

आयकर अपीलीय अधिकरण "B" न्यायपीठ मुंबई में।

**IN THE INCOME TAX APPELLATE TRIBUNAL "B" BENCH, MUMBAI
BEFORE SHRI MAHAVIR SINGH, JUDICIAL MEMBER
AND SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER**

आयकर अपील सं./I.T.A. No.1138/Mum/2016

(निर्धारण वर्ष / Assessment Year: 2010-11)

DCIT CENTRAL CIRCLE 8(1) R.No. 656, 6 th Floor, Aayakar Bhavan, M.K Road, Mumbai- 400020	बनाम/ v.	M/s. Borsad Tobacco Co. Pvt. Ltd., 21 ST Floor , Nirmal, Nariman Point, Mumbai-400021
स्थायी लेखा सं./PAN : AAACB5089K		
(अपीलार्थी / Appellant)	..	(प्रत्यर्थी / Respondent)

आयकर अपील सं./I.T.A. No.620/Mum/2016

(निर्धारण वर्ष / Assessment Year: 2010-11)

M/s. Borsad Tobacco Co. Pvt. Ltd., 21 Floor, Nirmal, Nariman Point, Mumbai-400021	बनाम/ v	DCIT , CENTRAL CIR 8(1) Mumbai
स्थायी लेखा सं./PAN : AAACB5089K		
(अपीलार्थी / Appellant)	..	(प्रत्यर्थी / Respondent)

Assessee by:	Dr. K. Shivaram Shri. Rahul K. Hakani
Revenue by :	Shri. D.G. Pansari (DR)

सुनवाई की तारीख /**Date of Hearing** : 27-08-2018

घोषणा की तारीख /**Date of Pronouncement** : 07-09-2018

आदेश / ORDER

PER RAMIT KOCHAR, Accountant Member

These cross appeals, filed by Revenue as well as by Assessee, being ITA No. 1138/Mum/2016 & ITA no. 620/Mum/2016 respectively both for assessment year 2010-11 are directed against the appellate order dated 30.11.2015 passed by learned Commissioner of Income-tax (Appeals)-50, Mumbai (hereinafter called "the CIT(A)"), the appellate proceedings had

arisen before learned CIT(A) from the assessment order dated 26.03.2013 passed by learned Assessing Officer (hereinafter called "the AO") u/s 143(3) of the Income-tax Act, 1961 (hereinafter called "the Act"). Both the Revenue and the assessee are aggrieved by the appellate order dated 30.11.2015 passed by learned CIT(A), hence these cross appeals before the Income-Tax Appellate Tribunal, Mumbai.

2. The grounds of appeal raised by the Revenue in the memo of appeal filed with the Income-Tax Appellate Tribunal, Mumbai (hereinafter called "the tribunal") in ITA no. 1138/Mum/2016 for AY 2010-11, read as under:-

"(1) On the facts and in the circumstances of the case and in law, the Ld CIT(A) has erred in deleting the addition of Rs. 3,35,68,481/- on account of low GP without appreciating the fact that the assessee has only submitted a general reply with regard to the low GP during the year in comparison with the GP of the earlier years and not substantiated the same with facts and figures and therefore, the AO was correct in estimating the GP as he was not satisfied with the correctness of the accounts of the assessee.

The Appellant prays that the order of the CIT-(A), on the above grounds be set aside and that of the Assessing Officer be restored.

The appellant craves leave to amend or alter any ground and /or add new grounds which may necessary."

3. The grounds of appeal raised by the assessee in the memo of appeal filed with the tribunal in ITA no. 620/Mum/2016 for AY 2010-11, read as under:-

"1) The learned CIT(A) erred in confirming disallowance of Staff Welfare Educational Benefit (Hanifa School) expenses of Rs. 19,59,268/- incurred for education of children of employees by invoking s. 40A(9) r.w.s. 40A(1) without appreciating that the said expenses were in the nature of reimbursement and thus not hit by the prohibition u/s. 40A(9) and that the said expenses were laid out wholly and exclusively for the business of the assessee and allowable u/s. 37 of the Income Tax Act, and hence the disallowance of Rs. 19,59,268/- ought to be deleted.

