

IN THE INCOME TAX APPELLATE TRIBUNAL, BENCH 'A' KOLKATA

[Before Hon'ble Shri P.M.Jagtap, AM & Shri S.S.Viswanethra Ravi, JM]

ITA No.1533/Kol/2015
Assessment Year : 2004-05

Haldia Petrochemicals Ltd.
Kolkata
(PAN : AAACH 7360 R)
(Appellant)

-versus-

A.C.I.T., Circle-8
Kolkata
(Respondent)

ITA No.168/Kol/2016
Assessment Year : 2004-05

D.C.I.T., Circle-11(1)
Kolkata
(Appellant)

-versus-

Haldia Petrochemicals Ltd.
Kolkata
(PAN: AAACH 7360 R)
(Respondent)

For the Assessee : Shri Harakamal Chakravorty, AR

For the Respondent: Shr P.K.Srihari, CIT

Date of Hearing : 09.05.2018.

Date of Pronouncement : 06.07.2018.

ORDER

Per S.S.Viswanethra Ravi, JM

Both these appeals by the assessee and Revenue are against common order dated 03.12.2015 passed by C.I.T-(A)-16, Kolkata for A.Y.2004-05.

2. The Id. AR submits that the issues raised in both the appeals are based on similar identical facts and therefore, we proceed to hear the appeals together and pass a consolidated order for the sake of convenience.

3. First we take up appeal of the assessee in ITA No.1533/Kol/2015.

4. The assessee apart from grounds of appeal raised initially and filed an application to take up the additional grounds. The said additional grounds are reproduced herein below :-

“A. On assessment under the normal provisions of the Act

1. Without prejudice to the grounds of appeal already submitted, the Appellant submits that the incentives received by the Appellant under the Incentive Scheme 1999 from the GOWB is a capital receipt and consequently not liable for Income-tax.

B. On assessment under MAT

2. Without prejudice to the grounds of appeal already submitted, the Appellant submits that the incentives received by the Appellant under the Incentive Scheme 1999 from the GOWB is a capital receipt and consequently not liable for Income-tax u/s 115JB of the Income-tax' Act. “

5. We find the issues raised in the additional grounds are covered by the decision of the Coordinate Bench of this Tribunal in the case of DCIT vs South Asian Petrochem Ltd in ITA No.1222/Kol/2014 for A.Y.2006-07 dated 03.05.2017 placed at page 156 of paper book. The relevant portion of which is reproduced herein below :-

“9. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position. The issue in the instant case relates to the taxability of subsidy received by the assessee from the Government of the West Bengal. There is no dispute with regard to the facts of the case of which have been elaborated in the foregoing paragraphs and therefore the same are not repeated for the sake of brevity. The issue before us for our adjudication is whether the impugned subsidy received by the assessee is "revenue in nature" or "capital in nature". If it is revenue in nature then it is liable to be taxed and in case it is capital in nature then it is not taxable under the provisions of Act. At this juncture, we find important to highlight the objects of West Bengal Incentive Scheme 1999, the preamble of the scheme reads as under:

"WHEREAS the Governor is of the opinion that it is necessary and expedient to extend incentive for the promotion of promotion of industries in this State"

Clause 4 of the said Scheme further lays down the applicability of the Scheme which read as follows:-

"The 1999 Scheme shall generally be applicable to all large, medium, cottage and small-scale projects and tourism units in large/medium sector to be set up and also expansion projects of existing units on or after 1st April 1999 in the private sector, co-operative sector, joint sector as also companies / undertakings owned and managed by State Government."

A plain look at the above scheme makes it clear that the incentive was being provided by the Government of West Bengal to promote the industries. The impugned incentive has nothing to do with the operational cost of the company. Similarly the manner in which the subsidy was computed has no role in deciding the nature of the subsidy. The assessee in the instant case has established a new industrial undertaking for the manufacture of "Bottle Grade Polyester Chips with a capacity of 140000 tonnes". Therefore the subsidy was given to assessee for the establishment of new industrial unit. The Hon'ble jurisdictional High Court in the case of CIT Vs. Rasoi Limited reported in 335 ITR 438 (Cal) has held that the Sales Tax Incentive granted by the West Bengal Government to the assessee with the object to provide incentive to set up new industrial undertaking or substantial expansion of the existing undertakings was capital receipt and not revenue in nature. The relevant extract of the judgment is extracted below:-

