IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD "I" BENCH, AHMEDABAD

[Coram: Pramod Kumar AM and S S Godara JM]

ITA No.1514/Ahd/2012
Assessment Year: 2008-09

Assistant Commissioner of Income Tax
Circle-7, Surat. **.....Appellant**

Vs.

Veer Gems, **.....Respondent**
7/2982, Parsi Seri,Saiyedpura,
Surat – 395 002. [PAN – AABFV 6446 L]

C.O. No.184/Ahd/2012
(In ITA No.1514/Ahd/2012)
Assessment Year: 2008-09

Veer Gems, **.....Appellant**
7/2982, Parsi Seri,Saiyedpura,
Surat – 395 002.[PAN – AABFV 6446 L]

Vs.

Assistant Commissioner of Income Tax
Circle-7, Surat. **..... Respondent**

Appearances by:

Dr. Banwari *for the revenue*
R.B. Shah *for the assessee*

Date of concluding the hearing : 05.10.2016
Date of pronouncing the order : 03.01.2017

O R D E R

Per Bench:

1. By way of this appeal, the Assessing Officer has challenged correctness of the order dated 28.03.2012, passed by the learned CIT(A)-V, Surat, in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2008-09. The assessee has also filed a Cross Objection against the same order passed

by the learned CIT(A). As the appeal and the cross objection call into question correctness of the same order, pertain to the same assessee, involve interconnected issues and were heard together, the appeal and the cross objection are being disposed of by way of this consolidated order.

2. The grounds of appeal numbers 1 to 4 in assesseeôs appeal, which relate to an armôs length price adjustment and which we will take up together, are as follows:

> ***"[1] On the facts and in the circumstances of the case and in law, the Ld.CIT (A) erred in deleting addition made of Rs.5,22,64,779/- u/s. 92CA(3) by holding that the TPO had initially placed reliance on mean margin ratio of six entities including exchange difference income but while passing the order u/s. 92CA(3), the addition had been proposed by taking the margin of only two entities excluding exchange difference income.***
>
> ***[2] The Ld.CIT(A) ought to have confirmed the addition as these issues had already been considered and elaborately discussed by the Transfer Pricing Officer and thereafter based on valid reasoning order u/s. 92CA(3) dtd. 28.10.2011 was passed by the TPO which fact was not considered by the first appellate authority.***
>
> ***[3] On the facts and in the circumstances of the case and in law, the Ld.CIT(A) erred in admitting and deciding the appeal in contravention of the provisions of section 144C of I.T. Act.***
>
> ***[4] On the facts and in the circumstances of the case and in law, the Ld. CIT[A] failed to appreciate that no objection filed by the assessee before the A.O., after receipt of draft assessment order as per the explicit provision of section 144C(2)(b)(ii) of I.T. Act.***

3. In the cross objection, the assessee has raised a grievance which is interconnected with the above grievances of the Assessing Officer and which is required to be taken up together with the above grievance of the Assessing Officer:

> ***"1. On the facts and in circumstances of the case as well as law on the subject, the learned Commissioner of Income Tax (Appeals) has erred in not giving any findings on assessee's contention that M/s Blue Gems BVBA is not an associated enterprise of assessee u/s 92A(2)(j) of the Act and consequently, Assessing Officer wrongly made reference to transfer pricing officer for determining the arm's length price in respect of transaction with M/s Blue Gems BVBA.***