2) The learned CIT(A) erred in confirming disallowance of Staff Welfare Educational Benefit (Hanifa School) expenses of Rs. 19,59,268/- incurred for education of children of employees by invoking s. 40A(9) r.w.s. 40A(1) by treating the said expenses as donation without appreciating that donation is not covered by S. 40A(9) and hence the disallowance of Rs. 19,59,268/- ought to be deleted.

3) *Without prejudice to above, the staff welfare Educational Benefit (Hanifa School) expenses of Rs. 19,59,268/- incurred for education of children of employees is laid out wholly and exclusively for business on grounds of commercial expediency and hence the said expenses are allowable u/s. 37 of the Income Tax Act.*

4) *The Appellant craves leave to add, amend, alter or delete any of the above grounds of appeal.”*

4.1 These are cross appeals filed by revenue as well as by assessee . Each of the respective appeal filed before the tribunal by assessee and revenue raises singular issue per grounds of appeal filed by the respective appellant, which we will deal hereinafter in this order .

4.2 The brief facts of the case are that the assessee is in the business of manufacturing & trading of tobacco products and r w tobacco.

4.3 The solitary issue raised in the Revenue’s appeal concern itself with the additions made by the AO owing to low gross profits earned by the assessee during the previous year relevant to the impugned assessment year vis-a-vis preceding years , which additions as were made by the AO stood deleted by learned CIT(A).

4.4. The solitary issue arising in assessee’s appeal concern itself with disallowance of payments made to Hanifa School which is being run by a Trust namely M/s. Aisha Bai Hazi Abdul Latif Charitable Trust situated at Borsad , where the assessee factory is stated to be situated.

Revenues Appeal in ITA no. 1138/Mum/2016-AY 2010-11

5.1 During the course of assessment proceedings u/s 143(3) r.w.s. 143(2) of the 1961 Act, the AO observed that the turnover in relevant previous year of the assessee has increased while the assessee has reported losses . The AO asked the assessee to submit comparative GP Ratio of preceding three years and justify the fall in GP ratio over the last three years. The assessee has earned GP ratio for the last three years as detailed hereunder:-

<i>Assessment year</i>	<i>Total Turn Over (Rs.)</i>	<i>Gross Profit (%)</i>	<i>Net Profit</i>
2008-09	18,33,19,831	24.61	5.68

2009-10	30,74,57,182	16.09	3.65
2010-11	41,08,01,086	7.92	N.A.

Thus in the impugned assessment year under consideration before us, the GP ratio was 7.92% as against 24.61% earned by the assessee for AY 2008-09 and 16.09% for AY 2009-10. The assessee submitted before the AO that during the previous year under consideration, there was huge stock holding as at the end of the year. It was submitted that the monsoon was quite favourable and hence the yield of tobacco was huge. The market rate of tobacco got effected due to bumper crop. It was submitted that the buyers/traders were only interested to purchase new crop of tobacco only which led to demand of old stock of tobacco falling remarkably. It was submitted that the assessee's closing stock became non moving and due to fall in market demand, the prices also fell. It was submitted that assessee invited quotations from different traders and based on the quotation of market prices as on 31.03.2010, the stock in hand as on 31.03.2010 was valued at cost or market price whichever is less. It was submitted that said pricing method for valuing inventory is accepted all across all the industries, It was submitted that neither the 1961 Act nor Income-tax Rules, 1962 prescribe or permit any particular method of valuation of stock. It was also submitted that valuing inventories at lower of cost or market price whichever is lower is as per method of valuation as prescribed by accounting standard AS-2 issued by ICAI.

