

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% Judgment reserved on : 23.3.2007

Date of Decision : 30.4.2007

+ 1. ITA No. 49/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

WOODWARD GOVERNOR
INDIA PVT. LTD. Respondent
Through Mr.C.S. Aggarwal, Sr.Advocate
with Mr. Prakash Kumar,Advocate

2. ITA No. 159/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

WOODWARD GOVERNOR
INDIA PVT. LTD. Respondent
Through Mr.C.S. Aggarwal, Sr.Advocate
with Mr. Prakash Kumar, Advocate

3. ITA No.52 /2002 with
ITA No. 271/2004 & ITC No. 19/1996

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

HERO HONDA MOTORS LTD. Respondent
Through Mr.Ajay Vohra & Ms. Kavita Jha,
Advocates

4. ITA No. 278/2002

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

HERO HONDA MOTORS LTD. Respondent
Through Mr. Ajay Vohra and
Ms. Kavita Jha, Advocates

5. ITA No. 276/2003

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

JINDAL STRIPS LTD. Respondent
Through Mr. Manmohan, Sr. Advocate with
Mr. Rajat Navet, Advocate

6. ITA No. 6/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

THE JAY ENGINEERING WORKS. Respondent
Through Mr. S. Ganesh, Sr. Advocate with
Mr. Ajay Vohra & Ms. Kavita Jha,
Advocates

7. ITA No. 304/2004 with ITA 2/2001

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

R.T. PACKAGING LTD. Respondent
Through None

8. ITA No. 325/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

HERO HONDA MOTORS LTD. Respondent
Through Mr. Ajay Vohra & Ms. Kavita Jha,
Advocates

9. ITA No. 638/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

SEAGRAM MANUFACTURING LTD. Respondent
Through Mr. C.S. Aggarwal, Sr. Advocate
with Mr. Prakash Kumar, Advocate

10. ITA No. 717/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

SALORA INTERNATIONAL LTD. Respondent
Through Mr. P.N. Monga with
Mr. Manu Monga, Advocates

11. ITA No. 733/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev

Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates
versus

HERO HONDA MOTORS LTD. Respondent
Through Mr. Ajay Vohra & Ms. Kavita Jha,
Advocates

12. ITA No. 9/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates
versus

HEWLETT PACKARD INDIA LTD. Respondent
Through Mr. Y.K. Kapur & Mr. Kaanan,
Advocates

13. ITA No. 20/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates
versus

HEWLETT PACKARD INDIA LTD. Respondent
Through Mr. Y.K. Kapur & Mr. Kaanan
Advocates

14. ITA No. 145/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates
versus

PERFETTI INDIA LTD. Respondent
Through Mr. Ajay Vohra & Ms. Kavita Jha,
Advocates

15. ITA No. 224/2005

COMMISSIONER OF INCOME TAX Appellant

Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates
versus

ESCORT LTD. Respondent
Through Ms. Simran Mehta, Advocate

16. ITA No. 262/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

SALORA INTERNATIONAL LTD. Respondent
Through Mr. P.N. Monga with
Mr. Manu Monga, Advocate

17. ITA No. 437/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

SOLARASON INDUSTRIES LTD. Respondent
Through None

18. ITA No. 481/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

HARYANA PETRO CHEMICALS LTD. Respondent
Through Mr. C.S. Aggarwal, Sr. Advocate
with Mr. Prakash Kumar, Adv.

19. ITA No.728/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

ORIFLAME INDIA PVT. LTD. Respondent
Through Mr.C.S. Aggarwal, Sr.Advocate
with Mr. Prakash Kumar,Adv.

20. ITA No.922/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

EICHER LTD. Respondent
Through Mr.S.Ganesh, Sr.Adv. With
Mr. Ajay Vohra & Ms. Kavita Jha,
Advocates

21. ITA No.1059/2005

COMMISSIONER OF INCOME TAX -V Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

NAV AURO INVESTMENT LTD. Respondent
Through Mr.Viraj R. Datar, Advocate

22. ITA No. 1062/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

SEAGRAM MANUFACTURING LTD. Respondent

Through Mr.C.S. Aggarwal, Sr.Advocate
with Mr. Prakash Kumar,Adv.

23. ITA No. 1063/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

SPL INDUSTRIES LTD. Respondent
Through Dr. Rakesh Gupta & Mr. Jitender
Saini, Advocates

24. ITA No. 1076/2005

COMMISSIONER OF INCOME TAX-III Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

SURYA ROSHNI LTD. Respondent
Through Mr.C.S. Aggarwal, Sr.Advocate
with Mr. Prakash Kumar,Adv.

25. ITA No.1083/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

DAEWOO MOTORS INDIA LTD. Respondent
Through None

26. ITA No. 941/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

M/S DCM DAEWOO MOTORS LTD. Respondent
Through None

27. ITA No. 1201/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

HARIG CRANK SHAFTS LTD. Respondent
Through None

28. ITA No. 14/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

HARYANA PETRO CHEMICALS TD. Respondent
Through Mr.C.S. Aggarwal, Sr.Advocate
with Mr. Prakash Kumar,Adv.

29. ITA No.172/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

HARIG CRANK SHAFTS LTD. Respondent
Through None

30. ITA No.285/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev

Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates
versus

HINDUSTAN SYRINGES & Respondent
MEDICAL DEVICES LTD. Through None

31. ITA No.595/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates
versus

HERO HONDA FINLEASE LTD. Respondent
Through None

32. ITA No. 645/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

TUPPERWARE INDIA PVT. LTD. Respondent
Through Mr. Vijay Nair, Advocate

33. ITA No. 748/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

SURYA ROSHNI LTD. Respondent
Through Mr.C.S. Aggarwal, Sr.Advocate
with Mr. Prakash Kumar,Adv.

34. ITA No.878/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &

Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

INTEGRATED DATABASES LTD. Respondent
Through None

35. ITA No.1051/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

TIMEX WATCHES LTD. Respondent
Through None

36. ITA No.1228/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

ESCORTS LTD. Respondent
Through Ms. Simran Mehta, Advocate

37. ITA No.1229/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

M/S ESCORTS LTD. Respondent
Through Ms. Simran Mehta, Advocate

38. ITA No.1389/2006

COMMISSIONER OF INCOME TAX Appellant

Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates
versus

MARUTI UDYOG LTD. Respondent
Through Mr. S. Ganesh, Sr. Advocate with
Mr. Ajay Vohra & Ms. Kavita Jha,
Advocates

39. ITA No.1390/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

MARUTI UDYOG LTD. Respondent
Through Mr. S. Ganesh, Sr. Advocate with
Mr. Ajay Vohra & Ms. Kavita Jha,
Advocates

40. ITA No.1508/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

DAEWOO MOTORS INDIA LTD. Respondent
Through None

41. ITA No.1589/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

JINDAL STRIPS LTD. Respondent
Through Mr. Manmohan, Sr. Advocate with
Mr. Rajat Navet, Advocate

42. ITA No.1590/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

JINDAL STRIPS LTD. Respondent
Through Mr. Manmohan, Sr. Advocate with
Mr. Rajat Navet, Advocate

43. ITA No.1633/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

INDIAN MEIZE & CHEMICALS LTD. Respondent
Through None

44. ITA No.1222/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

MONDIAL INDIA PVT. LTD. Respondent
Through Mr. S. Ganesh, Sr. Advocate with
Mr. Ajay Vohra & Ms. Kavita, Jha,
Advocates

45. ITA No.1738/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal &
Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Sanjeev
Sabharwal, Mr. Ajay K. Jha &
Ms. Rashmi Chopra, Advocates

versus

ELECTROLUX KELVINATOR LTD. Respondent
Through Ms. Mahua C. Kalra, Advocate

CORAM :-

HON'BLE MR. JUSTICE VIKRAMAJIT SEN
HON'BLE DR. JUSTICE S. MURALIDHAR

1. Whether Reporters of local papers may be allowed to see the order?
2. To be referred to the reporter or not?
3. Whether the order should be reported in the Digest?

