

IN THE INCOME TAX APPELLATE TRIBUNAL
INDORE BENCH, INDORE

BEFORE SHRI KUL BHARAT, JUDICIAL MEMBER
And
SHRI MANISH BORAD, ACCOUNTANT MEMBER

ITA No. 104/Ind/2013
A.Y. 2009-10

Industrial Filters & Fabrics Private Limited,
Indore

PAN – AAACI 3900 J

:: Appellant

Vs

ACIT-5(1), Indore

:: Respondent

Assessee by	Shri Pankaj Shah & Shri Anil Khandelwal, CAs
Respondent by	Shri R.P. Mourya, Sr.DR
Date of hearing	26.07.2018
Date of pronouncement	19.09.2018

O R D E R

PER SHRI KUL BHARAT, JM

This appeal by the assessee is directed against the order of Id.
CIT(A)-II, Indore, dated 22.11.2012 for the assessment year 2009-10 on
the following grounds of the appeal:

- “1. On the facts and in the circumstances of the case, the Id.
CIT(A) has erred in confirming the addition of Rs.25 lacs on

account of share application money received by the appellant.

2. On the facts and in the circumstances of the case, the Id. CIT(A) has erred in confirming the disallowance of Rs.50,62,032/- being loss on account of "Exchange Rate Difference" incurred on working capital limit in foreign exchange.
3. On the facts and in the circumstances of the case, the Id. CIT(A) has erred in confirming the addition of Rs.1,98,871/- out of "Interest" u/s 14A of the Act."

2. So far as ground no.1 regarding the confirmation of the addition of Rs.25 lacs on account of share application money received by the appellant from M/s. Javda India Impex Ltd. is concerned, both the parties submitted that this issue has already been argued in length in the assessee's own case for assessment years 2007-08 & 2008-09 in ITA Nos. 404 & 484/Ind/2012 and as such, the decision taken in the above years will prevail in the present year too.

3. Considering the rival submissions and the fact that the issue is covered vide our order dated 31.8.2018 in favour of the assessee in the assessee's own case for assessment years 2007-08 & 2008-09 in ITA Nos. 404 & 484/Ind/2012, we direct the Assessing Officer to delete the addition. Accordingly, this ground of appeal of the assessee is allowed.

4. As regards ground no.2, facts, in brief, are that the assessee submitted before the Assessing Officer that the assessee co. has obtained foreign exchange loan amounting to USD 585206 @Rs.42.72 per USD i.e. Rs.2.50 crores. Since the dollar rate as on 31.3.2009 has gone up to Rs.51.37/-, a liability of Rs.50,62,032/- was created on difference of dollar rate of Rs.8.65/- for USD 585206. It was explained that entry has been passed in the accounts based on accounting standards issued by the ICAI. Copy of loan sanction letter, bank, statement, calculation of loss provided and evidence in support of rate of dollar on that date were also furnished to the Assessing Officer. However, the Assessing Officer was of the view that such loss is not certain and should have been claimed in the year in which it has actually incurred. Aggrieved with the action of the Assessing Officer, the assessee went into appeal before the Id. CIT(A).

5. Before Id. CIT(A), it was submitted by the assessee that it is a settled position that fluctuations in the rates of foreign exchange resulting into gain or loss are on revenue account, if the foreign currency is held on revenue account or a trading account or as a part of circulating capital used in the business. Accordingly, any appreciation or depreciation in the value of the foreign currency is regarded either as profit or loss on trading/revenue account. On the other hand, if the foreign exchange

liability arises in relation to acquisition of fixed asset, the corresponding gain or loss is regarded as of a capital nature. However, Id. CIT(A) noted that the assessee is dealing in manufacturing of industrial filter bags, cages trading in industrial fabrics and related accessories, in which most of the purchases in capital account or revenue account is within India. There is no compulsion as such on the assessee to pay in dollars, as most purchases by the assessee are in India, where payment is required to be made in rupee and not in dollars and in fact, payment has been made in rupee currency only. In such circumstances, there was no business compulsion on the assessee to take foreign currency loan. Besides this, the Id. CIT(A) noted that many payments are made from this account for capital expenses. On 21.8.18 alone, there are payments vide two cheques of Rs.46,56,000/- and Rs.36,42,000/- towards land purchase in Mangalia. In the assessment year 2009-10, the assessee has made payments towards capital assets of Rs.3,37,34,144/-. As these capital assets are purchased in India from rupees currency, there was no payment in foreign currency for such assets and therefore, loss on account of foreign exchange fluctuation on such capital assets is not allowable even u/s 43A of the I.T. Act. Further, the assessee has not been able to provide any breakup of utilisation of such foreign currency loan towards capital account and revenue account. Discussing aforesaid facts, the Id. CIT(A) finally confirmed the addition holding as under:

“ In view of the various points mentioned above, as there was no business compulsion on the appellant to take foreign currency loan and as there is no bifurcation available in utilization of such loan towards capital account and revenue account and no capital account payment being made in foreign currency, the claim of loss on foreign exchange fluctuation loss is hereby disallowed. For this, reliance is placed on decision of Apex Court in case of Oil and Natural Gas Commission Ltd. (2010) 15 ITJ 297 (SC), as the foreign currency loan is taken for the first time during the year under consideration whereas in all earlier years, there was rupee loan, hence there is no consistency. Besides such loan is not taken for business compulsions, as most of the payments are made to Indian parties in rupees currency. No capital assets are imported or acquired in foreign currency. Even the conditions of agreements for loan between appellant and SBI cannot be brushed aside in which Point 13 states the policy for crystallization of laon which says that loan is to be crystallized and converted into rupee working capital demand loan at the prevailing T.T. selling rate for the currency of FCNRBTL, when the loan is not repaid on due date. Hence such loss due to foreign exchange rate fluctuation is crystallized as per the agreement only after one year of span of this loan i.e. after 1 year of 18.7.08 when loan of Rs.2,50,00,000/- was given and in fact such loan is repaid by appellant to the bank on 17.7.09 i.e. exactly after 1 year, when appellant repaid Rs.2,85,28,793/- to the bank.

Hence on the one hand loss on fluctuation of foreign exchange is not crystallized on 31.3.09 but it crystallized on 17.7.09 i.e. in A.Y.

10-11 and secondly claim of such loss of Rs.50,62,032/- is much higher than difference of only Rs.35,28,793/- in loan amount and repaid amount and such amount include both foreign exchange loss and interest component. Considering all the points mentioned above, the claim of loss on foreign exchange fluctuation of Rs.50,62,032/- as being disallowed by A.O., is upheld.

5. Being aggrieved, the assessee is before us. Before us, the learned Counsel for the assessee reiterated the submissions made before the Revenue Authorities and submitted that the assessee was enjoying Cash Credit (CC) working limit from State Bank of India amounting to Rs. 450 lakhs. Rate of interest being charged by the bank was 13.50% p.a. To reduce on interest cost, assessee requested for conversion of CC limit of Rs 250 lakhs into foreign currency loan @ LIBOR + 4 %. Accordingly an amount of Rs. 250 lakhs, after conversion of USD 585206 (@ Rs. 42.72 per dollar), was credited by the bank to the assessee's cash credit account on 18.07.2008 (page no. 3 of PB). This was repayable by the assessee exactly after one year i.e. on 17.07.2009. However, in the mean time while closing the accounts on 31.03.2009, the rate of dollar rose to Rs. 51.37 hence the assessee made a provision of Rs. 50,62,032 i.e. \$ 585206 X (51.37 – 42.72) and debited the same to P & L Account for the relevant FY 2008-09. In the next year i.e. FY 2009-10 when loan was settled on 17.7.2009, excess

provision at Rs.15,33,239/- was offered as income in P & L account. This treatment of charging loss in FY 2008-09 and offering the excess provision in FY 2009-10 was in accordance with the Accounting Standard prescribed by ICAI which are mandatory in nature under Companies Act, 1956. However, the Revenue Authorities disallowed/confirmed the amount stating that the loss was not certain. Further, the learned Counsel for the assessee filed a detailed written synopsis on this issue, which reads as under:

“2.2 It is a settled position that fluctuations in the rates of foreign exchange resulting into gain or loss are on revenue account, if the foreign currency is held on revenue account or a trading account or as a part of circulating capital used in the business. And accordingly, any appreciation or depreciation in the value of the foreign currency is regarded either as profit or loss on trading/revenue account. On the other hand, if the foreign exchange liability arises in relation to acquisition of fixed asset, the corresponding gain or loss is regarded as of a capital nature.

