IN THE INCOME TAX APPELLATE TRIBUNAL "A" BENCH : KOLKATA

[Before Hon'ble Shri Aby. T. Varkey, JM & Shri M.Balaganesh, AM]

I.T.A Nos. 2304 & 2305/Kol/2016

Assessment Year : 2013-14

ACIT, CC-2(1), Kolkata	-vs-	M/s Amrit Hatcheries Pvt. Ltd. [PAN: AACCA 5987 F]
(Appellant)		(Respondent)

For the Appellant : Shri G. Hangshing, CIT

For the Respondent : Shri D.S. Damle, FCA

Date of Hearing : 12.02.2018

Date of Pronouncement : 23.02.2018

ORDER

Per Bench:

1. The first appeal of the revenue in I.T.A. No. 2304/Kol/2016 for the assessment year 2013-14 is directed against the order passed by the Ld. Commissioner of Income Tax (Appeals)-20, Kolkata (in short 'the Ld. CIT(A)') in Appeal No. 15/CIT(A)-20/CC-2(1)/15-16 dated 13.10.2016 against the order passed by the DCIT, Central Circle-2(1), Kolkata, (in short 'the ld. AO') u/s 143(3) of the Income Tax Act, 1961 (in short 'the Act') on 30.03.2015. The second appeal in I.T.A. No. 2305/Kol/2016 of the revenue appeal for the assessment year 2013-14 is directed against the order passed by the Ld. CIT(A)-20, Kolkata in appeal No. 1091/CIT(A)-20/CC-2(1)/15-16 dated 27.09.2016 against the order passed by the ld. AO levying penalty u/s 271AAB of the Act for the assessment year 2013-14 vide order dated 22.09.2015.

2. Let us take up ITA No. 2304/Kol2016 – Quantum appeal

The revenue has raised the following grounds of appeal for the Asst Year 2013-14 for the quantum appeal:-

1. *That the Ld. CIT(A) has erred in accepting that the term 'manufacture' occurring in the context of section 80IB does not necessarily require that the end product of the manufacturing process is to be completely different from the ingredients, as regards its chemical composition, integral structure or its use,*

2. *That the Ld. CIT(A) has erred in accepting that the process of manufacturing of poultry feeds does not amount to mere mixing together of all different ingredients, without involving any change in the chemical composition of the ingredients,*

3. *That the Ld. CIT(A) has erred in accepting that the process of preparation of poultry feeds amount to production of an article within the meaning of section 80IB,*

4. *That the Ld. CIT(A) has erred in allowing the entire amount of Rs. 1,09,01,866/- claimed as deduction u/s 80IB.*

5. *That the Ld. CIT(A) has erred in directing the AO to net off the interest income credited in the profit and loss account of the eligible undertaking against the interest income debited in the said profit and loss account without the appreciating the facts and circumstances of the case supported by the decision of Hon'ble Supreme Court in the case of Pandian Chemicals Limited vs. CIT [2003] 129 TAXMAN 539 (S C) and the decision of High Court of Jammu & Kashmir in the case of Asian Cement Industries vs. Income Tax Appellate Tribunal, [2012] 28 TAXMAN 290 (Jammu & Kashmir).*

6. *That the Ld. CIT(A) has erred in directing the AO to re-computed the income of the eligible undertaking and re-compute the deduction u/s 80IB after netting off the interest income credited in the profit and loss account of the eligible undertaking against the interest expense debited in the said profit and loss account.*

7. *That the Department craves right to add, modify or abrogate the grounds of appeal during the course of hearing of the case.*

Ground Nos. (i) to (iv) raised by the revenue is with regard to the issue as to whether the ld CITA was justified in allowing the claim of the assessee for deduction u/s 80IB(5) of the Act on the profits derived by the assessee from manufacture and sale of poultry feed.

2.1 At the time of hearing it was submitted by the learned counsel for the Assessee that the aforesaid issue regarding the eligibility of the Assessee for deduction u/s 80IB(5) of the Act has already been decided by the ITAT Kolkata bench in Assessee's own case for A.y 2005-06 in I.T.A. No. 748/Kol/2008 order dated 07.08.2008 and this Tribunal following the decision rendered in the case of M/s Amrit Feeds in I.T.A. No. 1505/Kol/2007 for A.y. 2003-04 decided the issue in favour of the assessee holding that the profit derived from the activity of manufacture of poultry feed was entitled to deduction u/s 80IB(5) of the Act.

2.2. It was the plea of the Assessee that the process of producing poultry feed involved mechanical, chemical & electrical processes for which the Assessee used sophisticated Plant & Machinery. In the course of production of poultry feed raw materials which exceeded 30 in number, lost individual identity and the emerging product was distinct and separate in shape, character and end-use. The raw materials consumed in production of poultry feed could be individually used for different purposes, but the end product at the end of integrated production process was known to trade by its distinct commercial name as 'poultry feed. It could only be consumed by only one class of consumer i.e. poultry & none else. It was the claim of the Assessee the end product was known as poultry feed in the trade, commerce and industry and was considered as separate and distinct from various materials consumed in the process of its production. The assessee also pleaded that poultry feed manufacturing industry was notified by the Central Government to be eligible for claiming deduction for consecutive period of 10 years u/s 80IB(4) of the Act where the undertaking was located in any of the North Eastern States. It was the plea of the Assessee that deduction both u/s 80IB(4) & (5) could be

allowed only if newly set up industrial undertaking was engaged in manufacture and production of an article an different poultry feed industry was considered eligible by the Central Government for claiming deduction u/s 80IB(4) then the same industry should be considered to be eligible for deduction u/s 80IB(5) of the Act also on the ground at it was engaged in manufacture or production of an article.

2.3. The ld. AO however was of the view that in the production process explained by the assessee there was no change in chemical composition of the end product and therefore there was no manufacture. However before recording such an authentic technical finding, the ld. AO however did not refer to any scientific data or scientific experiments or technical report to support his conclusion. The ld. AO accordingly rejected the claim of the Assessee for deduction u/s 80IB(5) of the Act.

