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\* **IN THE HIGH COURT OF DELHI AT NEW DELHI**  
*Date of Decision: August 22, 2014*

+ **ITA 471/2014**

COMMISSIONER OF INCOME TAX VI ..... Appellant  
 Through: Mr.Rohit Madan, Standing  
 Counsel

Versus

CLIMATE SYSTEM PVT.LTD. .... Respondent  
 Through:

**CORAM:**  
**HON'BLE MR. JUSTICE SANJIV KHANNA**  
**HON'BLE MR. JUSTICE V. KAMESWAR RAO**

**SANJIV KHANNA, J (ORAL)**

1. This appeal by the revenue relates to the Assessment Year 2003-04 raises a singular issue, whether Rs. 49,98,072/- debited in the Profit and Loss Account were covered by Section 43A of Income Tax Act, 1961 ('Act, in short) and/or was otherwise expenditure of capital nature. The respondent assessee had issued 15% Unsecured Redeemable Non-convertible Debentures carrying interest @15% per annum. In order to repay the debentures, the respondent-assessee borrowed money. The loan was taken against Foreign Currency Non Resident Loan Account [FCNR(B) Loan]. The advantage/benefit was that the loan was availed at a lower rate of interest as compared to interest payable on the normal loan account. In order to hedge against foreign exchange fluctuations, the respondent-assessee had entered into forward contracts with banks



in India. The respondent-assessee incurred loss of Rs. 49,98,072/- on account of foreign exchange fluctuation on account of FCNR(B) Loan. The said amount was paid during the previous year relevant to the assessment year.

2. In the Assessment Order under Section 143(3) dated 31.01.2006, income of the respondent-assessee was assessed at Rs.2,76,29,016/- as against return income of Rs.2,46,94,573/-. It appears that no enquiry or questions were raised regarding expenditure of Rs.49,98,072/- during the original assessment proceedings.

3. Commissioner of Income Tax, by order dated 25.03.2008 under Section 263 of the Act, required the Assessing Officer to examine the issue of applicability of provisions of Section 43A after verifying the nature and source of expenditure relating to the foreign exchange fluctuations.

4. The aforesaid order passed by the Commissioner of Income Tax was not challenged and has attained finality.

5. In the assessment order dated 20.11.2008 passed under Section 263 read with Section 143, the Assessing Officer observed that decisions of the Delhi High Court in the case of *CIT Vs. Woodward Governor India Pvt. Ltd., [2007] 294 ITR 451* and *Oil and Natural Gas Corporation Vs. DVIT [2003] 261 ITR 0001* had not been accepted by the revenue and appeals stood preferred before the Supreme Court. He further observed that the respondent assessee's contention on Section 43A was not acceptable, though no asset had been acquired from the said loan, as assets were acquired in the earlier years for purpose of business or profession. Thus, the



provisions of Section 43A were applicable. He further observed that the decisions relied upon by the respondent assessee were not with reference to the foreign exchange fluctuations loss on loan account.

6. The aforesaid findings were reversed by the Commissioner of Income Tax (Appeals), who observed that the appellant had outstanding 15% Unsecured Redeemable Non-convertible Debentures of Rs. 100 Crores as on 31.03.1999 and these debentures were due for redemption in the financial year 1999-2000 (Assessment Year 2000-01). For repayment of debentures, the respondent-assessee had raised FCNR (B) Loan from banks on 27.01.2000 and loan was utilized for repayment of the debentures. The exercise of taking FCNR(B) Loan had resulted in reduction of financial expenditure as similar borrowing under a normal loan would have resulted in higher interest payment. The details with regard to the financial cost or interest rates had been submitted. Commissioner of Income Tax (Appeals) referred to the salient features of FCNR(B) loans as they offered low cost funding option to the Indian Corporates, but, had two elements; interest rate-risk which was bench marked on LIBOR rates and foreign exchange fluctuation risk i.e. risk of Indian Rupees (INR) depreciation against the foreign currency pertaining to the loan. These FCNR(B) loans were usually for short term and the loan taken by the respondent-assessee was in fact for six months only. This could be extended by refinance by way of a fresh FCNR(B) loan from time to time till complete repayment was made. In order to protect himself, the respondent-assessee entered into forward contracts to hedge against