JUDGMENT

Dr. S. Muralidhar, J.

The Issue

1. The substantial question of law that arises for consideration in these appeals, as formulated by this Court in some of them is as under:

Whether the alleged increase in liability due to foreign exchange fluctuation as per the exchange rate prevailing on the last day of the financial year is merely notional and cannot be allowed as a deduction?"

2. This question arises in two contexts. In some of the cases, fixed assets have been purchased by way of import, the payments for which have been agreed to be made in foreign exchange, on a deferred payment basis. The cost of the asset has been shown in the accounts of the assessee on the basis of the exchange rate prevailing on the date of the filing of the Bill of Entry. The question that arises is whether this cost of the asset would correspondingly increase or decrease with the fluctuation in the rate of foreign exchange. The contention of the assessees is that, consistent with Section 43-A of the Income Tax Act, 1961 ('Act') as it stood prior to its amendment with effect from 1-4-2003, the increase or decrease in the liability as a result of fluctuation would go to alter the cost of the asset, such increase or decrease being liable to be reflected in the year in which the fluctuation occurs. It is submitted that merely because the

payment is postponed to a later date, the liability does not cease. On the other hand, it is contended by the Revenue that since payment has been agreed to be made on a deferred basis, no actual liability accrues until and unless the liability to make the payment arises; and the increase or decrease in liability will be available to be reflected in the cost of the asset only on the date of payment. It is also contended that the amendment to Section 43-A with effect from 1-4-2003 is clarificatory and therefore retrospective.

3. The other context in which the question arises is on account of the increase or decrease in the value of the foreign currency held on revenue account or as a trading asset or as a part of circulating capital of the business. The contention of the assessees in these cases is that the fluctuation in foreign exchange would go to increase or decrease the liability on revenue account. It would qualify as business expenditure and therefore allowable under Section 37 of the Act despite the fact that the liability has not been discharged in the concerned previous year. The other contention is that if there is an increase in liability remaining to be discharged in respect of an outstanding liability at the beginning of the year, the losses suffered as a result of the increase in the value of foreign currency as compared to Indian currency would be a business loss eligible for claim of deduction under Section 28 of the Act. The contention of the Revenue, on the other hand, is that this fluctuation in foreign exchange does not actually result in any outflow of money. No amount is actually "laid out" and until payment becomes due, and in fact should have so become due at any time during the relevant previous year, the liability cannot be permitted to be revalued. It is contended that this is only a contingent or a notional liability and

therefore should not be permitted to be availed in the year in which such fluctuation occurs. These then are the contexts in which the question formulated arises for consideration and the broad submissions of either side thereon.

Submissions of Counsel

4. The arguments on behalf of the Appellant Revenue were advanced by Ms. Prem Lata Bansal and Mr. Sanjeev Sabharwal, Senior Standing Counsel assisted by Ms. Sonia Mathur, Junior Standing Counsel and the arguments on behalf of the assessees were addressed by Mr. C. S. Aggarwal, Mr. S. Ganesh, Learned Senior Advocates and Mr. Ajay Vohra, Advocate assisted by Ms. Kavita Jha, Advocate and Mr. Mehta and Mr. Rajat Navet, Advocates.

5. The submissions on behalf of the Appellant are as under:

(a) As regards the increase in liability on capital account incurred in relation to acquisition of capital assets on deferred foreign currency payment basis, the question to be asked is whether the liability on account of such increase has been incurred by the assessee during the previous year. It will not go to revise the cost of the asset till the increased cost is actually payable.

(b) The wording of Section 43-A of the Act indicates that the facility of revising the cost of the asset as a result of foreign exchange fluctuation is available only in five specific instances. It does not require the revaluation of the asset every time there is a fluctuation in foreign exchange.

(c) If the liability has to be revised every time there is a fluctuation in foreign exchange, then day-to-day fluctuations would also have to be accounted for and this

would make the system unworkable.

- (d) The decisions of this Court in *CIT -vs- IFFCO*, 142 Taxman 466 (Delhi) and *CIT -vs- Paper Products Ltd.*, 271 ITR 472 do not decide the of the applicability of the amendment to Section 43-A retrospectively. The decision in *Arvind Mills -vs- Commissioner of Income-Tax*, 193 ITR 255 (SC) does not apply on all fours since that decision was essentially about the impact of foreign exchange fluctuation on development rebate and not in the context of depreciation or investment allowance in the context of Section 43-A of the Act.
- (e) The amendment to Section 43-A with effect from 1-4-2003 is only clarificatory and has a retrospective effect. Reliance is placed on the decisions in *CWT -vs- Swaran Kumar Swarup*, 210 ITR 886 (SC), *Poddar Cement -vs- CIT*, 226 ITR 625 (SC), *Lohia Machines -vs- CIT*, 152 ITR 308, *Motilal Pesticides -vs- CIT*, 295 ITR 433.
- (f) In the context of increase in liability on account of increase in the rate of foreign exchange held in revenue account, it is submitted that unless the increase in the rate of exchange results in an outflow of money during the year in question, the liability is not required to be revalued.
- (g) Even in the mercantile system of accounting, the question to be asked is whether the payment or the liability has crystallised during the previous year. Reliance is placed in support of this submission on the decisions in *CIT -vs- Indian Overseas Bank*, 151 ITR 446, *Indian Molasses Company -vs- CIT*, 37 ITR 66 (SC), *CIT -vs- Nainital Bank Ltd.*, 62 ITR 638, *CIT -vs- Kamini Metal and Alloys*, 208 ITR 1017 (Bombay), *CIT -vs- Tata Iron and Steel Company*, 231 ITR 285 (SC).

6. On behalf of the assessees the submissions made are:

(a) In view of the decision of the Hon'ble Supreme Court in ***Arvind Mills*** followed by this Court in ***IFFCO*** and ***Paper Products***, the question of increase in liability on capital account as a result of foreign exchange fluctuation is fully settled in favour of the assessee and against the Revenue. In that view of the matter, these appeals do not give rise to any substantial question of law and therefore ought not to be entertained. Reliance is placed on the judgments in ***Union of India -vs- Kaumudini Narayan Dalal***, 249 ITR 219, ***Paper Products***, ***CIT -vs- Beekay Engineering***, 192 Taxation 187 (Delhi), ***CIT -vs- Sony India Ltd.***, 194 Taxation 344 (Delhi) and ***CIT -vs- Eicher Motors Ltd.*** (decision dated 18.10.2006 of the High Court of Madhya Pradesh at Indore in ITA No.28/2003).

