IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO. 1430 OF 2018

Principal Commissioner of Income Tax-15,
Mumbai
Aayakar Bhavan, M.K. Road, Mumbai 400020 ...**Appellant**

Versus

Galaxy Surfactants Ltd.
C-49/2, TTC Industrial Area, Pawne,
Navi Mumbai 400 703
PAN : AAACG1539P
AY 2009-10 ...**Respondent**

Mr. Akhileshwar Sharma, *Advocate for the Appellant.*

Mr. Nitesh Joshi, *a/w Atul Jasani, Advocates for Respondent-Assessee.*

CORAM : G. S. KULKARNI &
SOMASEKHAR SUNDARESAN, JJ.

RESERVED ON : AUGUST 09, 2024
PRONOUNCED ON : SEPTEMBER 24, 2024

JUDGEMENT: (*Per, Somasekhar Sundaresan J.*)

1. The captioned Appeal is a challenge to an order dated April 3, 2017 ("***Impugned Order***") passed by the Income Tax Appellate Tribunal, Mumbai, ("***ITAT***") allowing an appeal filed by Galaxy Surfactants Ltd., the Respondent-Assessee, setting aside the concurrent view of the

Assessing Officer ("***AO***") and the Commissioner of Income Tax Appeal ("***CIT-A***") in relation to the interpretation of Section 43A of the Income-tax Act, 1961 ("***the Act***"), and allowing a certain expense as revenue expenditure.

2. The questions of law raised in the captioned Appeal are as follows:

> *A. Whether in the facts and circumstances of the case, ITAT erred in allowing the claim of expenditure, in Indian Rupee, equivalent to the exchange rate difference, on loan liability denominated in foreign exchange, towards payment of capital goods acquired in India, without deciding as to whether the differential amount on account of exchange difference represent the circulating capital or the capital assets?*
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> *B. Whether in the facts and circumstances of the case, the increase in loan liability in Indian Rupee, equivalent to the exchange rate difference, on loan liability denominated in foreign exchange, towards payment of capital goods, acquired in India, does not represent circulating capital and therefore, not allowable as expenditure u/s 37(1) of the Income-tax Act 1961?*

Factual Background and Context:

3. The issue that lies at the heart of these questions is whether losses arising out of fluctuation of exchange rates in servicing a foreign currency loan that is utilized partly for acquiring assets from outside

India and partly for acquisition of assets within India, should be entirely capitalised with the value of the assets acquired. According to the Appellant-Revenue, such losses ought to be entirely capitalised regardless of whether the asset is acquired from outside India or from within India. According to the Respondent-Assessee, the losses must be broken down in proportion to the value of assets acquired from outside India and from within India; and the portion attributable to utilisation for import of assets into India must be capitalised under Section 43A of the Act, while the portion attributable to utilisation for acquiring assets from within India must be treated as revenue expenditure under Section 37(1) of the Act.

4. Before us, the position canvassed by the Revenue is that both the AO and CIT-A were right in holding that the entire foreign currency losses ought to be capitalised. Two primary reasons recorded in these decisions are that the losses are not attributable to trading in foreign exchange for them to be treated as revenue expenditure, and that as a point of principle, capitalization of the losses is provided for under Section 43A of the Act, and that principle must be applied entirely to the losses on account of exchange rate fluctuations in servicing the loan. The ITAT took the view that the provisions of Section 43A are not

attracted at all to the extent the loan was utilized for acquiring assets within India, and that there is no scope to capitalize such component of the losses. The ITAT allowed the foreign exchange losses to be broken up in proportion to the value of import of assets and value of assets acquired locally, and allowed the latter component to be treated as revenue expenditure.

5. The following factual matrix would be noteworthy:-

a) The assessment year in question is 2009-10;

b) The Respondent-Assessee had availed of foreign currency loan in the nature of external commercial borrowings from DBS Bank, Singapore towards capital expenditure;

c) As provided for under Accounting Standard (AS) 11 ("***AS-11***"), the balance outstanding in respect of such foreign currency loan had to be restated as of March 31, 2009 by marking to market, the exposure denominated in foreign exchange, which resulted in a loss of Rs.5,30,25,000/- owing to change in the exchange rate between the Indian Rupee and foreign currency;