2.4. On appeal by the assessee, the Ld. CIT(A) held that the assessee was eligible for deduction u/s 80IB(5) of the Act and in doing so relied on the decision rendered in Assessee's own case by the Tribunal referred to in the earlier part of this order.

2.5 Aggrieved by the order of the Ld. CIT(A), the revenue is in appeal before the Tribunal.

2.6 We have heard the rival submissions. The only issue involved in this ground relates to whether the assessee is engaged in the manufacture of a production of an article so that it may be eligible for deduction under section 80IB. This issue has duly been decided by this Bench in assessee's sister concern in I.T.A. No. 1505/Kol/2007 in the case of ACIT vs. Amrit Feeds Ltd., Kolkata in which, the similar issue has arisen. While deciding the similar issue, this Tribunal observed as under vide para 15 to 18 of its order.

"15. Sec 80IB(2) (iii) requires the eligible Industrial undertaking to be engaged in manufacture of production of an article'. The said section however does not define the expression "manufacture or production of' an article. In fact this expression is not defined .in the Act also. The Ld. CIT (A) extensively analysed meaning or the said expression with reference to judicial decision discussed in his order. The test laid down by the Courts is whether the emerging new product is known to the trade, industry and commerce by its own name having its own application use and has a market of its own. Applying the criteria as laid down in these judicial decisions we find that in physical appearance, colour and shape the. Poultry feed vastly differs from the input materials. The poultry reed is manufactured in a scientific and systematic manner with the use and assistance of sophisticated plant and machinery acquired at a substantial cost. Poultry feed is recognized not only by trade and commerce but also by the statutory authorities under Central Excise, Sales Tax etc. as independent products Applying the ratio laid down in judicial decisions discussed in the order of CTT(A) we have no hesitation in- holding that the assessee is engaged in manufacture or production of an article, contemplated in Sec 80IB(2)(iii);

16. We also find on the identical facts the Bangalore Bench of ITAT in the case of Kamrala Feeds -- Vs- DCIT 74 ITD 65 held that activity of producing poultry feed amounts to manufacture and therefore eligible for deduction u/s 80I, section 80I and Section 80IB are parameteria because conditions for part of deduction are same and therefore the said decision is equally applicable in the present case. .

17. Section 80IB is an incentive provision or the Income Tax Act enacted by the Legislature to promote economic and industrial growth in backward districts and states. In the case of Bajaj Tempo Ltd --Vs. CIT (196 ITR 188) the Supreme Court has Opined that a provision of taxing statute granting incentives for promoting growth and development should be construed liberally and since a provision for promoting economic growth has to be interpreted liberally the restriction thereon too has to be construed so as to advance the objective of the provision and not to frustrate it. Conditions of sec. 80IB(2)(iii) should be fulfilled by every new industrial undertaking claiming deduction either/under sub sec (3) (4) or (5) or Sec 80IB i.e. to say the undertaking must be engaged in manufacture or production or an article. If this condition is not fulfilled no deduction is permissible under any or the sub sections or Sec 80IB. The industrial undertakings notified and approved by the Central Govt. and situated in North Eastern States are eligible for tax holiday for period of 10 years as against period of 5 years available to other backwards state In Notification No. SO 627 {E} dated 04.08.1999 the Central Government has recognized poultry and cattle Iced industry, to be an eligible industry u/s 80IB(4). Once the Central Government notified the poultry 'feed industry u/s 80IB (4) then there is a tacit admission that it is engaged in "manufacture or production of an article". This is so because unless poultry feed industry does not manufacture an article; no

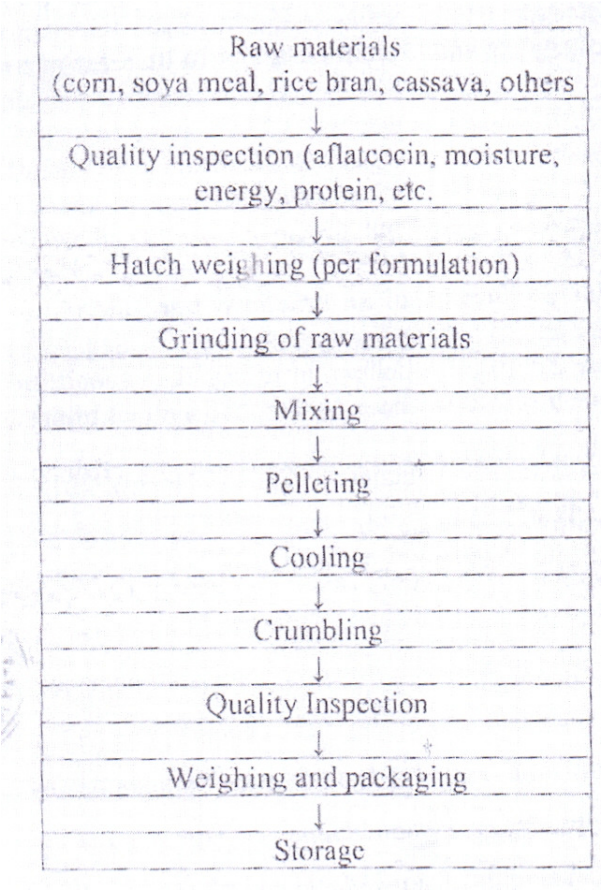
deduction can be permissible u/s 80lB. Once the Central Govt. accepted in principle that poultry feed is an eligible industry u/s 80lB(4); then the very same industry cannot be considered as non manufacturing industry under sub sections (3) and (5) , of Sec 80IB. With reference to same set of facts the revenue cannot hold the poultry feed industry as manufacturing industry if situated in North Eastern states and a 'processing industry" if situated in any other states Such an interpretation will only lead to an absurd legal position.

