

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH “A”, HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER**

**ITA No. 1514/Hyd/2016
Assessment Year: 2012-13**

Sri Ramadas Paper Boards (P) Ltd., Hyderabad. vs. Dy. Commissioner of Income-tax, Circle – 3(2), Hyderabad.

PAN – AADCS2140M

(Appellant)

(Respondent)

Assessee by : Shri G.V.N. Hari
Revenue by : Shri M.H. Naik

Date of hearing : 22/07/2019
Date of pronouncement : 09/08/2019

ORDER

PER S. RIFAUR RAHMAN, A.M.:

This appeal filed by the assessee is directed against the order of CIT(A) – 3, Hyderabad, dated 29/09/2016 for AY 2012-13.

2. Brief facts of the case are, assessee company engaged in the business of manufacturing paper products, filed its return of income for the AY 2012-13 on 26/09/2012 declaring loss of Rs. 32,92,517/-. This return was processed u/s 143(1) of the Income-tax Act, 1961 (in short ‘the Act’) and subsequently the case was selected for scrutiny under CASS. Accordingly, notices u/s 143(2) and 142(1) were issued and served on the assessee. In response, Id. AR of the assessee filed the relevant information as called for.

2.1 During the assessment proceedings, AO noticed that assessee has claimed finance cost of Rs. 4,80,93,348/- as against Rs. 2,33,95,822/- of previous year. When the AR was asked to explain the

substantial difference in the finance cost, in response, assessee filed a letter dated 12/12/2014, which is reproduced as under:

“State bank of India sanctioned FCNRB Loan to us during the F.Y: 2009-10 when the limits were taken over from syndicate Bank. The FCNRB loan will be sanctioned in it phased manner based on the availability of the US Dollars with the bank. As and when there is shortage of US Dollars with the Bank the loan Will be converted into INR loans. Accordingly our FCNR(B) Loans were converted into INR Loans during F.Y: 2011-12. The difference between FCNRB loan balances and the conversion into INR loans will be debited to our account. This difference will be treated as conversion charges or difference interest by the bank. Accordingly the difference between the FCNRB loan balance and their conversion into INR loan amounting to Rs.1,55,95,941/- debited to account as conversions charges/difference interest.”

2.2 AO noticed that by conversion of foreign currency loan into Indian currency loan, principle portion of the outstanding loan due to restatement of loan was included in the finance cost and claimed in the P&L A/c. Further, he noticed that assessee has availed initial loan from Syndicate Bank and the loan was taken for the purpose of civil works for construction of factory buildings and plant & machinery. In view of the above observations, the AO asked the assessee to justify the claim of expenditure. In response, assessee filed another letter dated 22/12/2014, which is reproduced below:

The assessee has initially availed term loans from Syndicate. Rank, Kakinada for expansion OF its existing unit in the year 2008-09. During the F.Y.2009-10, SBI, Rajahmundry has taken over the term loans from Syndicate Bank. As on the date of takeover, the outstanding term loans are to the tune, of Rs.20.20 crore into FCNRB Term Loan. The term. loans were converted into US dollars on forward contract basis.

As per the terms of sanction, we have to repay the term loans as per the repayment schedule, given by the bank in US dollars only. Accordingly, we, have regularly repaid the term loans as per forward contract foreign exchange loans. During the F.Y. 2011-12 SBI, has expressed its inability to continue its FCNRB loans to us in, view of the shortage USD with the bank and asked us to arrange US dollars for the remaining outstanding loans. As dollar rate is very high at that time, we have requested the bank to convert the FCNRB loans into rupee

loans. As a result of the conversion, there is an increase in Indian currency loan to the tune of Rs.1,55,95,941/-which represents roll over premium in respect of foreign exchange fluctuations and the same was treated as interest/bank charges by us for the FY 2011-12.