"From the objects and the reasons of the scheme of industrial promotion as well as the entitlement as indicated in s. 3 thereof it is clear that the Government has decided to grant the subsidy by way of financial assistance to tide over the period of crisis for promotion of the industries mentioned in the scheme which have the manufacturing units in West Bengal and which are in need of financial assistance for expansion of their capacities, modernization, and improving their marketing capabilities and such subsidy for the financial year in question was only for that year and was equivalent to ninety per centum of the amount of sales-tax paid by the industry concerned, for any quarter under the Sales-tax Act in respect of sales of such goods. The object of the subsidy is for expansion of their capacities, modernization, and improving their marketing capabilities and thus, those are for the assistance on capital account. Similarly, merely because the amount of subsidy was equivalent to 90 per cent of the sales-tax paid by the beneficiary does not imply that the same was in the form of refund of sales-tax paid. It is the quality of the payment that is decisive of the character of the payment and not the method of the payment or its measure, and makes it fall within capital or revenue. Thus, the amount paid as subsidy was really capital in nature.--CIT vs. Ponni Sugars & Chemicals Ltd. & Ors. (2008) 219 CTR (SC) 105 : (2008) 13 DTR (SC) 1 : (2008) 306 ITR 392 (SC) relied on; Senairam Doongarmall vs. CITAIR 1961 SC 1579 applied; CIT vs. Abhishek Industries Ltd. (2006) 205 CTR (P&H) 304 : (2006) 156 Taxman 257 (P&H) distinguished.

Subsidy received by assessee from the State Government under a scheme of industrial promotion which was meant to provide financial assistance to

specified industries for expansion of capacities, modernization and improving their marketing capabilities is capital receipt though the amount of subsidy is equivalent to 90 per cent of the sales-tax paid by the beneficiary."

9.1 The above judgement was delivered by the Hon'ble High Court of Calcutta after having reliance in the judgement of Hon'ble Supreme Court in the case of *CIT vs Ponni Sugars and Chemicals Limited* reported in 306 ITR 392 (SC) wherein it was held as under:-

*"The character of the receipt in the hands of the assessee has to be determined with respect to the purpose for which the subsidy is given. In other words, in such cases, one has to apply the purpose test. If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account. Therefore, it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. The form or the mechanism through which the subsidy is given is irrelevant. In the present case, receipt of the subsidy was capital in nature as the assessee was obliged to utilize the subsidy only for repayment of term loans undertaken by the assessee for setting up new units/expansion of existing business. Keeping in mind the object behind the payment of the incentive subsidy such payment received by the assessee under the Scheme ITA No.1222-1224/Kol/2014 A.Y. 06-07 to 07-08 & 09-10 DCIT,CC-XVI Kol. Vs. SAP Ltd. Page 7 was not in the course of a trade but was of capital nature.--*Sahney Steel & Press Works Ltd. & Ors. vs. CIT* (1997) 142 CTR (SC) 261 : (1997) 228 ITR 253 (SC) and *Seaham Harbour Dock Co. vs. Crook* (1931) 16 Tax Cases 333 (HL) applied."*

The case law i.e. *Sahney Steel & Press works Ltd vs. CIT* reported in 228 ITR 253 relied by the ld CIT(A) is distinguishable from the instant facts of the case. In that case the subsidy was provided to assist/ enable the assessee in carrying on its trade or business in more profitable manner. The subsidy was provided only after the set up of industry. Payments were not being made in the form of subsidy for the purpose of setting up of the industries.

Similarly the Kolkata Tribunal in the case of *DCIT vs Teesta Agro Industries Ltd.* in ITA No. 1237, 1053, 1753/Kol/2010 vide order dated 07.01.2011 has observed that the subsidy given in the form of the remission of sales-tax under the West Bengal State Incentive Scheme 1999 is in the nature of capital receipt and therefore not assessable to income tax. In view of above, we are of the opinion that the impugned subsidy is capital in nature and therefore not liable to tax. Simply the assessee has inadvertently offered the same to tax does not mean the capital receipt has become taxable.