2.3 Foreign exchange loss cannot be disallowed merely because the loss is not paid or the same is notional. Provision for loss has been made as prescribed by the Accounting Standard (AS) pronounced by ICAI. These AS are mandatory in nature for all the companies according to section 211 (3A) read with 211(3C) of the Companies Act, 1956, and section 145(2) of the Act. According to AS 11, monetary items such as foreign currency notes, balance in bank account denominated in the foreign currency which are receivable or payables, and loans denominated in the foreign currency must be valued at the closing foreign

exchange rate as on the balance sheet date. In case of loss on foreign exchange fluctuation arising on the balance sheet date, valuation of monetary /revenue item must be recognized as an expense in the relevant period.

2.4 Loss on account of exchange rate difference is covered under section 37 of the Act. Section 37 is a residual section for deduction of revenue expenditure and allows an expense to be deducted if it is not capital in nature or personal in nature, and it is incurred wholly and exclusively for the purpose of business and profession.

Further the “expenditure”, within the meaning of sec 37, does not connote only “what is paid out” and/or “something which is gone irretrievably”, but it may include a loss even though assessee has not paid the liability. The assessee being a co. has to compulsorily follow mercantile system of accounting [Sec. 209(3) of the Companies Act, 1956].

2.5 Had there been such an intention of the legislature as taken by the AO, the same would have been specifically provided as done in case of expenses covered u/s. 43 B. Even section 43A inserted specifically for foreign exchange loss covers loss on capital account only. It does not cover losses in case of revenue accounts which clarifies the intention of the legislature. Thus, it is very clear that the loss on the foreign exchange difference on the balance sheet date is expenditure u/s 37.

2.6 Appellant rely on the following cases :

- A. CIT Vs Woodward Governor India P.Ltd. 312 ITR 254 (SC)*
- B. CIT Vs. Martin & Harris P. Ltd. (1985) 154 ITR 460(Cal)*
- C. Oil & natural Gas Corp. Ltd. Vs CIT (2010) 15 ITJ 297 (SC)*
- D. Dy. CIT v. Cosmo Films Ltd. (2012) 13 ITR 340 (Delhi)(Trib.) : In this case, assessee converted the foreign currency assets and liabilities into rupee terms at the prevailing exchange rate at the last date of financial*

year and this was reflected in the profit and loss account. In the current year it was loss while in the immediate preceding year there was gain. It was held that the loss is allowable as business loss. (A.Ys. 2004-05, 2005-06, 2006-07) i.e Foreign currency loss is assessable as business loss.

2.7 Reasons for disallowance cited by Id. CIT(A):

Ld. CIT(A) confirmed the disallowance on the following grounds:

- A. That there was no compulsion for the assessee for any payment in foreign currency (page 7 of appellate order)*
- B. That the assessee has made payments from cash credit account for capital expenses (on 21.8.2009 Rs.4656000 + Rs.3642000 for buying the land).*

In respect of the above pleas of Ld CIT(A), it is submitted as below :

A(i) Assessee is free to manage its affairs in the manner he consider to be the best as per his prudence. Deduction of any expense is allowed on the basis of business expediency and not on "compulsion". The foreign currency loan was taken to reduce interest cost but proved to be wrong. However disallowance in income tax can not be made just for that reason as the expense were incurred for the business purpose.

A(ii) Assessee would have saved Rs 15.85 lakhs on interest cost which is approx @ 6.34 % (14.50% payable on cc limit – 4.5% + LIBOR on FC loan i.e. 8.16% actually paid). The sharp decline in rate of rupee as compared to dollar was an unusual event.

B(i) Ld. CIT(A) is wrong in interpreting that appellant has used CC limit for purchase of land. CC account is a bank account in which all receipts are deposited and payments are made there

from. Bank insist to route all transactions through one account so that they can keep a check over usage of credit limits, and check diversification of fund. Even otherwise, practically a separate bank account is nowhere maintained for capital transactions.

Besides, it is pertinent to note that the CC account has not become overdrawn even after two payments of Rs. 46,56,000 and Rs. 36,42,000 for land. Out of available limit of Rs. 200 lakhs, only 167 was being utilized even after these two payments were made (page 9 of paper book).

*Auditors are required to report on usage of funds. In audit report it is stated that, “**no funds raised on short term basis have been used for long term investment**” (page 35 of PB).*

B(ii) Appellant had sufficient long term funds at his disposal to purchase the land. This may be understood from Statement of Long Term Funds and its Utilisation as given on page no. 8 of the paper book. From that, it is clear that appellant had long term resources of Rs 768.39 lakhs where as deployment of funds for long term assets was Rs. 692.51 lakhs only. Thus there was a surplus of Rs. 75.88 lakhs of long term funds. Hence contention of the Ld CIT about using cash credit limit for land purchase is not correct.

