

IN THE HIGH COURT OF UTTARANCHAL AT NAINITAL

COURT'S ORDER WHETHER THE CASE IS OR IS NOT
APPROVED FOR REPORTING

[Chapter VIII, Rule 32(2)(b)]
Description of case

Decided on: 17th Jan., 2008

I.Tax Appeal No. 74 of 2007

Along with

I.Tax Appeal No. 76 of 2007

And

I.Tax Appeal No. 77 of 2007

A.F.R. (Approved for Reporting)
Not approved for Reporting

Date. 17.01.2008

(Initial of Judge)

Reserved Judgment

IN THE HIGH COURT OF UTTARAKHAND AT NAINITAL

Income Tax Appeal No. 74 of 2007

1. The Commissioner of Income-tax, Dehradun.
2. Assistant Commissioner of Income-tax (OSD)
Range-1, Dehradun.

..... Appellants

Versus

M/s Enron Oil and Gas India Limited
C/o Nangia and Company,
757, Rajpur Road, Dehradun.

..... Respondent

Mr. Arvind Vashisth, Advocate for the appellants.
Mr. S. Ganesh, Sr. Advocate assisted by Mr. Tarun Gulati,
and Mr. Vipul Sharma, Advocates for the respondent.

Along with

Income Tax Appeal No. 76 of 2007

1. The Commissioner of Income-tax, Dehradun.
2. Assistant Commissioner of Income-tax (OSD)
Range-1, Dehradun.

..... Appellants

Versus

M/s Enron Oil and Gas India Limited
C/o Nangia and Company,
757, Rajpur Road, Dehradun.

.... Respondent

Mr. Arvind Vashisth, Advocate for the appellants.
Mr. Sudhanshu Dhulia, Sr. Advocate assisted by Mr. Vipul Sharma,
and Mr. Tarun Gulati, Advocates for the respondent.

And

Income Tax Appeal No. 77 of 2007

1. The Commissioner of Income-tax, Dehradun.
2. Assistant Commissioner of Income-tax (OSD)
Range-1, Dehradun.

..... Appellants

Versus

M/s Enron Oil and Gas India Limited
C/o Nangia and Company,
757, Rajpur Road, Dehradun.

..... Respondent

Mr. Arvind Vashisth, Advocate for the appellants.
Mr. Sudhanshu Dhulia, Sr. Advocate assisted by Mr. Vipul Sharma,
and Mr. Tarun Gulati, Advocates for the respondent.

Coram: Hon'ble Prafulla C. Pant, J.
Hon'ble Dharam Veer, J.

[Per Hon'ble Prafulla C. Pant, J.]

All these three appeals, are directed against the same judgment and order dated 29th September 2006, passed by the Income Tax Appellate Tribunal, Delhi Bench 'H', New Delhi, in Income Tax Appeal No. 1821 of 2005; Income Tax Appeal No. 1823 of 2005 and Income Tax Appeal No. 1824 of 2005, relating to assessment years 1999-2000, 2000-2001 and 1998-1999, respectively, whereby the depreciation on account of foreign exchange loss allowed to the assessee by the Commissioner of Income-tax

(Appeals), Dehradun, vide his order dated 11.02.2005, is affirmed.

2) Heard learned counsel for the parties and perused the record.

3) Following are the substantial questions of law involved in these appeals:

In I.T.A. No. 74 of 2007:

Whether, Income Tax Appellate Tribunal erred in law in upholding the decision of CIT(A) on facts and circumstances of the case, in allowing foreign exchange loss of Rs. 11,58,44,887/- under Section 42 of the Income Tax Act, 1961, without appreciating the fact that the loss is only a book entry and no loss was incurred by the company / assessee?

In I.T.A. No. 76 of 2007:

Whether, Income Tax Appellate Tribunal erred in law in upholding the decision of CIT(A) on facts and circumstances of the case, in allowing foreign exchange loss of Rs. 46,54,30,105/- under Section 42 of the Income Tax Act, 1961, without appreciating the fact that the loss is only a book entry and no loss was incurred by the company/ assessee?

In I.T.A. No. 77 of 2007:

Whether, Income Tax Appellate Tribunal erred in law in upholding the decision of CIT(A) on facts

and circumstances of the case, in allowing foreign exchange loss of Rs. 38,63,38,980/- under Section 42 of the Income Tax Act, 1961, without appreciating the fact that the loss is only a book entry and no loss was incurred by the company / assessee?

In substance, in all the three appeals the same question is to be decided, whether the foreign exchange loss claimed by the assessee company was admissible under Section 42(1) of the Income Tax Act, 1961, in terms of agreement entered into between the parties on account of foreign exchange loss?

