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Tax Flash News



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Unrealised foreign exchange gain arising on year-end reinstatement of ECB utilised for acquiring Indian assets held taxable

Executive summary

In the case of *Umicore Autocat*,[1] the Mumbai Bench of the Tribunal ('the Tribunal') examined whether the unrealised foreign exchange gain arising on the year-end reinstatement of the External Commercial Borrowings ('ECB') used to acquire assets in India constituted a capital receipt or a revenue receipt and, consequently, whether such gain was taxable under the Income-tax Act, 1961 Act ('the 1961 Act').

The Tribunal held that section 43A applies only to assets acquired from outside India and does not apply to assets acquired in India merely because the acquisition was financed through foreign currency borrowings.

The Tribunal further held that foreign exchange fluctuations relating to the ECB utilised for acquiring assets in India must be examined under section 43AA, which governs foreign exchange fluctuations not covered by section 43A.

[1] *Umicore Autocat India Private Limited* v. *DCIT* (ITA No. 419/Mum/2026)

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Facts of the case

The taxpayer, an Indian company, had taken ECB for acquisition of capital assets, both from outside India ('imported assets') as well as within India ('indigenous assets').

For FY 2016-17, the taxpayer recognised an unrealised foreign exchange gain arising on year-end reinstatement of the ECB and treated the gain as a capital receipt in its tax return.

The tax officer argued that section 43A only deals with the forex adjustments relating to imported assets and does not cover the indigenous assets. Accordingly, the tax officer apportioned the total unrealised gain based on the amount of investment in imported and indigenous capital assets and treated the portion attributable to indigenous assets as taxable income.

Relevant provisions

Section 43A provides that where any asset is acquired from outside India using a foreign currency liability, any foreign exchange difference arising at the time of repayment of such liability should be adjusted, by way of addition to or deduction from, the actual cost of the asset.

Section 43AA was introduced by the Finance Act, 2018 with retrospective effect from 1 April 2017 (i.e. applicable from FY 2016-17). It provides that, *subject to the provisions of section 43A*, any foreign exchange gain or loss arising on account of any change in foreign exchange rates should be treated as income or loss computed in accordance with the notified income computation and disclosure standards. The section applies with respect to all foreign currency transactions, including those relating to monetary and non-monetary items.

Taxpayer's contentions

ECB was raised specifically for acquiring capital assets and, therefore, any gain arising from foreign exchange fluctuations retained the character of a capital receipt. Accordingly, such gain could not be brought to tax as business income in the absence of a specific charging provision under the 1961 Act.[2]

Invoked the 'real income theory' to contend that the unrealised foreign exchange gain arising on reinstatement of ECB at year-end was purely notional and could not be treated as real income.[3] The total amount of unrealised gain was merely a book entry made at the year-end to comply with the prescribed accounting standards, with no

[2] *Sutlej Cotton Mills Ltd.* v. *CIT* [1979] 116 ITR 1 (SC); *CIT* v. *Dempo & Co. Pvt. Ltd.* [1994] 206 ITR 291 (Bombay)

[3] *Godhara Electricity Co. Ltd.* v. *CIT* [1997] 225 ITR 746 (SC); *CIT* v. *Excel Industries Ltd.* [2013] 358 ITR 295 (SC)

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actual repayment of the ECB, and hence no real gain crystallised during the year.

Section 43A is a machinery provision for adjusting actual cost of the capital asset (for subsequent computation of depreciation) and not a charging section. The inability to reduce the cost of an indigenous asset under section 43A did not automatically transform a capital receipt into a revenue receipt.

Tribunal's decision



The Mumbai Bench of the Tribunal upheld the addition of unrealised foreign exchange gain on ECB liability incurred for acquisition of indigenous assets.

Key observations of the Tribunal included:

Applicability of section 43A

Section 43A deals with adjustment on account of change in foreign exchange rate relating to imported assets. The fact that the consideration for acquiring indigenous assets was financed through ECB did not, by itself, render the acquisition of such assets as acquisition from outside India.

Accordingly, the foreign exchange gain arising on reinstatement of the ECB liability utilised for acquiring indigenous assets would not attract section 43A.

Applicability of section 43AA

Once section 43A is held to be inapplicable, the foreign-exchange fluctuation arising from the reinstatement of the ECB liability is required to be examined under the otherwise applicable statutory framework, including section 43AA.

Section 43AA does not, in its application, distinguish merely on the basis of whether the underlying foreign-currency transaction has a capital or revenue character.

Our comments



This ruling provides important guidance on the interplay between sections 43A and 43AA in the context of foreign currency borrowings used for acquiring capital assets. It clarifies that foreign exchange fluctuations on borrowings used for acquiring assets in India do not fall outside the tax net merely because section 43A is inapplicable and may require examination under section 43AA.

[3] *Godhara Electricity Co. Ltd.* v. *CIT* [1997] 225 ITR 746 (SC); *CIT* v. *Excel Industries Ltd.* [2013] 358 ITR 295 (SC)

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