

Forex gain or loss, being an operating item would be adjusted while calculating margin of comparables

Summary – The Delhi ITAT in a recent case of SSP India (P.) Ltd., (the Assessee) held that Forex gain or loss from a trading transaction is not only an item of revenue nature, but is, in fact, a part of price of import or value of export transaction, hence an operating item

Facts

- The assessee-company was a wholly owned subsidiary of SSP (UK). It was a captive service provider and was engaged in providing support services for development and maintenance of software to SSP (UK).
- During the relevant assessment year, the assessee furnished a return of income declaring Nil income after claiming exemption under section 10A.
- As per the Transfer Pricing document furnished by the assessee, the assessee had entered into an international transaction for provision of software services. The arm's length price of the international transaction was determined by the assessee by applying TNMM. It was stated that the transaction was at arm's length price.
- The appellant had computed the PLI of the comparables by selecting a set of 10 comparables.
- The TPO excluded 9 comparables selected by the assessee and adopted a set of fresh 11 comparables and thus, computed the margin of the comparables with PLI as operating profit to operating cost (OP/OC) at 31.48 per cent. The TPO computed the net margin by considering foreign exchange gain/loss as non-operating item. On the aforesaid basis, the TPO made an adjustment of Rs. 2.70 crores.
- The DRP sustained the order of the TPO in computing net margin as required under TNMM by considering foreign exchange gain/loss as non-operating item. Further, pursuant to the directions of DRP out of the set of 12 comparables adopted by the TPO, one of the comparables namely Bodhtree Consulting Ltd. was directed to be excluded and margin was redetermined at 28 per cent on a set of 11 comparables.
- Pursuant to the above, the TPO passed a final order originally at an assessed income of Rs. 2.70 crores. However, subsequently, in pursuance to the DRP order, the Assessing Officer passed order determining the adjustment at Rs. 2.13 crores.
- On appeal to Tribunal:

Held

- The issue is no longer res-integra and stands concluded by the decision of the Coordinate Bench in the case of *Westfalia Separator India Pvt. Ltd. v. Asstt. CIT* [\[2014\] 52 taxmann.com 381 \(Delhi - Trib.\)](#) for assessment year 2003-04 wherein it has been held that forex gain or loss is the difference between the price at which an import or export transaction was recorded in the books of account on the basis of rate of foreign exchange then prevailing and the amount actually paid or received at the

rate of foreign exchange prevailing at the time of actual payment or receipt. Since such forex loss or gain is a direct outcome of the purchase or sale transaction, it partakes of the same character as that of the transaction to which it relates. Thus, forex gain or loss from a trading transaction is not only an item of revenue nature, but is, in fact, a part of the price of import or value of export transaction, as the case may be. Operating expense is ordinarily an expense that a business incurs as a result of performing its normal business operations. As the business of 'assembly' done by the assessee under this segment is not possible without purchases and forex gain is in relation to such purchase transactions, it is to be held that it is an item of operating cost.

- The revenue during the course of arguments, supported the action of the authorities below only on the ground that DRP has rejected the contention of the appellant by observing that the operating income/expenditure was never defined in any of the legislation so far. It was the conventional wisdom which went into the components of operating income/expenditure while calculating the operating profit. However, the position has changed since the notification of CBDT issued on 18-9-2013. This is the notification on 'Safe Harbour Rules'. Rule 10TA(j)(k) and (l) define the concept of 'operating expense', 'operating revenue' and 'operating profit' respectively. According to this rule, loss or income arising on account of foreign currency fluctuations are excluded from the calculation of 'operating expense' and 'operating income' respectively. Therefore the TPO was correct in excluding forex items from the calculation of operating profit.
- It is found on aforesaid basis that foreign exchange gain/loss should be treated as non-operating item is based on the Notification of CBDT issued on 18-9-2013 on safe harbour. However, such a contention has been rejected in the aforesaid order of the coordinate bench wherein it was held that rule 10T is a part of safe harbour rules notified on 18-9-2013 which are not applicable to the assessment year under consideration.
- Moreover, the Assessing Officer while computing the margin of the assessee, has adopted the foreign exchange loss as part of the operating cost; whereas while computing the margin of the comparables, he has treated foreign exchange gain/loss as non-operating item which is apparently contradictory and otherwise not in conformity with the aforesaid decision of the Tribunal. In light of the above, the Assessing Officer/TPO is directed to treat the foreign exchange gain/loss as an operating item. As such, the ground raised by the assessee is allowed.