9.2 Similarly the impugned receipt of subsidy will not be taxable being capital in nature under the provisions of MAT. *Under the Act*, income is chargeable to tax when it comes within the definition of income as specified u/s 2(24) of the Act. The Hon'ble Supreme Court in the case of Padmaraje R Kadambande Vs CIT reported in 195 ITR 877 (SC) has held that capital receipts are not income within the meaning of *section 2(24)* of the Act and hence not chargeable to tax. When a receipt cannot be brought to tax under the computation of income under the normal provisions as well as under the deeming provisions of the Act, then such receipt is out of the purview of the provisions of *section 115JB* of the Act. We find the decisions in support of this proposition that a capital receipt which is not chargeable to tax under any provisions of the Act would not be liable for book profits tax u/s 115JB of the Act which was rendered after considering the decisions of Hyderabad Special Bench in *Rain Commodities Rain Commodities Ltd vs DCIT*, 41 DTR 449, and the decision of Hon'ble Apex Court in *Apollo Tyres Ltd. vs. CIT* (2002) reported in 255 ITR 273 (SC). The Hon'ble Kolkata Tribunal also in the case of *Binani Industries Ltd., vs DCIT* in ITA No.1222-1224/Kol/2014 A.Y. 06-07 to 07-08 & 09-10 DCIT,CC-XVI Kol. Vs. SAP Ltd. Page 8 ITA No.144/Kol/2013 A.Y 2009-10 vide order dated 02-03-2016 has allowed the issue in favour of assessee as detailed under :

The issue in the above case was raised as under :

"The last issue to be decided in this appeal is as to whether, the forfeiture of share warrants amounting to Rs. 12,65,75,000/-, being a capital receipt, would be liable for taxation u/s 115JB of the Act just because it has been credited in the profit and loss account as an extraordinary item, in the facts and circumstances of the case.

The relevant operative portion of the order reads as under :

"28. In view of the foregoing discussions, we find merit in the contentions of the assessee that the profit arising on transfer of capital asset to its wholly owned Indian subsidiary company is liable to be excluded from the Net profit., i.e., the Net profit disclosed in the Profit and Loss account should be reduced by the amount of profit arising on transfer of capital asset and the amount so arrived at shall be taken as "Net profit as shown in the profit and loss account" for the purpose of computation of book profit under Explanation 1 to sec. 115JB of the Act. Alternatively, since the said profit does not fall under the definition of "income" at all and since it does not enter into the computation provisions at all, there is no question of including the same in the Book Profit as per the scheme of the provisions of sec. 115JB of the Act. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and direct the AO to exclude the above said profit from the computation of "Book Profit" for the reasons discussed above.

*In the instant case, the assessee also has duly disclosed the fact of forfeiture of share warrants amounting to Rs. 12,65,75,000/- in its notes on accounts vide Note No. 6 to Schedule 11 of Financial Statements for the year ended 31.3.2009. Hence respectfully following the aforesaid decision of the Mumbai Tribunal, the profit and loss account prepared in accordance with Part II and III of Schedule VI of Companies Act 1956, includes notes on accounts thereon and accordingly in order to determine the real profit of the assessee as laid down by the Hon'ble Apex Court in the case of *Indo Rama Synthetics (I) Ltd vs CIT* reported in (2011) 330 ITR 363 (SC), adjustment need to be made to the disclosures made in the notes on accounts forming part of the profit and loss account of the assessee and the profits arrived after such adjustment, should be considered for the purpose of computation of book profits u/s 115JB of the Act and thereafter, the Learned AO has to make adjustments for additions / deletions contemplated in Explanation to section 115JB of the Act."*

In view of the aforesaid facts and respectfully following the various judicial precedents relied upon hereinabove, we find no infirmity in the order passed by the Ld CIT(A) in this regard and accordingly we uphold the same. The ground raised by the Revenue is dismissed."

6. In view of the above findings of the Coordinate Bench we hold that the subsidy received by the assessee from Government of West Bengal under Incentive Scheme 1999 is a capital receipt is not taxable under normal provision of Act. Though it is a capital receipt is not liable for consideration under book profit under MAT proceedings u/s 115JB of the Act. Order of the CIT(A) is set aside. The additional ground Nos. 1 and 2 raised by the assessee are allowed.

7. Ground Nos. 1 (a) and (b) are relating to confirmation of expenses made on account deferred revenue expenditure.

8. We find this issue is covered by a consolidated order dated 29.07.2016 in assessee's own case for A.Ys 2006-07 and 2007-08. The relevant portion of which is reproduced herein below :-

"4. The next issue involved in Grounds No. 2 & 3 in assessee's appeal for A.Y. 2006-07 relates to the assessee's claim for deduction on account of deferred revenue expenses and the same is raised by way of the following grounds:-

"(2) For that the CIT(A) erred in holding that deferred revenue expenses amounting to Rs.15,46,30,000/- were not deductible in computing income under the *Income Tax Act*.

