AFR

Court No. - 3

Case :- INCOME TAX APPEAL No. - 137 of 2015

Appellant :- Shri Ram Kutir Khandsari Udyog Pvt. Ltd.
Respondent :- Principal Commissioner Of Income Tax-1 Ashok Marg Lucknow
Counsel for Appellant :- Surendra Kumar Garg, Ashish Bansal, Shashank Dhaon, R.C. Bansal
Counsel for Respondent :- Ghanshyam Chaudhary, Manish Mishra

Hon'ble Sudhir Agarwal,J.
Hon'ble Ravindra Nath Mishra-II,J.

1. Heard Sri R.C. Bansal & Sri Shashank Dhaon, learned counsel for appellant and Sri Manish Mishra, learned counsel for respondent.

2. This appeal under Section 260-A of Income Tax Act, 1961 (hereinafter referred to as the "Act, 1961") has been filed by *M/s Shri Ram Kutir Khandsari Udyog Pvt. Ltd.* (hereinafter referred to as "Assessee") being aggrieved by order dated 10.07.2015 passed by Income Tax Appellate Tribunal, Lucknow Bench 'B', Lucknow (hereinafter referred to as the "Tribunal") in ITA No. 630/LKW/2014.

3. The dispute relates to Assessment Year (hereinafter referred to as "A.Y.") 2010-11.

4. Learned counsel for parties at the outset agreed that there are only two substantial questions of law which need be admitted in this appeal, read as under:-

> "*(i) Whether on a true and correct application of the provisions of Section 145 the Tribunal was legally correct in upholding an addition of Rs. 63,05,208/- as had been made in the assessment on account of alleged under-valuation of closing stock?*
>
> *(ii) Whether the valuation of closing stock being based on "realizable value" as had been quantified by actual realisation*

after the close of the accounting year could be validly interfered with by the Tribunal, even though assessee's version stood fully supported by the accounting principle and law laid down by the Hon'ble Apex Court?"

5. Facts in brief necessary to appreciate and answer the aforesaid questions are stated as under.

6. Assessee is a private limited Company incorporated under the provisions of Companies Act, 1956 (hereinafter referred to as "Act, 1956"). It is engaged in manufacture of 'khandsari sugar' having its industrial unit at Lakhimpur Kheri.

7. The return of income for A.Y. 2010-11 was filed on 09.10.2010 declaring total income of Rs. 48,13,070/-. The case was selected for scrutiny. Notice under Section 143(2) of Act, 1961 was issued on 29.09.2011 and thereafter, further notices were issued under Section 143(2) and 142(1) alongwith questionnaire, etc.

8. Assessing Officer (hereinafter referred to as "A.O.") completed assessment order on 26.03.2013 making addition of Rs. 63,05,208/- towards suppressed value of closing stock and Rs. 1 lac towards transportation and installation charges. The total income as per assessment order was determined at Rs. 1,12,18,280/-.

9. Aggrieved thereto, Assessee preferred appeal before Commissioner of Income Tax (Appeal)-II (hereinafter referred to as "CIT(A)"). CIT(A) allowed appeal by deleting addition of Rs. 63,05,208/- and also granting relief of Rs. 50,000/- in respect of addition of Rs. 1 lac towards transportation charges, etc.

10. An appeal was filed by Revenue before Tribunal and Assessee preferred cross-objection. Tribunal while considering appeal of Revenue with regard to deletion of Rs. 63,05,208/- by CIT(A) accepted contention of Revenue that valuation of closing stock has to

be made on the market price closing on 31.03.2010 and, hence set aside order of CIT(A) with respect to valuation of stock and restored order of A.O. However, with respect to deletion of Rs. 50,000/- in regard to transportation charges, etc., appeal of Revenue was not accepted. Assessee's cross-appeal was dismissed.

11. Hence Tribunal allowed appeal of Revenue though partly but granting substantial relief by upholding addition of Rs. 63,05,208/- made by A.O. and otherwise findings recorded by CIT(A) were reversed.

12. In this backdrop, a question has to be considered about principles on which valuation of closing stock has to be made. In this regard, Tribunal has relied on the judgment in **Commissioner of Income Tax versus British Paints India Ltd. (1991) 188 ITR 44**.

13. Before us also, learned counsel appearing for Revenue relied on the same while on the part of Assessee reliance is placed on another judgment in **Challapalli Sugars Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad (1975) 98 ITR 167 (SC)**.

14. Closing stock of khandsari sugar disclosed by Assessee as on 31.03.2010 was 23,096 quintals. During subsequent period of April, 2010 to August, 2010, total quantity of 19031 quintals was sold out upto August, 2010. The month-wise break-up of quantity of khandsari sugar sold out and the price fetched to Assessee as also the average rate per quintal disclosed by Assessee is as under:-

Khandsari Sugar 1st class	**Weight in Qtl.**	**Sale amount in Rs.**	**Average rate per Qtl.**
April, 2010	2800	8628560	3082
May, 2010	1850	5636800	3047
June, 2010	320	886400	27770
July, 2010	6600	18516880	2806
August, 2010	7461	19375170	2597
Total Average	**19031**	**53043810**	**2787**

15. A.O. while referring to judgment in **Commissioner of Income Tax versus British Paints India Ltd. (supra)** observed that valuation of stock should be done either at cost price or market price, whichever is lower, on the closing date which in the present case is 31.03.2010. In view thereof, he further observed that average price fetched to the Assessee between April, 2010 to August, 2010 will not be relevant for determining cost of closing stock as on 31.03.2010. He, thereafter, took the price of khandsari sugar received by Assessee as on 02.04.2010, i.e., Rs. 3060/- and on that basis, A.O. made valuation of closing stock which came to Rs. 63,05,208/-.