(b) In the case of some of the assessees, the increase in liability has been allowed by the Department in the previous assessment years. The rule of consistency requires that this Court should not permit Revenue to keep shifting its stand or contradict the stand that it has taken in previous years. Reliance is placed upon ***CIT -vs- Rajiv Grinding Mills (Delhi)***, 142 Taxman 567, ***CWT -vs- RKKR International (P.) Ltd. (Delhi)***, 145 Taxman 322, ***CIT -vs- Neo Polypack Ltd.***, 245 ITR 492 (Del), ***Union of India -vs- Satis Panna Lal Shah***, 249 ITR 221(SC), ***Berger Paints India Ltd. -vs- CIT***, 266 ITR 99 (SC).

(c) It is further submitted that the question in the instant case has arisen for consideration before several High Courts and have been held in favour of the assessees. Placing reliance on the dictum of the Hon'ble Supreme Court in ***CIT -vs- P.J.Chemicals***, 210 ITR 310 (SC), it is submitted that a view which has found favour with the majority of the High Courts should normally be adopted by this Court as well.

(d) The assessees here follow the mercantile system of accounting and have, in terms of Section 145 of the Act, to

abide by the accounting standards laid down by the Institute of Chartered Accountants of India (ICAI). These accounting standards require the liability to be revised in the very year in which the fluctuation of exchange takes place in order to reflect the true state of affairs of the business of the assessee. The accounts have to be prepared by adopting the principle of prudence. The Courts have also generally deferred to accounting standards. Reliance is placed on the decisions in ***Challapalli Sugars Ltd. -vs-CIT***, 98 ITR 167 (SC) and ***CIT -vs- Indo Nippon***, 261 ITR 275(SC). It is further contended that Central Government also has issued Circulars from time to time recognising these accounting standards.

(e) It is emphasized that merely because payment is deferred to a later date, the liability does not cease; it continues to survive in the present. The liability 'accrues' the minute the contract is entered into and continues till it is fully discharged. This liability is neither contingent nor notional. Reliance is placed on decisions in ***E.D.Sasoon & Company Ltd. -vs- CIT***, 26 ITR 27 (SC), ***Calcutta Company Ltd. -vs- CIT***, 37 ITR 1 (SC), ***Bharat Earth Movers Ltd. -vs- CIT***, 245 ITR 428(SC), ***CIT -vs- BHEL***, 239 ITR 756, ***CIT -vs- Bank of India***, 218 ITR 371 and ***CIT -vs- IBM***, 161 ITR 673 (Bombay).

(f) As far as the capital account cases are concerned, the Statement of Object and Reasons appended to the Bill preceding the introduction of Section 43-A with effect from 1-4-1967 acknowledged the need to revise the actual cost of an asset consequent to the fluctuation in foreign currency rates. The amendment was made with a specific purpose of allowing depreciation to be availed of with reference to such increased or decreased cost. ***Arvind Mills, Usha Beltron Ltd. -vs- CIT***, 238 ITR 133, ***New India Industries -vs- CIT***, 203 ITR 933(Guj.), ***Padamjee Pulp & Paper Mills Ltd. -vs- CIT***, 210 ITR 97 (Bombay), ***Bestobell (India) Limited -vs- CIT***, 117 ITR 789 (Calcutta) are

sought to be relied upon.

(g) There is no manner of doubt that the amendment to Section 43-A has been explicitly made prospective with effect from 1-4-2003 and in that view of the matter the position obtaining prior to the amendment has to be given full effect as far as the present cases are concerned. The CBDT circular also makes it explicit that the amendment to Section 43-A is with effect from a prospective date. Reliance is placed on the decisions in *CIT -vs- Patel Brothers*, 215 ITR 165 SC), *CIT -vs- Varas*, 283 ITR 484(SC), *CIT -vs- Binitech*, 278 ITR 337 (Delhi) and **Indag Rubber Ltd.** -vs- CIT, 119 Taxman 736(Del).

Substantial Question of Law

7. The question whether fluctuation in foreign exchange rates affects the liability of the assessees either on capital or revenue account has indeed come up for consideration before the High Courts as well as the Hon'ble Supreme Court on earlier occasions. It is also true that the decision of the Hon'ble Supreme Court in ***Sutlej Cotton Mills Ltd.*** holds that the loss on account of adverse foreign exchange fluctuation in respect of foreign currency utilised for current account purposes is to be allowed as a revenue deduction whereas loss incurred in relation to acquisition of capital assets is to be regarded as a capital loss. Likewise the decision of the Hon'ble Supreme Court in ***Arvind Mills*** also holds that adjustment in the actual cost of assets in terms of Section 43-A of the Act would be allowed consequent upon the fluctuation in the foreign exchange rates. The only question that perhaps did not arise for consideration in the capital account cases was the effect of the amendment to Section 43-A with effect from 1-4-2003. Therefore, in the post-amendment scenario, the Revenue may be justified in contending that the question would require a fresh look

since the present amendment makes a dramatic change not only in the system of accounting but also the year in which the increase or decrease in liability has to be accounted for. What in fact the amendment does is to take away the impact of the earlier judicial decisions which were beneficial to the assessee. This explains the Revenue's contention that the amendments should be seen as being clarificatory and hence retrospective.

8. In view of the changed scenario brought about by the amendment to Section 43-A of the Act, it would appear that the question in the present form has not arisen for consideration in the capital account cases. Therefore, in the considered view of this Court, the capital account cases that give rise to the question of the effect of the amended Section 43-A do involve a substantial question of law.

9. The impact of the foreign exchange rate fluctuation on revenue account has in fact come up for consideration in a large number of cases earlier. To this extent the assessees may be right in their contention that in such appeals where this question arises, there is no substantial question of law that arises for consideration. Nevertheless, since these matters have been heard as a batch and for several days at length, this Court is not inclined to dismiss those appeals where a question has already been framed on admission of the appeal only on the ground that there is no substantial question of law. It may be clarified that in cases which are still at the 'notice' stage, i.e. where the appeals have not yet been admitted and no substantial question of law has been framed, it is proposed not to admit those appeals in view of the present judgment.

Concept of Accrual under Mercantile System of Accounting

10. Section 145 of the Act prescribes the method of accounting to be followed by the assessee for computing income chargeable under the head "Profits and Gains of Business and Profession." Section 145(1) states that the computation would be "in accordance with either cash or mercantile system of accounting regularly employed by the assessee." Section 145(2) further states that the Central Government may notify from time to time "accounting standards to be followed by any class of assessees or in respect of any class of income." The mercantile system as distinguished from the cash system brings in the concept of accrual of liability or income in the relevant previous year which is the subject matter of the assessment. The liability is reflected even where there is no actual expenditure; likewise the income is reflected even where there is no actual receipt of money. Moreover, Section 209(3) of the Companies Act makes it mandatory for companies to keep accounts on accrual basis only.

11. The concept of "accrual" has been explained by the Hon'ble Supreme Court in ***E.D.Sassoon*** as under:

"If income has accrued to the assessee it is certainly earned by him in the sense that he has contributed to its production or the parenthood of the income can be traced to him. But in order that the income can be said to have accrued to or earned by the assessee it is not only necessary that the assessee must have contributed to its accruing or arising by rendering services or otherwise but he must have created a debt in his favour. A debt must have come into existence and he must have acquired a right to receive the payment. Unless and until this

contribution or parenthood is effective in bringing into existence a debt or a right to receive the payment or in other words a *debitum in praesenti, solvendum in futuro* it cannot be said that any income has accrued to him. The mere expression "earned" in the sense of rendering the services etc. by itself is of no avail."