2. It is therefore prayed that above action made by Assessing Officer and confirmed by CIT(A) may please be deleted.”

4. The relevant material facts are like this. The assessee before us is engaged I the business of manufacture and sale, domestic as well as exports, of the polished diamonds. During the relevant previous year, the assessee had entered into certain international transactions with a Belgian entity by the name of Blue Gems BVBA. The Assessing Officer was of the considered view that this entity was an associated enterprises, for the purposes of Section 92A(2)(j) of the Act, of the assessee, and, accordingly, the matter regarding ascertainment of arm's length price of assessee's transactions with this entity was required to be referred to the Transfer Pricing Officer. The assessee, however, objected to the stand so taken by the Assessing Officer. It was submitted that even though Blue Gems BVBA was covered by the definition of a specified person, which are treated as related parties, under section 40A(2)(b), this fact was irrelevant for the purposes of invoking transfer pricing provisions. It was submitted that Blue Gems BVBA was not an associated enterprise of the assessee company under section 92A, as the conditions specified in the said section were not satisfied. The assessee made elaborate submissions in this regard and also pointed out that so far as the immediately preceding assessment year, i.e. assessment year 2007-08, was concerned, the assessee was an associated enterprise of the Blue Gems BVBA because the conditions under section 92A(2)(h) were satisfied only for that particular period inasmuch in the said assessment year more than ninety percent of the raw materials required by the assessee were supplied by the said concern. That was not the situation in the present case. The detailed submissions made by the assessee, however, did not find any favour with the Assessing Officer. He rejected these submissions and observed as follows:

4.2 The contention of the assessee has been considered. The assessee has stated that M/s. Blue Gems BVBA does not fall under the definition of Associate Enterprise as defined u/s. 92A(1) & (2) of the Act. It has also stated that report u/s.92E is required to be filed only after transactions are done with associate enterprise. Further, it has stated that it does not fall within the deeming provisions of section 92A(2). The contention of the assessee is not correct. For the sake of clarity, the relevant provision of sec.92(A)(2)(j), (k) and (m) are reproduced below.

Meaning of associated enterprise

92A.*(1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise -*

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirect, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) [For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year, -]

(a) .....
……

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

(j) where one enterprise is controlled by an individual, the oilier enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(k) where one enterprise is controlled by Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(i) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not

less than ten per cent interest in such firm, association of person or body of individuals; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

4.3 Veer Gems has made substantial purchases from M/s Blue Gems BVBA. The Partners of Veer Gems are three brothers Shri Piyush M Shah, Mukesh M Shah, Dilip M Shah and their wifes/son, together holding the entire partnership stake. The fourth brother Nareshkumar Shah, along with his wife Surekhaben Shah and his son Mitesh Shah control the entire share holding of M/s Blue Gems BVBA, the fourth brother and his son being directors of the company. It is clear that both the entities are being controlled by the same family or four brothers and their close relatives. It is clear that M/s. Blue Gems BVBA is closely related with M/s. Veer Gems and falls within the parameters of sec. 92A(2)(j).

4.4. In view of the above facts and express provision of law, it is held that contention of the assessee is devoid of any merit and reference for determination of transfer pricing is correctly made

5. The Assessing Officer thus proceeded to treat the assessee and Blue Gems BVBA as associated enterprises under section 92A of the Act. The international transactions entered into between these entities were, thus, subjected to armôs length price determination. On a reference being made to the Transfer Pricing Officer, an ALP adjustment of Rs 5,22,64,779 was made. On the matter being carried in appeal before the CIT(A), even before deciding whether the assessee and Blue Gems BVBA can indeed be held to be ôassociated enterprisesõ, the CIT(A) proceeded to deal with examine correctness of the ALP adjustment impugned in appeal before him, held it to be unsustainable on the facts of the case and in law, and then observed that ñ**as addition stands deleted on merits of the case, no discussion is made as to whether Blue Gems BVBA is associated enterprises of the assessee or not as the same is only academic in nature**ò. For the reasons we will set out a little later in this order, it is not really necessary to take note of the facts regarding ALP adjustment in more detail. Suffice to the note that none of the parties is satisfied with the stand so taken by the CIT(A). While the Assessing Officer is aggrieved of his deleting the impugned ALP adjustment of Rs 5,22,64,779 on merits, the assessee is aggrieved that the CIT(A) did not adjudicate on the fundamental question as to whether the assessee and Blue Gems BVBA could at all be said to be AEs. Both the parties are in appeal before us.

6. 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.

