IN THE INCOME TAX APPELLATE TRIBUNAL

DELHI BENCH "B" NEW DELHI

BEFORE SHRI A.D. JAIN, JUDICIAL MEMBER

AND

SHRI SHAMIM YAHYA, ACCOUNTANT MEMBER

I.T.A. No. 4021/Del/2010

A.Y. : 2004-05

Convergys India Services Private Limited, DLF Atria, Jacaranda Marg, DLF City Phase-II, Gurgaon (PAN/GIR NO. : AABCC5056G)	vs.	Deputy Commissioner of Income Tax, Circle 3(1), CR Building, New Delhi
(Appellant)		**(Respondent)**

Asseessee by	:	Sh. C.S. Aggarwal, Sr. Adv., & Sh. R.P. Mall, Adv. .
Department by	:	Sh. Jayant Mishra, C.I.T. (D.R.)

ORDER

PER SHAMIM YAHYA: AM

This appeal by the Assessee is directed against the order of the Ld. Commissioner of Income Tax (Appeals) dated 09.6.2010 pertaining to assessment year 2004-05.

2. The main issue raised is that Ld. Commissioner of Income Tax (Appeals) has erred both on facts and in law in upholding the disallowance of claim of deduction under section 10A of the Income Tax Act of ₹ 3,52,90,374/- made by the Asstt. Commissioner of Income Tax.

3. The assessee has also raised an additional ground which reads as under:-

> "That the Ld. Assessing Officer has erred both in law and on facts in computing the income at ₹ 3,52,90,374/- and further erred consequentially in denying the claim of deduction u/s 10A of the Act on the said sum."

Though this ground has been filed in writing and permission sought to raise the same, Ld. counsel of the assessee claimed that this is not an additional ground, it is an additional plea.

4. In this case, return of income declaring NIL income for assessment year 2004-05 was filed on 28.10.2004. Regular assessment u/s 143(3) was completed on 28.12.2006 at taxable income of ₹ 275830556/-.

5. Ld. Commissioner of Income Tax, Delhi-I, New Delhi u/s 263 of the IT Act, found the assessment order both erroneous and prejudicial to the interest of revenue on the following issue and directed the Assessing Officer to frame a speaking order after giving opportunity of being heard to the assessee in this matter:-

> "In the assessment year 2004-05 the assessee had shown income from foreign exchange fluctuation gain of ₹ 35290374/- under the head "other income" and this income is different from "income from operation". Provisions of section 10A envisage deduction of such profits and gains as are derived by an undertaking from the export of articles or things or computer software. Thus the grant of deduction on foreign exchange gain u/s 10A is clearly deviation from law which makes the order

granting such deduction both erroneous and prejudicial to the interest of revenue."

5.1 Pursuant to the aforesaid 263 order, Assessing Officer has framed this assessment order. Assessing Officer observed that during the year under consideration, assessee company had raised external commercial borrowings form its parent company for meeting its working capital requirements. The said ECBs were reinstated on 31.3.2004 i.e. at the end of the year which resulted in a notional foreign exchange gain of ₹ 38215000/- to the company. After adjusting the loss on export remittance, net income of ₹ 35290374/- was shown as "other income" in the profit and loss account for the year ended 31.3.2004. Assessing Officer rejected the assessee's contention that the gain arising on ECB taken to raise the working capital requirement of the company, constitutes business income of the company and is eligible for deduction u/s 10A of the Act. Accordingly deduction claimed by the assessee u/s 10A on foreign exchange gain of ₹ 35290374/- was disallowed.

6. Upon assessee's appeal Ld. Commissioner of Income Tax (Appeals) elaborately considered the issue and held as under:-

"I have carefully considered the submission by the Ld. A.R. and have gone through the assessment order. A perusal of P&L a/c shows that the appellant itself has segregated the income under two head i.e. 'income from operations' and 'other income'. In Schedule J of the balance sheet, 'other income' is mentioned as 'exchange difference (net)' at ₹ 35,290,374/-. The appellant's contention is that income on account of foreign exchange gain is eligible for deduction u/s 10A of the Act.

