

INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "B": NEW DELHI
BEFORE SHRI BHAVNESH SAINI, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No. 2291 & 2292/Del/2015
(Assessment Year: 2010-11 and 2011-12)

M/s. VRB Foods (P) Ltd, C/o. Dhingra & Juneja, CAs, 13/82, LGF, Vikram Vihar, Lajpat Nagar-IV, New Delhi PAN:AACCV2718D	Vs.	DCIT, Circle-17(1), New Delhi
(Appellant)		(Respondent)

Assessee by :	Dr. Rakesh Gupta, Adv
Revenue by:	Shri Subhash Verma, Sr. DR
Date of Hearing	10/10/2017
Date of pronouncement	29/12/2017

ORDER

PER PRASHANT MAHARISHI, A. M.

1. These are the appeals filed by the assessee against the order of the Id DCIT, Circle-17(1), New Delhi dated 03.02.2015 for the Assessment Year 2010-11 and 2011-12.

ITA No. 2291/Del/2015
Assessment Year 2010-11

2. The assessee has raised the following grounds of appeal for Assessment Year 2010-11 in ITA No. 2291/Del/2015:-

- “1. That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in rejecting the books of accounts of assessee u/s 145 of Income Tax Act, 1961.
2. That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in making addition of Rs. 1,56,06,861/- on account of alleged decline in gross profit/net profit and that too after applying the provisions of section 145 of the Act without any basis, material or evidence and impugned addition has been made by recording incorrect facts and findings and without giving adequate opportunity of hearing and without considering the evidences and submissions of the assessee and without following the principles of natural justice.
3. That in any case and in any view of the matter, action of Ld. CIT(A) in confirming the action of Ld. AO in rejecting the books of accounts u/s 145 and making addition of Rs.1,56,06,861/- on account of alleged decline in gross profit/net profit is bad in law and against the facts and circumstances of the case.

4. *That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in not allowing the deduction u/s 80IC as claimed by the appellant and also in respect of addition made (without prejudice).*
 5. *Without prejudice to the above ground and having regard to the facts and circumstances of the case. Ld CTT/At has erred in law and on facts in confirming the action of the ld AO in not allowing the deduction u/s 80IC on the amount of addition made in the impugned assessment order.*
 6. *That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in rejecting the books of accounts u/s 145 and making the impugned addition and framing the impugned assessment in violation of principles of natural justice in as much as passing the impugned order by recording incorrect facts and findings and without providing opportunity of cross examination and without confronting the entire adverse material used against the assessee and without providing adequate opportunity of hearing.*
 7. *That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in not reversing the action of Ld. AO in charging interest u/s 234A, 234B, 234C and 234D of the Income Tax Act, 1961.”*
3. The appellant/ assessee is a company engaged in the business of manufacturing and sale of processed food products. It filed its return of income on 29.09.2010 for Rs. 35713770/-. During the course of assessment proceedings, the ld Assessing Officer on the basis of report of the Statutory Auditor noted that auditor is unable to comment on the accuracy of the valuation of the inventories of finished goods. He further noted that net profit ratio for the year is 10.72% compared to 15.19%, hence, issued show cause notice to the assessee. The assessee submitted that company maintains excise records and note made by the ld Statutory Auditor is only with respect to the valuation. Therefore, not satisfied with the reply of the assessee he invoked the provisions of section 145 and estimated the net profit @15.19% of previous year and made an addition of Rs. 15606861/-. Consequently, assessment order u/s 143(3) was passed on 11.03.2013 at Rs. 51320633/-. The assessee challenged the same before the ld CIT(A). The ld CIT(A) based on his order in case of the assessee for Assessment Year 2011-12 confirmed the addition. He also upheld the applicability of section 145(3) of the Act. He also rejected the certificate given by the Auditor of the assessee dated 06.01.2014. Assessee being aggrieved has preferred appeal before us.
4. The ld AR submitted that as per ground No. 2 and 3 the additions are challenged. The ground No. 4 is with respect to the deduction u/s 80ic on the addition sustained by the CIT(A). Therefore, his argument was that if ground no. 2 and 3 assessee succeeds the ground No. 4 becomes redundant and if assessee fails on those grounds then ground No. 4 is covered in favour of the assessee by the circular of CBDT. With respect to ground No. 2 and 3 he