BRIEF FACTS OF THE CASE:

4) M/s Enron Oil and Gas India Limited (in short hereinafter referred as EOGIL) is a non-resident company (NRC), engaged during the relevant assessment years viz. 1998-1999; 1999-2000 and 2000-2001, in production of crude oil from Panna and Mukta oil fields along with its joint venture partners M/s Oil and Natural Gas Corporation Limited and M/s Reliance Industries Limited under the Production Sharing Contracts entered with the Government of India. During the assessment year 1998-1999, the assessee NRC has debited foreign exchange loss of Rs. 46,54,30,105/- to its Profit and Loss account (P&L) account). During the assessment year 1999- 2000, the assessee NRC has debited foreign exchange loss of Rs. 38,63,38,980/- to its P&L account. And, during the assessment year 2000-2001, the assessee NRC has claimed debit of foreign exchange loss to the tune of

Rs. 11,58,44,887/- to its P&L account. In all the three appeals, for translation purposes the previous month's average daily means of the buying and selling rate of exchange as per State Bank of India are used for the month in which the transaction has occurred as provided under Production Sharing Contract. The assessee NRC draws monthly balances. And monthly balances are translated in the balance sheet at the prevailing exchange rates as on the date of balance sheet. Foreign currency loans are repaid out of the sale proceeds received, in US Dollars from M/s Indian Oil Corporation Limited and Gas Authority of India Limited. The assessee NRC admittedly borrows in US Dollars and repays it in the same currency. On these facts, the Assessing Officers in the aforesaid assessment years took the view that foreign exchange loss claimed by the assessee NRC was notional and the same was not admissible to it as depreciation. The respondent assessee NRC preferred appeals against the orders of the Assessing Officers before the Commissioner of Income-tax (Appeals), Dehradun [for brevity CIT(A)], who registered the same as Appeal No. 21 / DDN / CIT(A)-II / 2004-05 against the order passed by Assessing Officer in respect of assessment year 1999-2000; Appeal No. 22 / DDN / CIT(A)-II / 2004-05 against the order passed by Assessing Officer in respect of assessment year 1998-1999 and Appeal No. 51 / DDN / CIT(A)-II / 2004-05 against the order passed by Assessing Officer in respect of assessment year 2000-2001. After hearing the parties, the CIT(A) Dehradun, allowed all the three appeals, accepting the assessee NRC's claim of foreign exchange loss vide his order dated 11.02.2005 in

the three appeals, mentioned above. Aggrieved by the same the Revenue filed Income Tax Appeal No. 1821 of 2005 against the order dated 11.02.2005, passed by CIT(A) in Appeal No. 21 / DDN / CIT(A)-II / 2004-05 in respect of assessment year 1999-2000; Income Tax Appeal No. 1823 of 2005 against the order dated 11.02.2005, passed by CIT(A) in Appeal No. 51 / DDN / CIT(A)-II / 2004-05 in respect of assessment year 1999-2000 and Income Tax Appeal No. 1824 of 2005 against the order dated 11.02.2005, passed by CIT(A) in Appeal No. 22 / DDN / CIT(A)-II / 2004-05 in respect of assessment year 1998-1999. All the three appeals were heard and decided by the Income Tax Appellate Tribunal, Delhi Bench 'H', New Delhi, which allowed the three appeals vide its orders dated 29th September 2006. Hence, these appeals are preferred by the Revenue under Section 260 A of the Income Tax Act, 1961, on the substantial questions of law, mentioned above.

Relevant provision of law and relevant clauses of the Agreement entered into between the parties:

5) Before further discussion, it is pertinent to mention here, the relevant provision of law applicable to the case. Section 42 of the Income Tax Act, 1961, reads as under:

“42 Special provision for deductions in the case of business for prospecting etc., for mineral oil.

For the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral oils in relation to which the Central Government has

entered into an agreement with any person for the association or participation [of the Central Government or any person authorized by it in such business] (which agreement has been laid on the Table of each House of Parliament), there shall be made in lieu of, or in addition to, the allowance admissible under this Act, such allowances as are specified in the agreement in relation-

- a) to expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee;
- b) after the beginning of commercial production, to expenditure incurred by the assessee, whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection, except assets on such allowance for depreciation is admissible under Section 32:

Provided that in relation to any agreement entered into after the 31st day of March, 1981, this clause shall have effect subject to the modification that the words and figures “except assets on which allowance for depreciation is admissible under section 32” had been omitted; and]

- c) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding year or years as may be specified in the agreement.

and such allowances shall be computed and made in the manner specified in the agreement, the other provisions of this Act being deemed for this purpose

to have been modified to the extent necessary to give effect to the terms of the agreement.

Explanation – for the purposes of this section, “mineral oil” includes petroleum and natural gas.

Now, we deem it proper to quote the Articles 1.6.1 and 1.6.2 of the production Sharing Contract (hereinafter referred as PSC) entered into between the parties, which provides accounting procedure. The same are being reproduced below:

1.6 Currency Exchange Rates:

1.6.1 For translation purposes between United States Dollars and Indian Rupees or any other currency, the previous month’s average of the daily means of the buying and selling rates of exchange as quoted by the State Bank of India (or any other financial body as may be mutually agreed between the parties) shall be used for the month in which the revenues, cost, expenditure, receipts or income are recorded. However, in the case of any single non-US Dollar transaction in excess of the equivalent of one hundred thousand US Dollars (US Dollar 100,000), the conversion into US Dollars shall be performed on the basis of the average of the applicable exchange rate for the day on which the transaction occurred.

