

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'A', NEW DELHI**

**BEFORE SH. C.M. GARG, JUDICIAL MEMBER
AND
SH. O.P. KANT, ACCOUNTANT MEMBER**

ITA No. 1224/Del/2017
Assessment Year: 2009-10

M/s. Bechtel India Pvt. Ltd., 418, Naurang House, 21 K.G. Marg, New Delhi	Vs.	ACIT, Circle-4(2), Room No. 398D, C.R. Building, New Delhi
PAN : AAACB0298A		
(Appellant)		(Respondent)

Appellant by	Sh. S.K. Aggarwal, CA
Respondent by	Sh. Ravi Jain, CIT(DR) & Sh. S.K. Jain, DR

Date of hearing	10.04.2017
Date of pronouncement	29.05.2017

ORDER

Per O.P. KANT, A.M.:

This appeal by the assessee is directed against the order of the Assessing Officer dated 27/01/2017 for assessment year 2009-10. The Income-Tax Appellate Tribunal (in short ~~the~~ Tribunal) in its order dated 14/10/2015 for the year under consideration, in ITA No. 882 /Del/2014, restored the issue of ~~marked~~ marked to market+ (MTM) losses on forward contracts for afresh adjudication to the Ld. ~~Dispute~~ Dispute Resolution Panel (in short ~~the~~ DRP). The Ld. DRP in compliance to the direction of the Tribunal issued direction to the Assessing Officer on 30/12/2006. In pursuant to the direction of the Ld. DRP, the Assessing Officer passed

the impugned order in terms of section 254/143 (3) read with section 144C of the Income-tax Act,1961 (in short ~~the Act~~). Grounds of appeal are reproduced as under:

“Following grounds of appeal are independent of, and without prejudice, to each other:

- 1. That on the facts and circumstances of the case and in law, the order dated 27 January 2017 passed by the Assistant Commissioner of Income Tax, Circle 4(2), New Delhi (‘Ld. AO’) is bad in law being contrary to facts of Appellant’s case and provisions of the Income Tax Act, 1961 (‘the Act’). The Ld. AO has erred in facts and in law in making the disallowance of INR 21,80,46,325 incurred by the Appellant on re-measuring of foreign exchange forward contracts (‘MTM losses’)*
- 2. That on the facts and circumstances of the case and in law, the order passed by the Ld. AO is barred by limitation as stipulated under section 153 of the Act and hence liable to be quashed.*
- 3. Without prejudice to the above, that on facts and circumstances of the case and in law, the Dispute Resolution Panel - 1 (‘Ld. DRP’) erred in directing the Ld. AO to disallow the loss of INR 21,80,46,325 towards MTM losses as on balance sheet date without appreciating the order dated 14 October 2015 passed by the Hon’ble Income Tax Appellate Tribunal (TTAT’) while setting aside the matter back to the file of Ld. AO / Ld. DRP.*
- 4. That the Ld. DRP has erred in directing the Ld. AO to disallow the MTM losses of INR 21,80,46,325 even though the Hon’ble ITAT in its order dated 14 October 2015, in view of the ratio laid by the Hon’ble Supreme Court in the case of Woodward Governor (312 ITR 254), in principle agreed that the MTM losses claimed by the Appellant is allowable under section 37(1) of the Act as the Appellant is following mercantile system of accounting. The Ld. DRP has further erred in holding that the Appellant failed to file necessary evidence to substantiate its claim for deduction of MTM losses.*
- 5. That on the facts and circumstances of the case, the Ld. AO has erred in facts and in law in passing the order in a malafide manner without taking into consideration the material furnished on record.*

6. *That the Ld. DRP / Ld. AO erred in placing reliance on Instruction No. 3/2010 dated 23 March 2010 issued by the Central Board of Direct Taxes, as this Instruction is issued with respect to assessees trading in forex-derivatives. Also, the Instruction is issued after the year under consideration. Thus, accordingly the same is not applicable to the Appellant. Further, the said Instruction is ultra vires to the scope of section 119 of the Act being prejudicial to the interest of the Appellant.*
7. *That the Ld. AO has erred in charging interest under sections 234B and 244A of the Act.*
8. *That on the facts and in circumstances of the case and in law, the Ld. AO has erred in initiating penalty proceedings under section 271(l)(c) of the Act.*
9. *That the appellant reserves its right to alter or amend any ground of appeal or add any further grounds either before or at the time of hearing of this appeal.*