(3) For that the CIT(A) erred in dismissing the alternative ground that the deferred revenue expenses amounting to Rs.15,46,30,000/- were required to be included in the actual cost of the assets for allowing depreciation under *section 32* of the *Income Tax Act*.

5. The assessee in the present case is a Company, which is engaged in the business of manufacturing and sale of Polymers and other Petrochemical Products. The return of income for the year under consideration, i.e. A.Y. 2006-07 was filed by it on 17.11.2006 declaring total income at 'nil'. In the Profit & Loss Account filed along with the said return, a sum of Rs.160.67 millions was debited by the assessee on account of amortization of miscellaneous expenditure. In support of its claim for the said deduction, it was explained by the assessee that indirect expenditure of Rs.805.65 millions was incurred by it before the commencement of commercial production on 01.08.2001 and the same was written off over a period of five years beginning from assessment year 2002-03. It was claimed that the expenditure so incurred was in the nature of revenue and the same, therefore, was allowable as deduction being deferred revenue expenditure. The Assessing Officer did not find merit in the claim made by the assessee on this count and disallowed the deduction claimed by the assessee on account of deferred revenue expenditure holding that there was no provision in the Act for allowing such deduction. On appeal, the Id. CIT(Appeals) confirmed the disallowance made by the Assessing Officer on this issue.

. At the time of hearing before us, the Id. representatives of both the sides have agreed that this issue is squarely covered in favour of the assessee by the decision of this Tribunal rendered in assessee's own case for A.Y. 2005-06 vide its order dated 13.04.2016 passed in ITA Nos. 581 & 587/KOL/2009, wherein the alternative claim of the assessee as raised in Ground No. 3 of the present appeal to include the deferred revenue expenditure in the actual cost of the assets for allowing depreciation under *section 32* of the Act was allowed by the Tribunal for the following reasons given in paragraph no. 17 of its order:-

"17. From the aforesaid discussion, we find that the assessee has incurred expenses prior to the commencement of business and classified as deferred revenue expenditure. The assessee started claiming those expenses after the commencement of business 1/5th over the period of 5 years. However, the lower authorities disallowed the same on the ground that there is no provision under the Act to claim the deferred revenue expenses. From the facts of the case we observe that the AO is not skeptical about the genuineness of the expenses incurred. The whole amount of Rs. 154.64 million has been incurred in connection of business prior to the commencement of commercial production. Any expense incurred in connection to the business is an allowable expenditure. From the above explained

citations of the cases denying the non existence of deferred revenue expenditure term in the act is not reasonable and tenable. In our considered view, all the expenses incurred prior to the commencement of production should be capitalized with the fixed assets of the assessee and depreciation should be allowed thereon accordingly as per law. In this connection, we are relying in the decision of Hon'ble Supreme Court in the case of [Challapalli Sugars Ltd v. CIT](#) (1975) 98 ITR 167 (SC) where the head notes is as reproduced:-

"As the expression "actual cost" has not been defined, it should be construed in the sense which no commercial man would misunderstand. For this purpose it would be necessary to ascertain the connotation of the expression in accordance with the normal rules of accountancy prevailing in commerce and industry. The accepted accountancy rule for determining cost of fixed assets is to include all expenditure necessary to bring such assets into existence and to put them in working condition. In case money is borrowed by a newly started company which is in the process of constructing and erecting its plan, the interest incurred before the commencement of production on such borrowed money can be capitalized and added to the cost of the fixed assets created as a result of such expenditure.

We are also relying in the guidance note issued by the Institute of Chartered Accountant of India on treatment of expenditure during construction period where it was recommended that the indirect expenditure incurred during the construction period should be capitalized as part of indirect construction cost to the extent to which the expenditure is indirectly related to construction or if incidental thereto. An illustrative list of such possible items of expenditure which would qualify for inclusion for the purpose of capitalization has been provided including the following:-

- "(a) Expenditure on employees who are either assigned to construction work or to supervision over construction work including salaries, provident fund and other benefits, staff welfare expenses, etc.*
- (b) Expenditure on technical and other consultants.*
- (c) General administrative and office expenditure which is indirectly related or incidental to construction, including, as may be appropriate, stationery and printing, rent, rates and taxes, postage and telegrams, travel and conveyance etc.*
- (d) Appropriate insurance charges.*
- (e) Appropriate expenditures on maintenance and operation of vehicles.*
- (f) Appropriate expenditures in connection with temporary structures and service facilities built or acquired specially for the purpose of construction (see paragraphs 9.4 and 9.5 of this Note).*
- (g) Preliminary project expenditure to the extent to which it is capitalized as part of the construction cost (see paragraph 3 of this Note).*

(h) Financial expenses including interest and other similar charges (see paragraph 4 of the Note).