For ascertaining the allowability of deduction u/s 10A in this case, it is relevant to refer to the provisions of section 10A. As per the specific provisions of section 10A, the deduction under this section is available on such profits and gains as are derived by an undertaking from the export of article or things or computer software. In the present case, the income of ₹ 35,290,374/- is computed on account of the 'exchange difference'. This income is not derived from the export of article or things or computer software. In such circumstances, the said income will not be eligible for deduction u/s 10A of the Act.

Ld. A.R. has placed reliance on certain case laws. However, these cases are distinguishable from the present appeal to elaborate, Ld. A.R. has relied on the case of Woodward Governor India, 223 CTR 1. However, as mentioned in para 11 of the judgement in that case, the dispute before the Hon'ble Supreme Court in the batch of civil appeals centred around the year(s) in which deduction would be admissible for the increased liability under section 37(1). Ld. Authorised Representative also referred to the decision in the case of Eltek SGS Pvt. Ltd. 300 ITR 6. However, in that case the issue related to the claim of deduction on customer duty drawbacks u/s 80IB. Ld. Authorised Representative has relied on the decision of the Hon'ble Mumbai Tribunal in the case of Living Stones Jewellery Pvt. Ltd. supra. However, in a subsequent decision in the case of Tricom India Ltd. vs ACIT ITA No. 1924/Mum/08 dated 1st December, 2009, Hon'ble Mumbai ITAT has held that the decision of the coordinate Bench in the case of Living Stones Jewellery Pvt. Ltd. is distinguishable because it has not considered the mandatory

decision available form Madras High Court in the case of C.I.T. vs. Menon Impex.

I further find that the issue of deduction u/s. 10A has been dealt with elaborately by Hon'ble Mumbai ITAT in the case of Tricom India Ltd vs. ACIT CL PB 186 – 196, supra, wherein it has been held that merely because the income has been assesseed as business income will not automatically confer the benefits of a particular deduction once there is a rider provision that income should be derived from a particular source Hon'ble Tribunal has followed the decision of Hon'ble Madras High Court in the case of India Cement International v. ITO 304 ITR 322 which was the only decision available. For the sake of convenience, relevant extracts of the order of the Hon'ble Tribunal are reproduced as under:-

> "Section 10B(4) merely gives the formula to make the deduction proportionate Say if there is export turnover of ₹ 50 and total turnover is also ₹ 100/- then the total business profit has to be divided by 50/100, because the total turnover (i.e. export turnover + domestic turnover). But the expression 'derived from' cannot be ignored in Section 10B(1) because the expression involves only these items of profit eligible for deduction which are derived from such undertaking.

We have also gone through the decisions of the Coordinate Bench of the tribunal in the case of J.P. Morgan India Pvt., Ltd. vs. DCIT (supra) and Living Stones Jewellery P Ltd. vs. DCIT (supra) and find that both the decisions are distinguishable because both the decisions have not considered mandatory decision available

fro the Hon'ble Madras High Court in the case of C.I.T. vs. Menon Imex v C.I.T. (supra). In addition the benefit of Third Member decision in the case of ITO v Banyan Chemicals Ltd. (Supra) was also not available in this case.

In any case the decision in the case of Menon Impex v. C.I.T. (supra) was followed by the Hon'ble Madras High Court in the case of India Comnet International v. ITO (304 ITR 322). This decision was rendered for the assessment year 2002-03 when sub-section (4) had already been inserted on the statute.

Looking into the facts of the case, I find that the Assessing Officer was justified in not allowing the deduction u/s 10A on the 'other income' which is derived on account of fluctuation of foreign exchange and does not satisfy the mandatory conditions of section 10A. These grounds of appeal are, therefore, dismissed."