As ours is a company, we have to follow the Accounting Standards issued by ICAI from time to time u/s 211(3C) of the Companies Act, 1956. Accounting Standard - 11 which deals with the effects of changes in Foreign Exchange rates and Accounting Standard - 16 which deals with Borrowing costs are also notified. by the Central Government under sec. 211(3C) of the Companies Act, 1956 and we have mandatorily follow these two standards.

According to Para - 36 of the Accounting Standard - 11, exchange differences on forward exchange contracts has to be charged to the Profit and loss account.

According to Standard-16 issued by the Institute of Chartered Accountants of India at Para – 4(e) of the said standard, which says as follows;

AS - 16 : Borrowing Cost

The objective of this standard is to prescribe the accounting treatment for borrowing costs. This Standard should be applied in accounting for borrowing costs.

The following terms are used in this Standard with the meanings specified.

Borrowing costs are interest and other costs incurred, by an enterprise in connection with borrowing of funds.

Borrowing costs may include :

(a) Interest and commitment charges on bank, borrowings and other short-term and long-term borrowings;

(b) amortization of discounts or premiums relating to borrowings;

(c) amortization of ancillary costs incurred in connection with the arrangement of borrowings;

(d) Finance charges in respect of assets acquired under finance leases or under other similar arrangements, and

(e) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest.

As per para 6 of AS-16:

Borrowing costs that are directly attributable to the acquisitions, construction or production of a quality asset should be capitalized as part of the asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this statement. Other borrowing costs should be recognized as an expense in the period in which they are incurred.

In view of the above, the difference on account of the fluctuations in foreign exchange has to be debited to profit and loss account and accordingly we have recognized them as expenditure "allowable under Sec. 36(1)(iii) of the Income Tax Act, 1961.

Since the expenditure above said was revenue expenditure it cannot be adjusted in the actual cost of the asset as defined under Sec. 43(1) of the IT Act or written down value of the assets as defined under Sec. 43(6) of the Income Tax Act, 1961.

However, there is one more provision under 'Sec. 43A dealing with changes in the rate; of foreign exchange currency under the Income, Tax Act" 1961 which reads as follows:

43A. Special provisions consequential to changes, in rate of exchange of currency.

Notwithstanding anything contained in any other provisions of this 'Act, where an assessee has acquired any asset in any previous year from a country outside India for the purposes of his business or profession and, in consequence of a change in the rate of exchange during any previous year ", after the acquisition of such asset, there is an increase or reduction in the liability ',of the assessee as expressed in Indian currency (as. compared to the liability existing at the time of acquisition of the asset) at the time of making payment.

(a) towards the whole or a part of the cost of the asset; or

(b) towards repayment of the whole or a part of the moneys borrowed by him ' from any person, directly or' indirectly, in any

foreign currency specifically for the purpose 'of acquiring the asset along with interest, if any.

The amount by which the liability as aforesaid is so increased or reduced during such 'previous year and which" is taken into account at the time of making the payment, irrespective of the method of accounting adopted by the assessee, shall be added to, or, as the case may be, deducted from-

(i) the actual cost of the asset as defined in clause (1) of section 43; or

(ii) the amount of expenditure of a capital nature referred to in clause (iv) of sub-section (1) of section 35; or

(iii) the amount of expenditure of a capital nature referred to in section 35A; or

(iv) the amount of expenditure of a capital nature' referred to in clause (ix) of sub-section (1) of section 36; or '

(v) the cost of acquisition of a capital asset (not being a capital asset referred to in section 50) for the purposes of section 48,

and the amount arrived at after such addition or deduction shall be taken to be the actual cost of the asset or the amount of expenditure of a capital expenditure or, as the case may be, the cost of acquisition of the capital asset as aforesaid:

provided that where an addition to or deduction from the, actual cost or expenditure or cost "of acquisition has been made under this 'section; as it" stood immediately before its substitution by the Finance Act, 2002, on account of an increase or reduction in the liability as aforesaid, the amount to be added to, or, as the case may be, deducted under this section from, the actual cost or' expenditure or cost of acquisition at the time of making the payment shall be 'so adjusted that the total amount added. to, or, as the, case may be, deducted from, the actual cost or expenditure or cost 'of acquisition, is equal to the increase or reduction. in the aforesaid liability taken into account at the time of making Payment.