2. The facts in brief of the case are that during the relevant period, the assessee company provided %Engineering & Design Service+ etc. to its Associated Enterprise (AEs) and raised invoices from time to time. To safeguard any losses in sales invoices raised, on account of exchange fluctuation in foreign currency, the assessee entered into 9 Forward Contracts with the Bank of America on 06/08/2008. These forward contracts were to be matured in the period from 03/04/2009 to 04/12/2009. The contracted rate of currency exchange varied from \$1 USD equivalent to Indian Rs. 42.97 to Rs. 43.55. According to the assessee, the exchange rate of the US dollar in forward market as on 31/03/2009 in respect of various maturity date of contracts varied from Rs. 50.78 to Rs. 51.49 and thus the assessee re-measured its forward contract on 31/03/2009 at prevalent forward market exchange rate and computed total loss of Rs.21,80,46,325/-, which was debited to the profit and loss account under the head %Exchange difference %and claimed in

the return of income. The particulars of the forward contracts taken and the computation of %MTM+ loss of Rs.21,80,46,325/-, submitted by the assessee before the Ld. DRP, is reproduced as under:

Date of Forward Contract taken	Contract No.	Date of Maturity	Amount of Forward Contract (USD)	Forward Contract Rate	Amount of Forward Contract (INR)	Cash Rate as on March 31, 2009	Date of Maturity	Amount (INR)	Gain/(Loss) (INR)
(1)	(2)	(3)	(4)	(5)	(6) = (4) * (5)	(7)	(8)	(9) = (4) * (7)	(10) = (6) - (9)
6-Aug-08	146164	3-Apr-09	2,900,000	42.97	124,613,000	50.78	3-Apr-09	147,247,500	(22,634,500)
6-Aug-08	146166	4-May-09	2,900,000	43.05	124,845,000	50.93	4-May-09	147,690,284	(22,845,284)
6-Aug-08	146167	4-Jun-09	3,000,000	43.17	129,510,000	51.05	4-Jun-09	153,149,362	(23,639,362)
6-Aug-08	146169	03-Jul-09	3,100,000	43.25	134,075,000	51.14	3-Jul-09	158,537,614	(24,462,614)
6-Aug-08	146171	4-Aug-09	3,100,000	43.33	134,323,000	51.23	4-Aug-09	158,798,696	(24,475,696)
6-Aug-08	146173	4-Sep-09	3,200,000	43.35	138,816,000	51.31	4-Sep-09	164,177,990	(25,361,990)
6-Aug-08	146174	1-Oct-09	3,300,000	43.44	143,352,000	51.38	1-Oct-09	169,540,704	(26,188,704)
6-Aug-08	146175	4-Nov-09	3,000,000	43.50	130,500,000	51.44	4-Nov-09	154,318,760	(23,818,760)
6-Aug-08	146176	4-Dec-09	3,100,000	43.55	135,005,000	51.49	4-Dec-09	159,624,415	(24,619,415)
Total			27,600,000		1,195,039,000			1,413,085,325	(218,046,325)

2.1 In Schedule . XIII to the Annual Financial Statement under significant accounting policies, the assessee reported in respect of forward foreign exchange contracts, as under:

“Schedule XIII - A. Significant Accounting Policies:-

iv) Foreign exchange transactions

Foreign exchange transactions are recorded at the exchange rate prevailing at the date of transaction. Realized gains and losses on foreign exchange transactions during the year are recognized in the Profit and Loss Account. Foreign currency monetary assets and liabilities are translated to India Rupees at year end rates and any resulting gain/loss on such translation is also recognized in the Profit and Loss Account.

v) Forward foreign exchange contracts

The company enters into forward foreign exchange contracts with the bankers to mitigate the risks associated with foreign exchange fluctuations associated with the accounts receivable and forecasted sales transactions. Any premium or discount arising at the inception of the forward exchange contract, which have been taken on underlying transaction, is recognized as expenses/income over the life of the contract and exchange differences arising on such forward exchange contract is recognized in the Profit and Loss account in the reporting period in which the exchange rate changes. The fair value of forward foreign exchange contract, which have been taken to cover foreign exchange risk in respect of probable forecasted transactions, being the difference between the contracted rate and forward rate at the Balance Sheet date, at recognized in the profit and loss account. ”

2.2 In first round of proceedings, the Assessing Officer held that the reporting of such notional losses to adhere to the accounting guidelines does not by itself tantamount to business loss deductible for income tax purposes. The provisions of Income-tax Act, 1961 do not allow deduction of any such notional loss for which the liability has not crystallized and, therefore, marked to market (MTM) losses on account of revaluation of forex derivatives are only notional and cannot be deductible as business loss under Income-tax provisions. Moreover, in this case, there was no actual outgo as the assessee was not liable to pay for such losses.

