IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI I BENCH, NEW DELHI

[Coram: Pramod Kumar AM and C. M. Garg JM]

I.T.A. No.: 6480/Del/12
Assessment year: 2008-09

AWB India Pvt Ltd ***……Appellant***
111, Rectangle 1
Saket District Centre, Saket
New Delhi 110 017 [PAN:AAFCA0734P]

Vs.

Deputy Commissioner of Income Tax
Circle 2(1), New Delhi ***……Respondent***

Appearances by:
G C Srivastava and **Saurabh Srivastava** *for the appellant*
Peeyush Jain and Yogesh Kumar Verma, *for the respondent*

Date of concluding the hearing : September 03, 2014
Date of pronouncing the order : October 13th, 2014

O R D E R

Per Pramod Kumar:

1. By way of this appeal, the appellant Assessing Officer has challenged correctness of order dated 3rd October 2012 passed by the Assessing Officer, in the matter of assessment under section 143(3) r.w.s. 144C of the Income Tax Act, 1961 (hereinafter referred to as 'the Act'), for the assessment year 2008-09.

2. Ground Nos. 1 and 2 are general in nature and do not call for any specific adjudication as such.

3. In ground no. 3, the assessee is aggrieved is that, "**the learned and DRP have erred in facts and on law in disallowing Rs 1,60,369 on account of unrealized loss on the commodity derivatives claimed in accordance with regular method of accounting followed by the appellant".**

4. So far as this grievance of the assessee is concerned, the relevant material facts are like this. During the course of assessment proceedings, the Assessing Officer noticed that Rs 57,82,954 disclosed by the assessee as gain on commodity derivatives is a net figure of such gains, after adjusting unrealized loss of Rs 1,60,369. The Assessing Officer required the assessee to show cause as to why adjustment of Rs 1,60,369 for unrealized loss not be disallowed. It was explained by the assessee that the said amount represents loss on open positions in trading transactions of commodity derivatives. The assessee explained, in substance, that once a loss can be reasonably estimated, as was the position in that case, such a loss is to be provided for in the books of accounts, and, in support of this broad contention, relied upon several judicial precedents, including landmark judgment in the case of **Chainrup Sampatram Vs CIT (24 ITR 481)**, and accounting practices, including accounting standards. The Assessing Officer was, however, not impressed by any of these arguments and he proposed to disallow the unrealized loss on commodity derivatives. Aggrieved, assessee approached the DRP but without any success. It was in this backdrop that the AO disallowed Rs 1,60,369. The assessee is aggrieved and in appeal before us.

5. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of applicable legal position.

6. It is only elementary that principle of conservatism, on one hand, requires all anticipated losses to be accounted for at the point of time when such losses can be reasonably estimated, and, on the other hand, yet it defers accounting for all anticipated profits to be accounted at the stage when these profits are realized. This principle, which is the conceptual foundation for the

stock valuation at cost price or market price- whichever is lower, is duly recognized by Hon'ble Supreme Court in the case of **Chainrup Sampathram** *(supra)* wherein Their Lordships observed as follows:

> "**While anticipated loss is thus taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account, as no prudent trader would care to show increased profit before its actual realisation. This is the theory underlying the rule that the closing stock is to be valued at cost or market price whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy. As profits for income-tax purposes are to be computed in conformity with the ordinary principles of commercial accounting, unless of course, such principles have been superseded or modified by legislative enactments, unrealised profits in the shape of appreciated value of goods remaining unsold at the end of an accounting year and carried over to the following year's account in a business that is continuing are not brought into the charge as a matter of practice, though, as already stated, loss due to a fall in price below cost is allowed even if such loss has not been actually realised. As truly observed by one of the learned Judges in Whimster & Co. vs. IRC (1926) 12 Tax Cases 813, 827, "Under this law (Revenue law) the profits are the profits realised in the course of the year. What seems an exception is recognised where a trader purchased and still holds goods or stocks which have fallen in value. No loss has been realised. Loss may not occur. Nevertheless, at the close of the year he is permitted to treat these goods or stocks as of their market value."**

7. It is for this reason that while anticipated profit for forward contracts are not taken into account but anticipated losses are duly taken into account in computation of business profits. Elaborating upon this legal position and dealing with the deductibility of anticipated but unrealized losses on forward exchange contracts, a special bench of this Tribunal**, in the case of DCIT Vs Bank of Bahrain & Kuwait (41 SOT 290),** has observed as follows:

> **58. In view of the above discussion, we allow the assessee's appeal for the following reasons :**
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> **(i) A binding obligation accrued against the assessee the minute it entered into forward foreign exchange contracts.**

(ii) A consistent method of accounting followed by assessee cannot be disregarded only on the ground that a better method could be adopted.