d) The Respondent-Assessee broke up such loss amount in the proportion of value of capital goods imported into India and value of capital goods acquired within India – such break up led to Rs.51,86,755/- being attributable to capital assets imported (which was capitalised along with the cost of the asset) and Rs.4,78,38,245/- being attributed to capital assets acquired within India (which was claimed as revenue expenditure);

e) Owing to a steep depreciation in the value of Indian Rupee against the US Dollar, the Government of India, under Section 211 of Companies Act, 1956, issued a notification giving an option to assessees, to either take the entire amount of loss due to exchange rate movement, to the profit and loss account; or to defer the impact of such loss by capitalizing such losses with the cost of the assets so acquired. The Respondent-Assessee, therefore, was of the view that it was for the Respondent-Assessee to decide how it would choose to absorb the impact arising out of exchange rate differences;

f) In its commercial books of account, the Respondent-Assessee exercised the option to add the entire exchange rate loss of Rs.5,30,25,000/- towards the cost of fixed assets i.e. it capitalised this loss amount;

g) However, for purposes of Computation of Total Income under the Act, the sum of Rs.51,86,755/- (attributed to capital assets imported) was capitalized under Section 43A of the Act. The balance Rs. 4,78,38,245/- (attributed to capital assets acquired domestically) was treated as revenue expenditure under Section 37(1) of the Act;

h) The AO took the position that the amount involved must entirely be capitalized, quite akin to the accounting treatment adopted by the Respondent-Assessee in its financial statements. The AO took a view that the requirement to capitalise the losses cannot be restricted to assets acquired from outside India. According to the AO, Section 43A was introduced to remove any controversy about treatment of foreign exchange fluctuation being regarded as capital expenditure or

revenue expenditure, and the principle underlying that provision ought to be applied to the entire loss;

i) The CIT-A took an identical view of the matter, and went on to add that the foreign currency loan was not utilized for trading activity. According to him, only if it were used for trading, and that led to losses, could the loss be treated as revenue expenditure;

j) The ITAT, interpreting Section 43A, explicitly held that unless the asset had been acquired outside India, Section 43A could have no relevance. Therefore, the ITAT deleted the disallowance of Rs.4,78,38,245/- that had been effected by the AO and confirmed by the CIT-A.

6. Aggrieved by the ITAT's deletion of the disallowance, the Revenue has come up in appeal, challenging the Impugned Order. We have heard, at length, Mr. Akhileshwar Sharma, Learned Counsel on behalf of the Appellant-Revenue and Mr. Nitesh Joshi, along with Mr. Atul Jasani, Learned Counsel on behalf of Respondent-Assessee.

Section 43A and Section 37(1):

7. While the questions framed by the Appellant-Revenue simply entailed interpretation of Section 43A of the Act, we were also keen that the parties also address us on Section 37(1) of the Act, since we are of the view that the issue at hand also involves examining interpreting whether the loss in question, *de hors* the implications of Section 43A of the Act, could be regarded as revenue expenditure. Both parties have addressed us at length on the issue.

8. Extracts from Section 43A, relevant to the matter at hand, are set out below:-

> ***Special provisions consequential to changes in rate of exchange of currency.***
>
> *43A.* ***Notwithstanding anything contained*** *in any other provision of this Act,* ***where an assessee has acquired any asset in any previous year from a country outside India for the purposes of his business or profession*** *and,* ***in consequence of a change in the rate of exchange*** *during any previous year after the acquisition of such asset,* ***there is an increase or reduction in the liability of the assessee as expressed in Indian currency*** *(as compared to the liability existing at the time of acquisition of the asset)* ***at the time of making payment****-*
>
> *(a) towards the whole or a part of the cost of the asset; or*
>
> *(b)* ***towards repayment of the whole or a part of the moneys borrowed by him from any person****, directly or indirectly,* ***in any***

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

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

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

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

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

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

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

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

Provided** that ***

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

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

(b) "foreign currency" and "Indian currency" have the meanings respectively assigned to them in section 2 of the Foreign Exchange

Management Act, 1999 (42 of 1999).

