also being in relation to acquisition of shares) should be held as capital receipt and accordingly not liable to tax.

Both the above grounds are independent and without prejudice to each other.

The appellant craves leave to add to alter, to ament or to delete any or all of the above grounds of appeal,at or prior to hearing of the appeal, so as to enable the honourable Income Tax Appellate Tribunal to decide the appeal according to law.

5.1 **Ground No. 1-Disallowance of interest on borrowings of Rs. 254,473,131/-**

The facts of this issue are stated in brief. The main reasons for making the disallowance of interest Rs.254,473,131/- by the Assessing Officer are as follows:

i. Out of borrowed funds of Rs. 454.83 croresRs. 441.25 crores have been applied towards acquisition of investments.
ii. Interest incomes shown in P& L A/c have no nexus with the appellant`s investment activities as the appellant has not earned any income from the above said investment during the year under consideration.
iii. No interest expenditure is attributable to the earning of interest income; foreign exchange gain and income from services shown in P & L A/c as these incomes have no nexus with application of interest bearing borrowed funds.
iv. The appellant Company suomoto disallowed the proportionate interest amount attributable to the acquisition of investment as ‘cost of such investments’ in the earlier A.Y. 2003-04.

v. The AR for the assessee submitted that the assessee has no explanation to offer when asked to show cause for treating the interest expenditure as 'cost of investments'.

vi. The facts of the case remains similar in the current year also and as such there is no reason why the assessee should deviate from the accepted method of accounting. Because the assessee has followed the same accounting practice in earlier A.Y. 2003-04 treating the interest expenditure as 'cost of investments.

vii. It is an established question of Law that expenses incurred in relation to the acquisition of investment should be treated as part of the cost of investments.

In view of the facts of the case and the reasoning as outlined above, the total interest expenditure of Rs. 25,44,73,131/- is treated as cost of investments and is, therefore, disallowed as revenue expenditure. In the result, the amount of Rs.25,44,73,131/- added back to the total income of the assessee.

5.2 Aggrieved from the order of the Assessing Officer, the assessee filed an appeal before the Commissioner of Income Tax (Appeals)-XII, Kolkata. The assessee submitted written submissions before the ld.CIT (A) and requested him to treat the said interest expenditure as revenue expenditure. A brief summary of the submissions of the assessee before CIT(A) are as follows:

i. The expenditure in question incurred is for the purpose of business and should be allowable U/s 36(1) (iii) of the I.T. Act.

ii. The interest expenditure incurred on borrowed funds for the purpose of commercial expediency.

iii. Section 36(1) (iii) of the I.T. Act requires nexus of interest expenditure with the business of the assessee and with the particular stream of income or activity.

iv. It is not necessary that expenditure incurred by the assessee must yield income in the current year only.

v. The stand adopted by the appellant in the preceding year is not binding on it for the current year as the principle of Res judicata is not applicable to the income tax matters;

vi. The expenditure incurred for the purpose of obtaining loan was considered to be a revenue expenditure in view of the following judicial decisions:

a.Ambika Prasad Sonar V. CIT 168 ITR 444

b.CIT Vs. RajeevaLochan (1994) 208 ITR 616 (Kolkata H.C)

c.CITVs.Jardine Henderson Ltd. (1994) 210 ITR 981 (Cal)

d.SA Builders Ltd. Vs. CIT 289 ITR 261

e. CIT Vs. Dalmic Cement Bharati Ltd (2002) 254 ITR 377

However, the ld CIT (A) rejected the stand taken by the assessee and held that interest expenditure incurred is on account of capital investment and accordingly the interest expenditure incurred on borrowed capital for making an investment in equity shares going to add to the cost of investment. Accordingly it should be capitalized.

Not being satisfied with the order of the ld CIT (A), the assessee is in further appeal before us.

5.3 Before us the ld AR for the assessee has submitted that investment made by the company for the purpose of business only. The assessee company is engaged in the business of investment and finance, therefore the interest paid by the company on

the amount borrowed for the purpose of business should be allowed as revenue expenditure under section 36(1) (iii)/ 37(1) of the Act.

The stand adopted by the appellant in the preceding year to capitalize the interest in the cost of investment, is not binding on it for the current year as the principle of Res judicata is not applicable to the income tax matters. Though the principle is well settled now, but one has to see the intention to know the real nature of transaction. The appellant in its own case suomoto disallowed proportionately a deduction in the earlier year and then realized that it erroneously disallowed a portion of the rightful claim of deduction. In the same way the department, if followed a method and accepted an issue in the earlier years it would not preclude to look into the issue in the next year in a different angle depending on the new facts and features noticed. The Ld AR also relied on the judgment of Mumbai ITAT in ITA No. 4918/Mum/2004 (ITO V. VikramsadanandHoskote) wherein it was held by the hon`ble ITAT that interest paid by the assessee for the period commencing from the date of acquisition of shares till the date of sale would not form part of the cost of acquisition.

5.4 On the other hand, the Departmental Representative (DR) has primarily reiterated the stand taken by the Assessing Officer, which we have already noted in earlier para 5.1 and is not being repeated for the sake of brevity.

5.5 Having heard the rival submissions, we are of the view that there is merit in the submissions of the assessee, as the propositions canvassed by the ld AR are supported by the facts and the case law cited above. As the ld AR pointed out that the assessee company is engaged in the business of investment and finance, therefore the interest paid by the company on the amount borrowed for the purpose

of business should be allowed as revenue expenditure under section 36(1) (iii)/ 37(1) of the Act. He also pointed out that the stand adopted by the appellant in the preceding year to capitalize the interest in the cost of investment, is not binding on it for the current year as the principle of Res judicata is not applicable to the income tax matters.Besides, we have already allowed the appeal filed by the Revenue in ITA No.838/Kol/2009 holding that foreign exchange gain on restatement of foreign loan liability should be chargeable to tax.