submitted that the assessee is engaged in the business of manufacturing of the foods products and valuation has been done of the finished products on the basis of unit costing of each of the product. He referred to page No. 95 to show that in valuation of the finished goods the quantum of raw material, packing, over heads are considered and even then, there is no difference in finished goods valuation. He further referred to his submission dated 15.07.2014 placed at page No. 103 to 125 of the paper book to support his contention. He further stated that complete valuation details are available with the Assessing Officer. He also referred to the tax audit report to show that complete quantitative details are maintained by the assessee and the auditor has certified that inventories are valued at lower of cost or net realizable value whichever is less and includes all the cost incurred to bring them to their present location. With respect to the manufactured goods he submitted that they are valued on the retail method wherein, from the selling price gross margin is reduced so that valuation of the inventory is determined. He further referred to the audit report and referred to the audit note and submitted that looking to the nature of the business of the assessee it is not possible to maintain product wise costing and certain overheads are required to be absorbed and therefore, assessee is using the retail method. He submitted that the above method is permitted by the accounting standard 2 on valuation of inventory. He further submitted that valuation of semi finished stock is also made on the basis of technical evaluation. He submitted that this method is adopted by the assessee for last several years and also in subsequent years and accepted by the revenue. He further referred to the provisions of section 145(3) of the Act to state that there is no error in the accounts of the assessee to render it in correctness and its incompleteness. He further submitted that this method of valuation is regularly followed by the assessee and further it complied with the accounting standard. In view of this he submitted that provision of section 145(3) of the Act does not apply. He further stated that even otherwise the valuation of finished goods becomes the opening stock of the next year and the opening stock of the year is also required to be adjusted hence, it become tax neutral. He submitted that the Id CIT(A) has brushed aside all these arguments of the assessee. He submitted that the issue involved in the appeal is with respect to the addition to the gross profit based on the earlier years financial results. He stated that addition to the gross profit cannot be made if the AO is of the view that valuation of stock is not proper. Anyway he submitted that addition on account of gross profit cannot be made when complete quantitative details subject to verification by Excise Authorities and where there is no defects in the books of account.

5. The Id Departmental Representative vehemently referred to the orders of the lower authorities and supported them.
6. We have carefully considered the rival contentions and also perused the orders of the lower authorities. The issue involved in this appeal is whether on the basis of qualification by the Auditor addition with respect to the gross profit can be made or not. It is necessary to go through the auditor's report issued u/s 227(4A) of the Companies Act as required under companies auditor's report order, 2003 to ascertain the correctness of accounts:-is required to be examined which is as under:-

“As explained in note 2(h) of the Schedule 15 of the financial statements, the company adopts the retail method for determining the value of its manufactured finished goods, whereby, the cost of the inventory is determined by reducing from the sale value of the inventory a percentage of gross margin considered appropriate by the management. As per Accounting Standard 2 valuation of inventory, retail method can be used as a valuation technique only when it approximates the actual cost of production for the goods manufactures by the company. However, in absence of adequate product wise cost records having been made available to us, we are unable to comment on the appropriateness of the usage of the retail method for valuation of manufactured finished goods by the company. As a result, we are unable to comment o the accuracy of valuation of inventories of manufactured finished gods as at year end and at the end of the previous year, increase/ decrease in stock and its resultant impact on the profit for the year, reserves and surplus and the related disclosures forming part of the financial statement.

Further, the company has not made available detailed records regarding consumption of raw material and packing materials, used in the manufacture of finished goods. We were also not made available the computation of consumption which could have been arrived on the basis of bill of materials of the finished goods produced during the year. In absence of the above mentioned details/ records, we are unable to comment on the accuracy of the amount of consumption of raw material and packing materials as reported, as it's resultant impact on the profits for the year.

vii. The company is valuing its inventory of semi finished goods on the basis of technical evaluation of their costs. However, we have not been made available the computation of the value of such semi finished goods. In the absence of such computation we are unable to comment on the appropriateness of the valuation method followed, compliance with AS-2 (Valuation of inventory) and accuracy of value of these semi finished goods (work in progress) the impact of which is not quantifiable and.....”

7. On perusal of the auditor's report, it is apparent that the Company's inventory are valued at lower of cost or net reliable value and includes all cost incurred in bringing the goods to their present location and conditions. There is no dispute about the valuation of raw material and packing material. The issue is with respect to the valuation of manufactured goods which are valued on the basis of retail method wherein, the assessee reduced the gross margin from the selling price of the goods to derive at the cost of goods produced. The auditor has stated that