*Explanation 2.******

*Explanation 3. ******

[Emphasis Supplied]

9. It would be apparent from a plain reading of the foregoing, that Section 43A imposes a positive obligation to capitalise losses arising out of exchange rate fluctuation in servicing a foreign currency loan taken for import of an asset from a country outside India for business of profession. That positive obligation, introduced with a non-obstante provision, would have to be met where the loan is intended to finance import of a capital asset. The jurisdictional fact for attracting Section 43A is that the territory from which the asset is acquired is outside India and the asset is brought into India. To that extent, there can be, and there is, no quarrel between the parties about the need to capitalise the amount of Rs. 51,86,755/- which is the proportionate component of the losses when they are broken up in the ratio of the value of assets acquired from outside India and from within India.

10. As regards the balance component of the foreign exchange losses, the question that emerges is whether, by default,

such component would automatically be treated as revenue expenditure under Section 37(1) of the Act. Relevant extracts from the said provision (shorn of the *Explanations* to the provision, which are not relevant to the matter at hand), for felicity, are set out below:-

> *"**General.***
> *37(1). Any **expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee**), laid out or **expended wholly and exclusively for the purposes of the business or profession** shall **be allowed in computing the income chargeable** under the head "Profits and gains of business or profession".*
>
> ***[Emphasis Supplied]***

11. From a plain reading of the foregoing, it would be clear that the first ingredient of the provision is that the expenditure in question must not be expenditure covered by Section 30 to Section 36 of the Act. The second ingredient of the provision is that the expenditure in question must not be capital expenditure. The third ingredient is that it should have been wholly expended for purposes of the business.

12. The parties are *ad idem* that the foreign exchange rate-

induced losses involved in the matter at hand, are not covered by the aforesaid range of sections of the Act, and that it has to be considered on the touchstone of Section 37(1) of the Act. The parties are also clear that the losses have been incurred pursuant to the borrowing in foreign exchange and that the borrowings have been deployed entirely to acquire assets – some from outside India and the balance from within India. What the parties have serious divergence on, is whether the expenditure in question (the expenditure other than the component that the Respondent-Assessee has capitalised of its own accord in its tax returns) can be regarded as not being in the nature of capital expenditure.

13. It is apparent that the controversy dealt with by the ITAT was about the scope of Section 43A which, as a matter of jurisdictional fact, requires the asset financed by the foreign currency loan to have brought into India from a country outside India. It was also important for the ITAT to examine whether, on its own merit, such expenditure would qualify as revenue expenditure for purposes of Section 37(1) of the Act, and towards that end, whether it can be stated conclusively that such

expenditure cannot be regarded as capital expenditure. Such analysis is missing in the proceedings that led to the Impugned Order.

Accounting Standard (AS) 11 and its amendment:

14. It is noteworthy that on March 31, 2009, the Ministry of Corporate Affairs, Government of India, issued a notification amending AS-11, which is the accounting standard under the Companies Act, 1956, that dealt with "*The Effects of Changes in Foreign Exchange Rates*". Such amendment provided an option to the reporting enterprise to irrevocably, for the period between December 7, 2006 and March 31, 2011, treat exchange rate differences, insofar as they relate to acquisition of a depreciable capital asset, to be added to or deducted from the cost of the asset, and thereby be depreciated over the balance life of the asset. Alternatively, the difference arising out of exchange rate fluctuation could be accumulated in a "*Foreign Currency Monetary Item Translation Difference Account*", to be amortised over the balance period of such long-term asset or liability, but not beyond

March 31, 2011.

15. Since the notification was issued on March 31, 2009, any difference pertaining to the accounting period that had commenced after December 7, 2006 and already previously recognized in the profit and loss account before the exercise of the option enabled on March 31, 2009, could also be reversed to the extent such exchange rate fluctuation related to the acquisition of a depreciable capital asset. The reporting enterprise was required to state the fact of exercise of such option in its financial statements.

16. In the case at hand, the Respondent-Assessee opted for capitalizing and adding the expense arising out of exchange rate fluctuation on its foreign currency loan to the cost of the capital asset. Such election was under AS-11 and therefore, obviously, regardless of whether the assets financed thereby had been imported from outside India or acquired locally in India. It is trite law that accounting treatment in the commercial books is no conclusive indication of treatment in the tax returns, and one must have regard to the legislative stipulation in the tax legislation to

ascertain if the expense is allowable as revenue expenditure or is to be capitalised as a capital expenditure. It is in this context that we are of the view that Section 37(1) must necessarily be dealt with.

