

आयकर अपीलीय अधिकरण, जयपुर न्यायपीठ, जयपुर
IN THE INCOME TAX APPELLATE TRIBUNAL, JAIPUR BENCHES, JAIPUR

श्री विजय पाल रॉव, न्यायिक सदस्य एवं श्री विक्रम सिंह यादव, लेखा सदस्य के समक्ष
BEFORE: SHRI VIJAY PAL RAO, JM AND SHRI VIKRAM SINGH YADAV, AM

आयकर अपील सं./ITA No. 527/JP/2018
निर्धारण वर्ष/Assessment Year : 2013-14.

Shambhu Dayal Agarwal (late), Bada Bazar, Newai, Tonk.	बनाम Vs.	The Income Tax Officer, Ward Tonk.
स्थायी लेखा सं./जीआईआर सं./PAN No. ABFPA 0159 G		
अपीलार्थी /Appellant		प्रत्यर्थी /Respondent

निर्धारिती की ओर से / Assessee by : Shri G.M. Mehta (CA)
राजस्व की ओर से / Revenue by: Shri J.C. Kulhari (JCIT)

सुनवाई की तारीख / Date of Hearing : 25.09.2018.
घोषणा की तारीख / Date of Pronouncement : 28/09/2018.

आदेश / ORDER

PER VIJAY PAL RAO, JM :

This appeal by the assessee is directed against the order dated 5th March, 2018 of Id. CIT (A)-3, Jaipur for the assessment year 2013-14. The assessee has raised the following grounds :-

- " (1) That both the lower authorities have erred in law and on facts in not considering from the basic documents (return of income, Form No. 35 & Power of Attorney) so also from the statement of legal heir Shri Kailash Chand recorded during the course of assessment proceedings that due to death of the assessee (date of death: 04.02.2013), these were signed by his legal heir and therefore assessment / appeal order (s) in name of deceased is void ab-initio.
- (2) Without prejudice to ground No. (1), Id. CIT (A) was not justified in sustaining following additions/disallowances though provisions of section 145(3) of IT Act were not applied :

- (i) Addition of Rs. 5,11,840/- on account of under valuation of closing stock, though the basis of such additions, being multiplication of quantity with FIFO rates was a wrong calculation.
- (ii) Rs. 54,000/- on account of salary payment to employees, being family members, whose salary was enhanced after three years.
- (iii) Disallowance of Rs. 26,369/- under four different head of business expenses on mere estimation/guess work, without pointing out any un-vouched nature or disallowable nature of expenses."

Ground No. 1 is regarding non bringing the Legal Heirs of the assessee on record.

2. At the time of hearing, the Id. A/R of the assessee has stated at bar that the assessee does not press ground no. 1 along with an application filed under Rule 29 of the ITAT Rules for admission of the said ground as an additional ground. Hence, in view of the statement of the Id. A/R, the ground no. 1 as well as the application under Rule 29 of the ITAT Rules are dismissed being not pressed.

Ground No. 2(i) is regarding addition on account of under valuation of closing stock.

3. The assessee is trading in agricultural commodities and filed return of income on 30th October, 2013 through his legal heir as the assessee was expired on 04.02.2013. In the scrutiny assessment, the AO noted that the assessee has valued closing stock of Til (Sesame) of 12,946.80 kg at Rs. 10,23,080/-. This valuation was done by the assessee on average cost basis. However, the AO noted that as per the Audit Report, the valuation of closing stock has to be done on market price or cost price whichever is lower. Similarly, the closing stock of Souf (Fennel seed) of 76,004 kg was valued at Rs. 29,60,979/-. The valuation of closing stock of Urad of 8,942.90

kg was shown at Rs. 2,31,985/-. The AO applied Fefo Method for valuation of closing stock of these three commodities and consequently made an addition of Rs. 5,11,840/- on account of under valuation of closing stock. The assessee challenged the action of the AO before the Id. CIT (A) but could not succeed.

4. Before us, the Id. A/R of the assessee has submitted that the assessee has been following the average cost method for valuation of closing stock consistently for the last several years and the AO has never disturbed the method adopted by the assessee in the past preceding years. He has referred to the assessment orders for the assessment years 2010-11 and 12-13. He has further contended that the AO has selected only 3 commodities for revaluation of closing stock out of 9 and, therefore, applying the Fefo method on the 3 selected commodities and accepting the valuation for the remaining 6 commodities on the basis of average cost price is not permissible. He has pointed out that even if the Fefo method is applied for valuation of closing stock for all the 9 commodities, then no addition is required as the valuation would result less than the value assigned by the assessee to the closing stock of all the commodities. Hence, the Id. A/R has submitted that the AO is not justified in selecting only few commodities whose market price was comparatively higher at the end of the financial year relevant to the assessment year and ignoring the rest of the closing stock is an arbitrary exercise on the part of the A.O. He has relied upon the decision of Hon'ble Gujarat High Court in the case of Voltamp Transformers Ltd. vs. CIT, 327 ITR 360 (Guj.) as well as the decision of Hon'ble Karnataka High Court in the case of Karnataka Bank Ltd. vs. ACIT, 356 ITR 549 (Kar.). The Id. A/R has also relied upon the decision of Coordinate Bench of the Tribunal dated 28th February, 2007 in the case of ACIT vs. Kalsan Engg. India Pvt.

Ltd. in ITA No. 518/JP/2004. The Id. A/R has submitted that disturbing the closing stock without giving effect to the opening stock will distort the result and, therefore, is not permitted.

5. On the other hand, the Id. D/R has relied upon the orders of the authorities below and submitted that the assessee in the Audit Report has stated that the closing stock is valued as per cost or market price whichever is less, hence the AO has rightly applied the FIFO Method for the purpose of valuation of closing stock which has resulted in addition on account of under valuation shown by the assessee.

6. We have considered the rival submissions as well as the relevant material on record. At the outset, we note that as per the details of closing stock as on 31st March, 2013 there are 10 commodities which are shown as part of the closing stock and valued on the basis of average cost or market price whichever is less. The AO in the assessment proceedings has selected only 3 commodities for revaluation of closing stock and applied FIFO method which has resulted in addition of Rs. 5,11,840/-. It is also not in dispute that the assessee has been consistently following the average cost method for valuation of closing stock and, therefore, when the opening stock of the assessee is based on the average cost then valuing the closing stock by applying a different method will distort the result. The AO has not disturbed the method adopted by the assessee in preceding years and the assessment year under consideration is the first year in which the AO has applied a different method and that too only for valuation of the closing stock of selected 3 commodities, namely, Til (Sesame), Souf (Fennel seed) and Urad Dal. We find that the action of the AO in applying FIFO Method only on selected 3 commodities is highly arbitrary and against the principle of consistency. Even if the AO finds that

the assessee has deliberately undervalued the closing stock, then the valuation of the entire closing stock of the assessee was required to be done by the AO by applying a consistent method. Hence, this action of the AO in applying a different method for selected commodities and remaining closing stock was valued on the basis of a different method being average cost method applied by the assessee is not permissible. The Hon'ble Gujarat High Court in the case of Voltamp Transformers Ltd. vs. CIT (supra) has held in para 11 to 15 as under :-

"11. In the facts of the present case the authorities have approached the issue, to say the least, in a confused manner. After discarding the market value adopted by the assessee the authorities have, more particularly, the CIT(A) and the Tribunal, proceeded to adopt cost price as the value of the closing stock. There is no basis, there is no evidence to discard the market value shown by the assessee merely because such a value is 1/3rd of the sale price. The sale price would not indicate in any manner that the market price shown by the assessee was not the market price as on 30th June, 1983 *i.e.* last day of the accounting period merely because subsequently higher sale price has been realised. The Tribunal has also failed to appreciate that even the CIT(A) had after disturbing the valuation put on the closing stock directed the AO to adopt the same valuation of the opening stock of the next year. The Tribunal was duty-bound, in the circumstances, to ascertain whether disturbing of the valuation put on the closing stock during the year under consideration would have any real effect when the same valuation would be reflected by opening stock of the immediately next accounting period.

12. In the circumstances one may fruitfully reproduce what the apex Court has stated in the case of Chainrup Sampatram as to what is the purpose of valuing the closing stock:

"It is wrong to assume that the valuation of the closing stock at market rate has, for its object, the bringing into charge any appreciation in the value of such stock. The true purpose of crediting the value of unsold stock is to balance the cost of those goods entered on the other side of the account at the time of their purchase, so that the cancelling out of the entries relating to the same stock from both sides of the account would leave only the transactions on which there have been actual sales in the course of the year showing the profit or loss actually realised on the year's trading. As pointed out in para 8 of the report of the Committee on Financial Risks attaching to the holding of Trading Stocks, 1919. 'As the entry for stock which appears in a trading account is merely intended to cancel the charge for the goods purchased which have not been sold, it should necessarily represent the cost of the goods. If it is more or less than the cost, then the effect is to state the profit on the goods which actually have been sold at the incorrect figure..... From this rigid

doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, viz. the adoption of market value at the date of making up accounts, if that value is less than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of attributing to the following year's results a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question' (extracted in para 281 of the report of the Committee on the Taxation of Trading Profits presented to British Parliament in April, 1951). While anticipated loss is thus taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account, as no prudent trader would care to show increased profit before its actual realisation. This is the theory underlying the rule that the closing stock is to be valued at cost or market price whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy. As profits for income-tax purpose are to be computed in conformity with the ordinary principles of commercial accounting unless of course, such principles have been superseded or modified by legislative enactments, unrealised profits in the shape of appreciated value of goods remaining unsold at the end of an accounting year and carried over to the following year's account in a business that is continuing are not brought into the charge as a matter of practice, though, as already stated, loss due to a fall in price below cost is allowed even if such loss has not been actually realised....

Again, it is misconception to think that any profits 'arises out of the valuation of the closing stock' and the situs of its arising or accrual is where the valuation is made. As already stated, valuation of unsold stock at the close of an accounting period is a necessary part of the process of determining the trading results of that period, and can in no sense be regarded as the 'source' of such profits."

13. If the Tribunal had borne the aforesaid principles in mind while determining the controversy before it the Tribunal would not have committed an error in law which the Tribunal has committed. The purpose of valuation of the closing stock is not for working out any profit on the basis of such valuation as stated by the apex Court. The valuation of unsold stock at the close of accounting period is a necessary requirement of commercial accounting, a part and parcel of determining the trading profits of the accounting period by ensuring that the expenses which have actually been incurred in the production of goods which remained unsold at the end of the year, are squared off to reflect the correct trading profits of the goods which have been sold during the year.

14. In the aforesaid set of facts and circumstances of the case, the approach of the Tribunal in disturbing the valuation of the closing stock as on 30th June, 1983 in relation to the two transformers cannot be sustained. The question referred for the opinion of this Court is accordingly answered in the affirmative *i.e.* in favour of the assessee and against the Revenue.

15. Reference stands disposed of accordingly with no order as to costs."

Thus once the assessee has been following the consistent method of valuation of closing stock which is one of the recognized method and was also accepted by the AO in the preceding years then without any cogent and material evidence brought on record to show that the method adopted by the assessee does not reflect all the components of the cost of goods forming part of the closing stock, the AO cannot substitute such method applied by the assessee. Accordingly in view of the above facts and circumstances of the case, we find that the AO has acted in an arbitrary manner without bringing any evidence that the assessee has suppressed the material facts regarding the valuation of closing stock. Hence we delete the addition made by the AO on this account.

Ground No. 2(ii) is regarding disallowance of salary payment to the employees who are family members of the assessee.

7. The AO noted that the assessee has paid a salary of Rs. 3 lacs each to his three family members in comparison to the salary paid in the earlier years of Rs. 2,40,000/- each. Thus the AO was of the view that the enhancement in the salary expenses of Rs. 1,80,000/- to these three family members is without any justification. Accordingly the AO after allowing the enhancement of 10% in the salary paid to the family members, has disallowed the balance of Rs. 1,08,000/-. The assessee challenged the action of the AO before the Id. CIT (A). The Id. CIT (A) has restricted the disallowance to 50% of the amount disallowed by the AO which comes to Rs. 54,000/-.

8. Before us, the Id. A/R has submitted that the AO has made the disallowance without considering or giving a finding that the salary paid to the employees who are family members of the assessee is excessive in comparison to the fair market price

of the services. Thus the Id. A/R has submitted that the AO without considering the provisions of section 40A(2)(b) of the IT Act has made an adhoc disallowance of salary expenditure. He has further contended that the salary was paid to the son and grandsons of the deceased assessee who are looking after the entire business affairs of the assessee. Since the assessee had already died at the old age and, therefore, the entire business was being looked after by the son and grandsons, hence the disallowance made by the AO and sustained by the Id. CIT (A) is not justified.

9. On the other hand, the Id. D/R has relied upon the orders of the Id. CIT (A) and submitted that the Id. CIT (A) had already granted substantial relief on this issue.

10. We have considered the rival submissions as well as the relevant material on record. The details of the salary paid during the year under consideration as well as in the earlier years are as under :-

S.No.	Name & Parentage	A.Y.2011-12	A.Y. 2012-13	A.Y. 2013-14
1.	Kailash Chand Agarwal S/o Late Shambhu Dayal	2,40,000	2,40,000	3,00,000
2.	Ravindra Kumar Agarwal S/o Kailash Chand Agarwal	2,40,000	2,40,000	3,00,000
3.	Sunil Kumar Agarwal S/o Kailash Chand Agarwal	2,28,000	2,40,000	3,00,000

Thus it is clear that the salary is being paid to three family members of the assessee who had already expired on 4th February, 2013 at the age of 85 years. The AO has allowed the enhancement of the salary at 10% and consequently disallowed the balance amount of Rs. 1,08,000/- out of the total enhancement of Rs. 1,80,000/-. We find that once the assessee was at the advance age of 85 years and finally died

on 4th February, 2013, then it is apparent that these three family members of the assessee were looking after the entire business affairs of the assessee. The fact of services rendered by these three family members has not been disputed by the AO. Further the AO has not done the exercise of ascertaining the fair market price/salary for the services rendered by these three related parties and has made an adhoc disallowance of salary paid to these family members of the deceased assessee. Though section 40A(2)(b) envisages the disallowance of excess payment to the related parties, however, to ascertain the fact whether the payment is excessive or not, the AO was required to first determine the fair market price/salary of the services rendered by the related parties and then only make the disallowance, if any. In the case in hand, when these three family members of the assessee were managing and doing all the business affairs of the assessee, then in the absence of any finding on the part of the AO that the salary paid to these persons is excessive in comparison to the fair market price/salary, the disallowance made by the AO and confirmed by the Id. CIT (A) is not sustainable. We, accordingly, delete the disallowance of Rs. 54,000/- made on account of salary paid to the family members.

Ground No. 2(iii) is regarding disallowance of business expenses for want of supporting evidence being vouchers.

11. The AO noted that the assessee has claimed various expenses on account of shop expenses, travelling expenses, petrol expenses, wages expenses. However, no proper vouchers were produced by the assessee in support of the expenses claimed. Accordingly, the AO made a disallowance of 20% of these expenses amounting to Rs. 52,738/-. On appeal, the Id. CIT (A) has sustained the disallowance at 10% of the expenses instead of 20% made by the AO.

12. We have heard the Id. A/R as well as the Id. D/R and considered the relevant material on record. We note that despite the specific query raised by the AO for production of supporting vouchers in respect of various expenses claimed, the assessee failed to produce the same. The only explanation put forth by the assessee is that the expenses claimed are reasonable having regard to the turnover of the assessee. Thus there is a clear failure on the part of the assessee to discharge its onus of proving the expenses were incurred wholly and exclusively for the purpose of business as the supporting evidence was not produced by the assessee. Though the expenses claimed by the assessee may not be excessive keeping in view of the turnover, however, once the assessee has failed to produce the supporting evidence, then the disallowance sustained by the Id. CIT (A) at 10% of the expenses is justified. Hence we do not find any reason to interfere with the impugned order of the Id. CIT (A).

13. In the result, appeal of the assessee is partly allowed.

Order is pronounced in the open court on 28/09/2018.

Sd/-
(विक्रम सिंह यादव)
(VIKRAM SINGH YADAV)
लेखा सदस्य/Accountant Member

Sd/-
(विजय पाल रॉव)
(VIJAY PAL RAO)
न्यायिक सदस्य/Judicial Member

Jaipur

Dated:- 28/09/2018.

Das/

आदेश की प्रतिलिपि अग्रेषित / Copy of the order forwarded to:

1. The Appellant- Shri Shambhu Dayal Agarwal, Tonk.
2. The Respondent – The ITO, Ward Tonk.
3. The CIT(A).
4. The CIT,
5. The DR, ITAT, Jaipur
6. Guard File (ITA No. 527/JP/2018)

आदेशानुसार / By order,

सहायक पंजीकार / Assistant. Registrar