7. We find that in order to invoke the transfer pricing provisions, and deal with the determination of arm's length price, it is absolutely essential that the international transaction in question must be between the associated enterprises. It is perhaps the most basic aspect of the matter and foundational basis on which transfer pricing provisions are invoked. It is, therefore, wholly unreasonable to decline to deal with this issue on the ground that, in any event, the ALP adjustment in question is also not sustainable in law. The issue whether the transactions between two entities are transactions between the associated enterprises cannot be infructuous or academic just because the transactions are at arm's length prices, though this proposition would be true the other way round i.e. the issue whether the transactions at arm's length price or not would be infructuous in the event of enterprises not being associated enterprises. We are unable to see any merits in the approach adopted by the learned CIT(A). In our considered view, the first thing that needs to be adjudicated upon is whether or not the assessee and Blue Gems BVBA are associated enterprises. As we proceed to deal with this question, we may first take note of Section 92A which, for ready reference, is reproduced below:

Meaning of associated enterprise.

92A. (1) ***For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise—***

(a) ***which participates, directly or indirectly****, or through one or more intermediaries****, in the management or control or capital of the other enterprise****; or*

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) ***For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,—***

(a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or

(c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or

(d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or

(e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

(f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

(g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

(h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

*(j) **where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual**; or*

(k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a

relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

[Emphasis, by underlining, supplied by us]

8. As we deal with this issue, lets first appreciate the scheme of Section 92A. A plain reading of this statutory provision makes the legal position quite clear. The basic rule for treating the enterprises as associated enterprises is set out in Section 92A(1). The illustrations in which basic rule finds application are set out in Section 92A(2). Section 92A(1) lays down the basic rule that in order to be treated as associated enterprise one enterprise, in relation to another enterprise, participate, directly or indirectly, or through one or more intermediaries, ñin the management or control or capital of the other enterpriseò or when ñone or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterpriseò. Section 92(A)(2) only provides illustrations of the cases in which such an enterprise participates in management, capital or control of another enterprise. In other words, what Section 92A (1) decides is the principle on the basis of which one has to examine whether or not two or more enterprise are associated enterprise or not. The principle is, as we have noted above, that one of the enterprise, in relation to other enterprise, participate, directly or indirectly, in the management or control or capital of the other enterprise and that persons who participate in such management, control or capital of both the enterprises are common. As long as an enterprise participates in any of the three aspects of the other enterprise, i.e. (a) management; (b) capital; or (c) control, these enterprises are required to be treated as associated enterprise, as also is the position when common persons participate in management, control or capital of both the enterprises. However, the expression ópartication in management or capital or controlô is not a defined expression. To find the meaning of this expression, one has take recourse to Section 92(2) which gives practical illustrations, which are exhaustive and not simply illustrative- as clarified in the Memorandum explaining the provisions of the Finance Bill 2002 which, while inserting the words ñ**For the purpose of sub section (1)**

*of section 92A*ò in Section 92A(2), observed that **"It is proposed to amend sub-section (2) of the said section to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprises, unless the criteria specified in sub-section (2) are fulfilled**ò. In this sense, Section 92A(2) governs the operation of Section 92A(1) by controlling the definition of participation in management or capital or control by one of the enterprise in the other enterprise. If a form of participation in management, capital or control is not recognized by Section 92A(2), even if it ends up in *de facto* or even *de jure* participation in management, capital or control by one of the enterprise in the other enterprise, it does not result in the related enterprises being treated as ñassociated enterprisesô Section 92A(1) and (2), in that sense, are required to be read together, even though Section 92A(2) does provide several deeming fictions which *prima facie* stretch the basic rule in Section 92A(1) quite considerably on the basis of, what appears to be, manner of participation in ñcontrolò of the other enterprise.What is thus clear that as long as the provisions of one of the clauses in Section 92A(2) are not satisfied, even if an enterprise has a *de facto* participation capital, management or control over the other enterprises, the two enterprises cannot be said to be associated enterprises. That is a what coordinate bench decisions in the cases of **Orchid Pharma Ltd Vs DCIT [(2016) 76 taxmann.com 63 (Chennai - Trib.)]** and **Page Industries Ltd Vs DCIT {(2016) 159 ITD 680 (Bang)]** also hold.

