

आयकर अपीलीय अधिकरण, 'सी' न्यायपीठ, चेन्नई
IN THE INCOME-TAX APPELLATE TRIBUNAL 'C' BENCH, CHENNAI
श्री वी. दुर्गा राव, न्यायिक सदस्य एवं श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष ।
**Before Shri V. Durga Rao, Judicial Member &
Shri Manoj Kumar Aggarwal, Accountant Member**

आयकर अपील सं./I.T.A. Nos.1701 & 1702/Chny/2019
निर्धारण वर्ष/Assessment Years: 2013-14 & 2014-15

M/s. AGS Health Private Limited,
05-02 A-South Tidel Park, No. 4,
Canal Bank Road, Taramani,
Chennai 600 113.
[PAN:AAICA9905D]

Vs. The Assistant Commissioner of
Income Tax,
Corporate Range 1,
Chennai.

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से / Appellant by : Shri R. Vijayaragahavan, Advocate
प्रत्यर्थी की ओर से/Respondent by : Shri M. Rajan, CIT
सुनवाई की तारीख/ Date of hearing : 12.04.2023
घोषणा की तारीख /Date of Pronouncement : 21.04.2023

आदेश /O R D E R

PER V. DURGA RAO, JUDICIAL MEMBER:

Both the appeals filed by the assessee are directed against separate orders of the Id. Principal Commissioner of Income Tax-1, Chennai, dated 28.03.2019 and 20.03.2019 relevant to the assessment years 2013-14 and 2014-15 respectively passed under section 263 of the Income Tax Act, 1961 ["Act" in short]. Since, common issue has been raised in an identical fact, for the sake of convenience; both appeals were heard together and are being disposed off by this consolidated order.

2. The appeal filed by the assessee for the assessment year 2014-15 is delayed by six days in filing the appeal before the Tribunal. The assessee has filed petition for condonation of delay in the form of an affidavit against which, the Id. DR has not objected. Since the assessee was prevented by reasonable cause, we hereby condone the delay of six days in filing the appeal and admit the appeal for adjudication.

3. Brief facts the case are that the assessee company M/s. AGS Health Private Limited is engaged in providing BPO services in Healthcare Industry and filed its Return of Income for the assessment year 2013-14 on 29.11.2013 admitting a total income of ₹.15,15,74,721/-. The case was selected for scrutiny and notice under section 143(2) of the Act dated 03.09.2014 was served on the assessee. A reference is made to the TPO to determine the Arms Length Price for the International Transactions the assessee had with its associated enterprises to the tune of ₹.60,77,04,100/-. The TPO-1(1) vide order dated 20.09.2016 had held that no adjustments was required to be made to the International Transactions of the assessee company. Accordingly, the assessment was completed under section 143(3) r.w.s. 92CA of the Act on 12.12.2016 assessing total income of ₹.8,98,83,670/-.

3.1 On perusal of the assessment record for the assessment year 2013-14, the Id. PCIT has noted from the reserves and surplus account that the assessee has credited the hedge reserve with an amount of ₹.1,01,08,500/- for the financial year 2012-13 relevant to the assessment year 2013-14. As noticed from Note 2.1(m) foreign currency transactions and balances, it has been stated that the company uses forward contracts to hedge its risks associated with foreign currency fluctuations relating to certain firm commitments and highly probable transactions. The company designates these hedging instruments as cash flow hedges, Hedging instruments are initially measured at fair value and are measured at subsequent: reporting dates. Changes in fair value of these derivatives that are designated and effective as hedges of future cash flows are recognised directly in shareholders' funds (hedge fluctuation reserve) and the ineffective portion was recognised immediately in the statement of profit and loss. At the time of forecasted transactions any cumulative gain or loss on the hedging instrument recognised in shareholders' funds is retained there until the forecasted transaction occurs. Further, from Note 28 the assessee has declared the forward exchange contracts including forward cover for forecasted revenue receivable transactions, as on 31.03.2013 stood at ₹.30,98,91,000/-. In this connection the Id. PCIT has observed that the income arising on account of forward contracts

hedging the debtors has been directly accounted under reserves and surplus account, without routing through the P & L account. As the assessee was following mercantile system of accounting any income arising on account of accrual basis shall be offered to tax in the year of such accrual.

3.2 In view of the decision in the case of CIT Vs. Woodward Governor India P. Ltd. (312 ITR 254), wherein, Supreme Court has observed that any difference, loss or gain arising on conversion of the liability at the closing rate, should be recognised in P & L account for the reporting period. Under revenue account, foreign exchange fluctuations are on an account of debtors for exports, creditors for purchases and expenses payable etc. Gain on fluctuations of these accounts will be recognised on accrual basis under the head profit and gains of business or profession. Similarly, loss on fluctuation is also allowed on accrual basis under section 37(1) of the Act. Hence the income of ₹.1,01,08,500/- should be assessed to tax for assessment year 2013-14.