18. For the reasons as set out herein before therefore we do not find any infirmity in the order or Ld. CIT(A) holding the assessee to be engaged in manufacture or production of an article. We are therefore of the considered opinion that the assessee satisfies the conditions of Sec 80IB(2) (iii) of the Act and is therefore eligible for deduction u/s 80IB. We therefore uphold the order Ld. CIT(A) directing A 0 to allow deduction u/s 80IB to the assessee."

2.7. In Assessee's own case this Tribunal in ITA No.748/Kol/2018 for AY 2005-06 by order dated 7.8.2008 allowed similar claim of the Assessee. From perusal of the said decisions of this Tribunal. it is apparent that this Tribunal has categorically held in the Case that the assessee is engaged in manufacturing or poultry feeds and that the assessee is engaged in the manufacture or production of an article.

2.8. The learned DR however submitted that in the decisions rendered by the Tribunal, the decision rendered by the Hyderabad Bench of ITAT in the case of Venkataswara Feeds vs. ACIT 22 Taxmann.com 234(Hyd.) was not properly considered and therefore the decision rendered in Assessee's own case requires reconsideration. In this regard it was submitted that the Tribunal in the case of Venkateswar Feeds (supra) found that various feed ingredients such as maize, rice bran, de-oiled soya etc. along with certain feed premixes are mixed in different proportions and then ground to form a course powdered material which was called mash feed. Such feed underwent a certain kind of physical changes and was converted into small pellets. The actual process involved was that the mash feed was carried through an elevator to a pellet making machine where it got mixed with steam and then forced through a press containing small holes to convert the feed into small pellets. It was held that there was no change of composition in the mash feed and the pellet feed. Hence, conversion of physical shape of the feed involves only processing and not manufacture.

2.9 The learned DR filed before us a chart explaining the process carried out by the Assessee, which is as follows:



It was submitted by him that the raw material and end product were the same and therefore what the Assessee does is only "Processing" and not "Manufacture". For an activity to be called "Manufacture" one of the important criteria is that the end product of the manufacturing process is to be completely different from the ingredients, as regards its chemical composition, integral structure or its use and such factor is missing in the case of the Assessee. It was also submitted that the activity carried out by the assessee was mere mixing together of different ingredients, without involving any change in the chemical composition of the ingredients and therefore, the decisions rendered on this issue have overlooked this aspect. It was submitted that the decision rendered in Assessee's own case did not consider the decision of the Hyderabad Bench

of ITAT in the case of Venkateswara Feeds (supra) and therefore the decision requires reconsideration.

2.10. The learned Counsel for the Assessee while relying on the order of the Ld. CIT(A) and decision of the Tribunal in Assessee's own case in A.Y. 2005-06 also submitted that in the case of Amrit Feeds (supra), the Hon'ble ITAT had considered and distinguished the decision rendered in the case of Venkateswara Feeds (supra) by ITAT Hyderabad Bench.

2.11 We have given a careful consideration to the rival submissions. In the case of Amrit Feeds (supra), the Tribunal considered the decision rendered in the case of Venkateswara Feeds (supra) and held that the assessee in that case had claimed deduction u/s 80IB on the activity of merely converting poultry mash feed into pellet feed and therefore that Bench has held that there was no change in the basic component or new or different article came into existence. As such, conversion was processing activity not manufacturing. The Tribunal held that the case of the assessee Amrit Feeds (supra) was entirely different. The assessee's eligible undertaking itself was independently carrying out the complete activity i.e. from mixing , grinding till the pelletisation. The raw materials once consumed could not be reconverted into the same position. Its utility gets changed. The prime raw materials such as maize, soya oil, rice bran, etc. can no more be regarded to be the rice bran, soya oil, maize. We are of the view that the issue in the Revenue's appeal is squarely covered against the revenue by the decision of the Co-ordinate Bench of this Tribunal in assessee's own case for the earlier years which was based on the decision rendered in the case of Amrit Feeds (supra). Respectfully following the decision of the Co-ordinate Bench of this tribunal in assessee's own case the finding of Ld. CIT(A) on this issue stands confirmed.

We find that this tribunal in assessee's own case for the Asst Years 2008-09 , 2010-11 to 2012-13 vide order dated 5.4.2017 had held in the aforesaid manner. In view of the aforesaid findings and respectfully following the judicial precedent relied upon hereinabove, we dismiss the Grounds (i) to (iv) raised by the revenue before us for the Asst Year 2013-14.

3. As far as Ground Nos. (v) & (vi) raised by the revenue for the Asst Year 2013-14 are concerned, the facts are that the assessee had received interest on fixed deposits of Rs 5,53,210/-. The ld. AO held that deduction u/s 80IB(5) of the Act is to be allowed only on 'profits derived' from the eligible business which clearly indicated that there should be a direct or immediate nexus between the income and business of the assessee. It was the plea of the assessee that the fixed deposits in question were given as security for availing credit facilities and therefore had direct nexus with the eligible business. The ld. AO, however, was of the view that the interest income in question had no nexus with the eligible business and therefore the said income has to be excluded from the profits of the business eligible for deduction u/s 80IB(5) of the Act.

3.1. Before Ld. CIT(A) the assessee submitted that the assessee company is principally engaged in the business of manufacture and production of poultry feed, having its manufacturing unit at Bankura, West Bengal. The said unit is eligible for deduction u/s 80IB of the Act. The assessee pointed out that it had obtained credit limits and arranged loan financing for the business of manufacture & sale of poultry feed. The assessee paid interest on the loans/credit facilities, which amounted to Rs. 46,60,037/- for the relevant year. Further, in order to obtain packing facilities and/or other working capital limits, the assessee was required to provide encashable fixed deposits as margin/security and for that purpose funds were invested in Fixed Deposits and those deposits yielded interest income in question. It was submitted that in the given circumstances the fixed deposits maintained by the assessee was inextricably linked with the business of the

assessee. The aforesaid interest earned from the fixed deposits went on to effectively reduce the overall cost of borrowing of the assessee. In view of the above the assessee submitted that the interest expense as well as interest income both have a proximate relationship with the business of the assessee. The interest income earned has direct co-relation with the business funds of the assessee and accordingly it should be considered for the purpose of computing deduction u/s 80IB of the Act.