(i) Depreciation on fixed assets as well as on temporary structure and other facilities used during the period of construction (see paragraph 9.4 and 9.5 of this Note).

(j) Expenses on test runs (see paragraph 11 of this Note).

(k) Expenses on land grading and leveling (see paragraph 96 of this Note).

Taking a consistent view by the decision of Hon'ble Supreme Court and reliance in the aforesaid guidance note we reverse the orders of authorities below. Hence, this ground of the assessee is allowed".

Respectfully following the order of the Tribunal dated 13.04.2016 (supra) in assessee's own case on a similar issue for A.Y. 2005-06, we decide this issue in favour of the assessee and allow Ground No. 3 of its appeal."

9. In view of the above, we set aside the order of CIT(A) and delete the addition made on account of deferred expenditure. Ground nos. 1(a) and (b) raised by the assessee are allowed.

10. Ground No.2 is relating to the questioning the action of CIT(A) in directing the AO to compute the disallowance @ 1% for the purpose of section 14A of the Act. We find the issue is covered by a consolidated order dated 29.07.2017 in assessee's own case for A.Y.2006-07 and 2007-08. The relevant portion of which is reproduced herein below :-

"7. The issue involved in Ground No. 4 of the assessee's appeal for A.Y. 2006-07 relates to the disallowance of Rs.4,83,40,000/- made by the Assessing Officer and confirmed by the ld. CIT(Appeals) under [section 14A](#) of the Income Tax Act, 1961 read with Rule 8D of the Income Tax Rules, 1962.

8. In its return of income filed for the year under consideration, i.e. A.Y. 2006-07, dividend income earned by the assessee amounting to Rs.39.30 crores was claimed to be exempt under [section 10\(34\)](#) of the Act. No disallowance on account of expenditure incurred in relation to the said exempt income, however, was offered by the assessee as required by the provisions of [section 14A](#) on the ground that no such expenditure was actually incurred by it. The Assessing Officer did not accept the stand of the assessee and computed the expenditure incurred by the assessee in relation to the exempt dividend income by applying Rule 8D at Rs.48.34 million and made a disallowance to that extent under [section 14A](#). On appeal, the ld. CIT(Appeals) confirmed the disallowance made by the Assessing Officer on this issue.

9. At the time of hearing before us, the ld. representatives of both the sides have agreed that a similar issue relating to the disallowance made under [section 14A](#) has already been decided by the Tribunal in assessee's own case for A.Y. 2005-06 vide paragraph no. 25 of its order dated 13.04.2016 (*supra*), which reads as under:-

"25. We have heard rival contentions and perused the materials available on record. Before us Ld. AR submitted that under [section 14A\(1\)](#) disallowance can be made only in respect of "expenditure incurred." Here the assessee has not incurred any expenditure in relation to dividend income. Hence Provision of [section 14A](#) do not apply at all. Assessee has relied on citation of the following cases:

1. [CIT vs. Hero Cycles Ltd](#) [323 ITR 518]- P&H High Court
2. [Maxopp Investment Limited vs. CIT](#) [(2012)347 ITR 272 (Delhi High Court)]
3. [CIT vs. Torrent Power Ltd.](#) [2014] 363 ITR 474 (Gujarat High Court)

It was held that Rule 8D was not applicable in the AY 2005-06 to 2007- 08. Rule 8D came into existence from 24.03.2008 and hence it was not applicable for the assessment year under consideration. In this support Ld.AR has relied on the judgement of Bombay High Court in case of Godrej & Boyce Mfg. Co. Ltd., Mumbai Vs. DCIT [(2010) 328 ITR 81 (Bom)].