Relying on the Central Board of Direct Taxes (CBDT) instruction bearing No. 17/2008 dated 26/11/2008 and 3/2010 dated 23/03/2010, the Assessing Officer disallowed the said loss.

2.3 The Ld. DRP, in first round of proceeding, upheld the finding of the Assessing Officer and also held that the forward contracts were not fully supported by the underlying support invoice both in terms of the amount as well as tenure. The Ld. DRP has drawn a table in the order, which is reproduced as under:

DETAIL OF OUTSTANDING FORWARD COVERS AS ON 31 ST MARCH, 2009, FOR WHICH INVOICING DONE TILL MARCH, 2009								
Contract	Contract Date	Contract Value (US#)	Invoice Date	Invoice Amt. USD	Invoice Amt. INR	Underlying Assets as at 31.03.09	FIRC No.	FIRC date
146164	6-Aug-08	2,900,000	Oct-08 Nov-08 Dec-08	632 144,247 2,755,121	31,640 7,208,024 131,942,759	YES YES YES	156473	2-Apr-09
146166	6-Aug-08	2,900,000	Oct-08 Nov-08 Dec-08 Jan-09 Mar-09	(5,001) 33 512,400 2,392,577 (9)	(250,495) 1,627 24,538,846 116,877,386 (452)	YES YES YES YES YES	157124	4-May-09
146167	6-Aug-08	3,000,000	Jan-09 Feb-09 Mar-00	830,550 2,169,380 70	40,572,363 108,230,382 3,567	YES YES YES	157869	4-Jun-09
146169	6-Aug-08	3,100,000	Jan-09 Feb-09 Mar-09	637 1,041,624 2,057,739	31,134 51,966,626 105,109,286	YES YES YES	158594	3-Jul-09
146171	6-Aug-08	828,047	Mar-09	828,047	42,296,660	YES	159290	4-Aug-09
Sub-Total		12,728,047		12,728,047	628,559,352		Grand Total	
146171	6-Aug-08	2,271,953	Beyond 31.3.09			NO	159290	4-Aug-09
146173	6-Aug-08	3,200,000	Beyond 31.3.09			NO	159930	4-Sep-09
146174	6-Aug-08	3,300,000	Beyond 31.3.09			NO	160558	1-Oct.-09
146175	7-Aug-08	3,000,000	Beyond 31.3.09			NO	161236	4-Nov-09
146176	7-Aug-08	3,100,000	Beyond 31.3.09			NO	162068	4-Del-09
Sub-Total		14,871,953						
Grand Total		27,600,000						

2.4 The Ld. DRP noted that out of nine forward contracts, the assessee has only used 4 (four) forward contracts fully and the

assessee had not used those forward contracts immediately but it started using them against the sale invoices after the lapse of time of few months. The Ld. DRP further noticed that contract No. 146164 was used for first-time on 31/10/2008 for a nominal sum of USD 632 and thereafter for USD 1,44,247 in November, 2008 and balance in December 2008 four USD 27,55,121/-. Thus, according to the Ld. DRP, there was no underlying asset for this contract from 06/08/2008 till 31/10/2008. Further, the Ld. DRP observed that contract No. 146167 and 146169 were taken on 06/08/2008 but have been started to be used by the assessee from January 2009 onwards and, thus, there was no underlying assets for these contracts from 06/08/2008 to 31/12/2008. The Ld. DRP, further observed that out of the forward contract No. 146171 only a small part of US dollar 8.28 was used by 31/03/2009, while the remaining 4 (four) forward contracts were not utilized at all till 31/03/2009. Thus, according to the Ld. DRP the forward contract transactions were in the nature of speculative transactions and the loss claimed on such transactions was not allowable to be adjusted against business profit.