Explanation 1 - In this section, unless the context otherwise requires,-

(a) "rate of exchange" means the rate of exchange determined recognised by the Central Government for the conversion of Indian currency into foreign currency or foreign currency into Indian currency;

(b) "foreign currency" and "Indian currency" have the 'meanings respectively assigned to them in section 2 of the Foreign 'Exchange ;Management Act, 1999' (42 of 1999).

Explanation 2. Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.

Explanation 3. Where the assessee has entered into a contract with an authorised dealer as defined in Section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999), for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, to be added to, or deducted from, the actual cost of the asset or the amount of expenditure of a capital nature or, as the case may be, the cost of acquisition of the capital asset under this section shall, in respect of so much of the sum specified in the contract as is available for discharging the liability aforesaid, be computed with reference to the rate of exchange specified therein.

As can be seen from the above, the above section basically applies to assets purchased from outside India and if when the payment was made, there is an exchange fluctuation arises.

In view of the above, the above section and the case laws based on the above section are not applicable to our case.

Because of the Accounting Standards and clauses of the Income Tax referred above, the expenditure incurred by us is not capital expenditure and hence cannot be capitalized. This view supports from the following case laws.

1) ELEPON ENGINEERING COMPANY.LTD.VS. ASST. COMMISSIONER OF INCOME TAX 322 ITR 11 (GUJ).

2) COMMISSIONER OF INCOME TAX Vs. TATA IRON & STEEL CO. LTD., 231 ITR 285 (SUPREME COURT). '

It is, therefore, requested that the above expenditure ay please be allowed

as revenue expenditure for the Asst. year 2012-13"

After considering the submissions of the assessee, AO observed that as a result of conversion of foreign currency loan into Indian rupee

loan, there is an increase in Indian currency loan to the tune of Rs. 1,55,95,941/- and this increased loan amount was debited to P&L A/c as interest/bank charges. He, therefore, was of the view that there is no merit in the claim of the assessee that conversion of loan from one currency to another currency is nothing but a restatement of the loan which resulted in enhancement of principle amount. He, therefore, held that repayment of principle amount of loan is not allowable expenditure since it is capital in nature. Further, he held that loan liability being related to acquisition of plant and machinery, the conversion loss has direct nexus with the acquisition of capital asset and hence, it is a capital loss which is not allowable. He relied on various case law to make the addition.

3. Aggrieved with the above order, assessee preferred an appeal before the CIT(A). The CIT(A) after considering the submissions of the assessee, dismissed the appeal of the assessee by observing as under:

"4. In the above background the appellant claims that the amount of Rs.1,55,95,941/- should be allowed to him for the following reasons.

a) According to AS-II which is to be mandatorily followed by the appellant company, the exchange rate difference in respect of forward contracts are to be charged to the profit and loss account.

b) As per AS-16 relating to borrowing cost, Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest.

c) Provisions of Sec.43A are not applicable in as much the FCNRB loan was availed only to discharge the term loan availed in Indian rupees from Syndicate Bank and none of the assets were purchased from outside India.

The appellant relied on the decision of Hon'ble ITAT, Pune Bench in case of Cooper Corporation Pvt Ltd DCIT Appeal No.866 of 2014 dated 29.4.2016 where in similar circumstances foreign exchange fluctuation loss was allowed u/s 37.

5. Section 43A deals with manner of adjustment to be made to cost of assets consequential to changes in rate of exchange of currency. The section states that: -

-When an asset was acquired from a foreign country,

-Due to change in rate of exchange there is increase or reduction in liability of amount to be paid on asset.

-The adjustment to the cost of asset by way of increase or decrease shall be made at the time of making the payment.

Assessing Officer as well as the appellant fairly admitted that Sec,43A is not applicable as the asset involved was not imported but purchased within the country .