7. Against the above order the assessee is in appeal before us.

8. First we shall deal with the additional plea/ground raised by the assessee. Having heard the contentions on this issue, we find that the issue is purely a legal one and on the anvil of Hon'ble Apex Court decision in the case of National Thermal Corporation vs. C.I.T. 229 ITR 383, we admit the same for adjudication,

9. As regards the merits of the additional plea/ground the assessee's stand is that no income has accrued, as it is a case of merely reflecting the income by mere book entry made. It has been claimed that certain entries have been made in the books of accounts in accordance with the Accounting Standard 11 issued by the Institute

of Chartered Accountants of India. It is submitted that the said sum does not represent an income, since it is an amount, which represents the difference between the amount credited to the account of the loan creditor by adopting the rate of exchange in Indian Rupees to the Foreign Currency on the date of raising the loan and, the rate of exchange at the close of the year, which sum alone is the liability to be discharged by the assessee. It has been claimed that there is no gain other than artificial gain, where mere book entry has been made. It has been claimed that at best, it could only be stated that there occurred a notional gain and assuming the same to be gain, then such a gain was from its own self and as such no income accrued or was deemed to have accrued or had been received by it to its credit.

10. We have carefully considered the rival contentions on this issue. We find that the issue regarding taxability of gain or deduction of loss arising on account of fluctuation in rate of foreign exchange has been the subject matter of the decision of the Hon'ble Delhi High Court in the case of C.I.T. vs. Woodword Governor India P Ltd. 294 ITR 451 and also the Hon'ble Apex Court in the case of Woodword Governor India Pvt. Ltd. 312 ITR 254. The Hon'ble Apex Court, at page 265, mentioned that in case of revenue item falling under section 37(1), paragraph 9 of AS-11, which deals with recognition of exchange differences, needs to be considered. Under that paragraph, exchange differences arising on foreign exchange transactions have to be recognized as income or as expenses in the period in which they arise except as stated in paragraph nos. 10 & 11, which deal with exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which topic falls under section 43A of the Act. Further, it has been mentioned in placitum 19 that if the rate of

exchange on the balance sheet date is different from the date on which the liability was incurred and the date on which the liability was paid, the effect of exchange difference has to be taken into account in the profit and loss account. The Hon'ble Court finally stated the decision as under:-

> "....we may stated that in order to find out if an expenditure is deductible the following have to be taken into account (i) whether the system of accounting followed by the assessee is the mercantile system, which brings into debit the expenditure amount for which a legal liability has been incurred before it is actually disbursed and brings into credit what is due, immediately it becomes due and before it is actually received; (ii) whether the same system is followed by the assessee from the very beginning and if there was a change in the system, whether the change was bonafide; (iii) whether the assessee has given the same treatment to losses claimed to have been accrued and to the gains that may accrue to it; (iv) whether the assessee has been consistent and definite in making entries in the account books in respect of losses and gains; (v) whether the method adopted by the assessee for making entries in the books both in respect of losses and gains is as per nationally accepted accounting stands; (vi) whether the system adopted by the assessee is fair and reasonable or is adopted only with a view to reducing the incidence of taxation."

11. The fact of the present case before us is also that assessee is following mercantile system of accounting. It has followed the same in respect of fluctuation in rate of foreign exchange. The assessee has

made entries in the books on this basis for profits and losses. This is in accordance with the nationally accepted Accounting Standard-11. The Hon'ble Supreme Court, in the case of Woodword Governor India P Ltd. (Supra) has repeatedly mentioned about the profit and loss and no distinction has been made between the profit and the loss.

11.1 In this connection, Rule 115 of the IT Rules, 1962 regarding 'rate of exchange' for conversion into rupees of income expressed in foreign currency is relevant.

> Sub-clause (c) of clause (2) of the Explanation to the Rule defines "specified date", in case of business profits to be the last date of the previous year. In sub-rule (1), it is provided that the rate of exchange for calculation of the value in rupees of an income accruing or arising are deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him in foreign currency shall be telegraphic transfer buying rate of such currency on the specified date. Thus, de hors AS-11, this rule requires that reduction in liability on revenue account on account of rate of foreign exchange shall be reckoned on the last date of the previous year as per telegraphic transfer buying rate. This means that any reduction in liability, leading to revenue gain will have to be accounted as profits in case of business income. Thus, this rule independently reinforces the contents of AS-11 for recognition of income as well as loss arising on revenue account.