5.2 The AO rejected the contentions of the assessee. The AO observed that the assessee could not explain fall in GP ratio. **The AO observed that no facts were presented by the assessee as to damage to closing stock and also no evidences are brought on record to prove that the prices of raw material declined substantially.** It was observed by the AO that the turnover of the assessee increased by 22.60%, 67.72% and 33.61% for AY 2008-09, 2009-10 and 2010-11 respectively, while GP ratio and NP ratio are failing over this period. The AO applied GP ratio of 16% to total turnover declared by the assessee of Rs. 41,08,01,086/- during relevant previous year

under consideration based on declared GP ratio of 16.09% for AY 2009-10 and additions to the tune of Rs. 3,35,68,481/- were accordingly made to the income of the assessee being differential GP ratio declared by the assessee of 7.92% and assessed GP ratio of 16% for impugned assessment year 2010-11, vide assessment order dated 26-03-2013 passed u/s 143(3) of the 1961 Act .

6.1 Aggrieved by the assessment order dated 26.03.2013 passed by AO u/s 143(3) of the 1961 Act , the assessee filed first appeal before Ld. CIT(A) .

6.2 The assessee submitted before learned CIT(A) that AO has not pointed out any flaw in the valuation of the closing stock or in the books of accounts maintained by the assessee. It was submitted that the additions were made arbitrarily by the AO. It was submitted that the prices of the raw materials have come down drastically which resulted in low GP ratio. It was submitted that accepted principles for valuation of inventory i.e. lower of cost or market price was followed and the said method of valuation is in sync with accounting standard AS-2 prescribed by ICAI . The assessee in order to justify that correct method of valuation was followed by it, relied upon the following judgments:-

- (i) *Gujrat High Court in Echke Ltd. v. CIT (173 Taxman 79 Guj)*
- (ii) *Madras High Court in the case of K. Mohamad Adam Sahib v. CIT , 561 ITR 360 Madras HC.*

6.3 The Ld. CIT(A) observed that no discrepancy was pointed out by AO nor any shortcoming in books of accounts were pointed by AO. It was observed by learned CIT(A) that the assessee has given reply that fall in gross profit ratio is due to the fall in the prices of the closing stock valuation. The AO merely rejected the explanation of the assessee and proceeded to estimate GP ratio. The learned CIT(A) observed that action of the AO is arbitrary as low GP ratio could be an indicator of probable suppression of income to trigger investigation but it cannot be a basis for making an addition and more so in the instant case when there is no omission on the part of the assessee. It was also observed by learned CIT(A) that no defects were pointed by the AO in assessee's books of accounts and the additions were made without rejecting books of accounts . The learned CIT(A) deleted the additions and granted relief to the assessee by holding that the action of the

AO is grossly illegal , vide appellate order dated 30.11.2015 passed by learned CIT(A).

7.1 Aggrieved by the appellate order dated 30.11.2015 passed by learned CIT(A), the Revenue has come in an appeal before the tribunal. The Ld. DR relied upon the order of the AO.

7.2 While on the other hand Ld. Senior Counsel for the assessee submitted that books of accounts were not rejected by AO . It was submitted that GP ratio was estimated by the AO without rejecting books of accounts which is not sustainable in eyes of law. The learned Senior Counsel drew out attention to page no. 77-84 of the paper book wherein it was submitted that complete reasoning of fall in GP ratio was submitted before the AO during the course of assessment proceedings . It was submitted that reasons for fall in GP ratio was the bumper crops of tobacco during relevant period and the buyers/ traders preferred new crop which led to fall in value of stock in hand and hence lower valuation for closing stock in hand , which led to fall in GP ratio. It was submitted that quotations were invited from other traders to prove that prices of tobacco had fallen and hence valuation on closing date of the year was at a lower value

7.3 The Ld. DR in rejoinder submitted that no details/evidences were submitted by assessee before the authorities below as to any damage to the stock held by the assessee or as to low prices prevailing of tobacco due to bumper crop .

