

**IN THE INCOME TAX APPELLATE TRIBUNAL “B” BENCH, MUMBAI
BEFORE SRI MAHAVIR SINGH, JM AND SRI RAJESH KUMAR, AM**

**ITA No.142/Mum/2012
(A.Y:2008-09)**

Balkrishna Industries Ltd. BKT House, C Wing, 15 th Floor, Trade World, Kamal Mills Compund, Senapati Bapat Marg, Lower Parel Mumbai-400 013	Vs.	Addl. Commissioner of Income Tax, CIT Cir Rg 6(1) Mumbai
Appellant	..	Respondent
PAN No. AAACB3333J		
Assessee by	..	Shri Farrokh Irani, AR
Revenue by	..	Shri Suman Kumar, DR
Date of hearing	..	09-02-2017
Date of pronouncement	..	26-04-2017

ORDER

PER MAHAVIR SINGH, JM:

This appeal by the assessee is arising out of the order of CIT(A)-14, Mumbai, in appeal No. CIT(A)-14/IT.87/RG.6(1)/10-11 dated 30-11-2011. The Assessment was framed by ACIT Circle-6(1), Mumbai for the A.Y. 2008-09 vide order dated 30-12-2010 u/s 143(3) of the Income Tax Act, 1961 (hereinafter ‘the Act’).

2. The First issue in this appeal of assessee is against the order of CIT(A) confirming the addition of deemed dividend under section 2(22)(e) of the Act made by AO. For this assessee has raised following ground No. 1: -

“1. On the facts and under the circumstances of the case and in law, the Learned Commissioner of Income Tax Appeals erred in confirming the action of Assessing Officer, of making the addition u/s 2(22) (e) of Rs. 2,36,16,645/- without appreciating: -

i. The advances were Inter-corporate Deposit (ICD) and interest bearing and same were refunded back on maturity.

ii. The appellant company is the Public Listed Company and its subsidiary is also a company in which public are interested

iii. Without Prejudice, the company giving ICD did not had any Restive on April 2007 to determine the amount of Deemed Dividend.

The AO wrongly applied provisions even though the same is not applicable.”

3. Briefly stated facts are that the AO noticed from the audit report of the assessee that it has received loan aggregate to Rs. 2,36,16,645/- from its subsidiary Balkrishna Paper Mills Ltd. The AO noted that the assessee company is registered shareholder in Balkrishna Paper Mills Ltd. is not a company in which public is substantial interested. The AO noted that the said loan in the nature of unsecured loan as certified in the audit report of Balkrishna Paper Mills Ltd. Therefore, according to AO, the provisions of section 2(22)(e) of the Act is clearly attracted. The assessee replied that this loan is Inter Corporate Deposits (ICD) and Inter Cooperate Deposits are different for loans and advances and would not come within the purview of deemed dividend under section 2(22) (e) of the Act. The AO noted that these are not Inter Corporate Deposits and assessee's case falls clearly under the provisions of deemed dividend under section 2(22) (e) of the Act vide Para 8.11 as under: -

“8.11 In view of the above, payment of Rs. 2,36,16,645/- by Balkrishna Paper Mills Ltd, by way of advance or loan to the assessee-company is chargeable to tax as "Dividend" u/s. 2(22)(e) of the Act The said dividend is not covered by section 115-0 of the Act and hence will- be chargeable as "Income" in the hands of the assessee-company. The amount of ks.2,36,16,645/- is therefore added as Deemed Dividend to the total income of the assessee. Penalty proceedings u/s 271(1)(c) read with, Explanation I thereto are initiated separately for

*furnishing inaccurate particulars of income/concealment
of income.,”*

Aggrieved assessee preferred the appeal before CIT(A). The CIT(A) also confirmed the action of the AO by observing in Para 5.3 as under: -.