9. The case of the revenue hinges on application of clause (j) of Section 92A(2). That is the only clause invoked by the Assessing Officer, and if this clause does not apply to the facts of this case, that is end of the matter. This clause provides that ñ**where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual**ò. In the present case, the assessee is a partnership concern and the assessee firm, therefore, cannot be said to be controlled by ñan individualò which is starting point for Section 92A(2)(j) being invoked. In the TPOôs order, a reference is also made to some other clauses of Section 92A(2) as follows:

> **The firm has made substantial purchases from M/s. Blue Gems BVBA. The partners of the firm are three brothers viz. Shri Piyush M. Shah, Mukesh M. Shah, Dilip M. Shah and their wifes/son, together holding the entire partnership stake. The fourth brother Nareshkumar Shah, along with his wife Surekhaben Shah and**

his son Mitesh Shah control the entire share holding of M/s Blue Gems BVBA, the fourth brother and his son being directors of the firm. It is clear that both the entities are being controlled by the same family of four brothers and their close relatives. It is also clear that M/s. Blue Gems BVBA is closely related with M/s. Veer Gems and falls within the parameters of sec. 92A(2)j, k and m.

10. The additional references to clauses (k) and (m) of Section 92A(2) are of no avail either. While clause (k) refers to an enterprise controlled by an HUF but no HUF has anything to do with either of the enterprise, clause (m) is only an enabling provision for prescribing any other relationship of mutual interest that can lead to the enterprises being treated as associated enterprises but then no such relationship has been prescribed as yet. Nothing, therefore, turns of Section 92A(2)(k) and 92A(2)(m) either. In any of the orders of authorities below, or during the course arguments before us, no other parts of Section 92A(2) have been relied upon by the authorities below or by the learned Departmental Representative. While a certain degree of control may actually be exercised by these enterprises over each other, due to relationships of the persons owning these enterprises, that itself is not sufficient to hold the relationship between the two enterprises as ôassociated enterprisesõ That would at best satisfy the conditions under section 92A(1) but then, as we have noted earlier in this order and as clarified in the Memorandum explaining the provisions of the Finance Bill 2002 which, while inserting the words ñ**For the purpose of sub section (1)** *of section 92A*ò in Section 92A(2), had observed that **"It is proposed to amend sub-section (2) of the said section to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprises, unless the criteria specified in sub-section (2) are fulfilled**ò. In our considered view, therefore, the assessee and Blue Gems BVBA cannot be said to be associated enterprises. As these enterprises are not associated enterprises, the ALP adjustments in respect of the transactions between these enterprises were wholly unwarranted. For this short reason, and without going any further into the matter, we approve the impugned deletion of ALP adjustment. The plea of the assesse, in cross objection, is upheld and, for that reason, grievance of the Assessing Officer, in appeal, is dismissed as infructuous.

11. Ground nos. 1 to 4, raised in the appeal filed by the Assessing Officer, are dismissed as infructuous, and grievances raised by the assessee, in the cross objection, are allowed.

12. Revenueôs next substantive ground seeks to restore section 68 unexplained cash credits addition of Rs.8,50,00,000/- followed by disallowance of interest expenses thereupon of Rs.66,94,929/-, made by the Assessing Officer and deleted in the lower appellate proceedings.

13. We come to the relevant facts first. Assesseeôs relevant books would show loans of Rs.50 lakhs, Rs.1.50 crores, Rs.2 crores, Rs.1.50 crores & Rs.1 crores each; obtained from M/s Saransh Gems (Surat), Impex Gems, Jinesh Gems, Minakshi Exports & Laxmi Diamonds, Milan & Co. And Navkar Diamonds (all Mumbai based entities). It filed confirmation and PAN details of all the said entities. The Assessing Officer issued section 133(6) notice as well as section 131 summons. He first of all expressed surprise that these seven entitiesô stated premises had remained closed for past 6 ï 7 years. He thus issued a commission to the DDIT (Inv.), Mumbai to carry out necessary enquiries. The said authority submitted its report inter alia sating that it could find although premises of M/s Impex Gems, there was nobody to attend the proceedings. Similarly, he recorded statement of one Shri Babulal Jain who confirmed to have given loans in question. The said authority thus reported that the above said entity(s) did not maintain their stock along with books of account. Nor did they carry out business transactions so as to lend money in question to the assessee. The Assessing Officer further referred to Shri Shambhumal Jainôs statement recorded under section 131 of the Act deposing in the same tone of not maintaining accounts of Jinesh Gems. This case file reveals that the Assessing Officer accordingly observed that the assesseeôs claim of having received the impugned loans was not supported by genuineness & creditworthy evidence which could prove that all the seven parties hereinabove had been having source thereof in the nature of income, they had meagre means without any capacity to lend the corresponding sums, no books of account were maintained and that all transactions had demonstrated a repetitive pattern of accumulated deposits in a short span of time followed by transfer of money to assesseeôs account is a calculated way of apparent genuine transaction in neatly arranged manner of fabricated records to serve its cause. All this resulted in the impugned section 68 addition of unexplained cash credit of Rs.8.50 crores followed by disallowance of interest thereupon to the tune of Rs.66,94,929/- in question.