fluctuation loss in value of Indian Rupees. During the year, the respondent-assessee had incurred foreign currency fluctuation loss of Rs. 49,98,072/-, which was the actual expense paid as was evident from the papers/documents filed before him. The aforesaid computation of actual expenditure was done as per the accounting procedures and Accounting Standards issued by the Institute of Chartered Accountants of India. It was further observed that the aforesaid decision to take FCNR(B) loan had resulted in benefit or saving to the assessee of Rs.69,67,717/-. Thus, the purpose of raising FCNR(B) loan was to reduce the cost of funding. As far as business of respondent-assessee was concerned, fixed assets had been purchased each and every year and old loans were repaid and new loans were taken on need to need basis. There was no foreign exchange loss on purchase of fixed assets as was stated in the Audit Report and also clear from the depreciation schedule as per the Companies Act, 1956 as well as Audit report as per the Act. Thus, the amount paid was for raising or repayment of loan and thus, was attributable to revenue account and not of capital nature. The reasoning given by the Commissioner of Income Tax (Appeals) is lucid and clear, and is worthy of reproduction:

*“10. I have gone through the facts of the case and submission of the Appellant and also to the remand report and rejoinder thereof. I have also perused the accounts of the assessee for the year under consideration and additional documents filed in course of appellate proceedings. I am inclined to accept the additional documents filed by the appellant as the same copies of the original documents and no prejudice cause to Department on accepting the same and is also in the interest of justice to dispose of present appeal on merits*



*of facts. My findings of the facts of the case are as under:-*

*The FCNR (B) loan has been taken on Jan. 27,2000 , (Fy1999-00) and the said amount is utilized for repayment of 15% Unsecured Redeemable Non-Convertible Debentures (Debentures) for Rs. 100,000,000/-. This fact is evidenced by the bank statement of Bank of America filed with submission.*

*It is also accepted that Foreign Currency Fluctuation Loss on short term loan amounting to Rs. 49,98,072/- is an actual expenditure incurred during the year on the purchase of forward contacts for repayment of FCNR(B) Loan and not notional or contingent as stated by the Ld. AO.*

*It is also admitted that by this FCNR (B) Loan, no fixed assets has been acquired in foreign currency by the appellant in earlier years or in this year. This fact is also supported by the audited accounts of earlier year and this year. It is evident from the extract of balance sheet that the debentures have been repaid and new loans are raised at lower finance cost. The appellant is able to reduce the cost of financing by Rs. 6,967,717/-. It is also clear from the submission made before me.*

*In respect of the applicability of section 43A of the Act, the, Ld. AO is wrong in applying the provisions of the section 43A in the present case, as from the fact is clearly evident that no assets were acquired by the assessee by raising the FCNR(B) loan by making the payment in foreign currency on acquisition of capital assets out of the borrowings of FCNR(B) loan as such amount is utilized for repayment of debentures.*

*The submission of the assessee that initial rupee loan is borrowed for acquisition of fixed assets has been withdrawn by the appellant in the light of the facts discussed above, hence the theory that FCNR(B) loan has indirectly utilized for purchasing the fixed assets in foreign currency could not be applied on present facts, especially in the light of the fact that the appellant is following is AS-11 and the accounts are audited wherein it has been stated that the Exchange difference*



*arising on settlement of transaction, except those relating to fixed assets, are only recognized as income or expense in the year in which they arise.*