In the same decision, the Court referred to the decision of the Privy Council in *Roggers Pyatt Shellac and Company -vs- Secretary of State for India*, 1925 1 ITC 363 at 371 where it was explained thus:

"'Accrues,' 'arises,' and 'is received' are three distinct terms. So far as receiving of income is concerned there can be no difficulty; it conveys a clear and definite meaning, and I can think of no expression which makes its meaning plainer than the word 'receiving' itself. The words 'accrue' and 'arise' also are not defined in the Act. The ordinary dictionary meanings of these words have got to be taken as the meanings attaching to them. 'Accruing' is synonymous with 'arising' in the sense of springing as a natural growth or result. The three expressions 'accrues', 'arises' and 'is received' having been used in the section, strictly speaking 'accrues' should not be taken as synonymous with 'arises' but in the distinct sense of growing up by way of addition or increase or as an accession or advantage; while the word 'arises' means comes into existence or notice or presents itself. The former connotes the idea of a growth or accumulation and the latter of the growth or accumulation with a tangible shape so as to be receivable. It is difficult to say that this distinction has been throughout maintained in the Act and perhaps the two words seem to denote the same idea or ideas very similar, and the difference only lies in this that one is more appropriate than the other when applied to particular cases. It is clear,

however, as pointed out by Fry, L.J. in *Colquhoun v. Brooks* [this part of the decision not having been affected by the reversal of the decision by the House of Lords] that both the words are used in contradistinction to the word 'receive' and indicate a right to receive. They represent a state anterior to the point of time when the income becomes receivable and connote a character of the income which is more or less inchoate.

One other matter need be referred to in connection with the section. What is sought to be taxed must be income and it cannot be taxed unless it has arrived at a stage when it can be called 'income'."

The above statement of the concept of 'accrual' has held good till date. Therefore, it follows that while computing business income chargeable to tax under Section 28 of the Act, the mercantile system of accounting has to be followed and provision for anticipated losses and foreseeable liabilities will have to be taken into account. Section 145 also acknowledges the need to follow accounting standards. These may be prescribed by the Central Government. The accounting standards prescribed by the ICAI are also required to be followed by the assessees. This has received recognition in several decisions of the High Courts and the Hon'ble Supreme Court.

Accounting Standards of the ICAI

12. The earliest acknowledgment by the Courts of accounting practices as explaining the concept of accrual can be found in the decision of the Privy Council in *The Commissioner of Income-Tax Bombay -vs- The Ahmedabad New Cotton Mills Co. Ltd.*, 4 ITC 245.

13. The accounting standards issued by the ICAI require that

accounting policies must be governed by the principle of 'prudence'. In other words, "Provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only the basic estimate in the light of available information." Para 6 of Accounting Standard 1 defines accrual as "...the assumption that revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate." What is required, therefore, is that all anticipated liabilities and foreseeable losses have to be provided for while caution is to be exercised against accounting for unearned gains. Ultimately, the emphasis is on presenting a true and correct state of affairs of the company as a going concern. This explains why, for instance, the valuation of closing stock as on the date of the balance sheet, is done at cost or market value, whichever is lower. Where the market value is lower than the cost, valuation at market value reflects the anticipated loss. On the other hand, where the market value is higher than the cost, the unrealised gains are not accounted for.

14. Accounting Standard 11 (AS 11) issued by the ICAI specifically deals with the issue of accounting for fluctuation in foreign exchange rates as impacting the current assets and liabilities. The relevant portion of AS 11 is as under:-

"Reporting Effects of Changes in Exchange Rates subsequent to Initial Recognition

7. At each balance sheet date

- a. monetary items denominated in a foreign currency (e.g. foreign currency notes,

balances in bank accounts denominated in a foreign currency, and receivables, payables and loans denominated in a foreign currency) should be reported using the closing rate. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g., where there are restrictions or remittances or where the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from, or required to disburse, such item at the balance sheet date;

b. non-monetary items other than fixed assets, which are carried in terms of historical cost denominated in a foreign currency, should be reported using the exchange rate at the date of the transaction;

c. non-monetary items other than fixed assets, which are carried in terms of fair value or other similar valuation, e.g. net realisable value, denominated in a foreign currency, should be reported using the exchange rates that existed when the values were determined (e.g. if the fair value is determined as on the balance sheet date, the exchange rate on the balance sheet date may be used); and

d. the carrying amount of fixed assets should be adjusted as stated in paragraphs

10 and 11 below.

Recognition of Exchange Differences

8. Paragraphs 9 to 11 set out the accounting treatment required by this Statement in respect of exchange differences on foreign currency transactions.

9. Exchange differences arising on foreign currency transactions should be recognised as income or as expense in the period in which they arise, except as stated in paragraphs 10 and 11 below.

10. Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which are carried in terms of historical cost, should be adjusted in the carrying amount of the fixed assets. The carrying amount of such fixed assets should, to the extent not already so adjusted or otherwise accounted for, also be adjusted to account for any increase or decrease in the liability of the enterprise, as expressed in the reporting currency by applying the closing rate, for making payment towards the whole or a part of the cost of the assets or for repayment of the whole or a part of the monies borrowed by the enterprise from any person, directly or indirectly, in foreign currency specifically for the purpose of acquiring those assets.

11. The carrying amount of fixed assets which are carried in terms of revalued amounts should also be adjusted in the manner described in paragraph 10 above. However, such adjustment should not result in the net book value of a class of revalued

fixed assets exceeding the recoverable amount of assets of that class, the remaining amount of the increase in liability if any, being debited to the revaluation reserve, or to the profit and loss statement in the event of inadequacy or absence of the revaluation reserve.

12. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, the entire exchange difference arises in that period. However, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period."

15. The Hon'ble Supreme Court has in ***Challapalli Sugars*** put its seal of approval on adopting the accounting standards while interpreting Section 10(2)(vi), (via), (vib) and Section 10(5) of the Income Tax Act 1922 while interpreting the expression "actual cost." The Supreme Court held (ITR, p. 173): "as the expression actual cost has not been defined, it should, in our opinion, be construed in the sense which no commercial man would misunderstand. For this purpose it would be necessary to ascertain the connotation of the above expression in accordance with the normal rules of accountancy prevailing in commerce and industry." More recently this was reiterated by the Hon'ble Supreme Court in ***Indo Nippon***. In the cases relied upon by the Revenue, particularly ***Nainital Bank***, no reference is made to the ICAI standards for determining if the liability

is contingent or accrued. That question also does not appear to have been considered in **Tata Iron and Steel Company Ltd.** In any event, the latter case appears to be related to an assessment year previous to the amendment to Section 43-A made in 1967. In fact, it is noted in the judgment itself that "in the instant case, there is no scope for application of Section 43A."

16. Therefore, the judicially accepted position appears to be that in determining whether there has in fact been accrual of liability or income, the accountancy standards prescribed by the ICAI would have to be followed and applied.