“5.3 I have considered the above submission, the facts of the case and the case law cited by the appellant. The appellant has not controverted the finding of the AO that the lender company namely Balkrishna Paper Mills Ltd is not a company in which public are substantially interested. The appellant has only claimed that Balkrishna Paper Mills Ltd is a public company. As per section 2(22)(e), the loan received by the appellant can be excluded from the definition of deemed dividend only if the said Balkrishna Paper Mills Ltd is a company in which public are substantially interested. From the analysis carried out by the AO it is evident that said Balkrishna Paper Mills Ltd is not a company in which public are substantially interested. If that is so, it is also seen that the statutory auditors of Balkrishna Paper Mills Ltd have, in their audit report stated that "as per the information and the explanations given to us, the company has not granted any loans, secured or unsecured, to companies, firms or other parties covered in the register maintained under section 301 of the Act, except unsecured loan to the holding company. The maximum amount involved during the year was Rs. 2.36.16.645/-- and the year end balance of the loan wanted was Rs. NIL". It is thus evident that the amount received by the appellant was in the nature of unsecured loan. The same was received from the subsidiary company Balkrishna Paper Mills Ltd in which obviously, the appellant has more than 10% of the voting power. And finally the said Balkrishna Paper Mills Ltd is not a company in which public are substantially interested. It is

thus evident that all the conditions prescribed in section 2(22) (e) for treating the said loan received by the appellant as deemed dividend are satisfied. The addition made by the AO is therefore upheld.”

Aggrieved, now assessee is in appeal before us.

4. At the outset, the learned Counsel for the assessee stated that the very premise of the AO and CIT(A) that Balkrishna Paper Mills Ltd. which is 100% subsidiary of assessee company is a Private Ltd. Company which is not a company in which public is substantially interested and hence, in view of the amended provisions of the company's amendment Act 2000 w.e.f 13-12-2000, the assessee is to be considered as Public Ltd. Company. The learned Counsel for the assessee filed copies of the Companies Act 1956 (Pre amended) wherein, the definition of Private Ltd. and Public Ltd. Company is provided. The learned Counsel for the assessee also filed copies of companies Act, 2000 (Post amended) with effect from 13-12-2000 has defined the Private Company vide section iii as under: -

“(iii) “Private Company” [means a company which has a minimum paid capital to one lakh rupees or such higher paid up capital as may prescribed, and by its articles

(a) restricts the right to transfer its shares, if any;

(b) limits the number of its members to fifty not including—

(i) persons who are in the employment of the company; and

(ii) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased; and

(c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company;

(d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives:]

Provided that where two or more persons hold one or more shares in a company joint iv, they shall, for the purposes of this definition, be treated as a single member;”

5. Similarly, the Public Ltd. Company’s definition is substituted for the following clause 4 by the companies (amendment) Act, 2000 with effect from 13-12-2000 and the same reads as under: -

“(iv) "public company" means a company which—

(a) is not a private company;

(b) has a minimum paid-up capital of five lakh rupees or such higher paid-up capital, as may be prescribed;

(c) is a private company which is a subsidiary of a company which is not a private company”

6. In view of the above the learned Counsel for the assessee stated that as per clause B of Section 2(18) of Companies Act said to be a company in which public substantially interested if it is a company which is not a private company as define in the Companies Act 1956 and the conditions either in item A or item B is satisfied. Section 3(iv) of the Companies Act 1956 has been substituted with effect from 13-12-2000 to provide that a private company which is subsidiary of a company, which is not a private company shall be a public company. It means, according to the learned Counsel, thus, where a private company is a subsidiary company of a public company, it was also to be a public company of that although the assessee company was originally registered as a private company but it became public company by virtue of the provisions of Section 3(iv)(c) of

the companies Act. The learned Counsel for the assessee referred to the decision of this coordinate Bench on this very issue in the case of Merdith Traders (P) Ltd. v. Income Tax Officer (2011) 142 TTJ 0182. The learned Counsel for the assessee in view of the above clearly stated the facts are not in dispute and assessee is Public Ltd. Company and once assessee is a Public Ltd. Company the provisions of Section 2(22) (e) of the Act will not apply to the present case. On the other hand, departmental representative supported the orders of the lower authorities and fully relied on the order of CIT(A).

7. We have heard the rival contentions and gone through the facts and circumstances of the case. We find from the above provisions of the Companies Act 1956, the amended provisions, that the assessee taken inter corporate deposit from its subsidiary named Balkrishna Paper Mills Ltd. and AO assessed the same as deemed dividend under section 2(22) (e) of the Act. We find that in view of the amended provisions of Companies Act 1956, the assessee being a Public Ltd. Company has taken loan from a subsidiary which is also a public Ltd. Company, by virtue of the amended provisions and therefore, the assessee falls within the provisions of section 2(18) read with relevant provisions of the Companies Act and hence, there is no dispute that the provisions of section 2(22)(e) of the Act will not attract to the present case of the assessee. Accordingly, we delete the addition and allow the appeal of the assessee on this issue.