14. The CIT(A) deletes the above two additions after taking note of assesseeôs contentions as follows :-

> *ñIn the course of appellate proceedings, it is submitted that assessing officer grossly erred in making addition of Rs.8,50,00,000/- to the total income off assessee as*

unexplained cash credit. During the course of assessment proceedings, assessee was asked to prove the identity, genuineness and creditworthiness of the persons from whom assessee had taken unsecured loan. In compliance of the same, assessee filed PAN and confirmations of the parties vide letter dated 20.10.2010 from whom unsecured loan was taken during the year under consideration. Assessee also filed copy of assessment orders passed u/s 143(3) of the Act in case of various parties from whom unsecured loans have been received. Assessing officer further issued notice u/s 133(6) of the Act calling for information from various parties from whom unsecured loan was received during the year under consideration. In response, the parties filed following details:

Sr. No.	*Name of Parties*	*Details submitted in response to notice u/s 133(6)*
1.	*Shri Jayprakash S. Jain (Prop. M/s Milan & Co.)*	*- Confirmation of account* *- Acknowledgment of return of income* *- Bank statement* *- Tax Audit Report*
2.	*Shri Manish A. Agarwal (Prop. M/s Laxmi Diamonds)*	*- Confirmation of account* *- Acknowledgment of return of income* *- Bank statement* *- Tax Audit Report*
3.	*M/s Meenakshi Exports*	*- Confirmation of account* *- Acknowledgment of return of income* *- Bank statement* *- Tax Audit Report*
4.	*M/s Navkar Diamonds*	*- Confirmation of account* *- Acknowledgment of return of income* *- Bank statement* *- Tax Audit Report*
5.	*Shri Ghanshyam Sharma (Prop. M/s Jewel Diamond)*	*- Confirmation of account* *- Acknowledgment of return of income* *- Bank statement* *- Tax Audit Report*
6.	*Shri Mahavir Jain (Prop. Impex Gems)*	*- Confirmation of account*

		- Acknowledgment of return of income *- Bank statement* *- Tax Audit Report*
7.	*Shri Kailashchand Sancheti (Prop. M/s Jinesh Gems)*	*- Ledger account of Veer Gems* *- Confirmation of account* *- Acknowledgment of return of income* *- Bank statement* *- Trading A/c, Profit & Loss A/c and Balance Sheet*

In view of filing of above cogent details, burden cast on assessee u/s 68 of the Act stands clearly discharged & thus, adverse inference cannot be drawn on the basis of conjectures and surmises. ***It is very pertinent to point out that all the loans have been repaid during the financial year itself*** *& this fact is evident on perusal of confirmation of accounts filed during the course of assessment proceedings. As the loans have already been repaid during the financial year itself, adverse inference in assessee's case cannot be drawn if information relating to their latest whereabouts could not be filed.* ***Further, it is very relevant to mention here that scrutiny assessment u/s 143(3) in case of most of the parties from whom assessee had taken loan has been completed and no discrepancies have been brought on record by the assessing officer in their assessment. In the instant case, assessing officer has completely ignored this fact while framing assessment in case of assessee. Once the scrutiny assessment has been completed in case of these parties, there can not be any doubt relating to existence / genuineness of the parties and it is illogical and absurd on the part of assessing officer to doubt their identity, genuineness and creditworthiness on the pretext that parties could not be found at Surat address.***