3.2 Without prejudice to the above, the assessee further submitted that interest income and interest expense are two sides of the same coin. It was submitted that the interest expense and interest income deserves to be netted off and only the net effect after set off should be considered for the purpose of section 80IB of the Act. It was argued that the ld. AO on one hand treated the interest expense in its entirety as expenditure incurred in connection with the eligible industrial unit u/s 80IB of the Act. However, on the other hand he treated the interest income in isolation and on gross basis making it fully chargeable to tax under the Income Tax Act, 1961. The assessee submitted that such action of the ld. AO was grossly unjustified in facts and also in law. The assessee placed reliance on the decision of the Hon'ble Supreme Court in the case of ACG Associated Capsules (P) Ltd. vs. CIT (18 Taxmann.com 137) . In the aforesaid decision, the question before the High Court was whether 'net' interest or 'gross interest' was to be considered for the purposes of computing deduction in respect of profits from export business under section 80HHC of the Act. It was the Department's contention that the gross interest income was to be excluded from 'profits of business' for the purposes of calculating deduction u/s 80HHC. On assessee's appeal, the Hon'ble Supreme Court held that it was not the 'gross' amount but only the 'net' amount, if any, which was to be excluded under Explanation (baa) to Section 80HHC. The Hon'ble Supreme Court accepted the assessee's contention that interest expense had to be netted of against the interest income and it was only the remaining net amount which was to be excluded. It was submitted that applying the ratio laid by the Apex Court in the foregoing decision

to the facts of the present case, the interest income is required to be netted off against the interest expense and any positive figure remaining, if any, should be excluded while computing profits eligible for deduction u/s 80IB of the Act.

3.3 The Ld. CIT(A) agreed with the submissions of the Assessee and he allowed the claim of the Assessee with the following observations:

> *"I have considered the finding of the ld. AO in the assessment order and the written submission filed by the ld. AR along with different case laws on this issue. I have considered the Hon'ble Supreme Court's decision in the Pandian Chemical's case (supra) and I have also considered the decision of the Hon'ble Supreme Court in the case of ACG Associated Capsules (P) Ltd. vs. CIT 343 ITR 89. I think even though the said decision was rendered in the context of provisions of section 80HHC, yet in my opinion the principle laid down in that decision has equal application in the assessee's case as well. I further find that on similar facts the ITAT, Kolkata in the case of DCIT vs. BMW Industries Limited (I.T.A. No. 2115/Kol/2007) dated 29.02.2008 had similarly held that for the purpose of computation of deduction u/s 80IB the interest income was liable to be netted off against interest expenses and only the net interest expenditure was required to be allowed in arriving at qualifying profits of the eligible undertaking u/s 80IB of the Act. I also find that the principle of netting off of interest income against interest expense has been upheld by jurisdictional Calcutta High Court in the case of Warren Tea Ltd. (374 ITR 6) for the purposes of interpreting & computing business income in the context of Rule 8 applicable to tea companies. Following the ratio laid down in these decisions, I hold that the ld. AO should net off the interest income credited in the profit and loss account eligible against the interest expense debited in the said profit and loss account. If net result thereof is expenditure, the same shall be considered to be the expenditure relatable to eligible undertaking. However, if the net result, after set off is income, then the assessee will not be eligible to claim deduction u/s 80IB in respect of such net income. The ld. AO shall accordingly re-compute the income of the eligible undertaking and re-compute the deduction u/s 80IB. Thus, assessee's appeal on grounds no. 3 to 6 are allowed."*

3.4. Aggrieved, by the order of Ld. CIT(A) the revenue has preferred ground nos. (iv) and (v) before the Tribunal.

3.5 The ld. DR relied on the order of the ld. AO. The ld. counsel for the assessee reiterated the submissions made before Ld. CIT(A) and relied on the order of the Ld. CIT(A). He also brought to our notice that the bank as a condition for giving credit

facility insisted that the FDRs should be offered as a security and therefore interest expenditure and the interest income had a direct nexus and hence, netting off interest income with the interest expense was rightly allowed by the Ld. CIT(A).

3.6. We have considered the rival submissions and are of the view that the interest income and the interest expenses had a direct nexus and therefore netting off interest income against the interest expenses had to be allowed. Since the interest expenses was much more than the interest income no interest income can be excluded from the profits on which deduction u/s 80IB(5) of the Act ought to be allowed. We therefore uphold the order of the Ld. CIT(A) on this issue. We find that this tribunal in assessee's own case for the Asst Years 2008-09 , 2010-11 to 2012-13 vide order dated 5.4.2017 had held in the aforesaid manner. In view of the aforesaid findings and respectfully following the judicial precedent relied upon hereinabove, we dismiss the Grounds (v) and (vi) raised by the revenue before us for the Asst Year 2013-14.

4. Let us take up ITA No. 2305/Kol/2016 with regard to cancellation of penalty levied u/s 271AAB of the Act.

5. The revenue had raised the following grounds of appeal before us :-

i) That Ld. CIT(A) erred in facts and circumstances of the case in deleting the penalty imposed on the assessee of Rs. 27,33,800/- u/s 271AAB(1)(a) of the I.T. Act, 1961 on account of disclosure made u/s 132(4) at the time of search on undisclosed stock.

ii) That Ld. CIT(A) failed to appreciate the provision of section 271AAB, as the penalty was imposed @10% of Rs. 2,73,38,000/- which is disclosed at the time of search.

iii) That the Ld. CIT(A) erred in facts and circumstances of the case in deleting the penalty imposed on the assessee of Rs. 32,70,560/- u/s 271AAB(1)(c) of the I.T. Act, 1961 on account of disallowance of deduction u/s 80IB, as the assessee did not manufacturing any articles or things.

iv) That the Department craves the right to add, modify or abrogate the grounds of appeal during the course of hearing of the case.