8. We have considered rival contentions and have perused the material on records including orders of the authorities below and case laws cited before us . We have observed that the assessee is in the business of manufacturing & trading of tobacco products and raw tobacco. The assessee has reflected following sales and GP ratio in the three years since AY 2008-09 to 2010-11, detailed of which are as hereunder:-

<i>Assessment year</i>	<i>Total Turn Over (Rs.)</i>	<i>Gross Profit (%)</i>	<i>Net Profit</i>
2008-09	18,33,19,831	24.61	5.68
2009-10	30,74,57,182	16.09	3.65

2010-11	41,08,01,086	7.92	N.A.
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As could be seen from above details of turnover and GP ratio of three years, the turnover of the assessee has increased from Rs. 18.33 crores during AY 2008-09 to Rs. 41.08 crores in AY 2010-11, while the GP ratio has fallen from 24.61% to 7.92% in the same period. The claim of the assessee for substantial fall in GP ratio is mainly resting on the contention that there was a bumper crop of tobacco which led to excess supply in the market leading to crash in prices of raw material wherein traders/buyers rushed to buy new crops of tobacco at lower prices. The assessee had claimed that since the assessee held old stock of tobacco in large quantities, it led to loss in value of stock in hand due to fall in prices of old tobacco as well lack of demand for old tobacco as the traders/buyers preferred buying new crop of tobacco. We have observed that the assessee has not placed any evidence on record to substantiate this contention of bumper prices and crash in prices of tobacco before any authorities including before tribunal and the claim is resting on statements which are not supported or corroborated with any evidence. The assessee has however produced quotations from three different Tobacco merchants/agents who have stated to have shown intention to buy different varieties of tobacco/tobacco products available at the assessee's premises after inspecting stock held by the assessee at the prices quoted by these tobacco merchants/agents. The said three quotations all dated 02-04-2010 from tobacco merchants and agents are placed in paper book (page 82-84). The prices quoted by these tobacco merchants/agents showing their intention to buy the available material of tobacco and tobacco products at assessee's site is stated to be at a lower price than cost of acquisition of these varieties of tobacco for reasons cited by the assessee as detailed above. Apart from these three quotations, there is no other evidence on record to corroborate or substantiate contention of the assessee to justify valuing inventory at substantially lower valuation. The assessee justified that it adopted method of valuation of stock being cost or market price whichever is lower which is in sync with the mandatory

accounting standard AS-2 issued by ICAI and the same should be accepted. Perusal of tax audit report at clause 12(a)(page number 25/pb) reveals that Chartered Accountant auditing the accounts of the assessee has certified that the assessee is consistently following the method of valuation for valuing raw material , packing material on weighted average basis which is valued at cost , while the assessee is claiming that it is valuing raw material at cost or market value whichever is lower which is in contrast to what is certified by tax-auditor of the assessee as certified in clause 12(a) of tax audit report. The assessee is however valuing finished/traded goods at cost or net realisable value whichever is lower. Perusal of the audited financial statements reveal that the assessee hold substantial inventory of Raw Material (including tradable Raw Material) to the tune of Rs. 11.61 crores (Preceding Year Rs. 14.72 crores) as at 31-03-2010 out of total inventory of Rs. 12.32 crores(Preceding Year Rs. 15.88 crores). This discrepancy in method of valuation of raw material as adopted by the assessee and as reported by tax-auditor as well bonfide of the change in method of valuation of raw material has not been explained by the assessee. It has also not been looked into by the authorities below The assessee did not presented any cogent evidences to corroborate its contention as to bumper crop of tobacco and its prices crashing owing to bumper crop. None of the authorities below have also verified the claim of the assessee as to bumper crop and crash in prices and there is no evidence on record to justify such contention except quotations all dated 02-04-2010 from three traders/ agents proposing to buy different varieties of tobacco from the assessee at a particular price which is claimed by the assessee to be substantially lower prices due to bumper crop of tobacco. These quotations in the absence of corroborative evidence does not inspire confidence . The bonafide of change in method of valuation of raw material from 'cost' basis to 'cost or market value whichever is lower' has not been explained by the assessee . The method adopted by the assessee for valuing raw material held as closing stock is in variance to what is stated by tax-auditor to be method of valuation of stock. None of the authorities below have made any enquiry or verifications as to contentions/ evidences filed by the assessee and no verification of the claim of the assessee was undertaken. The AO held that the assessee has not submitted sufficient evidence to substantiate that there was damage to stock nor any evidences are placed on