12. In the background of the aforesaid discussion and precedent, we are inclined to dismiss the additional ground taken by the assessee. Hence, the additional ground stands dismissed.

13. Now we come to the main substantive issue, viz., whether the Ld. Commissioner of Income Tax (Appeals) has erred both on facts and in law in upholding the disallowance of claim of deduction under section 10A of the Income Tax Act.

14. The assessee's submissions in this regard are summarized as under:-

> "Even, if it is held (assuming to be an income and is taxable), then too, since the liability as debited against its creditor stood reduced from the liability as was credited on the date of making an entry and the liability since stood reduced (which liability as was originally debited was not claimed or allowed as a deduction), then too the source of income remains the same i.e. such an income is derived from export and cannot be different as there is no other source of earning an income like in the case of sale licences, duty draw back, interest income and other income etc., though the cause for such a reduction of the liability by way of book entry may be different, (i.e. by virtue of fluctuation of rate of exchange), none the less source of alleged income would remain from the only business activity carried on by the assessee i.e. exports and as such, the income alleged to have accrued could not be regarded as not an income derived from exports. It be specifically stated that cause of accrual of income reflected is the book entry but the source is the exports activity only whereas in cases of earning of interest, duty drawback, or sale of licences, etc., source is an activity which makes an income accrue or arise. Further as is provided under section 10A(4) of the Act for the purpose of sub-section (1) and (1A), the profits

derived from computer software shall be the amount which bears to the profit of the business undertaking. In fact, the purported gain/income has neither been taxed as income from other sources nor it is held to be not an income from business. The other income reflected in the profit and loss account does not mean that the source is other than the profit and gains of the business. It is submitted that nomenclature used may not be decisive or conclusive to determine the character of the income."

15. In this connection, ld. counsel of the assessee has also referred to a catena of case laws mentioned in paper book as under:-

(i) Livingstones Jewellery (P) Ltd. v. DCIT (2009) 31 SOT 323 (Mum)

(ii) ACIT v Motorola India Electronics (P) Ltd. (2007) 112 TTJ 562 (TBAN)

(iii) M/s Rajesh Exports Ltd. vs. ACIT (2008)- TIOL- 457-ITAT-BANG

(iv) Hindustan Gum and Chemicals Ltd. v. ITO (2008) 23 SOT 143 (TKOL)

(v) M/s Cheviot Company Ltd. v ACIT (2007) 12 ITAT India 308 (TKOL)

(vi) M/s Metal Recycling Industry v ITO (2010) TIOL-247-ITAT-Mum.

(vii) Royal Exports vs ACIT ITA No. 730/2010 (Del)

(viii) C.I.T. vs Producin (P) Ltd. (2010) 191 Taxman 79 (SC)

(ix) C.I.T. vs. Bokaro Sttel Ltd. 91999) 236 315 (SC)

(x) Indian Oil Panipat Power Consortium Limited vs. ITO (2009) 315 ITR 255 (Del)

(xi) C.I.T. vs Menon Impex (P) ltd. (2003) 180 CTR 40 (Mad)

(xii) ITO vs. Banyan Chemicals Ltd. (2009) 121 TTJ 751 (TAHM)

(xiii) India Comnet International vs ITO (2008) 304 ITR 322 (Mad)

(xiv) M/s Tricom India Ltd. vs. ACIT (2010) 36 SOT 302(Mum)

(xv) Liberty India v. C.I.T. (2009) 317 ITR 218(SC)

(xvi) Motor Industries Co. Ltd. v JCIT (2007) 164 Taxman 279 (Kar)

(xvii) Pandian Chemicals Ltd. vs. C.I.T. (2003) 262 ITR 278 (SC)

xviii) Renaissance Jewellery P Ltd. vs. ITO (2006) 101 ITD 380 (Mum)

xix) Hindustan Aircraft Ltd. vs. C.I.T. (1962) 49 ITR 471 (Mys)

xx) C.I.T. v Sterling Foods (1999) 237 ITR 579 (SC)

xxi) C.I.T. Vs. Woodward Governor India P. Ltd. (2009) 312 ITR 254 (SC)

xxii) DCIT vs. Maruti Udyog Ltd. (2006) 99 ITD 666 (Del)

xxiii) Snam Progetti SPA vs. ACIT 132 ITR 70 (Del)

16. Ld. Departmental Representative on the other hand supported the orders of the authorities below and the case laws referred therein.