8. The next issue in this appeal of assessee is against the order of CIT(A) confirming the addition made by AO of non reconciled AIR data of Rs. 52,905/-. For this assessee has raised following ground No. 2: -

“2. On the facts and under the circumstances of the case and in law, the Learned Commissioner of Income Tax Appeals erred in confirming the action of Assessing Officer of making addition of Rs. 52,905/- being non reconciliation of AIR Data. The AO failed to appreciate that the company had never transacted with such company CIL Textiles Pvt. Ltd what is mentioned in AIR. Further this income is neither booked by the company nor

the credit of TDS on same is claimed/availed. The assessee does not know this party and the assessee cannot be asked to prove the negative.

The AO also failed to issue summons to the said party for confirmation.”

9. At the outset, both, the learned Counsel for the assessee as well as the learned Sr. Dr. fairly conceded that this issue can be sent back to the file of the AO for fresh reconciliation statement of the assessee so that he can verify vis-à-vis AIR information relevant reconciliation and accordingly, decide the issue. We direct the AO accordingly. This issue of assessee's appeal is allowed for statistical purposes.

10. The next issue in this appeal of assessee is against the order of CIT(A) confirming the action of the AO in making addition of valuation of closing stock by treating the change in method of closing stock as 'sham' amounting to Rs. 6,17,59,737/- For this assessee has raised following ground No.3: -

“3. On the facts and under the circumstances of the case and in law, the Learned Commissioner of Income Tax Appeals erred in confirming the action of Assessing Officer in treating the change in method of closing stock as a sham transaction and made the addition of Rs.6,17,59,737/- without appreciating that the change was one-time decision and is tax neutral between two years and the formula adopted is permitted as per accounting policy.”

11. Briefly stated facts that the AO during the course of assessment proceedings noticed that the assessee company has changed its method of accounting during the year as per note to accounts Para 1 of Para iii wherein it is mentioned that due to implementation of ERP system the valuation of closing stock is lowered by an amount of Rs. 6,17,59,737/-. The AO was of the view that the new method adopted by the assessee is inconsistent with FIFO method of accounting and the method of valuation of closing stock regularly followed by

the assessee till now. According to him, the valuation has been done by choosing the timings when the assessee has effected demerger of its undertaking and received substantial income by way of slump sale from the demerged units and reduce the profits. It has changed the method, the AO added back the lowering of value of the closing stock of Rs. 6,17,59,737/-. Aggrieved, assessee preferred the appeal before CIT(A) who confirmed the action of the AO by observing in Para 8.4, 8.12 & 8.13: -

“8.4 I have considered the above submissions as well as the facts of the case. However, I don't agree with the appellant that the change in the method of accounting from FIFO to the weighted average cost method can be said to be bona fide. As per various decisions on the subject, the change can be said to be bona fide only if it gives better and more accurate picture of trading results or else it is necessitated by way of any statute, rule or regulation. The appellant has failed to demonstrate the same (except for the fact that it claims that in the next year the profit would increase by the amount of reduction in the current year). The very fact that the valuation of closing stock has reduced by an amount of about 6.18 crores, itself indicates that in the current year the profits of the business are not computed correctly on account of change in the method of valuation of stock. Secondly, the change in the method of valuation is also not on account of any statute, rule or regulation. Yet another fact which cannot be ignored is that in the current year, two of appellant's undertakings have been demerged from it and additional income on slump sale basis had to be disclosed by the appellant. It appears, that the lowering of the profits on account of change in the method of stock valuation has been adopted by the appellant as a tool to offset its increased tax liability on account of demerger of its undertaking. In this regard, I would like to discuss the principles which have been laid down in the context of

stock valuation by various authorities. -----

---8.12 Although the appellant claims that for implementation of ERP system only weighted average cost method has to be followed, the same is not true because the ERP system is a system which is more advanced than the Tally system of accounting which was hitherto being followed by the appellant and where FIFO method of valuation of stock was being followed. It cannot be the case of the appellant that a more advanced software system would not be capable of following FIFO method and it would solely depend upon the weighted average cost method for valuation of stock. It cannot be said that an ERP system will not be able to handle (FIFO method) what Tally system could handle. I have consulted the software experts in the field in this regard and they have also confirmed my view. They have confirmed that an ERP system of accounting is capable of following any method of valuation of stock, including the FIFO method. Therefore, the only reason for the appellant to depart from the FIFO method was to lower or rather offset its increased tax liability on account of de-merger of two of its undertakings by lowering the valuation of closing stock under the guise of implementing the new ERP system. There can be no other justification for the appellant to depart from the FIFO method, except to lower its income chargeable to tax and hence the tax burden or rather off-set the increased tax burden on account of de-merger of its undertakings.