record that prices of raw material declined substantially . The learned CIT(A) blamed the AO of having taken arbitrary action without any investigation and without rejecting books of accounts. The learned CIT(A) observed that the AO did not pointed out any defect or discrepancy in books of accounts of the assessee nor books of accounts were rejected by the AO before making additions but learned CIT(A) did not went ahead and made verifications and enquiries as were warranted in the case. The 1961 Act postulate finding of correct income which is to be brought to tax and it was incumbent on authorities below to have gone into the evidences and books of accounts to see the bonafide of the assessee's claim as to low valuation of inventory based on fall in prices due to bumper crop. The learned CIT(A) whose powers are coterminous with the AO entered into blame game rather than evaluating evidences and making necessary enquiry as were warranted before arriving to compute income of the assessee chargeable to tax as per provisions of the 1961 Act . The learned CIT(A) simply accepted contentions of the assessee without evaluating evidences on record and without seeing that there was a change in method of valuation of inventory and its bonafide was not seen by any of the authorities below. We have also observed that in the immediately preceding year i.e. AY 2009-10, the assessment was framed by Revenue u/s 143(3) r.w.s. 153A vide assessment orders dated 31.12.2010 pursuant to search conducted by Revenue on 29.04.2008 against the assessee u/s 132(1) of the 196 Act , wherein additions have been made towards discrepancies in the stock wherein at different locations/ premises belonging to the assessee excess physical stock was found to the tune of Rs. 13.01 lacs while at the same time , in some of the locations/premises belonging to the assessee , excess book stock to the tune of Rs. 55.76 lacs was found. The rollover impact of such addition made by the AO in assessment of the AY 2009-10 to the year under consideration as was done by the assessee is not looked into by authorities below nor the authorities below looked into as to how the assessee adjusted said discrepancies in stock in its books of accounts which found itself manifested in AO making additions for said discrepancies in stock while framing assessment u/s 143(3) r.w.s. 153A . Thus, keeping in view totality of facts and circumstances of the case with a view to render justice to both the parties and fair play, we are of the considered view that the issue arising in this matter need to be set aside and

restored to the file of the AO for fresh denovo determination of the issue on merits in accordance with law, after conducting necessary verifications and enquiry as is warranted under the circumstances enumerated above. Needless to say that the AO shall provide proper and adequate opportunity of being heard to the assessee in denovo assessment proceedings in accordance with principles of natural justice in accordance with law. The evidences submitted by the assessee in denovo proceedings in its defence shall be admitted by the AO to be adjudicated on merits in accordance with law. This ground raised by Revenue is allowed for statistical purposes. We order accordingly.

ITA NO.620/MUM/2016-AY 2010-11

9 The second issue before us arose is in the appeal filed by the assessee and concern itself with respect to the payment made by the assessee of Rs. 19,59,268/- to 'Hanifa' School which is being run by a Trust namely M/s. Aisha Bai Hazi Abdul Latif Charitable Trust situated at Borsad, where the assessee factory is stated to be situated and its stated to be a rural area . The claim is made by the assessee that the employees of the assessee benefited due to the school located at Borsad as employees children are studying in the said school which is beneficial for the assessee's business . It is claimed that Borsad is a rural area and this school enable children of the employees to get education. The claim of commercial expediency was set up to claim that these expenses have direct nexus with the business of the assessee as in the rural area Borsad where factory of the assessee is situated the employees children study in this school which enable assessee to hire and retain these employees as in the absence of the school in rural area , the employees may not join or stay with the assessee, hence business nexus and commercial expediency in paying for school expenses .These expenses are claimed by the assessee to be in the nature of reimbursement by way of short fall in the expenses of the aforesaid school . The assessee has claimed these expenses as business expenses under the head 'Staff Welfare Educational Benefit (Hanifa School)' . The said claim set up by the assessee has already been rejected by the both the authorities below. The AO rejected these expenses on the grounds that the assessee failed to prove that the 'Hanifa' School is only used for education of employees children . The AO

also observed that the assessee failed to prove that no outsiders are admitted in the school and that no fee is collected from the above activities.