3.3 Further, the Id. PCIT has observed that M/s. AGS Health Private Limited hedges its risks associated with foreign currency fluctuations relating to certain firm commitments and highly probable forecast transactions using forward contracts. The assessee considers these

hedging instruments as cash flow hedges. Any changes in fair value of these forward contracts are recognised directly in shareholders' fund (hedge fluctuation reserve) until the forecasted transaction occurs. This accounting is in accordance with Accounting Standard – 30.

3.4 However, the Accounting Standard-11 on “the Effects of Changes in Foreign Exchange Rates” is applicable only to exchange differences on all forward exchange contracts entered into to hedge the foreign currency risks arising from existing assets and liabilities and is not applicable to the exchange difference arising on forward exchange contract entered into to hedge foreign currency risks from future transactions in respect of which firm commitments are made or which are highly probable forecast transactions.

3.5 Further as per Accounting Standard-30 on "Financial Instruments Recognition and Measurement" a hedged item is an asset, liability, firm commitment, highly probable forecast transactions or net investment in a foreign operation that –

- (a) exposes the entity to risks of changes in fair value or future cash flows and
- (b) is designated as being hedged.

On the basis of the above, accounting for exchange difference on forward contracts for hedging highly probable transactions should be covered under Accounting Standard-30.

3.5 As per Accounting Standard-30, foreign exchange gain/loss on hedging instruments constituting effective hedge for highly probable forecast transactions is not recognised in the P & L account but transferred to balance sheet in Hedging Reserve Account and the accumulated balance in such reserve account is transferred to P&L account as and when underlying hedged item gets recognised in P & L account i.e., when the firm commitment or highly probable forecast transactions takes place. Accordingly, an amount of ₹.1.010 crores has been recognised in hedge reserve during assessment year 2013-14.

3.6 As per Section 145 of the Act, income chargeable under the head "Profit and Gains of Business or Profession" or "Income from Other sources" shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

3.7 In this regard, reliance is placed on judgement of the Apex Court in case of CIT v. Woodward Governor India Pvt. Ltd. (supra), wherein, it has been held that accounting principles laid down by nationally accepted

account standards are supreme and must guide the computation of income under the Act where the system of accounting adopted is fair and reasonable and is not adopted with a view to reduce the incidence of taxation.

3.8 Since in the instant case the assessee has followed the accepted accounting standards i.e., AS-11 and AS-30 while preparing the financial statement for the assessment year 2013-14 and 2014-15, the assessee, has offered to tax the exchange difference gain on forward contracts recognised in P&L account as per applicable AS-11 in the financial statements. But, however, the assessee has not offered to tax the exchange difference gain on forward contracts credited to hedge reserve as per applicable AS-30.

3.9 Further, the draft tax accounting standard and Income Computation and Disclosure Standards (ICDS) which are applicable from assessment year 2016-17, also provide that exchange difference arising on forward exchange contract entered into to hedge foreign currency risks of future transactions in respect of which firm commitments are made or which are highly probable forecast transactions which should be treated as income/expense only on actual settlement basis.

3.10 Consistent with hedge principle the amount lying as credit balance in reserves is not permitted to be declared as dividend. This also supports that such gain is not treated as realised reserve.

3.11 Considering the principles in the case of Woodward Governor supra, provisions for AS-30, ICDS and draft tax AS, the hedge gain/loss of revenue items accounted in reserves pertaining to forward contracts on highly probable forecast transactions is not taxable/deductible and has to be recognised for tax purposes in accordance with the accounting treatment in the year when the said gain/loss is finally recognised in P & L account.

3.12 In view of the above detailed observations of the Id. PCIT, the income of ₹.1,01,08,500/- should be assessed to tax for assessment year 2013-14. Since the Assessing Officer has not made proper examination/verification before passing the assessment order under section 143(3) r.w.s. 92CA of the Act dated 12.12.2016, the Id. PCIT was of the opinion that the assessment order is erroneous and prejudicial to the interest of Revenue and show-caused the assessee vide notice under section 263 of the Act dated 25.03.2019 as to why the assessment order should not be set aside and called for explanation. In response to the notice, the assessee's AR filed a written submission on 28.03.2019 in

which it was submitted that the subject assessment order passed by the Assessing Officer is not erroneous nor prejudicial to the interest of the Revenue and proceedings under section 263 of the Act is unwarranted and may kindly be dropped. After considering the submissions of the assessee and in view of the detailed observations, the Id. PCIT has noted that the Assessing Officer has not at all examined foreign exchange gains and simply accepted the explanation of the assessee and therefore, set aside the assessment order passed under section 143(3) r.w.s. 92CA of the Act and directed the Assessing Officer to make complete verification and pass the assessment order afresh in accordance with law by granting opportunity to the assessee within stipulated time.