5.1. The brief facts of this issue is that the search and seizure operation was conducted in the "Amrit Group" u/s 132 of the Act on 30th / 31st August 2012. The assessee is one of the companies in the said group. The search was conducted at the office premises and residential premises of the promoters of the assessee. Survey operations u/s 133A of the Act were also conducted at the factories. The assessee was having huge stock of poultry feeds spread across various locations and hence thought it fit to carry out stock audit for the same. The Stock Auditor submitted his report on 20.8.2012 pursuant to his physical verification . Neither in the course of search nor in the survey proceedings, any of the authorized officers conducted physical stock verification. No physical inventory of raw materials or finished goods was taken nor the stock records verified by the search parties at any of the manufacturing units of Amrit Group as is evident from the panchanamas drawn up at the end of search operations at various premises.

Since the search operations were continuing for more than 36 hours, Prohibitory Orders u/s 132(3) were placed at various locations/rooms with a view to resume the search operations at a later date. The prohibitory orders inter alia included the same chambers at the Head office of the 'Amrit Group' at 'Infinity Benchmark' Block EP & GP, Sector-V, 6th Floor, Saltlake, Kolkata-700091. The search proceedings resumed on 29.10.2012; when the Prohibitory Order u/s 132(3) was revoked. In the course of resumed search conducted at the Head Office of the assessee on 29.10.2012 a report of M/s Damle Dhandhania & Co. (Chartered Accountants) was found, which contained their findings to the management of the appellant in respect of physical verification of the stock carried out at the factories of the assessee as well as sister concerns/group companies. The Stock taking exercise was conducted by the firm of Chartered Accountant in the ordinary course of appellant's book keeping. In their report the Chartered Accountant reported that few items of raw materials were physically found to

be in excess of the quantities as per the stock records. Accordingly, the CA had advised the company to adjust the stock records by making appropriate adjustment entries only in the stock records. Since the inventory actually found on physical verification was more than the inventory as per stock records; the additional inventory was incorporated in the stock records as well as in the financial books at 'NIL' cost. The assessee submitted the copies of the entries passed in the stock records on 31.8.2012 before the income tax department.

5.2. When confronted with the above mentioned Audit Report, Shri Harish Bagla, Director of the assessee gave a detailed explanation in his declaration u/s 132(4) dated 29.10.2012 wherein he stated as follows.

" .. we had engaged services of M/ s Damle Dhandhania & Co., Chartered Accountants to conduct physical inspection of inventory at all manufacturing locations. After the physical inspection was conducted by M/s Damle Dhandhania & Co. in mid August. they' had forwarded their report dated 20.08.2012 for taking further action. In this report, the Auditor had observed that on taking physical inspection of the inventories they had found excess stock of approximately Rs.2192 lacs, compared with stock records. Report of M/s Damle Dhandhania & Co. was found & seized from my office which is identified as Pages 42 to 44 in ID: AF/3. I submit that excess stock found in the course of physical inspection will be offered as income o[the Group Companies in the current year and the appropriate tax on such income will be paid in due course."

From the above facts, it shall therefore be observed that physical stock taking exercise was voluntarily carried out by the assessee through a firm of Chartered Accountant in the regular course of its business. The report contained findings with regard to excess/shortage of stock found on physical inspection at the various factories vis-a-vis the stock records. The said report was issued by the Chartered Accountants on

20.08.2012, and was received by the appellant on 23.08.2012. Admittedly appropriate entries in the stock records were passed on 31st August 2012 incorporating the findings of the Chartered Accountants and bringing the stock on material at pat with physical quantities found on physical inspection. Understandably the valuation of inventory was to be carried out & incorporated in. the financial books only at the time of closing of the accounts as on 31st March 2013. Accordingly the excess physical stock found by the Chartered Accountants at the appellant's factory premises was incorporated in the stock records in August 2012 at "NIL". The excess stock incorporated in stock records at zero cost was considered by the appellant when the inventory valuation was carried out at the time of preparation of annual financial statements for the year ended 31.03.2013. In the assessment order for AY 2013-14 passed u/s 143(3) the AO did not find any infirmity either with the quantity or inventory or with its valuation. In fact in the assessment order u/s 143(3) the AO admitted that excess stock reported in the Auditors' report was properly accounted in the appellant's books and accordingly the AO had accepted the assessee's declaration before the Authorized Officer.

In any business organization, the stock records are maintained separate and distinct from the financial books. The stock records are maintained at the plant level whereas financial records are maintained at the administrative offices. At periodic intervals stock records are reconciled with financial books. In the appellant's line of business raw materials are handled in bulk. When items of raw material are issued for production out of the stock, it is not always feasible to undertake the exact physical weighment of the individual item due to bulkiness of the material. In the circumstances entries in stock records are made by visual inspection which involves same degree and on approximation. However at periodic intervals the physical stock taking exercise is conducted so as to determine the exact quantities of stock of material physically available at the plant level. The discrepancies noted on physical stock taking are accounted in the stock records by aligning the "balances" as per books with physical

quantities actually found. The procedure of reconciling physical stock with stocks records is carried out routinely in all large business organizations and. the appellant's case was not an exception.

More particularly, during the FY 2012-13, the "Amrit Group" to which the appellant belongs had decided to implement SAP Accounting software. SAP Accounting software is an advanced version where the financial records and stock records are aligned with each other on real time basis and these are updated simultaneously.