Capital Account or Revenue Account: The Tests

17. Fluctuation in the rates of foreign exchange can result in either a gain or a loss depending on whether the value of the currency appreciates or depreciates. If the foreign currency is held by the assessee on revenue account or as a trading asset or as part of circulating capital used in the business, the appreciation or depreciation in the value of the foreign currency would result in either trading profit or trading loss. Thus, the gain or loss would be on the revenue account. On the other hand, if the foreign exchange liability arises in relation to acquisition of capital assets, the corresponding gain or loss would be of a capital nature. This was explained by the Hon'ble Supreme Court in **Sutlej Cotton Mills Ltd.** in the following terms (ITR, p.13):

"The law may, therefore, now be taken to be well settled that where profit or loss arises to an assessee on account of appreciation or depreciation in the value of foreign currency held by it, on conversion into

another currency, such profit or loss would ordinarily be trading profit or loss if the foreign currency is held by the assessee on revenue account or as a trading asset or as part of circulating capital embarked in the business. But, if on the other hand, the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital nature.”

18. Earlier in *CIT -vs- Tata Locomotive and Engineering Company Ltd.*, 60 ITR 405 (SC), the Hon'ble Supreme Court had explained that if the foreign exchange was used for a trading transaction then “any profit that would accrue would be Revenue receipt; if it was not part of or a trading transaction then the profit made would be a capital profit and not taxable”.

19. In *Commissioner of Income Tax -vs- V.S.Dempo and Co. Pvt. Ltd.(Bombay)*, 206 ITR 291 at 300, the Bombay High Court succinctly set out the tests for determining whether a loss as a result of devaluation of the Indian rupee would be allowable as a business loss. It summed up the position thus:

- “(i) A loss arising in the process of conversion of foreign currency which is part of the trading asset of the assessee is a trading loss as any other loss.
- (ii) In determining the true nature and character of the loss, the cause which occasions the loss is immaterial; what is material is whether the loss has occurred in the course of carrying on the business or is incidental to it.
- (iii) If there is loss in a trading asset, it would be a trading loss, whatever be its cause because it would be a loss in the course of carrying on the

business.

(iv) Loss in respect of circulating capital is revenue loss whereas loss in respect of fixed capital is not.

(v) Loss resulting from depreciation of the foreign currency which is utilised or intended to be utilised in business and is part of the circulating capital, would be a trading loss, but depreciation of fixed capital on account of alteration in exchange rate would be a capital loss.

(vi) For determining whether devaluation loss is revenue loss or capital loss what is relevant is the utilisation of the amount at the time of devaluation and not the object for which the loan had been obtained. Even if the foreign currency was intended or had originally been utilised for acquisition of fixed asset, if at the time of devaluation it had changed its character and had assumed the new character of stock-in-trade or circulating capital, the loss that occurred on account of devaluation shall be a revenue loss and not a capital loss.

(vii) The way in which the entries are made by an assessee in the books of account is not determinative of the question whether the assessee has earned any profit or suffered any loss. What is necessary to be considered is the true nature of the transaction and whether in fact it has resulted in profit or loss to the assessee.”

20. This Court in **BHEL** explained that if the loss was in respect of a trading asset it would be a trading loss and if it was in respect of capital asset, a capital loss.

21. The underlying principle that appears to have been firmly

settled as noted by the Hon'ble Supreme Court in ***Bharat Earth Movers*** as follows (ITR, p.431):

“If a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in present though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain.”

22. In restating the above settled position, the Supreme Court summarised the principles earlier laid down in *Metal Box Company of India Ltd. -vs- Their Workmen*, [1969] 73 ITR 53 (SC) as under:

“(i) For an assessee maintaining his accounts on the mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in the case of amounts actually expended or paid;

(ii) Just as receipts, though not actual receipts but accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business;

(iii) A condition subsequent, the fulfillment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability;

(iv) A trader computing his taxable profits for a particular year may properly deduct not only the payments actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated."

23. Ultimately the Court in ***Bharat Earth Movers*** held that provision made by the company for meeting the liability incurred by it under the leave encashment scheme proportionate with the entitlement earned by the employees of the company was entitled to deduction within the gross receipts for the accounting year in which the provision was made. It was held that the liability was not a contingent liability.

24. This Court respectfully follows the aforementioned settled law for determining whether the liability is on capital account or on revenue account. We turn now first to the revenue account cases.

Revenue Account Cases

25. In some of the appeals the question arises on account of the increase or decrease in the value of the foreign currency held on revenue account or as a trading asset or as a part of circulating capital of the business. The claim of the assessees is that the resultant increase or decrease in the liability would be in the nature of business expenditure allowable under Section 37 of the Act notwithstanding

that the liability has not been discharged in the year in which the fluctuation in the rate of foreign exchange occurred. On the other hand, the argument that the Appellant repeatedly advanced was that the liability was a contingent or a notional one and would get postponed to the date of actual payment.

26. In this context the reliance placed by the Revenue on the decision of the Madras High Court in ***Indian Overseas Bank*** is inappropriate. The Court there was dealing with the question whether unsettled foreign exchange contracts, held as stock-in-trade, could constitute contingent liability. It was held that the unpredictability of the loss or profit arising out of foreign exchange fluctuation rendered the liability contingent or notional and therefore not allowable as a deduction.

27. The Revenue relied upon the decision of the Calcutta High Court in ***Bestobell (India) Ltd.*** in support of the submission that the increased liability on repayment of a loan borrowed in foreign exchange for business purposes as a result of exchange rate fluctuation would be a capital loss and not a trading loss. What weighed with the Calcutta High Court there appears to be that there was no outflow of funds during the year, as has been urged by the Revenue before us. However, a closer scrutiny of the said decision indicates that the Calcutta High Court in this case relied upon its earlier judgment in ***Sutlej Cotton Mills Ltd. v. CIT***, (1971) 81 ITR 641 (Cal). It will be recalled that the Hon'ble the Supreme Court in ***Sutlej Cotton Mills Ltd.*** reversed the aforesaid decision of the Calcutta High Court on this point and held that such liability would be treated as a trading loss. In that view of the matter, the reliance

placed by the Revenue on the judgment of the Calcutta High Court in **Bestobell (India) Ltd.** appears misplaced.

28. In the instant cases, on the other hand, the liability arises out of already concluded contracts. The liability already stands accrued the minute the contract was entered into. The mere postponement of the payment to a different date cannot extinguish the liability and render it notional or contingent. The decision of the Hon'ble Supreme Court in **Bharat Earth Movers** settles the position. That decision explains that what should be certain is the incurring of the liability and it being estimated with reasonable certainty even if the exact quantification is not feasible. Even if the liability is discharged at a future date, it will nevertheless be a liability which is certain and not contingent. This approach is consistent with and informed by the accounting practices in the mercantile system, with further guidance from the accounting standards of the ICAI which have received judicial acknowledgment.

29. A sampling of the decisions of the High Courts which have followed this line of reasoning includes *Khandelwal Brothers (P) Ltd. -vs- CIT*, 117 ITR 452(Cal.), *Oil India Co. Ltd. -vs- CIT*, 137 ITR 156(Cal.), *CIT -vs- International Combustion(I)(P) Ltd.*, 137 ITR 184(Cal.), *CIT -vs- Martin and Hariss(P) Ltd.*, 154 ITR 460(Cal.), *CIT -vs- E.W. Stevens Co. Ltd.*, 158 ITR 235(Cal.) and *CIT -vs- IBM Trade Corporation*, 161 ITR 673(Bom.). These decisions, with which we respectfully concur, make it clear that the question whether the assessee can claim deduction of the increased liability in the revenue account as a result of fluctuation in the rate of foreign exchange has to be answered in the affirmative.