1.6.2. *Any realized or unrealized gains or losses from the exchange of currency in respect of petroleum operations shall be credited or charged to the accounts. A record of the exchange rates used in converting Indian Rupees or any other currencies into United State Dollars as specified in section 1.6.1 shall be maintained by the contractor and shall be identified in the relevant statements required to be submitted by the contractor in accordance with section 1.4.2.*

ARGUMENTS:-

6) Mr. Arvind Vashisth, learned counsel for the appellants (Revenue) argued that the foreign exchange loss claimed by the assessee NRC in respect of assessment years in question, is nothing but only a loss shown in the book entry as the assessee NRC had invested the amount under the contract in US Dollar and it has been repaid in the same currency. However, as against this, on behalf of the respondent / assessee NRC it is submitted that the loss claimed by the assessee NRC is the actual loss on account of change in the foreign exchange rates. It is contended on behalf of the respondent / assessee NRC that for the profits shown by the assessee NRC due to the change in foreign exchange rates in other assessment years, the Assessing officers have charged and accepted the tax on such profits shown, therefore, for the assessment years in which loss has occurred, for the same reason the depreciation cannot be denied. Lastly, it is submitted on behalf of the

respondent / assessee NRC that when the other co-venturers, namely M/s Oil and Natural Gas Corporation Limited and M/s Reliance Industries Limited were allowed depreciation on account of change of exchange rates, the assessee being foreign company cannot be deprived of the same.

DISCUSSION:

7) On behalf of the appellants / Revenue it is submitted that the decision of Income Tax Appellate Tribunal, Delhi, in ***O.N.G.C. Limited Vs. DCIT; is I.T.A. No. 2472 / DEL / 96 for Assessment Year 1991-1992***, relied by CIT(A) in the impugned order dated 11.02.2005, has been set aside by this High Court vide its judgment and order dated 29.03.2007 in Income Tax Appeal No. 91 of 2003; Commissioner of Income-Tax Vs. Oil and Natural Gas Corporation Ltd. (along with eight connected appeals). On that ground it is argued that the depreciation cannot be allowed unless there is actual loss to the assessee NRC. We have gone through the aforesaid judgment and order passed by this Court which interprets Section 37 of the Income Tax Act, 1961, and it that case no repayment of loan claimed was found to have been made by the borrowing company in the relevant assessment year, and only in the account books it was shown as expenditure. In the case in hand, the facts are different and it is nobody's case that no expenditure had taken place in relevant assessment years. The point of dispute is whether, on the expenditure made by the assessee NRC, is it entitled to the further loss incurred by it on account of change in the foreign exchange rates, or not ?

8) Section 42 of the Income Tax Act, 1961, quoted above, contains a special provision whereby the expenditure incurred by the assessee NRC in commercial production of mineral oil is to be depreciated in terms of the agreement mentioned therein. It is not the case of the parties that the agreement between the parties is not covered or it does not fulfill the requirements under Section 42 of the aforesaid Act. It is clear from Article 1.6.1 of the accounting procedure, quoted above, set out in the Appendix-C to the Production Sharing Contract (PSC) that expenditure incurred in foreign exchange by the co-venturer during any particular calendar month has to be converted into Indian Rupee at the rate which has to be determined at the end of the calendar month. The example quoted by CIT(A) in his judgment, passed in Appeal No. 21 / DDN / CIT(A)-II / 2004-05, is relevant to be reproduced here:

“To understand the conversion loss, let us take an example in the case of borrowing; assessee borrows dollar one lac USD at Rs. 38/ a dollar in the year 1999. Entry for the borrowing will be made at Rs. 38 lacs. Now the proceeds of sale which assessee receives is at Rs. 41/- a dollar as per the PSC. It repays the loan so borrowed out of sale proceeds converted at the rate of Rs. 41/- a dollar. Though he borrows in dollars and repays in dollar but actually he had incurred a loss of Rs .3/- per dollar because the dollar which the borrowed was at Rs. 38/-, he repaid loan in dollar which was converted at Rs. 41/-. Therefore, it is clear that he

has incurred loss of Rs. 3 lacs. This kind of transaction may also result in gain or profit in the case of currency appreciation. Under these circumstances, to say that assessee incurring notional loss, is incorrect.”

9) For the reasons as discussed above, we agree with the reasoning given by the CIT(A) and the Income Tax Appellate Tribunal in holding that the depreciation claimed by the assessee NRC on account of foreign exchange loss was admissible to it under Section 42 of the Income Tax Act, 1961, read with the clauses of the agreement, quoted above. We are also of the view that when the Revenue is accepting the tax on the profits / gains arisen out of the change in foreign exchange rates in other assessment years accrued to the respondent / assessee NRC, it cannot deny depreciation on account of loss incurred for that reason.

10) Accordingly, all the three substantial questions of law are answered against the Revenue. The appeals are liable to be dismissed. The same are dismissed.

(Dharam Veer, J.) (Prafulla C. Pant, J.)

Dt. January 17, 2008.

H. Negi