Positive Mandate of 43A vs. Negative Caveat in 37(1):

17. It is apparent that to attract the mandatory obligation to capitalise the expense relating to exchange rate fluctuation under Section 43A, the ingredients of Section 43A have to be attracted. The essential jurisdictional fact for the mandatory capitalisation of such an expense under Section 43A is that the capital asset financed by the foreign currency loan in question, must have been brought into India from a country outside India. To the extent the loan was utilised for such an import, even the Respondent-Assessee has without demur, capitalised the loss on exchange rate fluctuation in servicing the loan, to add to the cost of the asset.

18. However, looking at the ingredients of Section 37(1) of the Act, we believe it would be necessary to look at the substance of the expenditure and come to a view that it is not in the nature of

capital expenditure, for it to qualify as revenue expenditure for purposes of Section 37(1). The gap in the Impugned Order is that the analysis on whether the expenditure in question cannot be regarded as capital expenditure, is missing.

Wipro and implications:

19. Towards this end, pursuant to our queries, Mr. Nitesh Joshi, Learned Counsel for the Respondent-Assessee took us through various judgments, and in particular, the judgement in *Wipro Finance Ltd. v. Commissioner of Income-Tax*[1] (***Wipro***), a decision by a three-judge bench of the Supreme Court, that overturned a decision of a Division Bench of the Karnataka High Court. In ***Wipro***, the issue at hand had been the treatment of exchange rate fluctuation relating to foreign currency loan connected to acquisition of plant and machinery for purposes of determining the nature of expenditure. Section 43A of the Act had no relevance for ***Wipro***. The Karnataka High Court had taken a view that the expense arising out of foreign exchange fluctuation ought to be treated as capital expenditure, *inter alia* on the premise

[1] *[2022] 443 ITR 250 (SC)*

that there was no direct link between the loan availed of and the title to the assets acquired by the Assessee. The High Court had taken the view that the ITAT had been wrong in allowing the losses as revenue expenditure by stating that the ITAT's decision to allow the losses as revenue expenditure was not a reasoned order, when it reversed the view taken by the CIT-A. In contrast, the Supreme Court had held that it was the analysis of the ITAT and the conclusion of the ITAT that was relevant and accurate.

20. In ***Wipro***, the ITAT had stated that the foreign currency loan was not an "asset", and it was in fact a "liability". Therefore, the ITAT held that the objective for which the loan was taken was irrelevant for determining whether the exchange rate fluctuation led to a revenue expenditure. The ITAT had stated that what may be a capital receipt in the hands of a payee would not necessarily become capital expenditure in the hand of a payer. There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may be treated as revenue expenditure, and not every advantage of an enduring nature would automatically result in an expenditure being capital expenditure. Specifically, it

had been held by the ITAT that what is material to consider is the nature of the advantage in a commercial sense. It is only upon a determination that the advantage is in the capital field that the expenditure would be disallowable as a revenue expenditure. The ITAT had held that what is an outflow of capital and what is an outflow of revenue, was to be assessed from the effect of the outflow with a practical and business point of view, and that question must be viewed in a larger context of business expediency or business necessity.

21. Quoting the aforesaid findings of the ITAT with approval, the Supreme Court held that they were very relevant, which the High Court missed, in wrongly reversing the findings of the ITAT. The Supreme Court explicitly refused to be drawn into the relevance of Section 43A of the Act stating that issue could be totally irrelevant for a pure determination of whether an expenditure is in the nature of capital expenditure or revenue expenditure.

22. We find that the exposition of the law in ***Wipro*** makes it

clear that necessarily, the classification of expenditure between the nature of "capital" and "revenue" is a mixed question of fact and law. The ingredients and the tests for the determination of such mixed question of fact and law have been spelt out in ***Wipro***. When we apply these principles to the matter at hand, in assessing the accuracy of the Impugned Order, we unfortunately find that we do not have the benefit of any articulation by the ITAT as had been available from the ITAT in the case of ***Wipro***. In fact, the ruling in ***Wipro*** would require that the facets articulated by the ITAT in that case would be necessary for ascertaining of the expenditure is revenue in nature or capital in nature.

23. The issue framed in the cross-appeals before the ITAT in the instant case, insofar as it related to the treatment of exchange rate losses in the tax accounts, was restricted to whether Section 43A was attracted. In our opinion, considering that our jurisdiction is a jurisdiction on deciding substantial questions of law, not having the benefit of a detailed articulation of the issue with particular regard to the facts involved, we believe it would be just and fair to request the ITAT to specifically return findings on this

facet of the matter, applying its mind to ***Wipro***, and also to the case law cited by the Revenue.