On the other hand, Ld. DR vehemently relied on the orders of authorities Below. On perusal of appellate order, we find that direction has been issued to Assessing Officer for making disallowance in terms of provision of Sec. 14A r.w.s. 8D of the IT Rules, 1962. However we understand that the Rule 8D of the IT Rules came into effect from 24.03.2008 and the instant case before us is for AY 2005-06. Therefore, the provisions of Rule 8D of the IT Rules is not applicable in assessee's present case. We further find that prior to insertion of Rule 8D of the IT Rules various courts have held that the disallowance in terms of provision of Sec. 14A of the Act should be restricted @ 1% of dividend income. On the other hand the ld. DR vehemently supported the order of authorities below. However we disagree with the order of the lower authorities and put our reliance in GA No. 3019 of 2012 in ITAT No. 243 of 2012 of Hon'ble jurisdictional High Court in the case of [CIT v. M/s R.R.Sen & Brothers \(P\) Ltd.](#), where the Hon'ble court has held:

"The assessee did not show any expenditure incurred by him for the purpose of earning the money which is exempted under the income tax. The Tribunal has computed expenditure at 1 per cent of such dividend income which, according to them, is the thumb rule applied consistently. We find no reason to interfere. The appeal is dismissed."

In this view of the matter, we reverse the orders of authorities below and directed the Assessing Officer to make disallowance @ 1% of dividend income. Accordingly, this ground of assessee's appeal is allowed in part".

10. As the issue involved in the year under consideration as well as all the material facts relevant thereto are similar to that of A.Y. 2005-06, we respectfully follow the order of the Tribunal for A.Y. 2005-06 and direct the Assessing Officer to restrict the disallowance under [section 14A](#) to 1% of the exempt dividend income. Ground No. 4 of the assessee's appeal for A.Y. 2006-07 is thus partly allowed."

11. On perusal of the impugned order, we find that the CIT(A) by placing reliance on the decisions of ITAT Kolkata in the case of Civil Engineers Enterprises Pvt. Ltd in ITA No.859/Kol/2010 directed the AO to disallow 1% of dividend income at Rs.18,14,470/-. Therefore we find no infirmity in the order of CIT(A) . Ground no.2 raised by the assessee is dismissed.

12. Now we shall take up appeal of the Revenue in ITA No.168/Kol/2016.

13. Ground No.1 raised by the revenue challenging the action of CIT(A) in directing the AO to allow deduction u/s 35D of the Act. On perusal of page no.3 of AO's order we find the AO himself allowed deduction of Rs.6.50 million u/s 35D of the Act and was confirmed by the CIT(A) which is evident from para-3 of page-2 of impugned order. Therefore, ground No.1 raised by the revenue is misconceived and is dismissed.

14. Ground No.2 raised by the Revenue is relating to delation of disallowance of Rs.7,23,60,000/- made on account of loss for re-statement of foreign exchange. We find the issue is covered by the consolidated order in favour of the assessee in its own case in ITA No.581 & 587/Kol/2009 for A.Y.2005-06 placed at page 32 of paper book. The relevant portion of which is reproduced herein below :-

"28. The issue raised by Revenue in ground number 1 in this appeal is that learned CIT(A) erred in deleting the addition made by the AO for Rs.1,20,90,000/- on account of year end adjustment in loss on foreign exchange account due to revaluation of sundry creditors and SBI MMD ITA No.581 & 587/Kol/2009 A.Y.

2005-06 Haldia Petrochemicals Ltd. V. JCIT, Rng-12 Kol. Page 21 account. The assessee has debited the profit and loss account by an amount of Rs.1,20,90,000/- on account of difference arising from the foreign exchange in the value of sundry creditors account and MMD SBI account. The above said difference was recorded on the last day of the financial year while preparing the financial statements. The AO observed that it is a notional loss and represents contingent liabilities which have not been actually incurred by the assessee. Therefore the same was disallowed by the AO and added to the total income of the assessee.

29. Aggrieved, assessee preferred an appeal to learned CIT(A) where it was submitted that the assessee is following mercantile system of accounting. The difference on account of foreign exchange in the value of sundry creditors and SBI MMD account at the end of financial year was recorded in the profit and loss account in terms of accounting standard 11 issued by the Institute of Chartered Accountants of India. The assessee has also relied in the decision of Hon'ble Supreme Court in the case of Shri Sajjan Kumar Mills Limited versus Commissioner of income tax where it was held that the provisions in the accounts on account of difference in foreign exchange should be made by the company following mercantile system of accounting which are having effect on liabilities and as a result on the quantum of profits. It is well settled that pre-existing liabilities should be adjusted in the light of foreign exchange under mercantile system of accounting. The claim of the assessee cannot be denied merely on the ground that it is just a provision and no amount has been paid. Accordingly the learned CIT(A) has deleted the addition made by the AO by observing as under:-

"the appellant's contention in this regard is found to be acceptable, since the AR of the assessee vide his letter dt. 15.01.2009 has confirmed that the sundry creditors under this account were on revenue account and not on capital account. Since, it is submitted that such exchange fluctuation has arisen on account of normal business transactions of material procurement etc., it is an allowable deduction u/s. 37(1). I agree with the contention of the appellant and hence this ground is allowed."