(iii) The assessee has consistently followed the same method of accounting in regard to recognition of profit or loss both, in respect of forward foreign exchange contract as per the rate prevailing on 31st March.

(iv) A liability is said to have crystallised when a pending obligation on the balance sheet date is determinable with reasonable certainity. The considerations for accounting the income are entirely on different footing.

(v) As per AS-11, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period.

(vi) The forward foreign exchange contracts have all the trappings of stock-in-trade.

(vii) In view of the decision of Hon'ble Supreme Court in the case of Woodward Governor India (P) Ltd. (supra), the assessee's claim is allowable.

(viii) In the ultimate analysis, there is no revenue effect and it is only the timing of taxation of loss/profit.

59. We, accordingly, hold that where a forward contract is entered into by the assessee to sell the foreign currency at an agreed price at a future date falling beyond the last date of accounting period, the loss is incurred to the assessee on account of evaluation of the contract on the last date of the accounting period i.e. before the date of maturity of the forward contract.

8. In view of these discussions, it is clear that even when loss has not yet crystallized, a deduction is to be granted in respect of a reasonably anticipated loss. It is altogether a different issue that since these provisions for anticipated losses are reversed in the beginning of the next year, these deductions are completely tax neutral and the impact is confined to the timing of deduction. In such a situation, there cannot be a double deduction of the same loss- first one at the end of this accounting period and second one at the point of time when the transaction is finally settled. Therefore, as long as the assessee has reversed

this provision in the beginning of next year and thus effectively adjusted this loss against loss or profit finally realized commodity derivatives, no objection can be taken to this claim. For this limited verification, therefore, the matter stands restored to the file of the Assessing Officer.

9. Ground No. 3 is thus allowed for statistical purposes in the terms indicated above.

10. Ground No 4 us not pressed and is, as such, dismissed for want of prosecution.

11. In ground nos. 5 to 9, which we will take up together, the assessee has raised the following grievances:

> **5. That, on the facts and circumstances of the case, the DRP and TPO/AO have failed to appreciate the business model and business realities of the appellant and role of its AE, while conducting the economic analysis, and concluding that no service is received or no benefit, and/or services received are duplicative in nature.**
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> **6. That, on the facts and circumstances of the case, the DRP and TPO/AO erred in presumptively holding that the revenue authorities are empowered to question the commercial decision of the appellant and in not appreciating the jurisprudence that the DRP and the AO/TPO cannot go beyond their powers to question the business decision of the company.**
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> **7. That, on the facts and circumstances of the case, the DRP has erred in confirming that the TPO has discharged his statutory onus by establishing the conditions specified in (a) to (d) of Section 92C(3) of the Act have been satisfied before disregarding the arm's length price determined by the appellant and proceeding to decide the arm's length price himself.**
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> **8. That, on the facts and circumstances of the case, the DRP and TPO/AO have erred in conducting economic analysis of the international transactions without relying on any comparable transaction/companies using inappropriate method.**
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> **9. That, on the facts and circumstances of the case, the DRP and TPO/AO have erred in determining the arm's length price of**

international transactions consisting of cost and profit margin at 'nil'.

12. So far as these grievances of the assessee are concerned, the relevant material facts are as follows. The assessee is engaged in the business of trading in food grains. It is a part of AWB group Australia and its 99.999% equity is held by AWB Australia Limited and the balance .001% equity is held by another group company, namely AWB Investments Limited. One of the international transactions that the assessee entered into with its AEs was payment of Rs 58,20,571 towards 'management services'. On an analysis of the details of the payments made under this head, the TPO was of the view that the benefit of some of the services availed under the head 'management services' was not commensurate with the payments made for the same. He was also of the view that as against the use of TNMM by the assessee in benchmarking, the right course of action will be to follow CUP method because the value under CUP method will be best indicator of the value of these services. It was in this background that the TPO made certain adverse inferences against the assessee. The TPO was of the view that while the assessee has made a payment of Rs 20,35,907 towards financial management and reporting services, "but the services rendered are negligible compared to the cost incurred". The TPO was also of the view that "a minor clarification or seeking of certain guidance on verify basic issue does not call for a payment of Rs 20 lakhs. Therefore, the ALP of these services was taken as 'NIL'. He further noted that while the assessee has made a payment of Rs 1,23,476 towards human resources services, the assessee has "not furnished any specific input on training and development of human resources and it is also noticed that these services are of routine nature and duplicate at best". Accordingly, the TPO also treated ALP of these services as 'NIL'. As regards the payment of Rs 96,355 towards 'legal services', the TPO did take note of the services that the assessee was entitled to under these arrangements but as there is no evidence of any services having been actually rendered by the AE, the TPO concluded that it does not have any value in an arm's length situation. The value of this service was also taken as NIL. The same was the case with respect to the payments for other services. Accordingly, no