24. We find that the Impugned Order simply records the contentions and the case law cited by both sides, and deals with the issue on the premise that the accounting method followed by the Assessee consistently in the past has to be presumed to be correct unless the AO comes to the view that the accounts do not present a true and fair view of the state of affairs. The AO had accepted, the ITAT ruled, the book results of the Assessee and adopted the returned income, without finding any defects in the books of accounts.

25. We are afraid, that the articulation on what is essentially a mixed question of fact and law, with a requirement to delve deep into the factual and qualitative facets of the matter (on the lines articulated by the ITAT and endorsed by the Supreme Court in ***Wipro***) would be necessary, for a High Court adjudicating substantial questions of law, to appropriately exercise its jurisdiction.

26. Findings by the ITAT on these facets would enable us to take a view one way or the other, and unfortunately, such findings are not available on the record. However, the focus of the proceedings below had been simply on the import of Section 43A and we have no benefit of any articulation on applying Section 37(1) of the Act. The Impugned Order simply deals with the issue on the principle of consistency in accounting without articulating and adjudicating the import of Section 43A and its interplay with Section 37(1). Moreover, the very fact that AS-11 was amended on March 31, 2009, and the stance in the commercial books of accounts is driven by the option provided by such amended AS-11, underlines the need for a qualitative analysis of the fact of exchange rate losses from the ITAT. We are therefore constrained in adjudicating this Appeal, without having the benefit of an objective finding of fact in the matter.

27. Consequently, we are left with no option but to remand the matter to the ITAT for an effective adjudication of this specific issue. We believe it would be inappropriate for us to deal with the issue in its entirety for the first time in the High Court, and that

too, in exercise of the jurisdiction of determining substantial questions of law, on a matter which would involve returning findings on fact in order to answer mixed questions of fact and law.

28. It would be appropriate for the Assessee and the Revenue to address the ITAT on all facets of facts and the case law that had been cited before us in a bid to canvas the correct treatment of losses arising due to exchange rate fluctuation, essentially keeping in mind, the import of Section 37(1) of the Act.

29. Section 43A contains a positive enjoinment that losses due to exchange rate changes on a foreign currency loan taken for import of a capital asset must not be treated as revenue expenditure. This is why Section 43A is a *non-obstante* provision, that positively imposes such obligation notwithstanding anything contained in the Act. However, that positive obligation would not necessarily mean the converse – that any loss on exchange rate fluctuation on a foreign currency loan taken for acquiring capital assets would necessarily not be a capital expenditure, only because

the assets were not imported into India from abroad.

30. It is made clear that the relevance of whether the fluctuation results in erosion of an asset's value or in enhancement of a liability's size, can also be fully articulated by the parties before the ITAT – this was a facet hotly contested before us.

31. To be clear, the question to be answered by the ITAT on remand is as follows:-

> *Whether the expenditure in the sum of Rs. Rs.4,78,38,245/- that has been disallowed by the AO and the CIT-A, and allowed by the ITAT, would on its own showing (de hors Section 43A that contains a positive enjoinment of treating such exchange rate losses relating to foreign currency loan deployed to import assets as capital expenditure), qualify as not being capital expenditure, so that it can be considered towards allowance as revenue expenditure under Section 37(1).*

32. We are deeply conscious that this Appeal pertains to the

Assessment Year 2009-10. By the time this litigation came to be filed in the High Court, after traveling through two rounds of appeal, it was October 2017. Final hearing of this appeal took place in 2024. The scope of remand being limited, as articulated above, we trust the ITAT would deal with the remanded proceedings at its earliest possible convenience, bearing in mind the vintage of the proceedings. Both the Revenue and the Assessee are also requested to extend full cooperation to the ITAT by participating in the hearings expeditiously, without seeking unnecessary adjournments, so as to enable the ITAT to deal with the issue at the earliest.

33. We also make it clear that nothing contained in this judgement and order is to be regarded as an expression of our opinion on the merits of the issue being remanded to the ITAT.

34. The Appeal is ***disposed of*** in the aforesaid terms. There shall be no order as to costs.

[SOMASEKHAR SUNDARESAN, J.] **[G. S. KULKARNI, J.]**