2.5 Before the Tribunal, in first round of proceedings, the assessee contended that all forward contracts were duly honoured by actual delivery of US dollar, and therefore the forward contract transactions were not speculative in nature.

2.6 In view of the rival claims of parties, the Tribunal in its order dated 14-10-2015 restored the matter to the file of the AO/DRP for afresh adjudication after factual analysis and examination of the impugned transactions. The relevant finding of the Tribunal is reproduced as under:

“50. There is no observation of the Id. DRP in para 3.7.1 which support the contention of the assessee that all forward contracts were duly honoured by delivery of contracts under USD. In this situation, in principle, we agree that in

view of the ratio laid down by Hon'ble Supreme Court in the case of Woodward Governor (312 ITR 254), while the assessee is following mercantile system of accounting, the loss suffered by the assessee by fluctuation in the foreign exchange as on the date of balance sheet is an item of expenditure u/s 37(1) of the Act. Under this proposition and dicta of Hon'ble apex court, and facts emerging from the DRP order, we find it appropriate that the issue requires detailed examination and verification and calculation on scientific basis at the end of the AO/DRP in the light of relevant proposition and provisions of the Act. Therefore, relying on the said propositions and following the judgement of Hon'ble apex court in the case of Woodward Governor (312 ITR 254), we restore this issue to the file of AO/DRP for a fresh adjudication after factual analysis and examination of the impugned transactions after affording due opportunity of hearing for the assessee and without being prejudiced by the earlier orders."

2.7 Pursuant to the order of the Tribunal, the Id. DRP, allowed opportunities to the assessee for filing submissions and calculations in terms of the order of the Tribunal. The Ld. DRP has noted in the order that assessee failed to file the necessary evidence to substantiate its claim. The relevant finding of the Ld. DRP is reproduced as under:

"5. As discussed above, the matter was fixed for hearing and the assessee reiterated the submissions made earlier before the Hon'ble ITAT. The assessee was given another opportunity to file submissions and calculates in terms of the Hon'ble ITAT's order. The submissions of the assessee and the facts have been carefully considered. The assessee has only reiterated the submissions made earlier and has failed to file necessary evidence to substantiate its claim. When the assessee has challenged the addition before the Hon'ble ITAT and the Hon'ble ITAT have set aside the matter, it was for the assessee to controvert the findings of the AO and substantiate its claim with necessary evidence. The assessee has failed to do so. In para 3.7.7 of the DRP's earlier order, the DRP have observed that the assessee failed to furnish the required information. The DRP have observed that "losses so sustained on MTM basis are not allowable as business loss u/s 28 as these FCs have not been taken for the purposes of business of the assessee on raising of the export invoices but have been taken without due exposure". Even in the present proceedings, the assessee has only reiterated its submissions made earlier and has failed to controvert the findings of the AO and DRP and substantiate its claim with necessary evidence. As the assessee has failed to furnish complete details, an adverse inference is naturally drawn. This principle has been recognised by the Hon'ble Delhi High Court in CIT v. Motor General Finance Ltd (254 ITR 449)."

2.8 Aggrieved with the above finding of the Ld. DRP, the assessee is in appeal before the Tribunal raising the grounds as reproduced above .

3. In ground No. 7, the assessee has challenged charging of interest under section 234B and 244A of the Act, which being consequential in nature, we are not required to adjudicate upon and accordingly dismissed as infructuous. Similarly in ground No. 8, the assessee challenged initiation of penalty proceeding under section 271(1)(c) of the Act. Since no penalty has been levied by the Assessing Officer in the impugned order, the issue is premature at this stage and therefore accordingly dismissed as infructuous. In ground No. 2, the assessee has challenged the order passed by the Assessing Officer as barred by limitation and hence liable to be quashed. However, this ground was not argued specifically before us and therefore dismissed as not pressed on behalf of the assessee.

4. In ground Nos. 1 to 6 (except ground No.2), the assessee is aggrieved by disallowance of losses of Rs.21,80,46,325/- debited in the profit and loss account on account of re-measuring of forward contracts. The assessee characterized the said losses as %marked to market+ (MTM) losses.