Being aggrieved by this order of Ld. CIT(A) Revenue is in appeal before us.

30. We have heard rival contentions and perused the materials available on record. Before us Ld. DR vehemently supported the order of AO and on the other hand the learned AR relied on the order of Ld CIT(A) and filed a paper book which running from pages 1 to 97. From the aforesaid discussion, we find that the AO treated the difference arising on account of foreign exchange in the value of sundry creditors as notional loss and contingent liability which the assessee has not incurred so it was disallowed. However we strongly disagree with the view of the AO on the ground that this year and adjustment was made by the assessee in terms of AS 11 issued by ICAI and in pursuance of mercantile system of accounting as notified u/s 145 of the Act. The relevant extract of accounting standard 11 is reproduced below:-

"3.6 The Accounting Standards (A) 11, the Effects of changes in Foreign Exchange Rates (revised 2003), issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2004. Relevant extract of the Accounting Standard is reproduced as follows:-

'9. A foreign currency transactions should be recorded on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transactions.

10...

11 (a) At each balance sheet date foreign currency monetary items 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 realized from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g. where there are restrictions on 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 realized from, or required to disburse, such item at the balance sheet date:

11(b)...

11(c)...

12. Cash receivables and payables are examples of monetary items....

13. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise..."
At this juncture we also wish to reproduce the provisions of [section 145](#) of the Act which reads as under:-

"3.4 As per [section 145](#) of the Act, '(1) Income chargeable under the head "Profits and gains of business or profession" or "income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessee or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section

(2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in [section 144](#)."

31. We also find support from the decision of Hon'ble Delhi High Court in the case of [CIT vs Woodward Governor India Private Limited](#) [2007] 294 ITR 451 (Del) where it was held that:-

"We affirm the decision of the Income-tax Appellate Tribunal in Oil and natural Gas Corporation Ltd. V. Deputy CIT (Asstt.) [2003] 261 ITR (AT) 1 (Delhi) 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."

From the aforesaid discussion we find no reason to interfere in the order of Ld CIT(A) and accordingly we uphold. Hence this ground of Revenue's appeal is dismissed."

15. In view of the above we find no infirmity in the order of CIT(A). Accordingly ground no.2 raised by the Revenue is dismissed.

16. Ground No.3 is relating to deletion of addition made on account of freight charges. We find the issue raised by the Revenue is covered by the consolidated order in favour of the assessee in its own case in ITA No.581 & 587/Kol/2009 for A.Y.2005-06. The relevant portion of which is reproduced herein below :-

"32. The 2nd issue raised by Revenue in ground number 2 in this appeal is that learned CIT(A) erred in deleting the addition made by the AO for Rs.13,55,80,000/- on account of freight expenses.

33. During the year assessee has claimed net freight expenses incurred in connection with domestic, export of the goods and freight on stock transfer. The assessee has also recovered part of the freight charges from the customers incurred in connection with the sales. However the AO observed that expenses incurred on freight was more than the recovery made by the assessee from the customers. The AO also found that the claim of the assessee towards such freight expenses was also disallowed in the AYs 2003-04 and 2004-05, so the AO accordingly disallowed the claim of the assessee for freight expenses and added to the total income of the assessee.

34. Aggrieved, assessee is in appeal preferred an appeal to Ld CIT(A) where it was demonstrated that when the goods are sold to customers on delivery basis then the ITA No.1533/Kol/2015 & 168/Kol/2016 Haldia Petrochemicals A.Y.2004-05

assessee recovers freight charges from the customers as per the agreement but in some of the cases the freight charges are not recovered in full due to the competition in the market. Besides, assessee recovered the freight charges from the customers as per the agreed amount but on many occasions the assessee had borne more amount of freight charges over and above the amount agreed due to damages/detention charges, price increased due to increase in fuel cost. Moreover, the freight charges on the stock transfer from factories to depots are to be incurred by the assessee alone. The assessee submitted that for the earlier AYs 2003-04 and 2004-05 the freight charges were shown as receivable in the balance sheet of the respective years so the question of disallowance of freight expenses does not arise. However, in the instant case the freight expenses have been debited in the profit and loss account and nothing has been shown in the balance sheet as receivable. Finally, assessee prayed that these expenses are incurred in connection with the business only and are eligible for ITA No.581 & 587/Kol/2009 A.Y. 2005-06 Haldia Petrochemicals Ltd. V. JCIT, Rng-12 Kol. Page 25 deduction while computing the income under the head of "business". Accordingly the learned CIT(A) has deleted the addition made by the AO by observing as under:-