16. CIT(A) while taking an otherwise view held that valuation of closing stock by Assessee, on the basis of net realisable value, and also considering the accounting standard is justified and in consonance with the law laid down in **Chainrup Sampatram versus Commissioner of Income Tax (1953) 24 ITR 481 (SC)** and in **Challapalli Sugars Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad (supra)**. He also observed that judgment in **Commissioner of Income Tax versus British Paints India Ltd. (supra)** would not be applicable in a case where system adopted by Assessee will not result in determination of cost, illusory or distorted, or vague, or improper.

17. Broadly speaking, a closing stock by itself is not to be treated as income. No such provision has been shown to us by learned counsel for Revenue under the Act, 1961. However, valuation of stock in trade at the end of Accounting Year is computed for the purpose of determining profit and gains for the purpose of income tax which cannot be an exact and correct income which an Assessee may actually receive but it always involves a kind of estimation. Lord President in **Whimster and Co. versus CIR (1925) 12 Tax Cases 813**, said:

> "........ *in computing the balance of profit and gains for the purposes of incomes-tax, ...two general and fundamental common places have always to be kept in mind. In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and the expenditure laid out to earn those receipts. In the second place, the account of profits & loss to be made up for the purpose of ascertaining that difference must be framed consistently with the ordinary principles of commercial accounting, so far as applicable and in conformity with the rules of the Act, 1961, or of that Act as modified by the provisions and schedules of the Acts regulating excess profits duty, as the case may be. For example,* ***principles of commercial accounting require that in the profit and loss accounts of merchant's or manufacturer's business, the values of the stock- in-trade at the beginning and at the end of the period covered by the account should be entered at cost or market price, whichever is lower, although there is nothing about this in the taxing statute*****.....**" *(emphasis added)*

18. The above passage was quoted with approval in **Commissioner of Income Tax versus British Paints India Ltd. (supra)** where Court said that a well recognized principle of Commercial Accounting to enter in the profit and loss account is value of stock in trade at the beginning and at the end of Accounting Year at cost or market price whichever is lower. Cost also held, where market value has fallen before date of valuation and on that date market value of article is less than its actual cost, Assessee is entitled to value the article at market value and thus anticipate loss which he will probably incur at the time of sale of goods.

19. This Court also in **Commissioner of Income Tax, Central Circle, Kanpur Vs. Income Tax Settlement Commissioner, IV**

Floor and another, Writ Tax No. 773 of 2013 decided on 29.08.2016, in para 53 and 57, observed as under:-

> "*53.* ***Valuation of stock-in-trade at cost or market value, whichever is lower, is a matter entirely within the discretion of Assessee****. But whichever method he adopts,* ***it should disclose a true picture of his profit and gains****. If, on the other hand,* ***he adopts a system which does not disclose true state of affairs for determination of tax, even if ideally suited for other purposes of his business, such as the creation of a reserve declaration of dividends, planning and the like, it is duty of Assessing Officer to adopt any such computation as he deems appropriate for proper determination of true income of Assessee****. This is not only a right but a duty that is placed on the Officer, in terms of first proviso to Section 145 which concerns a correct and complete account but which, in the opinion of Officer does not disclose a true and proper income.*
>
> *57.* ***Profits of business*** *could only be ascertained by comparison of assets and liabilities of the business* ***at the opening and closing of the accounting year****. The method that an Assessee adopts for closing is an integral part of accounting, within the meaning of section 145.* ***There are different methods of valuation of closing stock****. The popular* ***system is cost or market, whichever is lower****. However,* ***adjustments may have to be made in the principle, having regard to the special character of assets****, the* ***nature of the business****, the* ***appropriate allowances permitted****, etc., to arrive at taxable profits.* " *(emphasis added)*

20. In the present case, Tribunal has not looked into this aspect of the matter that valuation can be made on the basis of actual cost price, marketing rate whichever is lower and instead it has taken only

the market rate and that too as on 02.04.2010 that is just one day later to determining for valuation of stock in trade which is not consistent with the law laid down as discussed above.

21. In the matter of Sugar as we have noted above in **Commissioner of Income Tax versus Ponni Sugars and Chemicals Ltd. (2008) 306 ITR 392 (SC)** Court allowed valuation of closing stock at levy price though it was less than cost of manufacturer of sugar. A.O. in fact has completely lost sight that the intention of valuation of stock in trade is not to penalize Assessee by computing a hypothetical income which has yet to be earned by Assessee but the object is that a proper valuation of entire stock must be available so that profit and loss in the particular Assessment Year must be asserted in the best possible manner.

22. We, therefore, are of the view that Tribunal has erred in law in upholding valuation of closing stock on the basis of price received by Assessee on 02.04.2010 and not in the light of principles as discussed above that is the actual cost price or market rate whichever is lower.

23. Appeal is, accordingly, allowed. We, therefore, answer both the questions in favour of Assessee and set aside judgment of Tribunal on this aspect. This is with regard to addition of Rs. 63,05,208/-. However, we remand the matter to Tribunal to reconsider the valuation of closing stock in the light of principles discussed above and pass appropriate order in accordance with law expeditiously.

24. There shall be no orders as to costs.

Order Date :- 2.2.2017
Shubham