It is further submitted that assessing officer received all the relevant information from the parties in compliance of the letters issued on them. No addition can be made on the basis of report of DDIT(Inv), Mumbai as all the relevant details are already filed on record & even otherwise also, it is evident on perusal of statement of Shri Bhanwarlal Jain that he confirmed the existence of various concerns from whom unsecured loans have been received as complete details of concerns being operated from the premises i.e. 316, Panchratna, Opera House, Mumbai was given by him along with their assessment details. In view of these facts, the contention of assessing officer that no books of accounts / stock is found does not have any bearing so far as assessee is concerned especially considering the fact that loans have been repaid in the same financial year."

"Creditworthiness of the parties from whom assessee had taken loan can not at all be doubted as these parties are regularly filing their return of income and capability to give loan to assessee is clearly evident from the return of income filed by theses parties & their returns of income have been accepted in the scrutiny assessments made in their respective cases. Thus, looking to the totality of facts & circumstances of instant case, it is clear that assessing officer has made this addition merely on the basis of conjectures and surmises and hence, the addition made by assessing office needs to be deleted.

Assessee places reliance on jurisdictional Gujarat High Court decision in case of Dy. CIT v. Rohini Builders. (256 ITR 230) (Guj) where it was held that no substantial question of law arises where assessee established identity of creditors by giving their complete addresses, GIR numbers/PAN as well as confirmation along with copies of assessment orders wherever available. It is to be noted that SLP filed by revenue against this decision has also been rejected - 254 ITR 275 (St.)."

Besides this, the learned AR placed reliance on various other judicial pronouncements and also contended that no addition can be made to the income of assessee if source of source is not established by assessee. He contended that as loans are very much genuine, no disallowance on account of interest of Rs. 66,94,929/- paid on unsecured loans can be made & hence, the addition / disallowance made by assessing officer may be deleted.

Decision:

6.3. I have considered the reasons given by assessing officer and also the submissions of appellant. After carefully analysing the facts of the case & evidences filed on record, it is seen that the addition has been made by assessing officer mainly on the basis of conclusion drawn from the report of DDIT (Inv) Unit-IV, Mumbai. It has been the main contention of assessing officer that depositors have no demonstrable source of income and that they are persons of meagre means. It is also seen that in the course qc assessment proceedings, all the depositors have submitted their confirmation letter along with various other details in response to inquiry made by assessing officer u/s 133(6) of the Act. It is further seen that the assessment order u/s 143(3) of the Act has also been passed in as many as 4 cases and copies of the same are also filed on record. Further, the bank statements of depositors have also been filed and it is seen that the loans received from all the 7 depositors have also been repaid in the same financial year. Now when all the depositors are assessed to tax and their assessment orders along with confirmation letters and bank statements are also filed on record, no addition can be made u/s 68 of the Act on the ground that identity/capacity of the parties have not been established. Similarly, adverse inference cannot be drawn on the basis of report of DDIT (Inv) as department has passed scrutiny assessment orders in various cases. Considering the overall facts and material on record, I am of the opinion that the ratio of ***Honourable Gujarat High Court*** *decision in case of M/s* ***Rohini Builders 256 ITR 230 (Guj)*** *is squarely applicable and no addition can be made u/s 68 of the Act as identity and capacity of depositors and genuineness of transactions stands very much established. Hence, addition made by assessing officer is hereby deleted.*

As the addition made on account of unexplained cash credit stands deleted, the disallowance of interest of Rs.66,94,929/- is not sustainable and, hence, the addition made on this disallowance is also hereby deleted."

15. We have heard both the parties. Learned Departmental Representative strongly argues that the Assessing Officer had rightly made the impugned addition. Case record reveals that the assessee had filed confirmation of accounts, acknowledge of return of income, bank statements and tax audit report in all seven cases apart from trading account, P&L account and balance sheet of the last entity M/s Jinesh Gems. It has further come on record that the assessee has been able to prove repayments of the loan sums in question in the impugned assessment year.