"This ground of the appellant is against disallowance of expenses of freight of Rs.13,55,80,000/-. The appellant during the relevant previous year has debited to the P & L a/c Rs.135.58 million under the heading 'freight charges'. Out of the said amount 46.99 million represents the element of freight cost in excess of recovery and 86.59 million representing freight charges on stock transfer which is not for any recovery or otherwise. The AO has disallowed the freight expenses on the ground that the freight charges is receivables of the appellant and in the nature of balance sheet item and hence the said disallowance was made. The AO has not disputed that these expenses were incurred by the appellant. The freight charges short received from customers can be for various reasons and the AO was not justified in disallowing the same only for the reason that they were recoverable from the customers. Such expenditure since has been incurred for the purposes of assessee's business is clearly an allowable item and as far as freight charges on stock transfer is concerned this is definitely expenditure incurred for business irrespective of the act that the same is recoverable or not from the customers, I find force in assessee's contentions in this regard, hence, this ground of the appellant is allowed."

Being aggrieved by this order of the learned CIT(A) Revenue is in appeal before us.

35. We have heard rival contentions and perused the materials available on record. Before us Ld. DR vehemently supported the order of AO and left the issue to the discretion of the Bench whereas Ld AR relied the order of Ld CIT(A). From the aforesaid rival materials, we find that the AO has disallowed the freight expenses on the ground that assessee has made short recovery from the customers and similar addition was made in the earlier assessment year. However, the AO has not disputed the quantum of expenses incurred by the assessee on freight. From the submission of Ld. AR we find that out of the total disallowance made by the AO towards freight expenses, a sum of Rs. 86,59,000/- was incurred on the stock transfer by the assessee

from the factory to the depots. In our view, the question of disallowance of freight expenses in connection with the stock transfer does not arise. This freight expense has direct connection with the business of the assessee. For other ITA No.581 & 587/Kol/2009 A.Y. 2005-06 Haldia Petrochemicals Ltd. V. JCIT, Rng-12 Kol. Page 26 freight expenses, the reason given by the AO for the disallowance is not tenable as the AO has not pointed out any reasonable reasons for the same. There is no doubt that the assessee had made short recovery from the customers but the reasons for the same were duly explained by the assessee. Accordingly the Ld. CIT(A) has given the relief to the assessee and on this point of view Ld. DR has not brought anything on record contrary to the findings of the Ld CIT(A). In view of above, we find no infirmity in the order of Ld CIT(A) and we uphold the same. Hence, this ground of Revenue's appeal is dismissed."

17. In view of the above we find no infirmity in the order of CIT(A). Accordingly ground no.3 raised by the Revenue is dismissed.

18. Ground No.4 is relating to restriction of disallowance @ 1% of dividend income as against 5% made by the AO. The issue raised in this ground is identical to the ground no.2 raised by the assessee in its appeal, wherein we confirmed the order of CIT(A) in directing the AO to make disallowance @1% of dividend income. We adopt the same and confirm the finding of the CIT(A). Accordingly ground no.4 raised by the revenue is dismissed.

19. In the result, the appeal of the assessee is partly allowed and appeal of the Revenue is dismissed.

Order pronounced in the open Court on 06.07.2018.

Sd/-

Sd/-

[P.M.Jagtap]
Accountant Member

[S.S.Viswanethra Ravi]
Judicial Member

Dated : 06.07.2018.

[RG Sr.PS]

Copy of the order forwarded to:

1. Halia Petrochemicals Ltd., 1, Auckland Place, Kolkata-700017.
2. ACIT-Circle-8, Kolkata/DCIT, Circle-11(1), Kolkata
3. C.I.T.(A)-16, Kolkata 4. C.I.T.-4, Kolkata.
5. CIT(DR), Kolkata Benches, Kolkata.

True Copy

By order,

Senior Private Secretary
Head of Office/D.D.O., ITAT, Kolkata Benches