arm's length value was assigned to these services also. In respect of these cases TNMM was rejected and CUP was applied- though, even under CUP method, value assigned was nil as, in the opinion of the TPO, these services were worthless.

13. When Assessing Officer proposed to make disallowance in respect of payments for the above services, arm's length value of which was taken at 'zero', aggregating to Rs 31,23,325, as against total management fees of Rs 58,20,571 paid by the assessee, assessee carried the matter before the DRP but without any success. The DRP confirmed the stand so taken by the TPO, Accordingly, an ALP adjustment of Rs 31,23,325 was made by the Assessing Officer. The assessee is aggrieved and is in appeal before us.

14. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

15. One of the very basic pre condition for use of CUP method is availability of the price of the same product and service in uncontrolled conditions. It is on this basis that ALP of the product or service can be ascertained. It cannot be a hypothetical or imaginary value but a real value on which similar transactions have taken place. Coming to the facts of this case, the application of CUP is dependent on the market value of the arrangements under which the present payments have been made. Unless the TPO can identify a comparable uncontrolled case in which such services, howsoever token or irrelevant services as he may consider these services to be, are rendered and find out consideration for the same, the CUP method cannot have any application. His perception that these services are worthless is of no relevance. It is not his job to decide whether a business enterprise should have incurred a particular expense or not. A business enterprise incurs the expenditure on the basis of what is commercially expedient and what is not commercially expedient. As held by Hon'ble jurisdictional High Court in the case of **CIT Vs EKL Appliances Limited (345 ITR 241)**, "**Even Rule 10B(1)(a) does not authorise**

disallowance of any expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same".

16. The very foundation of the action of the TPO is thus devoid of legally sustainable merits. There is no dispute that the impugned payments are made under an arrangement with the AE to provide certain services. It is not even the TPO's case that the payments for these services were not made for specific services under the contract but he is of the view that either the services were useless or there was no evidence of actual services having been rendered. As for the services being useless, as we have noted above, it is a call taken by the assessee whether the services are commercially expedient or not and all that the TPO can see is at what price similar services, whatever be the worth of such services, are actually rendered in the uncontrolled conditions.

17. As for the evidence for each of the service stated in the agreement, it is not even necessary that each of the service, which is specifically stated in the agreement, is rendered in every financial period. The actual use of services depends on whether or not use of such services was warranted by the business situations whereas payments under contracts are made for all such services as the user may require during the period covered. As long as agreement is not found to be a sham agreement, the value of the services covered under the agreement cannot be taken as 'nil' just because these services were not actually required by the assessee. In any case, having perused the material on record, we are satisfied that the services were actually rendered under the agreement and these services did justify the impugned payments.

18. We are also of the considered view that in the absence of prerequisites for application of CUP methods being absent in the present case, it was not open to the TPO to disregard the TNMM employed by the assessee. No defects have been pointed out in application or relevance of TNMM in this case. Under these circumstances, the TPO's impugned action cannot meet our judicial approval.

19. For the detailed reasons set out above, we uphold the grievance of the assessee and direct the AO to delete the impugned ALP adjustment of Rs.31,23,325. The assessee gets the relief accordingly.

20. Ground Nos, 5 to 9 are thus allowed.

21. In the result, the appeal is allowed. Pronounced in the open court today on 13th day of October, 2014.

Sd/-	Sd/-
C M Garg	**Pramod Kumar**
(Judicial Member)	(Accountant Member)

New Delhi, 13th day of October 2014

Copies to:	*(1)*	*The assessee*	*(2)*	*The Assessing Officer*
	(3)	*CIT*	*(4)*	*CIT(A)*
	(5)	*Departmental Representative*		
	(6)	*Guard File*		

By order etc

Assistant Registrar
Income Tax Appellate Tribunal
Delhi benches, New Delhi