This fact is further not disputed before us. It is therefore clear that the assessee has filed all the relevant details so as to prove identity, genuineness and creditworthiness of its loan transactions. The Revenue's case is that hon'ble Gujarat high court's decision in Rohini Builders (supra) is not applicable in the facts of the present case. We find this plea to be entirely misconceived. The assessee therein had proved identity of its creditors, their PAN Nos., copies of assessment orders followed by capacity and receipt of the amounts in question through banking channel. We have already indicated that the assessee before us has also proceeded on the same line of action by producing relevant record and all details of its seven creditors. Learned Departmental Representative then harps on Assessing Officer's findings that the seven creditors in question had meagre source of income and that they were further found to be not carrying out any business activity. We do not find any reason to concur with all these contentions. We are of the view that the Assessing Officer as well as DDIT (Inv) were first of all of the opinion that although six out of seven entities were based at Mumbai whereas their business were in Surat, they were able to trace all these creditors later on and get statement of their authorised persons recorded in the corresponding proceedings. It is thus not a case of identity dispute. Coming to the capacity aspect of the creditors, the assessee has already proved that its transactions have been routed through banking channel including repayment. We accordingly find no reason to interfere with CIT(A)'s observation hereinabove deleting the impugned section 68 addition as well as interest expenditure incurred there upon. This Revenue's substantive ground on both these aspects is accordingly declined.

16. The Revenue's last substantive ground pleads that the CIT(A) erred in deleting disallowance of provision of forward contract payable of Rs.34,35,000/- by holding that the entry passed in the books of account in respect of difference in exchange rate cannot be said to be in the nature of notional/unascertained liability. The assessee had made the impugned provision as per MTM certificate for the impugned assessment year followed by its reversal in the succeeding assessment year 2009-10 on account of foreign exchange rate difference as on 31.03.2008. The Assessing Officer disallowed the same by calling it as unascertained liability not allowable.

17. The CIT(A) accepts assessee's arguments as follows :-

> *"7.1. During the course of assessment proceedings, vide order sheet entry dated 01.11.2011, the assessee was required to give the full details of the provision entry of Rs. 34,35,000/- on account of forward contract payable. The assessee vide its submission dated 16.12.2011 submitted that the account shown as payable as per MTM certificate for A.Y. 2008-09 was reversed in the A.Y. 2009-10. Assessing officer observed that this liability which is worked out as on 31.03.2008 has not crystallised as on that date. According to A.O the same represents unascertained liability & is therefore, not allowable as expenditure under the I. T Act. On the basis of these observations, provision of*

forward contract payable of Rs. 34,35,000/- has been disallowed and added to the total income of assessee.

Submissions of the Appellant

7.2. During the course of appellate proceedings, the learned AR made various submissions; the relevant portion of the same is reproduced hereunder:

> *"In the course of appellate proceedings, it is submitted that assessing officer has erred in making addition of Rs. 34,35,000/- to the total income of assessee on account of provision for forward contract payable. During the course of assessment proceedings, assessee submitted that account of forward contract was reflected in the books of accounts as per MTM certificate of ABN Amro Bank. Assessee is required to record forward contract transactions as per Accounting Standard 11 of ICAI & the same provides that forward contracts remaining outstanding at the end of financial year should be recorded at closing rate prevailing at the end of the year i.e. 31st March. This treatment is in line with the accrual method of accounting as profits/ losses pertaining to the year under consideration are required to be reported in P & L A/c & therefore, fluctuation in exchange rate is required to be taken into consideration. However, contention of assessing officer to treat the same as unascertained liability is completely incorrect in as much as entry is passed on the basis of actual closing rate prevailing at the end of financial year as per MTM certificate issued by ABN Amro Bank.*
>
> *During the course of assessment proceedings, assessee filed copy of MTM certificate and copy of forward contract payable. As per MTM certificate, it is evident that exchange rate of USD has gone up as on 31st March as compared to the exchange rate prevailing at the time of booking of forward contracts & this has resulted into exchange loss to assessee for which provision entry is passed in the books of accounts.*
>
> *It is further relevant to point out that in the subsequent year, when the contract has been cancelled, assessee has recognised the gain / loss based on the difference between exchange rate prevailing at the .end of the current financial year as per MTM certificate & the exchange rate prevailing as on the date of cancellation of forward contract which is in line with the accrual system of accounting. As such assessee has passed entry for loss only in respect of the balance amount & the exchange loss is divided into two years as per accrual system of accounting & the Accounting Standard of ICAI.*
>
> *Now, if any disallowance is made for the year under consideration in that case, deduction should be allowed of this amount in subsequent year, as assessee has claimed only balance loss i.e. loss arising on account of difference between exchange rate as on 31/03/2008 & exchange rate prevailing as on the date of cancellation. The addition made by assessing officer has thus, resulted into double taxation as after set off of provision entry of Rs. 34,35,000/- made at the end of current year, only the balance amount is claimed as deduction in subsequent year."*