Here, we rely on the decision of Bombay High Court in the case of Reliance Utilities & Power Limited (2009) 178 Taxmann 135, which held that when interest free funds are available then a presumption would arise that investment would be out of interest free funds. (The appellant's had a surplus long term fund of Rs. 75.88 lakhs even after investment in land and all other fixed assets). The same ratio was followed in the case of M/s Orbitech Vs JCIT (2011) 11 axmann.com 225 (Bom).

B(iii) Bank granting the cash credit limit is more vigilant and concerned about the correct utilization of their money. They

have taken an undertaking that company will not divert short term working capital limit to long term usage. That's why they insist on maintaining a single account for routing all transactions and use other analysis/techniques to ascertain any possible diversification."

6. We have considered the rival submissions of both the parties and gone through the material available on the file. The Id. CIT(A) disallowed the claim of the assessee observing as under:

"Appellant has not been able to provide any breakup of utilization of such foreign currency loan towards such foreign currency loan towards capital account and revenue account. Appellant has also not bifurcated those purchases in which there is compulsion to make payment in dollars from those purchases where payments are made in rupees.

In view of the various points mentioned above, as there was no business compulsion on the appellant to take foreign currency loan and as there is no bifurcation available in utilization of such loan towards capital account and revenue account and no capital account payment being made in foreign currency, the claim of loss on foreign exchange fluctuation loss is hereby disallowed. For this, reliance is placed on decision of Apex Court in case of Oil and Natural Gas Commission Ltd. (2010) 15 ITJ 297 (SC), as the foreign

currency loan is taken for the first time during the year under consideration whereas in all earlier years, there was rupee loan, hence there is no consistency. Besides such loan is not taken for business compulsions, as most of the payments are made to Indian parties in rupees currency. No capital assets are imported or acquired in foreign currency. Even the conditions of agreements for loan between appellant and SBI cannot be brushed aside in which Point 13 states the policy for crystallization of loan which says that loan is to be crystallized and converted into rupee working capital demand loan at the prevailing T.T. selling rate for the currency of FCNRBTL, when the loan is not repaid on due date. Hence such loss due to foreign exchange rate fluctuation is crystallized as per the agreement only after one year of span of this loan i.e. after 1 year of 18.7.08 when loan of Rs.2,50,00,000/- was given and in fact such loan is repaid by appellant to the bank on 17.7.09 i.e. exactly after 1 year, when appellant repaid Rs.2,85,28,793/- to the bank.

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Rs.50,62,032/- is much higher than difference of only Rs.35,28,793/- in loan amount and repaid amount and such amount include both foreign exchange loss and interest component. Considering all the points mentioned above, the claim of loss on foreign exchange fluctuation of Rs.50,62,032/- as being disallowed by A.O., is upheld.”

7. We find that the decision of Id. CIT(A) is contrary to the decision of Hon'ble Supreme Court rendered in case of CIT Vs Woodward Governor India P.Ltd. 312 ITR 254 (SC). Ever otherwise, the assessee has demonstrated that any gain arising out of fluctuation in foreign exchange has been offered for taxation in the subsequent year. In view of these facts, we direct the Assessing Officer to delete the addition. Accordingly, this ground of the appeal of the assessee allowed.

8. The last ground pertains to confirmation of addition of Rs.1,98,871/- out of interest u/s 14A of the I.T. Act. Facts, in brief, are that from the balance-sheet, the Assessing Officer noticed that total investments were Rs.49,46,000/- in the preceding year which rose to Rs.56,95,000/-. The income from these investments will be in the shape of dividend only, which is exempt u/s 10 of the I.T. Act. The Assessing Officer asked the assessee to explain the same. The assessee submitted that the assessee co. has very old investment of equity shares of IFF Overseas P. Ltd. for Rs.25000/-. Besides this, the assessee co.