8.13 The question is whether the revenue should be deprived of its legitimate tax in the year one for no valid reason whatsoever, on the part of the appellant just because the appellant promises that it will be paying higher taxes in the year two. In my opinion, the answer to this question cannot be in the affirmative. Therefore,

since it is not correct on the part of the appellant to claim that under the ERP (SAP), the moving weighted average price method is the only method for valuation of goods, the change over from FIFO to the said method is not proved to be bona fide. Hence, in my opinion, the decision of the AO is justified and the arguments of the appellant is regard to this ground of appeal deserve to be rejected.”

Aggrieved assessee came in second appeal before Tribunal.

12. We have heard the rival contentions and gone through the facts and circumstances of the case. We find from the facts of the case that the AO treated the change in method of closing stock as tool to offset its increased tax liability on account of demerger of its undertakings. Apart from this bald statement the AO or CIT(A) could not brought on record any evidence that this change in method of accounting from FIFO to the weighted average cost method will in any way offset its increased tax liability. We find that neither the AO nor CIT(A) could make out any factual bases for not accepting the weighted average cost method adopted by the assessee as malafide and not bonafide We find that the assessee during the year has taken one time strategic decision for valuation of its inventories on adoption of new EPR system and valued the inventories on the basis of weighted average cost basis instead of FIFO basis which was followed up to earlier accounting years. The assessee has filed complete details of valuation on the basis of new EPR system which has resulted in lower value of closing stock at Rs. 6,17,59,737/- and this has not given any effect because as and when the finished goods were sold and raw material/ WIP (inputs) were consumed in subsequent year was neutralize by the same. We find that the assessee has followed a bonafide system of accounting and once the system is bonafide no interference can be done by Revenue in the valuation of stock. Hon'ble Bombay High Court in the case of Melmould Corporation vs. CIT (1993) 202 ITR 789 (Bom) has considered the issue and held that the assessee could not be required to revalue the opening stock by excluding all overhead expenses when the assessee has been permitted to revise the method of valuing

the closing stock for that year, as the assessee has decided to adopt the new method for valuation henceforth. The Hon'ble High Court held as under: -

"5. We are not here concerned with whether this is the correct method or an acceptable method for determining cost price. At no stage of the proceedings was the question ever raised as to whether it was permissible for the assessee to revalue its stock by not including in the cost price overhead expenses. The Tribunal has not dealt with this aspect, viz., the manner in which the closing stock has been valued in the present case. Therefore, the decision of the Supreme Court in the case CIT v. British Paints India Ltd. , is not attracted to the question before us for consideration. The decision of the Tribunal is on the footing that since the closing stock was valued by adopting a certain method, the same method should be adopted in valuing the opening stock. In other, words, the change in the method of valuation, according to the Tribunal, should commence with is to be adopted for valuing the opening stock of nay previous year by the new method which is to be adopted for valuing the closing stock as well. The assumption so made by the Tribunal appears to be contrary to the normally accepted accounting principles. Mr. Bhujale has drawn our attention to a booklet called "Valuation of stock and Work-in-Progress - Normally Accepted Accounting Principles" - brought out by Indian Merchants' Chamber Economic Research and Training Foundation and written by Shri G. P. Kapadia. At page 4 of this booklet there is a discussion about change from one valid basis to another valid basis. It states:

"2. Where a change from one valid basis to another valid basis as accepted certain consequences normally follow. The opening stock of the base year of valued on the same basis as the

closing stock whether the change is to a higher level or to a lower level, the Revenue normally does not seeks to revise to valuation of earlier years. It neither seek to raise additional assessment, nor does it admit relief under the error or mistake provisions.

3. It is not possible to define with precision what amounts to a change of basis. It is a convenience, both to the taxpayer and to the Revenue, not to regard every change in the method of valuation as a change of basis. In particular, the Revenue encourage the view that change which involves no more than a greater degree of accuracy, or a refinement, should not be treated as a change of basis, whether, the change results in a higher or a lower valuation. In such cases the new valuation is applied at the end of the year without amendment of the opening valuation."