Decision:

7.3. I have considered the reasons given by assessing officer & also the submissions of appellant. The assessee has made provision in respect of forward contract entered into

by it on the basis of difference in exchange rate prevailing as on the date on which forward contract has been booked and the exchange rate prevailing at the end of the year i.e. on 31.03.2008 as per MTM certificate issued by ABN Amro Bank. It is not in dispute that assessee is following mercantile method of accounting and as per this method, all the expenses/gains which pertains/arises during the year under consideration is required to be considered in the Profit and Loss account for that year itself. The provision entry has been made because the exchange as on 31st day of March has gone up as compared to the exchange rate of forward contract prevailing as on the date of transaction. In my view, the entry passed in the books of accounts in respect of the difference amount cannot be said to be in the nature of notional/unascertained liability as said entry is passed on the basis of actual exchange rate prevailing at the end of the year. The fluctuation in exchange rate has material bearing on the P & L A/c & as forward contract has been entered into during the year under consideration, losses/gain relating to the fluctuation in exchange rate pertaining to said forward contract should also be considered in P & L A/c for the year under consideration. It is also further seen that in the immediately succeeding year when forward contract has been cancelled, assessee has recognised expense/loss only in respect of the balance amount i.e. in respect of the amount in excess of the provision made during the year under consideration. Now, if any disallowance is made for the year under consideration, in that case corresponding deduction is required to be allowed in the subsequent year. However, there is no justifiable reason in doing such an exercise as treatment given by assessee in the books of accounts is in line with the accrual system of accounting and the same does not result into provision for any unascertained liability. Consequently, the addition made ***on this disallowance is hereby deleted."***

18. We have heard rival submissions. Relevant findings perused. The assessee has admittedly made the impugned provision in view of difference in exchange rate as on the date of booking of its forward contract vis-a-vis exchange rate prevailing as on 31.03.2008. It has fortified its claim in view of ABN Amro Bank's MTM certificate forming basis of the impugned provision. The Revenue fails to dispute that the assessee has followed mercantile system of accounting instead of cash system and it is accordingly supposed to account for all expenses/gains in the P&L account on the said basis. It thus emerges that assessee had sufficient reason to treat the impugned liability arising on account of foreign exchange rate difference so as to make the impugned provision as per the relevant accounting standard issued by the Institute of Chartered Accountants of India. We thus find no reason to restore the impugned disallowance. The Revenue's last substantive ground also fails. So is the outcome of its main appeal ITA No.1514/Ahd/2012.

19. We thus dismiss Revenue's appeal ITA No.1514/Ahd/2012 and allow assessee's cross objection no.184/Ahd/2012. Pronounced in the open Court on this 3rd day of January, 2017.

Sd/-	*Sd/-*
Pramod Kumar	**S.S. Godara**
(Accountant Member)	(Judicial Member)

Ahmedabad, the 3rd day of January, 2017

Copies to: *(1)* *The appellant*
(2) *The respondent*
(3) *Commissioner*
(4) *CIT(A)*
(5) *Departmental Representative*
(6) *Guard File*

By order

Assistant Registrar
Income Tax Appellate Tribunal
Ahmedabad benches, Ahmedabad