10. The assessee filed first appeal with learned CIT(A) who also dismissed appeal by holding that these payments do not constitute expenditure incurred for business of the assessee. The learned CIT(A) held that the school is run by a trust and the expenses were incurred by Trust and not by the assessee. The learned CIT(A) held that assessee has made donations to the Trust and governing section is Section 80G of the 1961 Act. The learned CIT(A) held that these deductions are prohibited by Section 40A(9) of the 1961 Act read with Section 40A(1) of the 1961 Act.

11 Aggrieved by the dismissal of the appeal by learned CIT(A), the assessee filed second appeal before the tribunal. Before us arguments have been advanced by Ld. Senior Counsel for the assessee in support of the contention while Ld. DR supported order of authorities of below . On being asked by the Bench about the details of the employees children who were studying in the school during the relevant period and other details concerning the school such as location of the school and other school in the vicinity , total children studying in the school , details of children of employees who were studying in the said school etc so as to justify and prove direct nexus of these expenses with business of the assessee so as to prove that these expenses were wholly and exclusively incurred for the business and the assessee . The Ld. Senior Counsel for the assessee submitted that presently these details are not readily available on record but if an opportunity is granted by setting aside and restoring the matter to the file of the AO for framing denovo fresh assessment, the assessee will produce all the records before the AO which AO can verify . Thus in nutshell prayer is made by learned Senior Counsel for the assessee to set aside and restore this issue back to file of the AO to enable assessee to prove with cogent evidences that these expenses were incurred wholly and exclusively for the purposes of business of the assessee. Thus considering the submissions of the assessee and factual matrix of the case as is emerging from records with a view to render complete justice to both the rival parties, we are of the considered view that the matter need to be set aside and restored to the file of the AO for framig denovo fresh assessment. The assessee is directed to produce all relevant

records before the AO as discussed by us as above to prove that these expenses were incurred wholly and exclusively in connection with the business of the assessee satisfying mandate of section 37(1) of the Act. The onus is on the assessee to prove and justify that these expenses are business expenses satisfying mandate of Section 37(1) of the 1961 Act as it is the assessee who has made claim for deduction of these expenses from its income. We would like to clarify that we have not commented on the merits of the case and all contentions are left open to be decided by the AO on merits in accordance with law. Needless to say that the AO shall provide proper and adequate opportunity of being heard to the assessee in denovo assessment proceedings in accordance with principles of natural justice in accordance with law. The evidences submitted by the assessee in denovo proceedings in its defence shall be admitted by the AO to be adjudicated on merits in accordance with law. This ground raised by assessee is allowed for statistical purposes. We order accordingly.

12. In the result, the appeal filed by the assessee in ITA no. 620/Mum/2016 is allowed for statistical purposes.

13. In the result both the appeals filed by the assessee in ITA no. 620/Mum/2016 and by revenue in ITA no. 1138/Mum/2016 are allowed for statistical purposes

Order pronounced in the open court on 07.09.2018

आदेश की घोषणा खुले न्यायालय में दिनांक: 07.09.2018 को की गई ।

Sd/-
(MAHAVIR SINGH)
JUDICIAL MEMBER

Sd/-
(RAMIT KOCHAR)
ACCOUNTANT MEMBER

Mumbai, dated: 07.09.2018

Nishant Verma
Sr. Private Secretary

copy to...

1. The appellant
2. The Respondent
3. The CIT(A) – Concerned, Mumbai
4. The CIT- Concerned, Mumbai
5. The DR Bench,
6. Master File

// Tue copy//

BY ORDER

DY/ASSTT. REGISTRAR
ITAT, MUMBAI

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