In particular the need for real time supervision and control of manufacturing operations at different plant locations was found necessary in view of the rapid growth which Amrit Group was witnessing since FY 2010-11. From perusal of the audited accounts of Amrit Group of Companies for the year ended 31st March 2013, your goodself will note that the sales turnover achieved by the main three operating companies viz., Amrit Feeds Limited, Amrit Hatcheries Limited and Amricon Agrovet Pvt Ltd for the Financial Year 2012-13 was Rs.1169.13 crores, Rs.704.47 crores & RS.240.48 crores respectively. The total turnover of these three operating companies for the FY 2012-13 amounted to Rs.2114.08 crores. The turnover of these three companies for the immediate preceding year was however only RS.1511.66 crores; meaning thereby in the FY 2012-13 the Amrit Group had achieved substantial quantum increase in its turnover. Moreover the production activities were carried on by the Group at more than 10 locations and therefore it was absolutely essential that the Head Office of the Group at Kolkata exercised tighter control over the inventories since the consumption of material constituted more than 85% of the cost of sales and therefore managing material consumption was the major challenge for achieving better productivity as well as profitability for the Group. In that view of the matter the management of the company had deemed it necessary to implement more sophisticated SAP software at all plant levels aligning the production records with financial books. In pursuance of the management decision taken for implementing SAP Software the task of stock taking

was assigned to MI s Damle Dhandhania & Co., Chartered Accountants who in their stock report reported variation between the balances as per stock records and physical quantities of various materials found at different manufacturing locations. As per the stock audit report the auditors reported excess stocks valued at Rs.17.61 crores for Amrit Feeds Limited, Rs.1.58 crores for Amrit Hatcheries Limited and Rs.2.73 crores for Amricon Agrovet Pvt Ltd. Although the quantum of variation in absolute numeric terms may aggregate to Rs.21. 92 crores and the same may look very substantial but when one takes into account the fact that the Group turnover of the three operating companies for the FY 2012-13 exceed Rs.2100 crores, then your goodself will appreciate that in comparative terms such variation was only 1% of the group turnover and not very significant.

The management of Amrit Group had decided upon implementation of SAP Software which would have enabled the management sitting at Head Office greater control over the production and inventory management in real time. In SAP Software the entries in the stock records automatically update the financial accounts and vice versa. Before the SAP Software was implemented management of the appellant considered it necessary that the physical quantities of the materials available at the plant levels tallied exactly with the inventory records so that no discrepancies remained at the time of commencement of SAP. With this objective in mind the appellant had suo moto appointed M/s Damle &Dhandhania & Co.; Chartered Accountants to undertake physical verification of the stocks at company's different plants. The appointment of the said Chartered Accountant and the physical stock taking exercise was concluded much prior to the date of search. The said firm of Chartered Accountant had submitted its report prior to the date of search in which they had reported variations between the quantities of raw material items as per stock records and as found on physical inspection. The excesses and shortages of stocks noted on physical inspection were reported by the said Auditor. The Auditor had also recommended steps to be taken for

correcting the stock records. On receipt of the stock audit report the management of the appellant had issued necessary instructions to the factory managers to reconcile the stock records and incorporate the correct quantitative details in the stock records in compliance with the fmdings of the stock auditor as contained in the stock audit report. On 31st August 2012, appropriate entries were also passed in the stock records and the excess quantities physically found by the stock auditor were suitably increased in the stock records at 'NIL' cost.

In course of resumed search operation on 29.10.2012 report of M/s. Damle Dhandhania & Co., Chartered Accountant dated 20.08.012 in respect of physical verification of stock undertaken at different places was found and seized [ID Mark AF /3, Pages 42 to 441 by the Investigation authorities. With reference to the said audit report Shri Harish Bagla was asked to furnish his explanations. In response in his sworn statement u/s 132(4), Shri Harish Bagla, Director of the appellant had clarified that with reference to the findings of the stock taking report, appropriate entries in the stock registers were being incorporated and effect thereof would be given in the financial accounts. For the FY 2012-13 Shri Harish Bagla in his statement admitted that the findings of the report prepared by the Chartered Accountant would result in increase in the profit for the FY 2012-13 and that the same was being incorporated in the books of the appellant company. However nowhere in his statement the Director of the appellant had admitted that the excess quantity of stock reported in the audit report represented appellant's "undisclosed" or "unexplained" stock. Shri Bagla had only clarified that with reference to stock adjustment accounted in the appellant's books amounting to Rs.2, 73,38,800 / -; income of Amrit Group will stand increased and the same would form part of the disclosure of Rs.35 crs mentioned in his initial statement u/s 132(4) of the Act dated 31.08.2012. It is submitted that the stock records had been updated and appropriate entries in stock records had been passed at the respective factories much before 29.10.2012 when the Authorized Officer had found the stock audit report and with reference to which Director's statement was recorded. Further in compliance with the

declaration ix] s 132(4), the difference in stock which had already been incorporated in the stock records. The sum of Rs.2,73,38,000/- being value of the excess stock found in physical verification therefore formed part of the regular books of the appellant and was offered to tax by the appellant in the return of income filed u/s 139(1).

The above facts and the assessee's explanation were examined and verified by the AO in the course of assessment. In the course of proceedings u/s 143(3), the AO specifically show caused the appellant to explain as to whether the above stock of Rs.2,73,38,000/- was incorporated in the books of account. In response the appellant filed its explanation dated 09.03.2015 in which it was stated that the difference in quantity as reported by the stock auditor had been duly incorporated in the stock records on 31st August 2012 itself and formed part of the regular books of account. Copies of the journal entries were also furnished before the AO. After the stock records were reconciled with the report of the stock auditor; there remained no discrepancy between the two. Accordingly when the inventory was valued by the company as at 31.03.2013; the value of the excess quantity reported in audit report was included. Being satisfied with the submissions of the appellant, the AO accepted the stock records and the valuation of closing stock and no adverse inference-was drawn in this regard.

5.3. The assessee pleaded that in view of the aforesaid facts, the following facts emerge in the assessee’s case:-

No stock taking exercise was ever conducted by the Department nor was any excess stock was detected by the Department either at the time of search or at any other point of time.

Stock report of Damle Dhandhania & Co. was obtained by the assessee in the regular course of business. The said stock audit report containing findings with regard to difference in stock found on the physical inspection vis-à-vis the stock records was obtained prior to conducting of search u/s 132. The stock report was found in the course

of search operations on October, 2012 by which time stock records had already been updated.