30. We may also refer to the decision of the Special Bench of the ITAT in the **ONGC** where the following question was considered:

“Whether on the facts and circumstances of the case and in law the additional liability arising on account of fluctuations in the rate of exchange in respect of loans taken for revenue purposes could be allowed as deduction in the year of fluctuations in the rate of exchange or the same could only be allowed in the year of repayment of such loans”.

Answering the question in favour of the assessee, it was held that the assessee's claim of loss on account of fluctuation in foreign currency rates is allowable. The ITAT explained its conclusion in the following manner:

“After careful consideration it held that the assessee's claim for loss arising as a result of fluctuation in foreign exchange rates on the closing day of the year has been disallowed by the Assessing Officer, *inter alia*, on the ground that this liability was a contingent liability and the loss was a notional one. The main ingredient of a contingent liability is that it depends upon happening of a certain event. We are of the considered opinion that 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.”

31. We affirm the decision of the ITAT in **ONGC** which rightly follows the settled position as explained in the judgment of the Hon'ble Supreme Court which we have referred to. We, therefore, reject the submission of the Appellant in these appeals that the increase in liability on account of the fluctuation in the rate of foreign exchange remaining on the last day of the financial year is notional or contingent and therefore cannot be allowed as a deduction.

Capital Account Cases

32. We then turn to the position with regard to the losses on Capital Account where higher depreciation or investment allowance could be claimed as a result of the reworking of the cost of asset consequent upon the appreciation in the rate of foreign exchange. We proceed to examine the position prior to the amendment to Section 43-A with effect from 1-4-2003 and the change as a result of that amendment.

33. Section 43(1) of the Act defines actual cost for the purpose of depreciation to mean "the actual cost of the asset to the assessee." There was no provision for the assessment of the actual cost at a stage subsequent to the date of acquisition of the asset. Depreciation had to be worked out thereafter only on the basis of the actual cost at the time of acquisition to provide for the subsequent revisions to the actual cost. Section 43-A was inserted by the Finance Act, 1967 with effect from 1-4-1967. In the explanatory process contained in the Bill preceding the Act it was explained as under:-

"The proposed section 43-A, in substance, secures that where an assessee had acquired any capital asset from a country outside India for the purposes of his business or profession on deferred payment terms or against foreign loan, before the date of devaluation of the rupee, the additional rupee liability incurred by him in meeting the instalments of the cost of the asset or of the foreign loan, as the case may be, falling due for payment after the date of devaluation, will be allowed to be added to the original actual cost of the asset for the purpose of calculating the allowance on account of depreciation in computing the profits for the assessment year 1967-68 and subsequent assessment years. Similarly increase in the original actual cost will be allowed to be made in respect of capital assets acquired by the

assessee to be used in scientific research related to the class of business carried on by him or patent rights or copyrights acquired from abroad or any capital asset required by a company for the purpose of promoting family planning amongst its employees. Further, in computing the capital gains arising to the assessee on the sale or transfer of a capital asset acquired by him from abroad on deferred payment terms or against foreign loan, the additional rupee liability incurred by him in repaying the instalments of the cost or the foreign loan, as the case may be, after the date of devaluation of the rupee, will be added to the original actual cost of the asset. The proposed section also secures that where there is a decrease in the rupee liability of the assessee in respect of assets acquired by him from abroad due to a change in the exchange value of the rupee, the original actual cost of the asset will be correspondingly reduced.

The additional rupee liability incurred on imported capital assets or, as the case may be, any decrease in such liability, the circumstances stated in the earlier paragraph will not, however, be taken into account in computing the actual cost of the asset for the purpose of deduction on account of development rebate."

34. This was further illustrated in Circular No.5 issued by the CBDT dated 9-10-1967 in the following terms:

"The provisions of the new section 43-A apply in a case where an assessee has acquired any capital asset from abroad for the purpose of his business or profession, on credit or on deferred payment terms, or against a loan in foreign currency, and the whole or a part of the cost of such asset or of the loan in foreign currency as on the date on which there is a change in the rate of exchange of currency. In such a case where, in consequence of the change in the

rate of exchange of currency, there is an increase or reduction in the assessee's liability as expressed in Indian currency for payment of the whole or apart of the cost of the assets or of the loan in foreign currency, the original actual cost, to the assessee, of the machinery or plant or other capital asset, is required to be increased or, as the case may be, reduced, correspondingly for the following purposes:

...The above-mentioned adjustment to the original actual cost of the assessee to the imported capital asset is to be made in respect of the previous year in which there is an increase or reduction in the assessee's liability in terms of Indian currency for payment of the whole or part of the cost of the asset or for repayment of the foreign loan against which the asset has been acquired. With reference to the recent devaluation of the rupee, this will be the previous year in which the date of devaluation, viz., 6th June, 1966 falls....

It has been expressly provided in sub-section (2) of section 43-A that the abovementioned provisions for adjustment to the original actual cost of imported capital assets due to an increase or reduction in the assessee's liability for payment of the installments of the cost of the asset or for repayment of the foreign loan against which the asset has been acquired, will not be applicable in computing the actual cost of the asset for the purpose of the deduction on account of development rebate under section 33..."

35. The occasion to examine if the benefit of the deduction as a result of fluctuation in foreign exchange rate would go to affect the computation of development rebate under Section 33 came to be examined by the Hon'ble Supreme Court in **Arvind Mills**. It was held that the Section itself expressly excluded the availability of the deduction for computing development rebate. The said decision

nevertheless acknowledged that the actual cost of the asset would have to be reworked to reflect the increased liability arising as a result of the foreign exchange fluctuation. The Court there observed (ITR p.270): "It (Section 43-A) lays down, firstly, that the increase or decrease in liability should be taken into account to modify the figure of actual cost and secondly that such adjustment should be made in the year in which the increase or decrease in liability arises on account of the fluctuation in the rat of exchange".

36. In a large number of decisions of the High Courts, the adjustments of the actual cost of the asset was allowed under Section 43-A of the Act. These include *CIT -vs- Motor Industries Company Ltd.*, 229 ITR 137 (Karnataka), *CIT -vs- Madras Fertilisers Ltd.*, 124 Taxman 581 (Madras), ***Usha Beltron*** (Patna), ***New India Industries Ltd.*** (Guj.) and ***Padamjee Pulp and Paper Mills Ltd.*** (Bombay). In the last mentioned case, the Bombay High Court has followed ***Arvind Mills*** and interpreted Section 43-A in the following words with which we entirely concur (ITR p.101):

"From a reading of the above section (Section 43-A) it is clear that where an assessee had borrowed money for acquisition of any asset from a country outside India and in consequence of the change in the rate of exchange at any time after the acquisition of such asset there is an increase in the liability of the asset as expressed in Indian currency in repayment of the whole or a part of the moneys borrowed by him from any person in any foreign currency specifically for the purpose of acquiring such asset, the amount by which the liability is so increased shall be added to the actual cost of the asset as defined in clause (1) of section 43 of the Act. This section specially provides for the treatment of increased liability of the assessee as expressed in Indian currency for repayment of the moneys borrowed by him from any person in foreign

currency specifically for the purposes of acquiring the asset”.

