

Bombay HC taxes exchange fluctuation after considering principles of AS-11

Summary – The High Court of Bombay in a recent case of Ballarpur Industries Ltd., (the Assessee) held that where the royalty and interest income were claimed as exempt on accrual basis in earlier years, forex fluctuation gain or loss arising on receipt of such income in subsequent period could not also be considered as exempt. Such gain or loss could not be considered as part of royalty or interest income and it should be taxed on basis of AS-11

Facts

- (a) Assessee-company had accounted for royalty and interest income on accrual basis, which were exempt under the then India-Malaysia DTAA.
- (b) During subsequent period, assessee had received such income more than that was accounted in earlier years due to exchange differences.
- (c) The assessee argued that the exchange difference should be treated as part of royalty and interest income. Accordingly, it would be exempt from tax as per India-Malaysia DTAA.

The High Court held as under:

1. Gain or loss arising on account of foreign exchange variation could not bear the same character of exempt income.
2. The revenue had correctly placed reliance on AS 11 which indicates that benefit derived on account of currency fluctuation after the year of accrual is to be considered as income or expense in the period in which they arise.
3. This gain/loss on account of foreign exchange fluctuation is not part of royalty and interest nor is it any accretion to it. In this case, it is the generation of further income which is taxable in the subject assessment year when the variation in foreign exchange has resulted in further income in India.
4. Thus, differential amount arising on account of exchange fluctuation was an extra income which would be subject to tax in the year in which it was received.

Editor's Note

- As per new India-Malaysia treaty India has right to tax interest and royalty income. However, the rate of tax shall not exceed 10% if the receipt of income is beneficial owner in the state of residence.