4.1. Before us, the Ld. counsel of the assessee filed paper book containing pages 1 to 355. The Ld. counsel also filed a chart showing details of forward contracts entered into by the assessee viz-a-viz Forward Inward Remittance Certificates (FIRC), submitted in the paper book, evidencing that all forward contracts were settled with actual delivery. The Ld. Counsel contended that all the necessary information were filed before the Id. DRP , however the Id. DRP did not consider its submission and repeated its finding given in earlier order. The Id. Counsel further reiterated the arguments taken before the lower authorities that it was mandatory for the assessee to measure the %MTM+

losses on the unexpired forward contracts at the end of the year in accordance with the method of accounting consistently followed by it with respect to the effect of changes in foreign exchange rates.

4.2 The Ld. counsel further submitted that %MTM+ losses at year end were ascertained liability. An anticipated liability coupled with present obligation, the quantification of which may vary depending on future events, can be said to have crystallized on the balance sheet date and thus allowable on accrual basis under the Act.

4.3 The Ld. counsel placed reliance on the judgment of the Hon ϕ le Supreme Court in the case of CIT versus Woodward governor India private limited (2009) 312 ITR 254.

4.4 On the other hand, the Ld. CIT(DR) placed reliance on the order of the Ld. DRP and submitted that despite sufficient opportunity provided by the Ld. DRP, the assessee did not file the required details for complying the direction of the Tribunal and in such circumstances the matter need to be restored back to the file of the DRP for deciding whether the transactions in question are speculative transaction or hedging transactions, after analysis of copy of forward contracts agreements with Banks and Foreign Inward Remittance Certificates(FIRC) issued by the Banks and other documents filed by the assessee in the paper book.

4.5 We have heard the rival submission and perused the relevant material on record. The Ld. counsel has placed reliance on the judgment of the Hon ϕ le Supreme Court in the case of Woodward Governor Private Limited (supra). In assessment year 2008-09, the forex fluctuation loss on unexpired forward contracts was allowed by the Tribunal following the Hon ϕ le Supreme Court in the case of Woodward Governor (312 ITR 254).Therefore, it is relevant to refer the ratio of the Hon ϕ le Supreme Court in the case. In the said case, questions of law were raised in respect of impact of variation in foreign currency exchange rate on the

balance sheet date both on the expenditure on account of capital as well as revenue. The questions of law framed in the case of Woodward Governor (supra) are as under:

"(i) Whether, on the facts and circumstances of the case and in law, the additional liability arising on account of fluctuation in the rate of exchange in respect of loans taken for revenue purposes could be allowed as deduction under s. 37(1) in the year of fluctuation in the rate of exchange or whether the same could only be allowed in the year of repayment of such loans?"

"(ii) Whether the assessee is entitled to adjust the actual cost of imported assets acquired in foreign currency on account of fluctuation in the rate of exchange at each balance sheet date, pending actual payment of the varied liability?"

4.5.1 As far as second question of law is concerned, the effect of fluctuation in exchange rate of foreign currency on capital expenditure is governed by the Section 43A of the Act. Since in the above batch of the appeals, the assessment year involved was 1998-99, the Hon^{ble} Supreme Court decided the issue raised in second question of law in view of section 43A (pre-amended w.e.f. 01/04/2003) of the Act and held *that it became possible to adjust the increase/decrease in liability relating to acquisition of capital assets on account of exchange rate fluctuation, in the actual cost of the assets acquired in foreign currency and for, inter alia, depreciation to be allowed with reference to such increased/decreased cost.* After 1-4-2003, the issue is governed by the amended section 43A of the Act.

4.5.2 As regards the first question of law in the case of Woodward Governor (supra), we find that there was a loan liability in the books of accounts of the assessee on revenue account as a monetary transaction appearing in the balance sheet and was raised in foreign currency. Due to fluctuation in foreign currency exchange as on 31st March of the accounting year, the liability had increased. The assessee debited the increase in liability due to fluctuation as loss in the profit and loss account. The Honble Supreme Court held that *the loss suffered by the assessee on revenue account, maintaining accounts regularly on Mercantile system and following accounting standards prescribed by the Institute of chartered accountant of India (ICAI), on account of fluctuation in rate of foreign exchange as on the date of balance sheet, was an item of expenditure under section 37(1) of the Act notwithstanding that the liability had not been discharged in the year in which the fluctuation in the rate of foreign currency occurred.* While allowing the loss due to fluctuation in the rate of exchange on the balance sheet date, the Honble Supreme Court explained the position through following example:

“19. A company imports raw material worth US \$ 250000 on 15th Jan., 2002 when the exchange rate was Rs. 46 per US \$. The company records the transaction at that rate. The payment for the imports is made on 15th April, 2002 when the exchange rate is Rs. 49 per US \$. However, on the balance sheet date, 31st March, 2002, the rate of exchange is Rs. 50 per US \$. In such a case, in terms of AS-11, the effect of the exchange difference has to be taken into P&L account. Sundry creditors is a monetary item and hence such item has to be valued at the closing rate, i.e. Rs. 50 at 31st March, 2002, irrespective of the payment for the sale subsequently at a lower rate. The difference of Rs. 4 (50-46) per US \$ is to be shown as an exchange loss in the P&L account and is not to be adjusted against the cost of raw materials.”

4.5.3 The Hon^{ble} Supreme Court in the case of Woodward Governor (supra) has followed the decision of the Hon^{ble} Supreme Court in the case of Sulej Cotton Mills Ltd. Vs. CIT, (1979) 116 ITR 1 (SC), where it is held that if loss of foreign exchange fluctuation was on account of trading liability, the same would be allowable. Further, Hon^{ble} Delhi High Court in the case of Eicher Good Earth in ITA No. 7078 of 1992 observed that the mercantile system of accounting made it mandatory to translate the outstanding liability on the basis of fluctuation of foreign currency rate and amount of increase in such liability as allowable. In this respect, it is relevant to refer the decision of Hon^{ble} Supreme Court in the case of CIT Vs. Dempo and company private limited reported in 206 ITR 291, wherein trading liability has been summarized as under;

- *A loss arising in the process of conversion of foreign currency which is part of trading asset of the assessee is a trading loss as any other loss.*
- *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.*
- *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.*
- *Loss in respect of circulating capital is revenue loss whereas loss in respect of fixed capital is not.*
- *Loss resulting from depreciation of the foreign currency which is utilized or intended to be utilized 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 capital loss.*
- *For determining whether devaluation loss is revenue loss or capital loss what is relevant is the utilization 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 utilized 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.*

4.5.4 The Hon^{ble} Supreme Court in the above case has also held that *the way in which entries are made by the assessee in the books of accounts is not determinative of the question whether the assessee has*

earned any profit or suffer any loss and 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.

4.5.5 In the present case, the assessee exported certain services to its associated enterprise and part of those export receipts were pending on the balance sheet date i.e. 31/03/2009 and were shown as receivables of Rs. 71.64 crores in the balance sheet. The receivables in the case of the assessee are items of balance sheet and arisen due to trading transactions. In view of the ratio of the Woodward Governor Private Limited (supra), the assessee was having option of measuring its exports receivables at exchange rate of US dollar on the balance sheet date, and any gain or loss on the same would have been allowable to the assessee. But the assessee did not do so.

4.5.6 Whereas, according to the submission of the assessee before us, the assessee entered into forward contracts with banks at predetermined exchange rate of foreign currency to safeguard its receivables from any fluctuation in foreign exchange. By entering into such forward contracts, the assessee hedged its receivables and immuned itself from effect of any change in exchange rate of foreign currency. Whatever may be the foreign change rate on the date of receipt of exports, whether it is higher or lower than the contracted rate, the assessee was certain of receiving the contracted rate under the forward contract. For example, in forward contract No. 146164, which is available on page 78 of the paper book the assessee agreed to sell US dollar 29,00,000 at the rate contacted of Rs. 42.97 per US dollar. The maturity date of the said contract was 03/04/2009 and according to the FIRC issued by the bank, which is available on page 300 of the paper book, the assessee received USD 29,00,000/- from its associated enterprises M/s BECHTEL Capital Management Corporation, which was sold to bank at the rate of Rs.

42.97 per dollar as already contracted. According to the decision in the case of Woodward Governor (supra), the assessee could have re-measured its receivables on the balance sheet date according to the foreign exchange rate contracted in the forward contracts. For example, the assessee made sales of 632 USD in Oct., 2008 and recorded sales in Indian rupees at Rs.31,640/- in books of account. According to this exchange rate, on the date of sale was Rs. 50.06. The assessee apprehended decline in foreign exchange rate and already entered into a forward contract with the banks having contracted foreign exchange rate of Rs. 42.97 USD. On the date of balance sheet, the forward contract was not matured. In such circumstances, following the Woodward Governor (supra), the assessee could have valued export receivable of 632 USD at the rate of Rs. 42.97 which would be Rs. 27,157/- and in that case the assessee would have a loss of Rs. 31,640 - 27,157 = Rs. 4,483/-, on balance-sheet date as per ~~marked to market~~, which would have been allowed as a loss to the assessee .

4.5.7 But the assessee has not claimed the loss on the trading liability which was allowable following the case of Woodward Governor (supra). The assessee instead of measuring the receivables on balance sheet date at foreign exchange rate contracted, it measured the pending forward contracts on balance sheet date at a value of foreign currency in the forward market. The assessee has entered into 9 forward contracts. The first forward contract No. 146164 was entered into for sale of 29,00,000 USD at the rate of contracted rate of foreign exchange of Rs. 42.97 and the assessee has valued this forward contract on balance sheet date at foreign exchange rate of Rs. 50.78. The assessee has treated the forward contract as its liability to pay and thus according to the assessee its liability to pay to the bank has increased by an amount of rupees 29,00,000 (50.78-42.97) = 2,26,49,000/- . The assessee has

claimed this liability as loss. Similarly, the assessee has claimed loss on all the forward contracts, which is amounted to Rs.21,80,46,325/-.

4.5.8 In our opinion, the kind of loss claimed with assessee is not allowable in view of the decision of the Honble Supreme Court in the case of Woodward Governor (supra) and other decisions discussed above, due to following reasons:

- (i) In relevant period, the assessee was evidently not dealing in forward contracts and those forward contracts were not part of a stock in trade of the assessee. Thus, these transactions were in not on account of the trading and, therefore, there was no trading liability.
- (ii) The assessee, to avoid any unforeseen losses on account of downfall in foreign exchange rate, entered into forward contracts and sealed the amount of foreign exchange rate, which would be receivables to it. In such a situation, the assessee is not affected by any up or down in the foreign change rate of US dollar either on the balance sheet date or on the date of actual receipt of foreign currency from buyers till maturity date of the contract. It eliminated effect of any change in the currency exchange fluctuation rate on the receivables. The assessee was certain of receiving US dollar equivalent to what it agreed to sale to the bank in respect of forward contracts. Had the assessee not have the underlying receivables, then on the date of maturity of forward contracts, the assessee would have required to settle the contracts either by the purchasing US dollar from market or paying difference of exchange rate. If the assessee, would have required to buy US dollar for honouring its forward contracts of sale of US dollar, the liability of the assessee would have definitely dependent on the foreign exchange rate on maturity date or balance sheet date. But in the instant case, as the assessee has submitted that it entered into hedging forward contract transactions and settled

all the forward contract by way of export receivables, therefore, it was immuned from any such fluctuation in the foreign exchange rate and there was no liability, which could arise on account of such fluctuation in foreign exchange on maturity of contract. In such circumstances, when it is certain that no additional liability would arise to the assessee on the maturity of the contract, the possibility of such liability on the balance sheet date also cannot arise. The only outgo on account of the forward contracts was premium or discount payments to the banks at the inception of forward exchange contracts and there was no outgo on possible fluctuation in the foreign exchange rate, and thus, there was no liability on revenue account in respect of the forward contracts.

4.5.9 The assessee to immune itself from any losses on account of fluctuation in foreign exchange rate at the time of receipt of payment against the sale invoices, entered into forward contracts with banks. The assessee entered into a contract with the bank to sale US dollar at a predetermined rate on future date. For example, according to forward contract No. 146164 dated 06/08/2008, the assessee agreed to sale 29,00,000 US dollar at the rate of Rs.42.97 per dollar. This forward contract was having maturity date of 03/04/2009. The assessee was expecting receipt of US dollar against sale invoices amounting to USD 632 (October, 2008); USD 1,44,247 (November, 2008) and USD 27,55,121 (December, 2008) before maturity period of the forward contract. By entering into forward contract with banks at predetermined rate of Rs.42.97 per dollar having corresponding export invoices as underlying, the assessee immuned itself from any fluctuation in the foreign exchange rate. From the foreign inward remittance certificate issued by the bank on 02/04/2009, also it is evident that amount of US

dollars 29,00,000/- was received against invoices and which was credited at the rate of Rs. 42.97 per US dollar in account of the assessee.

4.6 The Tribunal in assessment year 2008-09 allowed the foreign exchange fluctuation loss with following finding:

“8. Coming to the corporate additions i.e. disallowance of loss, it clearly emerges from the record that the assessee in respect of foreign exchange realization follows mercantile system of accounting and not case system of accounting. The loss has been incurred for hedging of foreign currency fluctuation involved in sales invoices on the basis of forward contracts, which is a business decision to safeguard its interest. The loss has been incurred on the basis of scientific method in the ordinary course of business. The loss being based on a scientific method, on the basis of contractual liability with banks and on mercantile system has to be allowed to the assessee following Hon'ble Supreme Court judgment in the case of Woodward Governor India (P.) Ltd. (supra). Our view is further fortified by the fact that DRP in its own order in subsequent year has itself held that the issue about the loss on mercantile system is pending dispute in A.Y. 2008-09. Therefore, the allowability of the loss on actual payment in A.Y. 2009-10 has been made subject to the allowability of the loss for A.Y. 2008-09. This stand of the DRP itself negates the observations of Assessing Officer that it is a notional loss and establishes that it is a business loss incurred by the assessee on mercantile system which method is consistently followed by the assessee. Under these circumstances, we are inclined to allow the foreign exchange fluctuation loss to assessee in this year. This ground of the assessee is allowed.”

4.7 In our opinion, in the assessment year 2008-09, facts in detail were not brought before the Tribunal, as to whether the foreign-exchange fluctuation liability was in respect of export receivables, which was an item of trading account or in respect of forward contracts, which were not part of trading account of the assessee.

4.8 In view of our discussion above, we are of the opinion that hedging forward contracts of foreign currency cannot be marked to market+ (MTM) on balance sheet date as already there is a underlying asset and there is no extra outgo for settlement of the forward contract other than already determined in the contract and thus there is no additional liability or benefit to the assessee on the settlement date. Once there is no liability or benefit on the settlement date, there is no possibility of liability or benefit to the assessee on balance sheet date also.

4.9 We find that in second round of proceedings, the Ld. DRP in absence of submission /calculation from the assessee, held the forward contract transactions as a speculative transactions and following the decision of the Tribunal in the case of Sh. Vinod Kumar Diamonds Private Limited Vs. Addl. CIT, Range-5(3), Mumbai in ITA No. 506/Mum/2013, the addition made by the AO not allowing the MTM loss, was upheld. As the issue was restored to the file of the AO/DRP for afresh adjudication after factual analysis and examination of the impugned transaction following the judgment of the Hon^{ble} Apex Court in the case of Woodward Governor Private Limited (supra) but no such analysis and examination of all the transactions of forward contract has been carried out by the Ld. DRP due to reasons mentioned in the order of the Ld. DRP. The assessee has filed copy of all the forward contracts before us from page 78 to 87 of the paper book. Bottom portion in all these contracts has been blackened with ink, and therefore the contents are not visible. The assessee has also filed copies of Foreign Inward Remittance Certificates (FIRC) before us, which are available on page 300 to 308 of the paper book. It is contested by the Revenue that in certain forward contracts, there was no underlying asset as on the date of balance sheet and, therefore, it need to be examined whether same were forward contract transaction in the nature of hedging or in the

nature of speculation. However, in our opinion, when the contention of the assessee that all the forward contracts were settled by way of actual delivery through dollars received on export receivables, the assessee cannot be allowed %mark to market+losses on such forward contract and therefore it is not required to examine whether those forward contract transactions were speculative in nature.

4.9.1 In view of above facts and circumstances, we hold that the loss of Rs.21,80,46,325/- claimed by the assessee on account of mark to market losses on account of fluctuation in foreign currency in respect of hedging forward contract is not allowable. The grounds of appeal, raised by the assessee in this respect are accordingly dismissed.

5. In the result, the appeal of the assessee is dismissed

The decision is pronounced in the open court on 29th May, 2017.

Sd/-
(C.M. GARG)
JUDICIAL MEMBER

Dated: 29th May, 2017.
RK/(D.T.D)

Sd/-
(O.P. KANT)
ACCOUNTANT MEMBER

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, New Delhi