37. This Court in ***Paper Products*** considered the question whether for the purpose of depreciation, an assessee is entitled to make adjustment in the original actual cost of the imported capital asset to him when there is an increase or decrease in his liability for payment of the cost of the asset on account of fluctuation in the rate of foreign exchange. The Bench comprising Justice D.K. Jain (as His Lordship then was) and Justice Madan B. Lokur, in upholding the view of the Tribunal answered the question thus:

“We are in agreement with the Tribunal that the issue raised is no more *res integra*. In ***Arvind Mills Ltd.***’s case [1992] 193 ITR 255(SC), while explaining the scope of section 43-A of the Act, their Lordships of the Supreme Court have held that the said section lays down two things, namely: (i) the increase or decrease in the liability is to be taken into account to modify the figure of actual cost, and (ii) that such adjustment should be made in the year in which the increase or decrease in liability arises on account of fluctuations in the rate of exchange. It has been clearly held by the apex court that even in a case where the assessee has completely paid for the plant and machinery in foreign currency prior to the date of devaluation but the variation in exchange rate affects the liability of the assessee (as expressed in Indian currency) for repayment of the whole or part of the monies borrowed by him from any person, directly or indirectly in any foreign currency specifically for the purposes of acquiring the asset, adjustments in terms of section 43A(1) can be made”.

38. The same Bench answered a similar question likewise in ***IFFCO Ltd.***, in line with their view in ***Paper Products***. The impugned order of the Tribunal was held to not involve any question of law, much less a substantial question of law. The Bombay High Court recently in

Associated Bearing Co. Ltd. v. CIT (2006) 205 CTR (Bom.) 150

applied the same reasoning to uphold the contention of the assessee that “there is not reason why Section 43 A (1) should be applied to vary depreciation but not investment allowance.”

39. One more argument of the Revenue requires to be dealt with. It was argued that Section 43-A is limited to five specific instances and that it does not require the revaluation of the asset every time there is a fluctuation in the rate of foreign exchange. It was also suggested that if this argument of the assessee were to be accepted then the cost of the asset will have to be reworked every time there is a fluctuation. This Court does not find merit in this submission. The ICAI standards referred to clearly indicate the manner in which the cost of the asset has to be reworked. The accepted method appears to be to rework the cost with reference to the rate prevailing on the last date of the financial year in which the fluctuation occurs. Further, it has been demonstrated, with reference to hypothetical figures by Mr. Ajay Vohra, counsel for the assessee that the net effect as a result of the increase or decrease in the liability, either with reference to the last date of the financial year or with reference to every date when a fluctuation occurs, is the same. We, therefore, reject this contention of the Revenue.

40. Therefore, the position that emerges is that consequent upon the introduction of Section 43-A of the Act, a large number of High Courts have consistently held in favour of the assessee in permitting reworking of the actual cost or the depreciation as the case might be as a result of the fluctuation in the foreign exchange rate. We see no reason to take a different view. We accordingly hold that in the capital account cases where the cost of asset has been either paid fully or in

part prior to the fluctuation in the rate of foreign exchange, the cost of the asset would correspondingly be permitted to be reworked for purposes of repayment or depreciation or investment allowance as the case may be with reference to the rate prevailing on the last date of the financial year in which the fluctuation occurs.

Amendment to Section 43-A is prospective

41. The next question that arises is whether the Appellant is right in contending that amendment to Section 43-A brought about by the Finance Act, 2002 with effect from 1-4-2003 is merely clarificatory and, therefore, retrospective. One reason for this contention is that the amendment brings about a fundamental change regarding the time of payment and the method of contract. The amended Section now provides that the amount by which the liability is increased or reduced as a result of change in the rate of exchange "during any previous year after the acquisition of such asset" would be taken into account "at the time of making the payment, irrespective of the method of an accounting adopted by the assessee." The effect of the amendment is plainly to negate the benefit that was extended to the assessee as a result of the interpretation placed on the provisions as it stood prior to the amendment in the numerous judgments of the High Court and the Hon'ble Supreme Court. However, the amendment itself makes it clear that it is with effect from 1-4-2003. This has further been clarified by the CBDT Circular No.8 of 2002 which in no uncertain terms states in para 34.5 that "the amendment will take effect from 1-4-2003 and will, accordingly, apply in relation to the assessment year 2003-04 and subsequent years."

42. Accordingly, there is no scope for entertaining the plea of the Revenue that the amendment is declaratory and, therefore,

retrospective. Accepting such a plea would be negating the express terms of the amendment and that is clearly impermissible. This Court, therefore, does not find it necessary to discuss the cases cited by the Revenue in support of its plea. The decision in **Lohia Machines** did not involve an amendment to a substantive provision but to a procedural provision in the form of Rule 19 of the Rules. Likewise in **Sharwan Kumar Swarup** the amendment was to Rule 1BB of the Wealth Tax Rules expressly to be procedural. The amendments to the provisions involved in **Poddar Cements** and **Motilal Pesticides** were held to be declaratory in view of the wording of those provisions. These decisions are clearly distinguishable in their application to the instant cases where the amendment to Section 43 A, far from being merely procedural, brings about a drastic change as already noticed. Secondly, the amendment itself makes it clear that it is prospective.

43. In our view not only is the law in this regard well settled but in terms of the explicit statement contained in the amendment itself clarified by the CBDT Circular, no ambiguity exists in the position that the amendment is prospective.

The Plea of Consistency

44. The above discussion notices that a number of High Courts have consistently upheld the contentions of the assessee similar to the contentions advanced by them before us. This is definitely one other reason that persuades us to hold in favour of the assessee in these cases. We are reminded of the following observations of the Hon'ble Supreme Court in **P.J. Chemicals** (ITR p.841):

“On a consideration of the matter the view that commends itself as acceptable is the one which has commended itself

to the majority of the High Courts. It is, of course, not the numerical strength that prevails – though the fact that a particular view has commended itself to a majority of the High Courts in the country is a matter for consideration – but the tensile strength of the acceptable logic in those decisions. It is aptly said that “a judge who announces a decision must be able to demonstrate that he began from recognized legal principles and reasoned in an intellectually coherent and politically neutral way to his result”.

45. The assessee is also justified in their contention that in some of the cases, the Revenue has been taking contradictory stands in the successive assessment years on the question involved in the present appeals in respect of the same assessee. We have adverted to this aspect in some of the cases below. In those cases this is a further ground on which we have dismissed the appeal of the Revenue.

Summary of the Conclusions

46. We may briefly summarise our conclusions:

- (i) The judicially accepted position appears to be that in determining whether there has in fact been “accrual” of liability or income, the accountancy standards prescribed by the ICAI would have to be followed and applied.
- (ii) In the context of the revenue account cases, we affirm the decision of the ITAT in ***ONGC*** which rightly follows the settled position as explained in the judgment of the Hon’ble Supreme Court which we have referred to. We, therefore, reject the submission of the Appellant in these appeals that in the revenue account cases, the increase in liability on account of the fluctuation in the rate of foreign exchange prevailing on the last day of the financial year is

notional or contingent and therefore cannot be allowed as a deduction in terms of Section 37 of the Act.

(iii) In the capital account cases where the cost of asset has been either paid fully or in part prior to the fluctuation in the rate of foreign exchange, the cost of the asset would correspondingly be permitted to be reworked for purposes of repayment or depreciation or investment allowance as the case may be with reference to the rate prevailing on the last date of the financial year in which the fluctuation occurs.

(iv) The amendment to Section 43 A with effect from 1.4.2003 is prospective. There is no scope for entertaining the Revenue's plea to the contrary.