6. The same principle has been adopted by the Karnataka High Court in CIT v. Corporation Bank Ltd. . It has said (headnote) :

"The two principles applicable with regard to the valuation of stock are that the assessee is entitled to value the closing stock either at cost price or market value, whichever is lower, and that the closing stock must be the value of the opening stock in the succeeding year. It is thus, clear, that irrespective of the basis adopted for valuation in the earlier years, the assessee has the option to change the method of valuation of the closing stock at cost or market price, whichever is lower, provided the change is bona fide and followed regularly thereafter."

7. Thus, the value of the closing stock of the preceding year must be the value of the opening stock of the next years. The change, therefore, has to be effected by adopting the new method for valuing the closing stock which will, in its turn, become the value of the opening stock of the next year. If, instead, a procedure is adopted for changing the value of the opening stock, it will lead to a chain reaction of changes in the sense that the closing value of the stock of the year preceding will also have to change and correspondingly the value of the opening stock of that year and so on. This was pointed out by the Madras High Court in the case of CIT v. Carborundum Universal Ltd. . In the case before the Madras High Court also the valuation of opening stock had been done by the company on the basis of valuation for the closing stock to "direct cost", i.e., cost without overheads. This change in method was made bona fide and the assessee said that it would be adopting this method consistently in the future just as in the present case. The court in that case held :

"The change was a bona fide one and was a permanent arrangement which was to be followed year after year, the change would have to be accepted notwithstanding the fact that during the assessment year in question, which was the first year when the change of method was brought about, a prejudice or detriment might be caused to the revenue, because the opening stock was valued at total cost while stock was valued at direct cost."

8. It said (head note):

"If the assessee is called upon to apply the new method of valuation to the opening stock of the accounting year as well, the value of the closing

stock of the year previous to the accounting year will also have to get altered which is result in a modification of the assessment of that previous year."

9. *The same reasoning has been adopted by the Andhra Pradesh High Court in the case of CIT v. Mopeds India Ltd. . Before the Andhra Pradesh High Court also, the assessee was valuing its closing stock, in the past years, by what is known as total cost method in which the proportionate over heads for administrative expenses, selling expenses and interest in stock valuation, were taken into account, for the assessment year in question, the assessee adopted the works cost system where the administrative overheads were not taken into account. The court held :*

"Change in the method had to be effected with change in the at valuation of the closing stock of the first year and that the Tribunal was right in holding that opening stock should be revalued, was incorrect."

10. *Similar question was dealt with by the Allahabad High Court in the case of Triveni Engineering Works Ltd. v. CIT , in a similar manner.*

11. *Reliance was placed by the Revenue on a decision of the Privy Council in the case of CIT v. Ahmedabad New Cotton Mills Ltd. . In the case before the Privy Council both the opening and closing stock were undervalued. The Privy Council observed in this connection:*

"Mistake cannot be rectified by raising valuation of closing stock only, the valuation of both the opening and closing stock had to be raised."

12. *This decision has no application to the question before us which deals with the change method of valuation and the manner in which such change has to be*

brought about. Whenever, there is a change in the method of valuation. There is bound to be some distortion in the calculation of profit in the year in which the change takes place. But if the change is brought about bona fide and is no reason why such a change should not be permitted. Undoubtedly, the proviso to section 145 of the Income-tax Act, 1961, lays down that :

"Provided that in any case where the accounts are correct and complete to the satisfaction of the assessing Officer but the method employed is such that, in the opinion of Assessing Officer, the income cannot properly be deducted therefrom, then the computation shall be made upon such basis and in such manner as the Assessing officer may determine."

13. This is not such a case. The only question is whether the opening stock is also required to be revalued by excluding all overhead expenses when the assessee has been permitted to revise the method of valuing the closing stock for that year, as the assessee has decided to adopt this new method of valuation henceforth."

13. Respectfully following the principal laid down by the Hon'ble Bombay High Court cited (supra) and the fact of the case that none of the authorities below have doubted the bonafide of the assessee in regard to change in method of valuation of closing stock, we delete the addition and allow the appeal of the assessee on this issue.

14. **In the result, the appeal of assessee is partly allowed for statistical purposes.**

Order pronounced in the open court on 26-04-2017.

Sd/-
(RAJESH KUMAR)
ACCOUNTANT MEMBER

Sd/-
(MAHAVIR SINGH)
JUDICIAL MEMBER

Mumbai, Dated: 26-04-2017
Sudip Sarkar /Sr.PS

Copy of the Order forwarded to:

1. The Appellant
2. The Respondent.
3. The CIT (A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//
BY ORDER,
Assistant Registrar
ITAT, MUMBAI