6. The judicial precedents on the issue of allowing gain or loss on account of foreign exchange fluctuation are discussed as under:

The Hon'ble Supreme Court in case of CIT VS Tata Iron &. steel Co Ltd (1998) 231 ITR 285 (A.Y.60-61 &. 61-62) held that fluctuation in exchange rate resulting in gain or loss at the time of repayment of loan would not alter the actual cost incurred for purchase of asset for computing the depreciation. This judgment was rendered before Sec,43A was brought into Act vide Finance Act, 2002 w.e.f. 1/4/2003. Sec,43A clearly stipulates that the cost of asset would increase / decrease depending on fluctuation in foreign exchange rates.

The Hon'ble Supreme Court in case of Sutej Cotton Mills Ltd Vs CIT (1979) 116 ITR 1 (A.Y 1957-58,&1959-60) clearly held that the loss in respect of capital asset would not be allowable. The Hon'ble Court further held that whether the loss suffered by the assessee was a trading loss or not would depend on the answer" to the question, whether the loss was in respect of a trading asset or a capital asset. In the former case, it would be trading loss but not so in the latter. The test may also be formulated in another way by asking the question whether the loss was in respect of circulating capital or in respect of fixed capital. Further the Hon'ble Supreme Court while referring to several precedents on the issue of foreign exchange fluctuation referred to Davies Vs Shell Co. of China Ltd. (1952) 22 ITR (Suppl.)I (CA) wherein the Hon'ble Court held that the result of change in foreign exchange fluctuation would bear the same character (Capital or Revenue) for which the loans were taken The Hon'ble Supreme Court in case of ACIT Vs Elecon Engineering Co. Ltd (2010) 322 ITR 20 (A.Y1986-87)held that roll over charges paid on foreign exchange forward contracts in

respect of liabilities relating to the acquisition of 'fixed assets' are to be capitalized in terms of Expln.3 to S,43A as it stood prior to the amendment made by the Finance Act, 2002, and same are not allowable as business expenditure”.

In view of the above discussion, admittedly the loans were taken for the purpose of acquiring plant & machinery and the loss due to foreign exchange fluctuation relate to the principal amount of loan therefore the loss incurred is capital in nature and cannot be allowed.”

4. Aggrieved by the order of CIT(A), the assessee is in appeal before us raising the following grounds of appeal:

“1. The order of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and also the law applicable to the facts of the case.

2. The learned Commissioner of Income Tax (Appeals) is not justified in sustaining the addition of Rs. 1,55,95,941 made by the assessing officer towards disallowance of claim on account of reconversion of FCNRB Loan to Rupee term loan.

3. Without prejudice to the above, the learned Commissioner of Income Tax (Appeals) ought to have directed the assessing officer to grant depreciation on the aforesaid amount held to be capital expenditure.

4. Any other ground that may be urged at the time of appeal hearing.”

5. Before us, Id. AR of the assessee brought to our notice the facts relevant to the availing of loan and conversion of FCNR to Indian currency loan. He submitted that assessee has converted the term loan availed in Indian currency into foreign currency loan in order to avail interest benefit and subsequently, due to heavy fluctuation in the foreign currency, assessee decided to convert the FCNR loan into Indian currency loan and due to conversion, assessee has incurred rate difference, which is nothing but finance charges, which is charged to P&L A/c. He submitted that such conversion of loan is allowable expenditure, for which he relied on the following case law:-

1. Cooper Corporation Pvt. Ltd., ITA No. 866/PN/14, order dated 29/04/2016.

5.1 Further, he submitted that section 43A is not applicable to the present case. For this proposition, he relied on the decision of Hon'ble Delhi High Court in the case of Climate System Pvt. Ltd., 90 CCH 40, in particular relied on para 10.7 of the order.

5.2 Further, he brought to our notice a statement, as per which, assessee has paid interest during the period of conversion of loan from rupee into FCNR loan and he submitted that assessee has paid actually Rs. 2,26,68,647 as interest, whereas, in the normal situation, assessee must have paid Rs. 4,29,28,900/-. He submitted that, now, the assessee has charged to P&L A/c of dollar difference to the extent of Rs. 1,57,06,189. Still, assessee has benefited with the above conversion of foreign currency loan into rupee loan.