47. In view of the above discussion, the substantial question of law that arises in these appeals is answered in affirmative by holding that the increase in liability due to foreign exchange fluctuation as per the exchange rate prevailing on the last date of the financial year is allowable as a deduction and is not merely notional or contingent. Accordingly, the question is answered in favour of the assessee and against the Revenue.

48. We now proceed to the merits of the individual appeals that constitute the present batch matter of appeals.

ITA 49/2005 & 159/2006 (CIT v. Woodward Governor India Ltd.)

49. ITA No.49/2005 is directed against the judgment dated 6-9-2004 in ITA No. 839/Del/2001 for the Assessment Year 1997-98. Following its earlier Orders for the Assessment Years 1995-96 and 1996-97 the

ITAT held that the assessee was justified in accounting for unrealised loss as well as gains on the basis of rate of foreign exchange as prevailing in the last accounting year.

50. ITA 159/2006 is directed against the judgment dated 1.4.2005 of the ITAT in ITA No.694 (Del/2002) and 459 (Del/2002) for the Assessment Year 1998-99. Following its own ruling for the Assessment Years 1995-96 and 1996-97, the ITAT allowed the plea of the assessee for deducting the unrealised losses and accounting for the unrealised gains.

51. In both cases, the Assessing Officer disallowed the plea of the assessee on the ground that the liability was contingent and notional. The CIT (Appeals) upheld the decision of the AO to the extent that the liability was held to be contingent but on similar basis held that the accrued income would also not be taxable. Therefore, both the assessee and the Revenue appealed to the ITAT, which passed the impugned orders as already noticed.

52. While admitting this appeal on 14.2.2005 this Court framed a substantial question of law similar to the one set out in para 1 of this judgment. In view of the judgment rendered by us today the question stands answered in favour of the assessee and against the Revenue. In that view of the matter the appeal ought to be dismissed on this ground itself.

53. The appeal is also liable to be dismissed on the ground of consistency. Mr.C.S.Aggarwal, learned Senior Advocate appearing for the Respondent is right in pointing out that in each of the previous Assessment Years the plea of the assessee was accepted. Thus in the years 1995-96 and 1996-97 in the case of the assessee itself the ITAT by its

Orders dated 28-3-2003 in ITA 5676/1998 and 8-3-2004 in ITA 3439/2000 respectively upheld the contention of the assessee. Following **BHEL** and **Indag Rubber Ltd.** we held that on the principle of consistency, the Revenue should not be permitted to challenge the impugned orders of the ITAT. Therefore, on this additional ground as well, the appeals are dismissed.

ITA Nos.9/2005, 1076/2005, 941/2006, 645/2006, 748/2006, 878/2006, 1051/2006, 1508/2006, 1633/2006, 1222/2006, 1738/2006

54. These appeals by the Revenue are yet to be admitted. In light of the view that we have taken in our Judgment in ITA No.49/2005 delivered today, we find that no substantial question of law arises for consideration in the present appeals. The appeals are dismissed.

ITA No.52/2002, 278/2002, 6/2004, 304/2004, 325/2004, 638/2004, 717/2004, 733/2004, 20/2005, 145/2005, 224/2005, 262/2005, 437/2005, 481/2005, 728/2005, 922/2005, 1059/2005, 1062/2005, 1063/2005, 1083/2005, 1201/2005, 14/2006, 172/2006, 285/2006, 595/2006, 1228/2006, 1229/2006, 1589/2006, 1590/2006

55. These appeals by the Revenue were admitted on a substantial question of law not different in substance from the question formulated in paragraph 1 of this judgment. The question is therefore answered against the Revenue and in favour of the assessee. The appeals are dismissed.

ITA 276/2003 (CIT v. Jindal Strips Ltd.)

56. This appeal is directed against the Order dated 17.10.2002 passed by the ITAT, Delhi in ITA No.1140/1998 for the Assessment Year 1996-97. The appeal was admitted by this Court on 3.3.2005 on the following two substantial questions of law:

1. Whether Income Tax Appellate Tribunal was correct in law in allowing the claim of the assessee of Rs.6.47 crore being the loss on account of Foreign Exchange Rate Fluctuation which in fact did not accrue during the relevant year?

2. Whether the order of the Income Tax Appellate Tribunal is perverse when it did not decide the issue whether the assessee had utilized the amount raised by way of Euro Bonds as Capital Expenditure or as Working Capital when the Assessing Officer had given a specified finding that the same was utilized for financing the fixed assets/capital work in progress or purchase of investments?

57. As regards question No.1 Mr. Rajat Navet, Advocate appearing for the Respondent rightly points out that the question whether the fluctuation in foreign exchange rate "did not accrue during the relevant year" did not arise for consideration in that form before the ITAT. The question before the ITAT was whether the CIT (Appeals) erred in "deleting the addition of Rs.6,47,95,725/- made by disallowing the claim of loss on account of foreign exchange fluctuations?" However, in view of this judgment, question no.1 has to be answered in the affirmative, i.e. in favour of the assessee and against the Revenue.

58. As regards question No.2 the ITAT concurred with the CIT (Appeals) and held against the Revenue. The finding of the CIT (Appeals) on this point was that the Fund Flow Statement produced by the assessee showed that out of the total loans obtained by issue of Euro Bonds, a substantial portion was used for Capital Assets and the remaining towards Working Capital. The CIT (A) observed "since the assessee had utilised part of the loan for acquiring capital assets and part of the loan was used towards working capital, the additional

liability on account of fluctuation rate was to be capitalised partly and was to be debited to the Profit and Loss Account partly as an allowable expenditure". The CIT(A) followed the decision of the *Calcutta High Court in Oil India Company Ltd. -vs- CIT*, 187 ITR 156.

59. The decision of the CIT (A) which has been affirmed by the ITAT is consistent with what we have held in this judgment. Accordingly, question No.2 is answered in the negative, i.e in favour of the assessee and against the Revenue.

60. Accordingly, the appeal is dismissed.

ITA 1389-1390/2006 (CIT v. Maruti Udyog Ltd.)

61. ITA 1389/2006 is an appeal by the Revenue against the impugned Order dated 20.2.2006 of the Income Tax Appellate Tribunal (ITAT), Delhi in ITA No.5331/1998 for the Assessment Year 1993-1994. ITA 1390/2006 is an appeal by the Revenue against the Order dated 17.2.2006 of the ITAT in ITA No.7042/1994 for the Assessment Year 1991-1992. Both appeals are at the notice stage and are yet to be admitted.

62. The substantial question of law urged by the Revenue in these appeals is no different from the one formulated and answered against the Revenue in this judgment. Therefore, these appeals ought to be dismissed on this ground alone.

63. Mr. S. Ganesh, learned Senior Advocate appearing on behalf of the Respondent assessee, submitted that the appeals should be dismissed additionally on the ground of consistency. He points out

that for the Assessment Years 1985-1986 to 1990-1991, the deduction on account of foreign exchange rate fluctuation was allowed to the assessee as a revenue deduction. There was no change in the circumstances warranting a departure for the Assessment Years 1991-1992 and 1993-1994 in respect of which these two appeals have been filed.

64. We agree with the submission made on behalf of the assessee. These appeals are dismissed also on the ground of consistency.

65. Registry is directed to place a copy of this judgment on the record of each Appeal.

(S. Muralidhar)
Judge

(Vikramajit Sen)
Judge

April 30, 2007
nj/tp