*11. Thus, the sole purpose of raising of FCNR(B) loan in FY 1999-2000 would only be termed as swapping of Debenture loan to, FCNR(B) Loan to reduce the revenue expenditure of the appellant as the payment on interest on debenture is an revenue expenditure even if the amount of such debenture is utilized for acquisition of fixed assets. The issue also needs examination from another angle. In case the appellant has not repaid the debenture, the whole interest of Rs. 1,500,000/- would be allowed as a deductible expenditure. However, since the assessee has paid the debenture by obtaining another loan, the reduced cost of that loan of Rs. 4,998,072/- would not be allowed as a deductible expenditure. This would result into absurd situation i.e. the higher interest on debenture is an allowable expenditure whereas expenditure incurred to arrange finance for the redemption would not be allowed.*

*12. Further, the issue of allow ability of foreign exchange loss has been no more res-integral in view of the decision of the Apex court in the case of CIT vs Woodward Governor India (P) Ltd. 312 ITR 254 wherein it has held that exchange fluctuation arising on revenue account transaction should be allowed as deductible, expenditure. In view of the above Supreme Court decision, the expenditure in question is an allowable expenditure and ground of the ld. AO that the Department had preferred an appeal in Hon'ble Supreme Court against that the order of the Hon'ble Delhi High Court in the case of CIT vs. Woodward Governor, 291 ITR 451 in the assessment order would not hold good after the decision of the Apex Court wherein the decision of the Hon'ble Delhi High Court has been upheld”.*

7. On appeal filed by the revenue, the aforesaid decision was



affirmed by the Income Tax Appellate Tribunal.

8. Decision of the Delhi High Court in *Woodward Governor India Pvt. Ltd. (supra)* has been affirmed by the Supreme Court in decision reported as *Commissioner of Income Tax, Delhi Vs. Woodward Governor India Pvt. Ltd. [2009] 312 ITR 254*. It has been, inter alia, held that the expression “expenditure” in Section 37(1) of the Act connotes “what is paid out” and what has gone irretrievably. But the word “expenditure” used in context of Section 37(1) would also cover ‘loss’ even though the said amount had not gone out from the pocket of the assessee. The said provision was a residuary provision extending the allowance to items of business expenditure, not covered by Section 30 to 36 of the Act. Reference was made to Section 28 and 29 read with Section 145(1) of the Act, and it was observed that accounts maintained in the normal course of business should be taken as correct unless there were strong and sufficient reasons for their unreliability. Thus, the ‘profits and gains’ of the previous year were required to be computed with regard to the relevant Accounting Standards. The reference also made to Accounting Standard-11, which deals with the effects of foreign exchange fluctuations, and it was accordingly observed as under:

*“21. In conclusion, we may state that in order to find out if an expenditure is deductible the following 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 definite 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”.*

Thereafter, reference was made to Section 43A of the Act, both as the provision stood prior to 01.04.2003 and thereafter. However, we need not to go further into the said issue as the Supreme Court in **Woodward Governor India Pvt. Ltd. (supra)** had dealt with the un-amended Section 43A of the Act.

9. Reference to Section 43A would be redundant and not necessary as the revenue has not been able to state and point out that the loan taken under the heading FCNR(B) loan was for purpose of acquisition of any capital asset. The Assessing Officer has accepted that the loan was not for acquisition of an asset but he observed that assets had been acquired in the earlier period. He did not specify or hold that an asset was acquired. Finding of the Commissioner of Income Tax (Appeals) is clear and categorical that the loan was not for acquisition of an asset, payment for which was to be made in foreign currency. Rs. 49,98,072/- was the actual expenditure incurred by the assessee as per the terms negotiated. The payment was to save and protect the assessee from foreign exchange



fluctuation loss. The payment of Rs.49,98,072/- was made during the previous year relevant to the assessment year in question. This is not disputed. Keeping in view the aforesaid aspects, it is clear that the payment of Rs. 49,98,072/- would be of revenue nature i.e. virtually in nature of payment of interest for the loan taken having regard to the nature and type of loan which was taken i.e. FCNR(B) Loan Account. It is part and parcel of payment towards debt servicing.

10. In view of the aforesaid, we do not find merit in the present appeal and the same is dismissed.

11. No costs.

**SANJIV KHANNA, J**

**V. KAMESWAR RAO, J**

**AUGUST 22, 2014/akb**