invested an amount of Rs. 4921000/- in shares of IFF Hilson P Ltd in FY 2007-08 and a further investment of Rs. 700000/- was made in the relevant year 2008-09. This is a trade investment in a subsidiary company for business purpose (not to earn dividend). In the investee company, i.e. IFF Hilson P Ltd., assessee company / group hold 51% equity and 49% is held by "Hillson" group of U.K. Thus it is a joint venture company exclusively promoted for manufacturing and marketing "Cages" which is one of the important component of assessee's product "Industrial Filter Bags". Hilson group of UK commended good market reputation as manufacturer of cages and it also provides technology for the same. Assessee envisaged a boost for its own product as a result of association with the "Hillson" since cages being an important component in industrial filter bags manufactured by the assessee. An understanding was made that the assessee would buy cages from IFF Hillson P Ltd. for its filter bags, and it would also market the same. Thus the said investment is purely a trade venture. In view of the fact that the investment is a trade investment with an intention to boost own business besides earning income also, the provisions of section 14A are not applicable. However, the Assessing Officer did not agree with the submission of the assessee and calculated disallowance u/s 14A r.w. Rule 8D at Rs.1,98,871/-. Aggrieved with the action of the Assessing Officer, the assessee challenged the issue before the Id. CIT(A).

9. Ld. CIT(A) noted that Rule 8D r.w.s. 14A has been prospectively applied from the assessment year 2008-09 and in the present case, the year involved is assessment year 2009-10. The case-laws relied by the assessee are for assessment years prior to amendment and insertion of Rule 8D. The investment made at Rs.56,95,000/- gives rise to dividend and in such cases, Statute provides for proportionate disallowance under Rule 8D r.w.s. 14A of the I.T. Act. Considering this and also the fact that such disallowance was confirmed in assessee's own case for the assessment year 2008-09, the Id. CIT(A) confirmed the disallowance at Rs.1,98,871/- u/s 14A r.w. Rule 8D. Being aggrieved, the assessee has challenged this issue before us.

10. Before us, the learned Counsel for the assessee has reiterated the submissions made before Revenue Authorities and submitted that dividend or capital gain were not the motive for promoting the company/ buying the shares. The assessee was not just an investor but promoter. Investment was to benefit indirectly by way of increase in goodwill and turnover which ultimately result into increase in the income too. Following transactions during the relevant year with the investee company proves the object of promoting it :

Goods Purchases (Traded)	Rs. 66677526
Goods Purchases (Raw Material)	Rs. 1354533
Job Work Payments	Rs. 5716319

In the balance sheet also, these are classified as Trade Investment. In support of the claim the Id. Counsel for the assessee relied upon the decision in the case of CIT Vs Phil Corporation Ltd. (Bombay HC at Goa) (2011) 244 CTR (Bom) 226 along with the following judicial pronouncements:

- A. Expenses on earning exempt income - investment in group co. (2012) 19 ITJ MPFC Vs DCIT;
- B. Interest on borrowed capital to gain control on subsidiary is allowed u/s 36(i)(iii) : CIT Vs Phil Corp Ltd. 244 CTR 226 (Bom);
- C. Investments made in earlier years in which interest was allowed. In current year, no evidence brought by revenue to prove that borrowed funds were used for investing. Disallowance is not called for.: MPFC Vs DCIT in (2012) 19 ITJ 145 Trib Indore;
- D. Narendra Narang Vs Addl CIT (2011) 18 ITJ 383 (Indore Trib); and
- E. When interest is paid on borrowed capital to gain control on subsidiary, it is allowable u/s. 36(i)(iii) : ACIT Vs Tulip Star Hotels Ltd. 338 ITR 482 & S. A. Builders 288 ITR 1 (SC) 288 ITR 1 (SC).

11. On the other hand, the Id. DR relied on the orders of the Revenue Authorities and submitted that the Revenue Authorities were justified in their actions because the income from these investments is in the shape of dividend, which is exempt u/s 10 of the I.T. Act.

12. We have considered the rival submissions of both the parties and gone through the material available on the file. The only explanation of the assessee that the investment is made for commercial expediency. We are unable to accept the explanation of the assessee in the light of the recent judgment of the Hon'ble Apex Court rendered in the case of Max Opp Investment Ltd. vs. CIT [2018] 91 taxmann.com 154 (SC). We,

therefore, decline to interfere with the order of the Id. CIT(A). Same is hereby affirmed. This ground of the appeal of the assessee is dismissed.

Finally, the appeal of the assessee is partly allowed.

Order was pronounced in the open court on 19.9.2018.

Sd/-
(MANISH BORAD)
ACCOUNTANT MEMBER

Sd/-
(KUL BHARAT)
JUDICIAL MEMBER

Dated : 19.9.2018

Copy to: Assessee/Respondent/CIT(A)/CIT/DR, Indore