4. On being aggrieved, the assessee carried the matter in appeal before the Tribunal. The Id. Counsel for the assessee has submitted that during the course of assessment proceedings, the Assessing Officer has asked the details in respect of foreign exchange gain vide notice under section 142(1) of the Act dated 02.11.2016 as per paper book page No. 53 and detailed reply to the above notice was filed on 10.11.2016 as per paper book page 55 and the same are reproduced as under:

3. *Provide the details of 'Forward Contract Receivable' shown under 'Short-term loans & advances':*

Response: *An amount of ₹.1,01,08,500 is shown as "forward contract receivable" under Short term loans and advances and contra is shown as "Hedge reserve"*

under “reserves & surplus”. This amount is recorded both as asset and liability in the books, just to represent the ineffectiveness in hedging of our forward contracts in accordance with the accounting standards prescribed by Institute of Chartered Accounts of India.

Thus, the Id. Counsel for the assessee has submitted that the assessment order is neither erroneous nor prejudicial to the interest of the Revenue.

5. On the other hand, the Id. DR has submitted that the Assessing Officer has called for explanation and the assessee gave the reply. However, without examining the details, the Assessing Officer has simply accepted the reply of the assessee and passed the assessment order which is erroneous and prejudicial to the interest of the Revenue and strongly supported the revision order passed by the Id. PCIT under section 263 of the Act.

6. We have heard both the sides, perused the materials available on record and gone through the orders of authorities below. The issue involved in this appeal relates to forward contract receivable shown under short term loans and advances. As per notice under section 142(1) of the Act, the Assessing Officer has asked the assessee to file the details in respect of forward contract receivable shown under short term loans and advances and the assessee also filed reply by stating that an amount of ₹.1,01,08,500/- was shown as “forward contract receivable” under Short

term loans and advances and contra shown as “Hedge reserve” under “reserves & surplus” and moreover, this amount was recorded both as asset and liability in the books, just to represent the ineffectiveness in hedging of our forward contracts in accordance with the accounting standards prescribed by Institute of Chartered Accounts of India. However, the Assessing Officer has not called for any other details from the assessee nor asked any further explanation and simply accepted the reply filed by the assessee. In our opinion, the assessment order passed under section 143(3) r.w.s. 92CA of the Act dated 12.12.2016 is not correct. The issue is such a complicated and it needs detailed verification with regard to the accounting standard followed by the assessee, the law applicable to the subject matter, etc. By considering the decision of the Hon’ble Supreme Court in the case of CIT Vs. Woodward Governor India P. Ltd. (supra), the Id. PCIT was of the opinion that the method followed by the assessee was inconsistency, any difference, loss or gain arising on conversion of the liability at the closing rate, should be recognised in P&L account for the reporting period. The Assessing Officer, without examining, simply accepted the explanation of the assessee, which is erroneous and prejudicial to the interest of the Revenue. That apart, the Id. PCIT, directed the Assessing Officer to verify and pass the assessment order afresh in accordance with law after affording an

opportunity to the assessee. Thus, we find no reason to interfere with the order passed by the Id. PCIT.

6.1 Similarly, for the assessment year 2014-15 also, the assessee has challenged the revision order passed under section 263 of the Act on identical facts. In view of our above findings in the assessment year 2013-14, the appeal filed for the assessment year 2014-15 also we confirm the order passed under section 263 of the Act and dismiss the appeal filed by the assessee.

7. In the result, both the appeals filed by the assessee are dismissed.

Order pronounced on 21st April, 2023 at Chennai.

Sd/-
(MANOJ KUMAR AGGARWAL)
ACCOUNTANT MEMBER

Sd/-
(V. DURGA RAO)
JUDICIAL MEMBER

Chennai, Dated, 21.04.2023

Vm/-

आदेश की प्रतिलिपि अग्रेषित/Copy to: 1. अपीलार्थी/Appellant, 2. प्रत्यर्थी/ Respondent,
3. आयकर आयुक्त (अपील)/CIT(A), 4. आयकर आयुक्त/CIT, 5. विभागीय प्रतिनिधि/DR &
6. गार्ड फाईल/GF.