Appropriate Reconciliation Entries pursuant to the stock audit report were passed in the regular stock Records incorporating the difference in stock on 31st August, 2012 at NIL cost.

In the statement u/s 132(4), nowhere did the Director of the Appellant admitted that the difference in physical stock represented 'undisclosed stock'. Instead it was categorically mentioned that the difference in stock was found on physical inspection vis-à-vis stock records by Stock Auditor; and the findings reported by them shall be incorporated in the regular financial books of the assessee for assessment year 2012-13.

No 'undisclosed income' or 'undisclosed stock' was ever found by the Department nor was any such allegation leveled by the Department against the assessee either in the course of search operations or assessment proceedings.

In the explanation dated 09.03.2015 filed in proceedings u/s 143(3) the assessee reiterated that the differences repeated by the stock auditor had been incorporated in the stock records on 31st August, 2012. At no time did the assessee state that such excess physical stock represented 'undisclosed stock'. The explanation of the assessee was accepted by the Assessing Officer.

5.4. The assessee further pleaded that what the Authorized Officer found in the assessee's office premises in the course of resumed search was the report of the Chartered Accountant concerning physical inspection of the Inventory. No discrepancy in the physical quantities of raw materials was however found by the Department in the course of search. It is therefore the submission of the assessee that no 'undisclosed income' was found or unearthed in the course of search and therefore no penalty u/s 271AAB was leviable in respect of income which was included in the total income on account of inventory adjustment carried out in the books of the assessee for financial year 2012-13. The ld. AO however without properly appreciating the facts and

explanations offered by the assessee mechanically levied penalty @ 10% amounting Rs. 27,33,800/- u/s 271AAB(1)(a) of the Act.

It is submitted that the penalty proceedings are quasi criminal in nature and the same are distinct and separate from assessment proceedings. Before levying penalty for concealment of income, it is necessary for the authority to prove that sum of Rs. 2,73,38,000/- in fact constituted assessee's 'undisclosed income' and further such income was unearthed or detected as a result of the search u/s 132 conducted against the assessee. In the present case admittedly no such incriminating material was unearthed by the Investigation Wing in the course of search nor was any excess physical stock was found by the IT authorities. The difference in stock had been duly incorporated in the regular stock records prior to the date on which the stock audit report was found and declaration u/s 132(4) was recorded from the Director. The assessee thus submits that the income of Rs. 2,73,38,000/- which it incorporated in its books for the financial year 2012-13 did not in any manner represent 'undisclosed income' of the assessee as contemplated by sec 271AAB of the Act. In the present case the sum of Rs. 2,73,38,000/- was incorporated by the assessee in the regular books of accounts. The assessee had already decided to incorporate the difference in stock found on the physical inspection prior to the date on which stock audit report was seized by the Authorized Officer u/s 132 on 29.10.2012. In the statement u/s 132(4) dated 29.10.2012, the assessee had merely admitted that the income with reference to excess quantities reported in the stock audit report would be included in taxable income for the assessment year 2013-14 and the same was to be part of income declared in the statement recorded u/s 132(4) on 31.08.2012 cannot be construed to be 'undisclosed income' of the company for the purposes of levy of penalty u/s 271AAB of the Act.

The assessee pleaded that the sum of Rs 2,73,38,000/- assessed as assessee's income for the relevant year did not represent any 'unexplained money, bullion, jewellery, valuable article or any other asest', for the simple reason that no such asset had been identified by the ld AO and no undisclosed asset came to light as a result of the search conducted

by the investigation authorities. Accordingly, the sum of Rs 2,73,38,000/- does not come within the first limb of the definition of 'undisclosed income' as mentioned in section 271AAB of the Act. Similarly the assessee pleaded that its case does not fall under any of the limb of definition of 'undisclosed income' defined in section 271AAB of the Act.

5.5. The ld CITA duly appreciated the contentions of the assessee and deleted the levy of penalty u/s 271AAB of the Act . Aggrieved, the revenue is in appeal before us.

6. We have heard the rival submissions and perused the materials available on record. We find that the ld AO had levied penalty u/s 271AAB of the Act for the Asst Year 2013-14 being the year of search. What is relevant for section 271AAB of the Act is that there should be undisclosed income which should have been detected by the search party at the time of search. The expression 'undisclosed income' has been defined in section 271AAB of the Act as under:-

"(c) undisclosed income means –

(i) Any income of the specified previous year represented, either wholly or partly, by any money, bullion, jewellery or other valuable article or thing or any entry in the books of accounts or other documents or transactions found in the course of a search under section 132, which has-

(A) Not been recorded on or before the date of search in the books of account or other documents maintained in the normal course relating to such previous year; or

(B) Otherwise not been disclosed to the [Principal Chief Commissioner or] Chief Commissioner or [Principal Commissioner or] Commissioner before the date of search; or

ii) any income of the specified previous year represented , either wholly or partly, by any entry in respect of an expense recorded in the books of accounts or other documents maintained in the normal course relating to the specified previous year which is found to be false and would not have been found to be so had the search not been conducted."

6.1. We find that the director of assessee company in his statement u/s 132(4) of the Act had explained that the stock verification was carried out by the independent chartered

accountant since the company was in the process of implementing an integrated ERP-SAP system of accounting. Since in the records, it was deemed necessary by the management that physical inventory should tally with stock records at the time when ERP system was being implemented. On taking physical inventory of raw materials and finished goods, the auditor had reported in his report discrepancies which he had found between the physical quantities of materials and their corresponding stock records. These discrepancies were presented to the management in tabular form in the report submitted to the management of the company. Accordingly, the director with reference to the said report had stated that as per the stock audit report the physical stock found was in excess of stock as per stock records and the value of excess stock in the case of the assessee was Rs 2,73,38,000/-. It is crucial at this juncture to note that the excess stock found in the stock audit report represents investment made by the assessee out of the books of the assessee which would take the colour of undisclosed income. Without making purchases, how could there be excess physical stock. Hence the element of undisclosed income enters the scenario at this juncture towards unexplained investment made towards purchases. This would be irrespective of the fact that the assessee would have entered the excess quantity in the stock register by increasing the quantity alone with Nil value attached to it. The moment the excess stock is found physically when compared to the quantity reflected in the stock register, the undisclosed income theory sets into motion. This would not undergo any change even though the Director of the assessee company u/s 132(4) of the Act had stated that the excess stock found on physical verification was incorporated in the stock records of the assessee at Nil cost and thereby the value of excess would be accounted as income at the time when the stock valuation shall be incorporated in the final accounts as on 31.3.2013.

6.2. What is to be seen is whether there was any undisclosed stock that were found in the sum of Rs 2.73 crores at the time of search. Admittedly, the stock audit report

containing the excess stock were found at the time of search by the search team on 29.10.2012. The statement of the Director of the assessee company u/s 132(4) of the Act only goes to prove that the assessee had entered the excess stock found in the stock register on 31.8.2012 at Nil Cost. No corresponding entry was made in the financial records which is very crucial for determination of income i.e undisclosed income. The Director of the assessee company Shri Harish Bagla, in effect, actually admitted that the said discrepancies in stock (i.e excess stock found in stock audit report) would be treated as part and parcel of the assessee's regular income for the Asst Year 2013-14 and taxes thereon would be paid in regular course. But the same would still partake the character of undisclosed income for the purpose of section 271AAB of the Act alone.

6.3. The ld AR argued that if the version of the ld AO is to be accepted, then any person who has been subjected to search u/s 132 of the Act in a year and who had not properly updated the accounts probably due to the absence of his accountant for few days just prior to the search, can it be said that the unupdated transactions in the regular books of accounts or other documents would be construed as 'undisclosed income' for the purpose of section 271AAB of the Act. In our considered opinion, the remedy is available to the assessee in such a situation, to clearly mention in the statement recorded u/s 132(4) of the Act by explaining the fact of absence of the accountant and also adduce evidences by showing the relevant purchases, sales, proof of movement of goods and expenses bills that are not recorded in the books of accounts, wherein from the relevant papers, it is possible to arrive at the true profits / losses of the assessee on that date for the unrecorded period. What is required to be seen is that the assessee had maintained the relevant papers which would enable him to record the same in the regular books of accounts which might be recorded with some timing difference.

6.4. It appears that there is no escape from the rigor of Sec.271AAB(1) of the Act, if income of the specified previous year emanates from the material found in the course of

search and such income or transaction has not been records in the books of accounts maintained by the Assessee. Situations contemplated in paragraph 6.3 of this order would be determinative in such cases as to ascertain whether the Assessee would have attempted not to disclose income. The legislature has given sanctity to entries made in the Books of accounts maintained in the ordinary course of business on the premise that it is maintained contemporaneously. If there is excess stock physically found than what is recorded in the books of accounts, then Sec.69 of the Act (Unexplained investments not recorded in the books), comes into play. Therefore such income does not have any source as the source is unexplained. It is also undisclosed because it is not recorded in the books of accounts of the Assessee.

6.5. Hence we have no hesitation in holding that the excess stock in the sum of Rs 2,73,38,000/- does fall under the definition of 'undisclosed income' and consequently penalty u/s 271AAB of the Act is leviable for the same. Accordingly, the grounds raised by the revenue in this regard are allowed.

7. The next issue to be decided in this appeal in ITA No. 2305/Kol/2016 is as to whether the levy of penalty u/s 271AAB of the Act was justified on account of denial of deduction u/s 80IB of the Act, in the facts and circumstances of the case.

7.1. We have heard the rival submissions. This issue has now become academic. Since we have already held that the assessee is indeed entitled for deduction u/s 80IB of the Act and accordingly deleted the disallowance in quantum appeal, the penalty u/s 271AAB of the Act is only a fallout of the said issue. Since quantum disallowance is deleted , the penalty thereon u/s 271AAB of the Act does not survive. In any case, we find in the facts of the case, that there was absolutely no seizure of any material or documents at the time of search to reach to a different conclusion that assessee is not entitled for deduction u/s 80IB of the Act. Hence the same does not fall within the

definition of the expression 'undisclosed income' and therefore would be outside the ambit of penalty u/s 271AAB of the Act. The assessee has been claiming deduction u/s 80IB of the Act consistently from earlier years. Since the revenue had denied deduction thereon in earlier years, it was denied for the year under appeal also . This has nothing to do with the search proceedings so as to fall within the ambit of undisclosed income and consequential levy of penalty u/s 271AAB of the Act. Accordingly, we hold that the ld CITA had rightly deleted the levy of penalty u/s 271AAB of the Act in respect of denial of deduction u/s 80IB of the Act. Accordingly, the grounds raised by the revenue in this regard are dismissed.

8. In the result, the appeal of the revenue in ITA No. 2304/Kol/2016 is dismissed and appeal of the revenue in ITA No. 2305/Kol/2016 is partly allowed.

Order pronounced in the Court on 23.02.2018

Sd/-

[A.T. Varkey] [M.Balaganesh]

Judicial Member Accountant Member

Dated : 23.02.2018
SB, Sr. PS

Copy of the order forwarded to:
1. ACIT, CC-2(1), 3rd Floor, Aayakar Bhawan, Poorva E.M. Bye Pass, 110, Shanti Pally, Kolkata-700107.
2. M/s Amrit Hatcheries Pvt. Ltd., 158, Lenin Sarani, 2nd Floor, Kolkata- 700013.
3. C.I.T(A)- , Kolkata 4. C.I.T.- Kolkata.
5. CIT(DR), Kolkata Benches, Kolkata.

True copy

By Order

Senior Private Secretary
Head of Office/D.D.O., ITAT, Kolkata Benches