

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“C” BENCH, AHMEDABAD**

**BEFORE SHRI MAHAVIR PRASAD, JUDICIAL MEMBER And  
SHRI WASEEM AHMED, ACCOUNTANT MEMBER**

आयकर अपील सं./ITA No. 1157/Ahd/2014

(निर्धारण वर्ष/Assessment Year : 2009-10)

Rajendra Ship Breakers Pvt.Ltd. D-79, Near Ram Mantra Mandir,Kalvibid, Bhavnagar	<b>बनाम/ Vs.</b>	The Joint Commissioner of Income=tax Bhavngar Range-1 Bhavnagar
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AABCR 0105 P		
(अपीलार्थी/Appellant)	..	(प्रत्यर्थी / Respondent)

अपीलार्थी ओर से/ Appellant by :	Shri B.R. Popat, AR
प्रत्यर्थी की ओर से/Respondent by:	Shri L.P. Jain, Sr.DR

सुनवाई की तारीख/ Date of Hearing	27/11/2018
घोषणा की तारीख/Date of Pronouncement	01 /01/2019

**आदेश / ORDER**

**PER WASEEM AHMED, ACCOUNTANT MEMBER:**

The captioned appeal has been filed at the instance of the Assessee against the order of the Commissioner of Income Tax (Appeals)–XX, Ahmedabad [CIT(A) in short] vide appeal no.CIT(A)-XX/289/11-12 dated 28/03/2014 arising in the assessment order passed under s.143(3) of the Income Tax Act, 1961(here-in-after referred to as "the Act") dated 27/12/2011 relevant to Assessment Year (AY) 2008-09.

2. The assessee has raised following grounds of appeal:-

*The Hon'ble CIT(A)-XX, Ahmedabad, has erred in law and on facts in –*

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1. *Confirming the action of the Assessing Officer in rejecting the books of account.*
2. *Partly confirming the aggregate addition of Rs.1,13,65,375/- originally made by the Assessing Officer (by disturbing the shortage suffered in ship breaking activities) at Rs.84,69,465/-, by estimating the shortage at 11%. Considering the facts of the case in totality, he ought to have deleted the entire addition.*
3. *Holding that out of the aggregate addition of Rs.52,00,000/- on account of alleged suppressed income, a sum of Rs.26,00,000/- is being confirmed, though telescoped against the other addition to the extent sustained. Considering the facts of the case in totality, he ought to have held that there was no suppressed income and no such consequential addition was ever warranted.*

3. The issues raised by the assessee in ground Nos. 1 and 2 are interconnected. Therefore we have clubbed both the issues together for the sake of convenience and adjudication.

4. The 1<sup>st</sup> issue raised by the assessee is that Ld. CIT(A) erred in rejecting the books of accounts and partly confirming the addition made by the AO at Rs. 84,69,465/- by estimating the shortage at 11%.

5. Briefly stated facts are that the assessee in the present case is a private Ltd company and engaged in the business of ship breaking and trading in scrap. The assessee in the year under consideration has declared a gross profit of Rs. 90,63,397/- against the total sales of Rs. 46,27,85,969/- which is constituting GP rate at the rate of 1.96% of the turnover.

5.1. However, the assessee in the immediately preceding assessment year has declared a gross profit of Rs. 1,04,95,270/- against the total sales

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of Rs. 20,09,75,597/- which is constituting gross profit ratio at the rate of 5.22%.

5. 2. There was also a shortfall in the net profit in comparison to the last year. As such the assessee has declared the net profit in the immediately preceding assessment year at Rs. 58,16,848/- whereas in the current year it stands at Rs. 27,01,998/- which has reduced to .58% from 2.89%.

5.3. The AO also observed that the assessee is not maintaining details of day to day consumptions of the raw materials and day to day production of the finished goods. The assessee recorded that the production of finished goods in the books of accounts only at the time of sale. However the assessee has claimed shortage of materials in the books at 1735.313 kg. As such the AO found certain defects as detailed under:

1. In the absence of consumption and production registers, the shortage shown by the assessee was not verifiable.
2. The closing stock of raw material was shown as the balancing figure on an estimated basis. The assessee admitted this fact during the assessment proceedings.
3. There was no closing stock of finished or semi-finished goods.

5.4. On the above observation of the AO, the assessee made a detailed submission as detailed under:

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**regarding the lower GP ratio and net profit**

- i. The GP ratio in the ship breaking industries varies very frequently on year to Year basis. It is because it depends upon the quality and content of the material derived from the breaking of the ship. If the material is of good quality, then it will fetch the good sale price and vice versa. Again the quality and contents of the material depend upon the various factors including the type of ship such as naval vessels, passenger ships, tankers, car passenger vessels, etc.
- ii. It has incurred a loss of Rs. 3,15,14,934/- on account of foreign exchange variation which caused the fall in the GP ratio. If this loss is removed, then the GP ratio is coming 8.77% which is much higher than the average profit declared in the last few years.
- iii. It is registered with various government department such as central excise department, custom department, Labour department, sales tax department, etc. Under all these laws it is required to maintain the necessary records such as details of the purchases, sales, quantitative details of various products but no defect of whatsoever was pointed out. Similarly, the books of accounts are audited, and there was an unqualified report filed by the auditors.

**Regarding non-maintenance of consumption & production registers.**

- i. It records the total weight of the ship purchased as inward raw material. Subsequently, the ship is broken, and its parts are sold in the market. The sales of the parts of the broken ship are recorded as outward material. Accordingly, the balance quantity arrives which is further adjusted against the shortage of the material as wastage which is occurred during the process of dismantling the ship.
- ii. The shortage/ scrap of the material during the process of dismantling the ship are worked out on the basis of the report of

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metallurgical and engineering consultants (India) Ltd. (for short MECON)

- iii. The financial statements for any fiscal year are prepared after the gap of a few months. Therefore the events which occur after the end of the financial year but before the date of preparation of the financial statements are considered to work out the shortage of quantity resulting from the activity of dismantling the ship to arrive at the closing stock of the uncut ship at the end of the relevant financial year.
- iv. The Revenue has also accepted a variation of 10% as wastage in working out the closing stock of the uncut ship.
- v. The closing stock of one year becomes the opening stock of next year. Therefore there is no impact on the profitability of the company due to stock.

5.5. However, the AO disagreed with the submission of the assessee on his observation as detailed under:

*“I. The assessee not maintaining accounts which may show the correct position of consumption of raw material/production of finished goods/remaining stock/shortage.*

*II. Production of the finished goods is only disclosed in the accounts when it was sold.*

*III. No detail of day to day consumption of the raw material is maintained.*

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*IV. No detail of shortage is maintained. For a given day neither the consumption of the raw material can be ascertained nor the shortage occurred can be ascertained.*

*V. The shortage is being taken as balancing figure.*

*VI. Stock of remaining raw material i.e. uncut Ship is being estimated.*

*VII. Regarding the estimation of the uncut ship as well as shortage the assessee has also having in direct acceptance in view of his submission filed during the course of assessment.”*

5.6. In view of the above, the AO invoked the provisions of section 145(3) of the Act and rejected the books of accounts of the assessee.

5.7. The AO further observed that the assessee has shown shortage/wastage of raw material in respect of certain ships up to the month of October 2008 for 1164 MT which is constituting 14% of the raw material consumed whereas for the remaining period of the financial year the assessee has shown shortage/wastage at 589.3 MT which is constituting 8% of the raw material consumed. Accordingly, the AO sought an explanation from the assessee showing/ justifying the mismatch in the wastage/shortage of production.

5.8. The assessee in compliance to it submitted that the shortage/wastage in the production varies depending upon various factors including the quality and contents of the ships. There are different kinds of ships used by different industries having a different lifetime, and accordingly, the wastage/ shortage cannot be standardized.

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5.9. The average shortage in the instant case is worked out at 11.20% of the raw material consumed which is within the permissible range accepted by the Revenue in most of the cases.

5.10. Similarly, such percentage of wastage /shortage as shown by the assessee is within the acceptable limit as certified by the independent agencies which were appointed by the Ministry of steel authority, the Government of India.

5.11. However, the AO disagreed with the submission of the assessee by observing that the assessee has not produced any documentary evidence in support of his claim.

5.12. Similarly, the report of metal logical and engineering consultant is silent about the specific shortage on the basis of weight/life of the ship. Accordingly, the AO was of the view that the wastage/shortage declared by the assessee at the rate of 14% of the raw material consumed is on the higher side. As per the AO, it should be reduced to 10% which comes out 829.20 MT. Thus the excess shortage shown by the assessee, i.e. 334.80 MT(1164-829.20 MT) was disallowed. Such excess shortage was valued at Rs. 1,13,65,375/- and added to the total income of the assessee.

6. Aggrieved assessee preferred an appeal to Ld. CIT(A). The assessee before the Id. CIT-A submitted as under:

**Rejection of the books of accounts**

7. The assessee before the Ld. CIT(A) submitted that the decline in the gross profit was due to unavoidable reasons. However, the gross profit declared by it is arising as per the books of accounts which are supported with necessary documents. As such the gross profit reduced in the year under consideration due to the loss of exchange fluctuation amounting to Rs. 3,15,14,934/-. The assessee also submitted that in the immediately preceding assessment year there was a gain on account of foreign exchange fluctuation amounting to Rs. 29,07,420/- which was accepted by the Revenue.

7.1. It has maintained complete quantitative records under the central excise law in the prescribed registers. However, the closing inventory of the uncut ship is always determined on the estimated basis. The AO has also admitted the shortage/wastage of the material during the process of dismantling the ship can be estimated on a reasonable basis.

7.2. The materials which are taken out from the ship are treated as finished goods. These finished goods are sold immediately on the removal from the ship. Thus there was no closing stock of the finished goods as well as an opening stock of the finished goods.

7.3. It was not possible to maintain the registers showing the consumption of raw materials because once the material is removed from

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the ship, it is treated as finished goods which are sold immediately. As such once the entire ship gets dismantled then the difference between the weight recorded at the time of purchase and the weight recorded in the production cum sale register is treated the shortage of the raw material which is accounted automatically.

7.4. The shortage in the process of dismantling the ship is recorded on an estimated basis. As such the assessee has recorded a shortage which is within the permissible limit.

7.5. Without prejudice to the above, the assessee also submitted that the AO rejected the books without giving a proper opportunity of being heard in this. Thus the order of the AO is against the provisions of law.

**Addition on account of shortage of stock**

8. The average shortage reported by the assessee was 11.20% as per the audit financial statements. But the AO arbitrarily has divided such shortage in respect of opening stock and the 1<sup>st</sup> ship purchased during the year as 14%, and for the subsequent vessels, it was estimated at the rate of 8%. As such the loss on account of shortage/ weight loss should be determined for a particular year or a period and the same cannot be linked to a particular vessel. The assessee was not maintaining the stock separately for each vessel purchased by it. As such the opening stock gets mixed with the vessels purchased subsequently. The material of all the vessels purchased in the year under consideration gets mixed with each

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other. Therefore the AO cannot estimate the shortage of the stock separately for each ship.

8.1. The shortage of the materials during the process of dismantling the ship as suggested by the metallurgical and engineering consultants (India) Limited cannot be ignored as it was worked out at the instance of the Ministry of steel. Had there been any malafide intention of the assessee to report the excessive shortage than it should not have reported the shortage for the subsequent period as observed by the AO at 8%. Thus the allegation of the AO is based on his surmise and conjecture.

8.2. The 1<sup>st</sup> ship purchased by the assessee was used to carry the fish obtained from the sea/Ocean. Thus the vessel was exposed to the sea water most of the time. Thus there was excessive corrosion when it was brought to the seabed for breaking. Thus in such a case, the weight loss will always be higher which has also been admitted by the MECON in its report.

8.3. The books of accounts were audited under the income tax Act. The activity of ship breaking is subject to excise law and therefore it was maintaining all the necessary registers showing the inventory of the materials. There was no adverse remark either by the auditor or by any government department such as excise etc.

8.4. The assessee has reported a shortage at the rate of 13.04% and 13.62% in the assessment years 2007-08 and 2008-09 in the

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immediately preceding assessment years which were not disturbed by the Revenue. Similarly, it has reported shortage at the rate of 11.19% in the assessment year 2010-11 immediately in the succeeding assessment year which was also accepted by the Revenue.

8.5. However, the Ld. CIT(A) confirmed the order of the AO rejecting the books of accounts and partly confirmed the addition on account of excess shortage of wastage.

**Rejection of the books of accounts**

9. There was a downfall in the net profit ratio which has not been suitably explained by the assessee.

9.1. Even the GP of the assessee is assumed at the rate of 9.85% for the year under consideration, yet it is less in comparison to the other assessee involved in the same business particularly Sunjay trading Corporation wherein the GP at the rate 10.04% was declared.

9.2. The assessee was not maintaining the sufficient stock registers such as consumptions register and production registers.

**Addition on account of excess shortage of wastage**

10. The assessee has shown shortage at the rate of 14% in respect of opening stock and the 1<sup>st</sup> ship which was sold up to October 2008, whereas the assessee has shown shortage at the rate of 8% for the

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subsequent period. However, the assessee has not explained such excessive loss in respect of opening stock and 1<sup>st</sup> ship by documentary evidence.

10.1. The Ld. CIT (A) was of the view that the shortage of the material to the extent of 11% is sufficient enough in the activity of ship breaking business. In this regard, the CIT (A) relied on the order of the Ld. CIT(A) in the case of Sunjay trade Corporation in appeal number CIT (A)-XX/296/11-12 DATED 20 March 2014 where the loss on account of the shortage was allowed at the rate of 10.53%. Accordingly, the Ld. CIT(A) confirmed the order of the AO in part by observing as under:

*“3.15. It has been noticed that the Assessing Officer has already allowed the shortage @ 10% of the consumption as against the claim of 14%. So being the appellant’s case similar to the business activities of M/s.Sanjay Trade Corporation referred above the shortage ratio of 10.53% claimed in that case by rounding off it at 11% is considered in appellant’s case then also the excessive shortage works out to 251.88 MT (1164 MT (-) 11% of 8292 MT = 912.12 MT) in place of 334.8 MT worked out by the A.O. So the addition on account of the unaccounted production and consequently unaccounted sales of the 251.88 M.T. @ Rs.33,625/- works out to Rs.84,69,465/- is correct and justified and to this extent the addition made by the A.O. is confirmed. The appellant gets the relief of Rs.28,95,910/-. Hence Ground No.2 of the appellant is partly allowed.”*

11. Being aggrieved by the order of the Ld. CIT(A) assessee is in appeal before us.

12. The Ld. AR before us filed two paper book running from pages 1 to 100 and 1 to 152 and submitted that the issue is covered in favor of the

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assessee by the order of this Tribunal in the case of Sanjay Trade Corporation Vs. JCIT in ITA 1158/AHD/2014 vide order dated 9-4-2018 and the ACIT Vs. Laxmi Steel Rolling Mills in ITA No. 3467/AHD/2015 vide order dated 28-3-2018. The ld. AR reiterated the submission made before the authorities below.

12.1. On the other hand, the ld. DR vehemently supported the orders of the authorities below.

13. We have heard the rival contention and perused the materials available on record. The issue in the instant case relates to the rejection of the books of accounts Vis a Vis unaccounted sale of the excess shortage of the wastage claimed by the assessee.

13.1. The AO during the assessment proceedings found that the assessee is not maintaining stock registers to show the consumption of the raw materials, finished goods, semi-finished goods, etc. Similarly, the AO also found that there was a decline in the GP ratio as well as the net profit ratio of the assessee in comparison to the previous year. Thus, the AO rejected the books of accounts. The Ld CIT-A subsequently confirmed the view taken by the AO.

13.2. The AO besides the above also noticed that the assessee had claimed an excessive loss in respect of raw material consumption. Therefore, such excess loss of stock was assumed as unaccounted sales made by the assessee that was accordingly added by the AO to the total

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income of the assessee. However, the Ld. CIT(A) subsequently partly confirmed the order of the AO.

13.3. Now the controversy before us arises on account of two reasons which are adjudicated as under:

13.4. The 1<sup>st</sup> controversy is the rejection of the books of accounts.

13.5. In the ship breaking activity/business, when the assessee acquires a ship, it takes the weight of the ship as reported by the manufacturing company. The lifespan of a ship ranges from 20 to 40 years depending upon the purpose for which it is used. Once the ship retires from effective use, when it comes for sale. It is quite natural there will be a significant difference in the weight of the ship when it was manufactured and when it is sold as scrap after the expiry of its useful life.

13.6. However, there is no mechanism in worldwide to check the weight of the ship when it retires from the effective use and available for sale as scrap. But in the ship breaking industry the weight as recorded at the time of manufacturing was used as the weight/ quantity purchase by the assessee. After that, the assessee keeps on dismantling the ship and selling the same in parts simultaneously. The assessee at the time of sale records the part of the ship which is sold as finished goods. Accordingly, the weight recorded at the time of sale is reduced against the weight of the ship when it was acquired. There is no issue in case of a ship which is sold in the same financial year in which it was acquired. In such a case

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the difference between the in-ward quantity of the ship and out-ward quantity of the ship can be ascertained in the same financial year. Thus the difference between these two figures of the quantity can be assumed as the actual shortage in the process of dismantling the ship.

13.7. However, the controversy arises when a ship is purchased in a financial year, and the same is sold in the same financial year and subsequent financial years. The quantity of the purchases of the ship is available and the quantity for the sale of the ship in a particular year is also available. But when the quantity of closing stock is determined then some percentage of the shortage is estimated which pertains to the relevant financial year.

13.8. However, there is no doubt that the entire shortage of the material pertaining to a particular ship is accounted for by the assessee in the process of acquisition, dismantling and sale of the entire ship.

14. Now coming to the case on hand, we find that the assessee is not maintaining consumption registers, production registers, etc. We hold so on the fact that the assessee before us has not produced such documents in the paper book.

14.1. But we find that the assessee was maintaining the inventory as it purchased in the form of the ship and the inventory sold in the year under consideration. As per the assessee whatever is removed from the ship is sold immediately. The quantity sold is adjusted against the quantity of

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the ship purchased by the assessee. Thus we note that the assessee was maintaining the quantitative details in the form of purchase and sales. The quantity of purchase and sales has not been doubted.

14.2. The assessee has been using this method of accounting for valuing the inventory as well as a shortage of material for the last several years which was not disputed by the AO. Thus, there cannot be the rejection of the books of accounts merely on the ground that the assessee is not maintaining stock registers. It is because the stocks are worked out for the out of the purchase and sales of the goods. Once, the information of purchase and sales of the materials are available with the Revenue then the stock can be worked out.

14.3. In this regard, we find support and guidance from the order of the Gujarat High Court in case of Jaytick Intermediates (P) Ltd Vs. ACIT reported in 73 taxmann.com 195 wherein it was held as under:

*“In CIT v. Smt. Poonam Rani [\[2010\] 192 Taxman 167/326 ITR 223 \(Delhi\)](#) it was held that if stock register is not maintained by the assessee that may put the Assessing Officer on guard against the falsity of the return made by the assessee and persuade him to carefully scrutinize the account books of the assessee. But the absence of one register alone does not amount to such a material as would lead to the conclusion that the account books were incomplete or inaccurate. Similarly, if the rate of gross profit declared by the assessee in a particular period is lower as compared to the gross profit declared by him in the preceding year, that may alert the Assessing Officer and serve as a warning to him, to look into the accounts more carefully and to look for some material which could lead to the conclusion that the accounts maintained by the assessee were not correct. But, a low rate of gross profit, in the absence of any material pointing towards falsehood*

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*of the account books, cannot, by itself, be a ground to reject the account books under section 145(3).”*

14.4. In addition to the above, we also note that the books cannot be rejected merely on the ground that there was a decline in the GP and NP of the assessee. It was the duty of the AO to find out the defect in the books of accounts. As such we note that there was no defect pointed out by the AO in the books maintained by the assessee which were also produced before the AO. We also note that the assessee has shown a huge loss on account of exchange fluctuation amounting to Rs. 3,15,14,934/-which has resulted a decline in the gross profit ratio. If this loss is removed then the assessee has declared GP ratio greater than the ratio declared by it in the earlier assessment year.

14.5. Similarly, the decline in the net profit cannot be a basis for rejecting the books of accounts. The AO was supposed to record the finding that the assessee's books are not complete or correct with the supporting evidence. But there is no such finding of the AO in his assessment order.

14.6. As per the principles of natural justice, the AO was under the obligation to issue a show cause notice to the assessee before the rejection of the books of accounts. The Ld. DR before us has not brought anything on record suggesting that the opportunity of being heard was given to the assessee. Thus on this count as well we hold that the books cannot be rejected. In this regard, we find support and guidance from the

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order of Hon'ble High court of Delhi in case of PCIT Vs. IBILT technologies Ltd reported in 98 taxmann.com 255 weherein it was held as under:

*“9. If there is fall in the gross profit ratio, reasons and grounds given by the respondent/assessee have to be examined objectively, fairly and in a non-partisan manner. Past results could be a good reason to conduct detailed verification, albeit would not be the only ground and reason to make addition by rejecting the books of account. Good and cogent reason why the financial results should be rejected has to be given. Books of account cannot be rejected as the respondent- assessee has suffered losses, where as in the immediate earlier year profit was made. Fall in gross profit ratio could be due to various reasons, and cannot be the sole and only ground to reject the book results in entirety and frame best judgment assessment [see CIT v. Poonam Rani [\[2010\] 326 ITR 223/192 Taxman 167 \(Delhi\)](#), Action Electricals v. Dy. CIT [\[2003\] 132 Taxman 640/\[2002\] 258 ITR 188 \(Delhi\)](#)]. The reasoning given in the assessment order to compute income on hypothetical basis by applying gross profit ratio of 4% is completely fallacious, wrong and is contrary to well-settled law, as expounded vide judgments reported as CIT v. Calcutta Discount Co. Ltd. [\[1973\] 91 ITR 8 \(SC\)](#), Dhakeshwari Cotton Mills Ltd. v. CIT [\[1954\] 26 ITR 775 \(SC\)](#) and Raghubar Mandal Harihar Mandal v. State of Bihar AIR 1957 SC 810.”*

14.7. In view of the above, we reverse the order of authorities below and hold that the books in the given facts and circumstances cannot be rejected.

**Regarding the sale of an excess shortage of material as the unaccounted sale**

15. As there is no mechanism to check the inventory in respect of the uncut ship lying at the end of the financial year, therefore the closing inventory is determined after taking into account the estimated loss

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occurred in the process of dismantling the ship. The issue arises for estimating/ determining the basis of quantifying such loss occurred in the process of dismantling the ship.

15.1. In the instant case, the assessee has shown such loss at the rate 11.20% on account of shortage in the material. The assessee shows this shortage pertaining to the financial year under consideration. However, the AO has worked out the shortage in respect of each vessel separately. Thus the AO claimed that the assessee had shown such shortage in respect of opening stock and 1<sup>st</sup> vessel at the rate of 14% which was excessive in the opinion of the AO.

15.2. However, we note that the assessee is not maintaining its accounts in respect of each ship separately. Therefore, we find force in the argument of the assessee that the quantity purchased during the year gets mixed with each other. Therefore, the loss on account of excessive shortage determined by the AO for the part of the previous year cannot be accepted. The loss if any due to the shortage of material has to be seen for the entire year. In the case before us, the loss shown by the assessee for the entire year is 11.20% which is within the permissible limit. Thus we disagree with the finding of the lower authorities.

15.3. We also referred the sales ledgers which are placed on page no.73 of a 1<sup>st</sup> paper book and noted that the same was not maintained ship wise. Rather it was showing the sales of the material without making any reference to the particular ship.

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15.4. We also note that the Revenue in the own case of the assessee in the earlier assessment has admitted the shortage of material at the rate of 13% which is excess from the loss shown by the assessee in the year under consideration.

15.5. We also note that once the AO has rejected the books of accounts than on the same set of books of accounts no other addition can be made on account of mismatch in the shortage of inventory. Thus in our considered view, the AO erred on the one hand in rejecting the books of accounts and on the other hand relying on the same for making the addition as discussed above.

15.6. We also find that the order relied on by the Ld. CIT(A) for determining the loss at the rate of 11%, was reversed by the Hon'ble ITAT in ITA No. 1158/AHD/2014 vide order dated 09.04.2018 wherein it was held as under:

*“8. We have gone through the relevant record and impugned order. In this case, appellant is engaged in the business of ship breaking, wherein old and discarded marine vessels are imported from international market. The vessels so purchased are dismantled and the products obtained therefrom are sold in the market. Since the ship breaking industry is subjected to the levy of excise duty, complete quantitative records are maintained in the registers prescribed under the Central Excise Law. The AO should have appreciated the fact that there was the ship settles on the sea bed, there was no mechanism invented in this world which may enable a person to actually weigh the ship or part thereof, which may in turn, enable the Appellant to precisely work out the exact quantity of shortage and of the corresponding stock of uncut portion of ship on any particular day. These have to be estimated by taking a logical base as very much explained by the appellant before the*

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*lower authorities. It is possible for appellant to precisely work out the exact quantity of day to day basis in the ship breaking industry. The Appellant's contention was whenever an old and discarded marine vessel is imported for breaking, the same is being negotiated and documented on the basis of her weight as mentioned in various construction and ownership documents that may be available either with the seller of the ship or in the records of Lloyds, an international agency operating in this regard. Every single document invariably mentions the weight of the ship when she was built a few decades back. As against this, the actual weight of the ship is substantially less, when she is imported and beached in the ship breaking plot for breaking.*

*9. Appellant cited an order of ITAT, Ahmedabad Bench in ITA Nos.1963 & 2274/Ahd/2014 for Asst Year 2010-11, in similar facts and circumstances of the case, relief was given to the appellant. In ITA No.1158/Ahd/14 Sanjay Trade Corporation vs. JCIT Asst.Year -2009-10 the said case, assessee is engaged in ship breaking industry, whereby old and used vessels are discarded, generating mostly old & used plates, melting scrap etc. Old & discarded ships are bought by the assessee for dismantling purpose. The ships are purchased on the weight basis, for which, the reference was made to the weight when it was manufactured and changes if any, made during its life cycle. Most of these records are maintained in the trim & stability book of the vessel. Though, the ships are purchased on weight basis, it is not possible to weigh the ship before or while taking the delivery. Hence, the ship is purchased assuming the weight mentioned in the Memorandum of Agreement as correct.*

*10. Appellant has also filed audited account in which we do not find any infirmity and considering the co-ordinate bench's judgment and facts and circumstances of the case, we allow appeal of the appellant and delete the addition made by the lower authorities”*

15.7. We also note that the assessing officer in his order has admitted that the production of the finished goods was recorded in the books of accounts at the time of sale. The relevant observation of the AO is reproduced as under:

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*“Production of the finished goods is being reported in the accounts only at the time of their sale.”*

15.8. We also find that the AO in his order has also admitted that there was sufficient stock of raw material in the books of accounts of the assessee as on 31 March 2009. The relevant observation of the AO is reproduced as under:

*“There is sufficient raw material in the hands of the assessee at the end of the year and his manufacturing activities were also going on regularly up to 31.03.2009 even though the assessee has not disclosed any stock of finished or semi-finished goods.”*

15.9. The above observation of the AO evidence that there was no sale made out of the books of accounts either of the raw material or finished goods/semi-finished goods. Thus we can conclude that there was no sale made by the assessee outside the books of accounts.

15.10. In view of the above, we hold that the addition made by the AO and confirmed by the Ld. CIT(A) is not sustainable. Thus we reverse the order of authorities below. Accordingly, we set aside the order of the Ld. CIT(A) and direct the AO to delete the addition made by him. Hence the ground of appeal of the assessee is allowed.

16. The next issue raised by the assessee is that the Ld. CIT(A) erred in partly confirming the addition made by the AO Rs. 26,00,000/- on account of suppressed income.

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16.1. The AO during the assessment proceedings observed that the assessee had shown the sale of pieces of machinery and its parts of 40.535 MT only. The AO was of the view that the assessee in the year under consideration has sold an opening quantity of uncut ship and the 1<sup>st</sup> ship acquired during the year. Thus the assessing officer was of the view that the assessee must have shown the sale of two main ship engines and two DG set beside the other machinery and spare parts. As such the assessee has neither shown the sale of 2 ship engines and 2 DG sets and other pieces of machinery including accessory nor it has shown the same as closing stock.

16.2. On a question, by the AO the assessee submitted that on many occasions the machinery dismantled from the ships are sold as scrap because these are not saleable as it is in the market. Therefore, there cannot be any standard rule that the assessee shall show the sale of requisite pieces of machinery in its books of accounts.

16.3. However, the AO disagreed with the submission of the assessee and treated the sale of 2 DG sets and 2 ship engines and other parts of machinery amounting to Rs. 52 lakhs respectively as undisclosed income. However, the AO did not make any addition of the sum described above separately on the ground that he has already made the addition due to the shortage of the material as discussed in the preceding paragraph.

17. The aggrieved assessee preferred an appeal to Ld. CIT(A). The assessee before the Ld. CIT(A) submitted that it had sold the DG sets and

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ship engines as scrap. It is because these items were not capable of sale as it is. Therefore, these were broken and sold separately which were recorded as machinery sales in the books of accounts.

17.1. The basis adopted by the AO for valuing the unaccounted sale of ship engines and the DG sets and the pieces of machinery was not provided to the assessee for his rebuttal.

17.2. The AO has not provided an opportunity of being heard to the assessee before making the impugned addition in the hands of the assessee.

17.3. However, the Ld. CIT(A) after considering the submission of the assessee confirmed the order of the AO in part by observing as under:

*“5.8. I have carefully considered the facts on record and the submissions of the assessee made before the Assessing Officer as well as before me and I am not fully convinced with the same. While, on one hand, the sale bills appended with the assessment order do not contain any details, in the same way, the purported sale of spare parts from alleged dismantled ships by the appellant also does not contain any specific detail. In this background of what is discussed above, when engine/DG set of ship finally broken was in working condition, though may be very old, it does not make any commercial sense to dismantle such engine and sell the same by weight as scrap. The details furnished also do not indicate the nature of sale of important spare parts retrieved from alleged breaking of engine. In such circumstances, I am not inclined to accept the claim of the Ld. AR that the engines were also dismantled and sold as scrap. The sale price shown in the sale bills appended to the assessment order is not of any help because the name of ship from which it was retrieved is not even mentioned much less any technical details or at least the HP of such engine. The appellant has*

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*specifically failed to demonstrate from the books of accounts that in what manner the sale proceeds of the engines, D.G. Sets/other machineries either without cut or by cutting them in pieces as scrap has been shown or lying in the closing stock. On totality of the facts and circumstances, I partly agree with the Assessing Officer's observation regarding possibility of sale of two engines and two DG sets but not with the estimate of sale proceeds as done by him which is without any basis at all and hence confirm the lumpsum addition of Rs.26,00,000/- would take care of the possible leakage of revenue in respect of above items and meet the end of justice. I therefore sustain addition of Rs.26,00,000/- on this account. The ground of the appellant is partly allowed"*

18. Being aggrieved by the order of the Ld. CIT(A), the assessee is in appeal before us.

19. The Ld. AR before us reiterated the submission made before the authorities below.

19.1. On the other hand, the ld. DR vehemently supported the order of the authorities below.

20. We have heard the rival contentions and perused the materials available on record. In the instant case, the issue relates to the unaccounted sales of ship engines, DG sets and machinery/spare parts made by the AO.

20.1. The AO was of the view that the assessee on the dismantling of the ships must have sold the products as described above. But there was no sale shown by the assessee in its books of accounts for these items.

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Similarly, these items were also not shown as closing inventory in the books of accounts. Therefore, the AO worked out the value of such items and treated the same as the undisclosed sale of the assessee.

20.2. However, the Ld. CIT(A) agreed with the finding of the AO but reduced the market value of such items from Rs. 52 lakhs to Rs. 26 lakhs which was confirmed by him.

20.3. The assessee argues that it was not possible to sale the ship engines and DJ sets and other pieces of machinery as it is. Therefore, these products were dismantled and sold as scrap which was classified under the head sale of pieces of machinery. The assessee in support of his claim has drawn our attention on page no 77 to 81 of the 1<sup>st</sup> paper book where the sample invoices of the sales were recorded.

20.4. In this regard, we note that the assessee has shown the shortage of the materials as 11.20% which is within the range of the permissible limit. We have also confirmed the shortage shown by the assessee at 11.20% in paragraph number 14 to 15 of this order.

20.5. Thus, if we hold that the assessee has sold the items as discussed above outside the books of accounts, then the wastage/ shortage or closing stock of the material would have increased simultaneously. Accordingly, the shortage in aggregate would have exceeded the permissible limit as discussed above. Once, we have held that the shortage shown by the assessee within the permissible limit than we are

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not inclined to make any addition on account of unaccounted sales of the items as discussed above.

20.6. We also note that the assessee before the authorities below has claimed that it has broken the ship engines and DG sets as it was not in a position to sale the same as it is. This argument of the assessee has not been proved wrong.

20.7. We also find that the assessee has produced the copy of the invoices and other details which are placed on pages 67 to 92 of the paper book and no defect of whatsoever was pointed out by the authorities below.

20.8. There was also no documentary evidence available with the authorities below suggesting that the assessee has made any sale of the items as discussed above outside the accounts. Even it is assumed that the contention of the Revenue is correct, but the same should be based on the supporting evidence. As such the Revenue has not brought anything on record evidencing that the assessee has made sales of these items without recording the same in the books of accounts.

20.9. In this regard, we find support and guidance from the judgment of Hon'ble ITAT Ahmedabad in case of ACIT Vs. M/s Laxmi Steel Rolling Mill-Unit II in ITA No.3467/Ahd/2015 dated 28.03.2018 wherein it was held as under:

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“9. We have gone through the relevant record and impugned order. Assessing Officer could not brought anything on record to establish that the engine/DG/Machinery were sold out of the books of the account. On the other hand, assessee’s contention was that the machinery and DG sets were also dismantled and sold as scrap as ferrous as well as non-ferrous material. The dismantle items are excisable goods and the assessee was also maintaining excise register and in the excise register nowhere mentioned of sale of DG sets/engine/ machinery etc.

10. In our considered opinion, ld.CIT(A) has rightly allowed the claim of assessee. Therefore, this ground of appeal is dismissed.

11. So far as deleting the addition of Rs.3,34,559/- is concerned. AO has discussed this issue at Para No.5.6 and ld. CIT(A) has discussed this matter at Para 13 and 14. In this regard, ld. AO has made addition of estimated basis without any sustainable reason.

12. In our considered opinion, ld.CIT(A) has rightly allowed the claim of assessee, hence this ground of appeal is dismissed.

13. So far as deleting the disallowance of currency loss of Rs.6,30,421/- is concerned. AO has discussed this matter at Para no.4 and Ld. CIT(A) has discussed the same at Para no.22. In this regard, assessee has claimed that the loss on account of currency derivatives is not a speculative transactions in view of the clause (d) of the proviso of section 43(5) of the Act and the "Futures" transactions in currencies traded in the trading platform of the four recognized stock exchanges viz., National Stock Exchange , Bombay Stock Exchange , MCX Stock Exchange and United Stock Exchange of India are normal business transactions and not speculative transactions and loss arising there from can be adjusted against any other business income including speculative income.

14. In the case of **Adani Enterprises Ltd.** 55 taxmann.com 375, The Co-ordinate Bench has held as under:

“Section 43(5) of the Income-tax Act, 1961 - Speculative transactions (Currencies) - Assessment year 2008-09 - Whether provisions of section 43(5) do not apply to currencies and, therefore, loss incurred by assessee in currency swap contract cannot be denied to be set off against other heads of income taking it as speculative loss - Held, yes [Para 4,10] [In favour of assessee]”

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15. Respectfully following the aforesaid order of co-ordinate bench, we dismiss this ground of appeal of the revenue.

16. Therefore, in our considered opinion, ld. CIT(A) has passed detailed and reasoned order, therefore, we are not incline to interfere in the order passed by the ld.CIT(A).

17. In the result, appeal filed by the department is dismissed.”

21. In view of the above, we are inclined to reverse the order of the authorities below. Thus we set aside the order of the Ld. CIT(A). Hence, the ground of the appeal of the assessee is allowed.

22. In the result, the appeal of the assessee is allowed.

<b>This Order pronounced in Open Court on</b>	<b>01/01/2019</b>
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**Sd/-**  
**(MAHAVIR PRASAD)**  
**JUDICIAL MEMBER**

**Sd/-**  
**(WASEEM AHMED)**  
**ACCOUNTANT MEMBER**

Ahmedabad; Dated 01/01/2019

*टी.सी.नायर, व.नि.स./T.C. NAIR, Sr. PS*

**आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :**

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त(अपील) / The CIT(A)-XX, Ahmedabad
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, अहमदाबाद / DR, ITAT, Ahmedabad
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

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