17. We have carefully considered the rival submissions in light of the materials produced and precedents relied upon. We can gainfully refer here the provisions of section 10A(1) and 10A(4) of the IT Act.

> 10A(1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by an undertaking from the export of articles or things or computer software for a period ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee"
>
> 10A(4) For the purposes of sub sections (1) and (1A), the profits derived from exports of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.

18. We find that the fact before us is that assessee has raised external commercial borrowings form its parent company for meeting its working capital requirements. Now, it is to be considered whether the gain in this regard on account of foreign exchange fluctuation is sourced from the export activity only or not. In this connection, assessee's counsel has referred to the decision of the Mumbai, ITAT Bench in the case of Livingstones Jewellery (P) Ltd. 31 SOT 323 where

it has been held that all profits which have direct nexus with the business of the undertaking will qualify for deduction u/s 10A of the IT Act.

19. The Ld. Commissioner of Income Tax (Appeals) has distinguished this decision by mentioning that the tribunal has not considered the decision available from Hon'ble Madras High Court in the case of C.I.T vs. Menon Impex P Ltd. 259 ITR 403 (2003). This observation of the Ld. Commissioner of Income Tax (Appeals) is not found to be incorrect.

19A. In Menon Impex (Supra), the Hon'ble Madras High Court has held as under:-

> "The interest received by the assessee was on deposits made by it in the banks. It is that deposit which is the source of income. The mere fact that the deposit was for the purpose of obtaining letter of credit which letter of credit in turn used for the purpose of the business of the industrial undertaking does not establish a direct nexus between the interest and the industrial undertaking. The Tribunal, therefore, was in error in holding that there was direct nexus between the two. The interest income derived by the assessee from funds in connection with letter of credit is not income derived from the profits of the business of the industrial undertaking so as to be entitled to get the benefit of s. 10A – Cambay Electric Supply Industrial Co.

Ltd. vs. C.I.T. 1978 CTR (SC) 50 : (1978) 113 ITR 84 (SC) and C.I.T. vs. Sterling Foods (1999) 153 CTR (SC) 439 : (1999) 237 ITR 579 (SC) applied."

20. Upon careful consideration, we find that section 10A(1) provides for connotation of such profit or gain as are derived from the export of articles or things or computer software.

20.1 As reiterated by the Hon'ble Apex Court in Liberty India (Supra) the contention of the words "derived from" is narrower as compared to that of words "attributable". By using the expression "derived from" in S. 10A(1), the Parliament intended to cover sources not beyond the first degree.

20.2 In the present case, we note that gain is not on account of fluctuation in foreign exchange relating to assessee's export activities. The same is with respect to the external commercial borrowings. This cannot be termed as derived from the export activity of the assessee. The assessee's reliance in this regard on section 10A(4) does not come to its rescue, as the said sub-section only provides the formula for computing profits derived from the export activity. First, the income or gain has to be derived from export activity, only then the computation formula can be applied.

21. In the background of the aforesaid discussion and precedents from Hon'ble High Court and Hon'ble Apex Court, we do not find any infirmity or illegality in the order of the Ld. Commissioner of Income Tax (Appeals). Accordingly, we uphold the same.

22. In the result, appeal filed by the assessee stands dismissed.

Order pronounced in the open court on 27/5/2011.

Sd/-	Sd/-
[A.D. JAIN] JUDICIAL MEMBER	[SHAMIM YAHYA] ACCOUNTANT MEMBER

Date 27/5/2011

SRB

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By Order,

Deputy Registrar,
ITAT, Delhi Benches