6. The Id. DR, on the other hand, submitted that the CIT(A) has elaborately discussed the facts of the case and came to proper conclusion. He relied on the judgment of the Hon'ble Supreme Court in the case of Challapalli Sugars Vs. CIT [1975] 98 ITR 167. Further, he submitted that term loan conversion into FCNR and back in rupee loan is only a conversion of capital and it is capital in nature, as such conversion cannot be allowed as revenue expenditure.

7. Considered the rival submissions and perused the material on record. In the given case, assessee availed term loan from Syndicate Bank for the purpose of construction of factory building and plant & machinery. All the plant & machinery are domestic and the above term loan was rupee loan. Subsequently, assessee availed the FCNR loan from SBI and settled the loan taken from Syndicate Bank. As per the advise of SBI, assessee has to close the FCNR loan due to shortage in the availability of USD with the bank. Accordingly, the FCNR loan was converted into rupee loan and assessee has to

absorb the exchange difference at the time of conversion of FCNR loan into rupee loan.

7.1 With that back ground, let us analyse the present case, Id. CIT(A) dismissed the appeal of the assessee by holding that the provisions of section 43A is applicable in this case. But, in our view, section 43A has no application considering the fact that the fixed assets were purchased in Indian currency and only the term loan was converted into FCNR and back to rupee loan. The provisions of section 43A are applicable only when the assessee acquires any asset in any previous year from a country outside India and in consequence of a change in the exchange rate, there may be increase or decrease in the liability as expressed in Indian currency as compared to the liability at the time of acquisition of such asset and at the time of settlement. Since, the assets acquired by assessee are not in foreign currency, the provisions of section 43A are not applicable.

7.2 Coming to the main issue, let us consider that the assessee has availed rupee loan of Rs. 1 lakh from Syndicate Bank @ interest cost of 10% and later assessee converts the same into FCNR loan with the interest rate of 5%. The assessee services the FCNR loan and at the time of availing the FCNR loan, assessee aware that it is taking interest rate benefit but at the same time, there is exposure of foreign rate fluctuation. Subsequently, assessee converts the FCNR loan into rupee loan during this AY and due to exchange fluctuation, the liability of the assessee towards term loan increases to, let us say, Rs. 1,05,000/-. The original term loan availed by the assessee remains same but due to exchange fluctuation, the assessee takes the additional burden of Rs. 5,000/-. The question before us is, how to treat the above loss of Rs. 5,000/-.

7.3 In our view, the assessee has converted the rupee loan into FCNR in order to take the interest benefit. It is purely a business decision and at the time of conversion, it is aware that there is exposure to the fluctuation of currency rates. Again, assessee converted the FCNR loan into rupee loan, the assessee has absorbed the exchange difference, it definitely falls under business decision and falls within the ambit of section 37 of the Act. As explained earlier, the original term loan availed by assessee has not changed and remain same and there is no impact on the value of fixed assets since it is acquired in Indian currency. Therefore, it cannot be held that the capital value of the asset or liability has undergone change. Hence, as per the above decision, we allow the grounds raised by the assessee.

8. In the result, appeal of the assessee is allowed.

Pronounced in the open Court on 9th August, 2019.

**Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER**

**Sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER**

Hyderabad, Dated: 9th August, 2019

kv

Copy to:-

- 1) *M/s Sri Ramadas Paper Boards Pvt. Ltd., 21o, Ramakrishna Towers, Nagarjuna Nagar, Ameerpet, Hyderabad – 500 073.*
- 2) *DCIT, Circle – 3(2), Hyderabad.*
- 3) *CIT(A) – 3, Hyderabad.*
- 4) *Pr. CIT - 3, Hyd.*
- 5) *The Departmental Representative, I.T.A.T., Hyderabad.*
- 6) *Guard File*