Therefore, considering the facts and case law cited above and in the interest of justice it would be fair and proper to allow the interest expenses on loan as revenue expenditure. Accordingly, we allow the appeal filed by the assessee.

5.6 In the result, the appeal filed by the assessee is allowed.

6.**Ground No.2 Non-taxability of income from service fees of Rs.168,500,000/-**

The facts of this issue are stated in brief. The said issue has not been raised by the assessee before the Assessing Officer. The assessee has raised this issue first time before the ld CIT (A) and it was a purely a legal ground raised by the assessee on the facts existed on record. This ground related to income `from services fees offered by the appellant itself as income in the return and accordingly the same has been assessed as such. M/s GE Capital Services India was providing a loan to EssarTeleholding Ltd. against pledge of another company shares, required the assessee to grant put option in respect of the shares pledged. In this process the assessee granted put option and received Rs. 16,85,00,000/- from M/s EssarTeleholding as a consideration for the services rendered and accordingly the assessee showed in its books as receipt. The assessee has shown this receipt in his books of accounts as revenue income. But during the proceedings before the CIT

(A) the assessee had filed an additional ground and requested the CIT (A) to treat income from service fee as capital receipt instead of revenue receipt. However, the ld CIT (A) has dismissed the ground raised by the assessee observing the followings:

i. *Nature of 'receipt' receiving from EssarTeleholding for the services provided by the appellant by way of granting put option.*
ii. *Secondly no consideration paid to fulfill the exercise of the condition of the option. It is only like a conditional guarantee depending on the happening of an event.*
iii. *Exercising option by the GE capital is only contingent and to meet the contingent option the appellant offered a put option and received a consideration from third party for rendering services to act as a guarantor on behalf of the third party.*
iv. *In this process the assessee company is not accruing any right or accruing a capital asset. It is purely an act of adventure in trade by way of rendering services and receiving a consideration as a 'trading receipt'. At any stretch of imagination the same can not be treated as a `capital receipt'.*
v. *Even if GE capital exercises its option which again 'contingent' in nature, the appellant has to exercise put option and purchase shares. These shares will be stock in trade for the appellant as the appellant company never has the intention of purchasing the shares as investment. It is like a trader acquiring the goods who performing as a guarantor for a third party.*
vi. *The appellant`s arguments that if interest paid on funds borrowed for purchase of shares is in relation to acquisition of those shares as held by the AO, consideration received for granting put option in respect of shares will aslo be in relation to acquisition of those shares only and accordingly the*

consideration received on that logic to be treated as on capital account, is not tenable and does not stand to logic. The treatment of interest on borrowed capital on capital account is on the ground that the borrowed capital is invested in acquiring a capital asset (equity) with a clear intention of appreciation in capital asset. On the other hand the consideration thereof received is for rendering services to its sister concern and not with an intention to acquire a capital asset and that the entire theory receiving the shares on capital account is just contingent nature. Hence it is not correct to equate with transactions as the nature and intention is different.

vii. *The appellant also referred to section 51 of the I. T. Act and treated the transaction on par with cost of acquisition of a capital asset. At the outset it is to be mentioned here that there were no negotiations had on previous occasion for transfer of any capital asset as per provisions of section 51. The appellant only granted the option and and received consideration in lieu of services rendered. Secondly, the appellant received the money as consideration for services rendered and not an advance as contemplated in the above said section, since no transfer of asset is involved and the entire transaction is only contingent in nature.*

viii. *The other argument that if GE capital does not exercise the put option the consideration for granting put option will remain as a capital receipt and can not be taxed even under the head capital gain as there is no existence of a capital asset, so transfer of capital asset and consequently no gain arising on transfer of such capital asset. This argument looks very odd and contrary to earlier argument treating the asset under the category of 'transfer of capital asset.'*

In view of the above facts and discussions held, I am of the opinion that the additional ground raised in not logical,correct and factually wrong and deserves to be rejected."

Thus, the main findings of the ld CIT(A) is that in case of put option it is contingent and based of future uncertain events, there is no transfer and there is no capital asset.

6.1 The ld AR for the assessee has submitted before us that since the interest on borrowed capital has been treated as capital in nature by AO and ldCIT(A), therefore, the consideration of put option should also be treated capital in nature.

6.2 The ld DR for the Revenue has primarily reiterated the stand taken by the ld CIT(A), which we have already noted in our earlier para 6 and is not being repeated for the sake of brevity.

6.3 Having heard the rival submissions, we are of the view that there is merit in the stand taken by the ld DR, as the propositions canvassed by him are supported by the findings of the ld CIT(A), as explained above. As ld CIT(A) pointed out that in case of put option it is contingent and based of future uncertain events, there is no transfer and there is no capital asset accruing to the assessee, therefore the consideration of put option is not a capital asset. Besides, we have already allowed in this appeal the interest on borrowed capital,(to acquire the fixed investments), as revenue in nature. Considering the above cited factual position, we dismiss the said ground of the assessee.

6.4 In the result, the appeal filed by the assessee on this ground is dismissed.

Order Pronounced in the Open Court on 21-09-2016

Sd/-	**Sd/-**
(N.V.Vasudevan)	**(Dr. A.L.Saini)**
JudicialMember	**Accountant Member**

Dated: 21/09 /2016

Talukdar (Sr.PS)

Copy of the order forwarded to:

1. Revenue
2 Assessee
3. The CIT-I, 4. The CIT(A)-I,
5. DR, Kolkata Benches, Kolkata

True Copy,

By order,

Asst. Registrar**,** ITAT, Kolkata Benches