such method can be used when the actual cost of production is approximate. As the assessee is in the business of manufacturing and selling of processed foods like sauces, mayonnaise, spreads, dips, mustards, milk shake mixes, egg-less cake mixes, peanut butter and culinary powders. Therefore, it is apparent that in the nature of the business activities carried on by the assessee, it is not possible to keep the production cost of each and every finished products, therefore, in such type of industry certain cost are used on approximate basis and they are then spread over the goods produced. The another method which is called the retail method based on which from the selling price of the goods the gross margin of the product is reduced which is obviously the actual cost of the goods produced by the assessee. In case if there is a net loss then such finished goods are valued at selling price as the cost price is higher than the sale price. The auditor has also stated that such method can be used as a valuation technique when the actual cost of the product is not feasible to be ascertained. According to the para no. 21 of the Accounting Standard where the techniques for measurement of cost is mentioned that technique for the measurement of cost of the inventories such as the standard cost method or retail method may be used for convenience if the results approximates the cost. In para No. 22 it is stated that retail method is often used in retail industry where, large numbers of rapidly changing items with similar margins for which it is im-practicable to use other costing methods. In such circumstances the cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage of the gross margin. An average percentage for each retail department is often used. Therefore, looking at the accounting standard for inventory valuation we do not find any infirmity in the method of techniques of measurement of cost as well as cost formula used by the assessee. The assessee in fact has followed the accounting standard only. In view of this, we find that provision of section 145(3) of the Act are incorrectly invoked by the Id Assessing Officer and confirmed by the Id CIT(A) because the valuation method is correct and therefore, it does not impact the correctness or completeness of the account of the assessee. In fact it makes the accounts of the assessee complete and correct. Furthermore, the Id Assessing Officer has applied the past year's gross profit ratio in that year also the valuation of the inventory was on similar basis therefore, if opinion of the AO is accepted then it cannot be said that accounts of previous year were correct and complete. The method of valuation of inventory followed by the assessee is year to year same. Furthermore, the assessee has maintained complete quantitative details also. No defects have been pointed out by the AO in the books of account other than what is stated by the Auditor. To invoke provisions of section 145(3) of the Act it is necessary that accounts of the assessee suffers

from latent, patent and glaring errors. In the present case, we do not find any such finding by the Id AO. Further, the assessee has given detailed reason for the down fall in the gross profit also. Further, the details of valuation of closing stock of the manufactured goods as per retail method were also filed before the lower authorities and no infirmity was found in the same. In view of this, we do not find any reason to sustain the orders passed by the lower authorities with respect to the invocation of provisions of section 145(3) of the Act and consequently, making the addition of Rs. 15606861/- to the total income of assessee. In the result Ground No. 1 to 3 of the appeal are allowed.

8. Ground No. 4 to 7 of the appeal are either general or consequential in nature and therefore, they are dismissed.
9. In the result ITA No. 2291/Del/2015 for Assessment Year 2010-11 is partly allowed.

ITA No. 2292/Del/2015
Assessment Year 2011-12.

10. Now we come to ITA No. 2292/Del/2015 for the Assessment Year 2011-12, wherein following grounds of appeal for Assessment Year 2011-12:-

- “1. *That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in rejecting the books of accounts of assessee u/s 145 of Income Tax Act, 1961.*
2. *That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in making addition of Rs.2,02,27,358/- on account of alleged decline in gross profit/net profit and that too after applying the provisions of section 145 of the Act without any basis, material or evidence and impugned addition has been made by recording incorrect facts and findings and without giving adequate opportunity of hearing and without considering the evidences and submissions of the assessee and without following the principles of natural justice.*
3. *That in any case and in any view of the matter, action of Ld. CIT(A) in confirming the action of Ld. AO in rejecting the books of accounts u/s 145 and making addition of Rs.2,02,27,358/- on account of alleged decline in gross profit/net profit is bad in law and against the facts and circumstances of the case.*
4. *That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in not allowing the deduction u/s 80IC as claimed by the appellant and also in respect of addition made (without prejudice).*
5. *Without prejudice to the above ground and having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in not allowing the deduction u/s 80IC on the amount of addition made in the impugned assessment order.*
6. *That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in rejecting the books of accounts u/s 145 and making the impugned addition and framing the impugned assessment in violation of principles of natural justice in as much as passing the impugned order by recording incorrect facts and findings and without providing*

opportunity of cross examination and without confronting the entire adverse material used against the assessee and without providing adequate opportunity of hearing.

7. *That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in not reversing the action of Ld. AO in charging interest u/s 234A, 234B, 234C and 234D of the Income Tax Act, 1961.”*
11. Parties submitted before us that issue in this appeal is identical to the issues in appeal of the assessee for Assessment Year 2010-11. Their arguments and pleadings also remains the same and facts are also same except change in the amount of addition.
12. We have carefully considered the arguments of the parties and we are also of the view that facts are similar to the appeal of the assessee in Assessment Year 2010-11. While deciding the appeal for Assessment Year 2010-11, we have already held that there is no infirmity in the method of valuation of finished goods in case of the assessee and hence, deleted the addition made for that year. Therefore, for the same reasons we also reverse the finding of the lower authorities and directs the Id Assessing Officer to delete the addition of Rs. 20227358/-. In the result ground Nos. 1 to 3 of the appeal is allowed.
13. Ground No. 4 to 7 are general or consequential in nature and therefore, they are dismissed.
14. In the result, the appeal of the assessee for AY 2011-12 is partly allowed.
- Order pronounced in the open court on 29/12/2017.

-Sd/-

(BHAVNESH SAINI)
JUDICIAL MEMBER

-Sd/-

(PRASHANT MAHARISHI)
ACCOUNTANT MEMBER

Dated:29/12/2017
A K Keot

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi