

**आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ 'D' अहमदाबाद ।**  
**IN THE INCOME TAX APPELLATE TRIBUNAL**  
**“D” BENCH, AHMEDABAD**

**BEFORE SHRI RAJPAL YADAV, JUDICIAL MEMBER &**  
**SHRI PRADIP KUMAR KEDIA, ACCOUNTANT MEMBER**

आयकर अपील सं./I.T.A. No. 2042/Ahd/2014

(निर्धारण वर्ष / Assessment Year : 2010-11)

<b>Tonira Pharma Ltd.</b> (Since amalgamated with IPCA Lab. Ltd.) 301, Yogi Complex, Sampatrao Colony, Alkapuri, Baroda - 390007	<b>बनाम/</b> Vs.	<b>ACIT</b> Circle - 4, Baroda
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AABCT0638F		
(अपीलार्थी /Appellant)	..	(प्रत्यर्थी / Respondent)

अपीलार्थी ओर से /Appellant by :	Shri S. N. Soparkar & Shri Parin Shah, A.R.
प्रत्यर्थी की ओर से / Respondent by :	Shri Rajesh Meena, Sr.D.R.

सुनवाई की तारीख / Date of Hearing	27/06/2019
घोषणा की तारीख /Date of Pronouncement	29/07/2019

**आदेश/ORDER**

**PER PRADIP KUMAR KEDIA - AM:**

The captioned appeal has been filed at the instance of the assessee against the order of the Commissioner of Income Tax (Appeals)-III, Baroda ('CIT(A)' in short), dated 15.05.2014 arising in the assessment order dated 26.03.2013 passed by the Assessing Officer (AO) under s. 143(3) of the Income Tax Act, 1961 (the Act) concerning AY 2010-11.

2. The grounds of appeal raised by assessee read as under:

- “1 *Ld. CIT (A) erred in law and on facts in confirming action of AO in rejecting write off of obsolete inventory to the extent of Rs. 1,00,68,057/-by the appellant. Ld. CIT (A) ought to have deleted disallowance holding write off of obsolete stock having nil realizable value in accordance with accounting principles is an allowable deduction. It be so held now.*
- 2 *Both the lower authorities erred in law and on facts in not appreciating the fact that obsolete pharmaceutical products hazardous for human lives were required to be destroyed by appellant under norms of the pharma industry. Ld. CIT (A) ought to have accepted write off of material due to its expiry and non usability by deleting disallowance made by AO. It be so held now.*
- 3 *Alternatively and without prejudice to the above contention, the appellant ought to be allowed the writing off of raw materials becoming obsolete as business loss u/s 28 of the Act. Ld. CIT (A) ought to have allowed genuine business loss suffered by appellant on writing off of stock found obsolete on detection during the year under consideration. It be so held now.*
- 4 *Ld. CIT (A) erred in law and on facts in confirming adhoc disallowance of interest expenses estimating 10% of WIP value u/s 36(1)(iii) of the Act. Ld. CIT (A) further erred in law and on facts in directing AO to allow depreciation on capitalized interest in the year in which capital asset is put to use. Ld. CIT (A) ought to have allowed depreciation during the year.*
- 5 *Ld. CIT (A) erred in law and on facts in confirming disallowance by AO on account of bad debts of Rs. 2,68,465/- written off in respect of excise duty refund. Ld. CIT (A) ought to have deleted disallowance. It be so held now.*
- 6 *Ld. CIT (A) erred in law and on facts in restricting disallowance made by AO to Rs. 19,216/- for earning exempt income of Rs. 1134/- u/s 14A of the Act. Ld. CIT (A) ought to have deleted disallowance in absence of any expenses incurred by the appellant to earn exempt income.*
- 7 *Ld. CIT (A) erred in law and on facts in confirming action of AO making adjustment in book profit by amount of addition made u/s 14A of the Act. Ld. CIT (A) ought to have deleted such adjustment not permissible under law. It be so held now.”*

3. Ground Nos. 1 to 3 concern loss arising from write off of inventory to the extent of Rs.1,00,68,057/- claimed to be obsolete and non-usable by the assessee company.

4. Briefly stated, the assessee is engaged in the business of manufacturing of bulk drugs, intermediates and fine chemicals. In the course of assessment proceedings, the AO noted substantial fall in the gross profit ratio declared by the assessee vis-à-vis earlier years. On further inquiry, it was noticed by the AO that the assessee has reduced its closing stock by sum of Rs.1,00,68,057/-. It was explained on behalf of the assessee that lowering of closing stock is on account of write off of value of certain materials because of its expiry or technical non-usability as advised by Plant Managers. The summary of non-moving stock for write off as furnished to the AO is reproduced hereunder:

<i>Particulars</i>	<i>Ankleshwar</i>	<i>Nandesari</i>	<i>Total</i>
<i>Raw Material</i>	1780778.88	946574.51	2727353.39
<i>W.I.P.</i>	171044.20	5653439.29	5824483.49
<i>Finished Goods</i>	1516219.83	0.00	1516219.83
<i>Total</i>	3468042.91	6600013.80	10068056.71

5. The AO however observed that the assessee has failed to furnish the supportive evidences, such as, certificate from Narcotics and Excise Authorities or some other competent authorities. The documentary evidences showing expiry date of material under write off was also not furnished. The AO also noticed that some letters addressed to Excise Authorities were submitted where the assessee has made a request to the authorities to destroy the raw materials of Rs.4,61,078/- which letter also relates to FY 2012-13 and therefore, it is difficult to ascertain whether the destruction was of the material relatable to FY 09-10 concerning AY 2010-11 or other period. The AO further noted that inventory was valued at full cost till last year without any write off and therefore it was for the assessee to show that the material has turned obsolete and rendered unusable during the FY 2009-10 in question. In the absence of any technical report or certificate from competent authorities for identification of non-moving items or obsolete items, the AO rejected the claim of loss made by the assessee and consequent lowering of closing stock owing to such obsolescence. The taxable income was consequently increased to the extent of Rs.1,00,68,057/-.

6. Aggrieved, the assessee preferred appeal before the CIT(A).

7. The CIT(A) re-visited the submissions made on behalf of the assessee as reproduced in para 4.2 of its order but found little merit in the claim of loss resulting from write off of value of inventory. The conclusion drawn by the CIT(A) on the issue is reproduced hereunder for ready reference:

*“4.3. I have considered the facts of the case, the submission made by the appellant and the AO's observations. A perusal of the Audit Report in Form No. 3CD shows that during the previous year 2009-10, the appellant had valued the closing stock at cost or at net realizable value whichever is lower, work in progress was valued at estimated cost and raw material and other stock were valued at cost. Thus, this is not a case where the appellant was valuing the raw material at cost or net realizable value whichever is lower. Hence, the reliance placed by the appellant on the decision in the case of Sonic Biochem Extractions Pvt. Ltd. 59 SOT 4 (Mum) is not applicable. Further, in the decisions relied upon by the appellant in the case of Emersons Process Management India Pvt. Ltd. 45 SOT 157 (Mum) and Bharat Heavy Electricals Ltd. 98 TTJ (Del) 565, findings have been given that there were mechanism for identifying such stock: in one case a special committee had recommended the write off and in other case there was Auditor verification for the fact that the stocks had become non moving or obsolete. In the present case there is no such mechanism involved. Infact, the auditor's report as well as the audited accounts of the appellant are totally silent in this regard. Nowhere it has been mentioned by the auditor, either in audit report or in the audited accounts that certain parts of raw materials and finished goods 'had been treated as obsolete and had been valued at nil amount. Even when the AO asked the appellant to provide the reason for the downfall in gross profit as compared to the earlier year, in the first submission the appellant did not refer to any such stock worth ₹ 1,00,68,057/- having nil value. It was only in the second submission that the appellant claimed so, Even, during the course of appellate proceedings, the appellant has only submitted the list of such items and have not explained the scientific basis for valuation of such stock at nil. The only evidence submitted is regarding the destruction of the small part of such stock after taking approval from Narcotics Control Bureau of India. This has also not happened during the FY 2009-10 but in subsequent year. Thus, the appellant has not produced any evidence to substantiate its claim that the value of such closing stock had become nil during the FY 2009-10 itself. It may be mentioned that majority part of such stock is raw material which was being valued at cost by the appellant. Under such circumstances, the valuation of such stock at nil means that the appellant is claiming business loss u/s 28 of the IT Act, 1961 on account of such action. Under such circumstances, the appellant has to establish that the value of such stock become nil in the year in which these were valued at nil amount and not in any preceding year or subsequent year. This is, as per the ratio laid down by the Hon'ble Supreme Court of India in the case of Glass Miniature Bulb Industries 204 ITR 352 (SC), Hence, the claim of the appellant is not allowable.*

*Accordingly, the AO's action of making disallowance of this amount is upheld and this ground of appeal is dismissed.*

8. Aggrieved by the endorsement of the action of the AO by the CIT(A), the assessee preferred appeal before the Tribunal.

9. The learned AR for the assessee broadly reiterated various submissions made before the lower authorities. It was contended that material used in pharmaceutical industry are typical and is rendered unusable with the efflux of time. The loss arising from obsolescence of material is a normal incidence of the business of the assessee. The learned AR submitted that the loss towards obsolete stock carrying no value has been claimed by the assessee in accordance with Generally Accepted Accounting Practices and Policies in India and therefore, there was no warrant for the Revenue authorities to reject the same in wholesale. The learned AR referred to the details of non-moving stock for write off at page nos. 8 to 13 of its paper book and contended that the objective details were provided to the AO while indulging in such write off. However, on a query from the bench regarding details of similar write off in the earlier years, the learned AR did not offer any comments. The learned AR, however, in the same vein, insisted that the claim made by the assessee towards such write off is also supportable by some of the correspondences with the regulatory authorities. The learned AR also placed on record judicial precedents and submitted that the version of the assessee requires to be accepted unless there are strong reasons to disbelieve such version. It was thus urged that the bonafide claim of loss made by the assessee towards write off of closing inventory cannot be shrugged and discredited in a summary manner.

10. The learned DR, on the other hand, relied upon the orders of the AO and CIT(A). It was further submitted that the onus was on the assessee to provide the documentary evidences and details for claiming write off of such huge amount against a meager book profit of Rs.1.34 Crores and a closing inventory of Rs.11.73 Crores. It was submitted that write off of

nearly Rs.1 Crore of such closing stock is very high and is not commensurate in the context of the case and the profit declared of Rs.1.34 Crore would also indicate lack of justification of such huge obsolescence occurred in the business. The learned DR accordingly submitted that no interference with the order of the CIT(A) is called for.

11. We have carefully considered the rival submissions and perused the material referred to and relied upon in terms of Rule 18(6) of ITAT Rules and case laws cited. The essential question before the Tribunal is whether the Revenue authorities were justified in denying the claim of Rs.1,00,68,057/- as loss towards obsolete and non-usable stock.

11.1 As noticed from the facts narrated in earlier paras, the assessee has claimed loss towards write off of obsolete and non-moving stock to the tune of Rs.1,00,68,057/-. The assessee has explained that the write off is mainly on account of obsolete items identified by the assessee to be non-moving and unusable and having regard to the typical character of pharma companies. Accordingly, the assessee has reduced the value of closing stock towards obsolete material recognized by it. The AO held that the assessee has neither furnished the supportive documents for claiming such loss on account of obsolete items nor produced any record to show that items were not moving. The AO accordingly denied the loss claimed on account of such obsolescence.

11.2 We pause here to note that there can be no dispute that the assessee is entitled to value the closing stock at market value or at cost whichever is lower in tune of recognized accounting policies. However, the question arises as to whether the action of the assessee in declaring a list of certain items to be unfit and non-usable for the purpose of its ongoing business is justified and supportable. In this context, while we note that having regard to the special nature of material claimed to be used in pharmaceutical industries which are of sensitive nature, some obsolescence may arise on a regular basis. It is the bounden duty of the management to eliminate such obsolete stock from the process.

11.3 Keeping this narrative in the mind, we however note that the assessee has totally failed to provide any justification for quantification of obsolete stock. As noticed from the list of slow moving stock as identified by the assessee, some 'items code' is mentioned against the material. Therefore, the specific raw material and finished goods are objectively identifiable. It should not be difficult for the assessee at least provide basis for holding the stock to be obsolete on test check basis. No proof of destruction of such obsolete stock in the form of certification of competent authority viz. Central Excise, Narcotics etc. is available. It is also seen from the audited annual accounts of the earlier financial year concerning FY 2008-09 ( para 2 of the Annexure to the audit report) that the inventories were admittedly verified physically by the management for the year ending March 2009 which represents the opening stock of this year. We do not find anything on record to suggest that any obsolete stock was surfaced in the preceding year and loss towards such obsolete items were recognized in the earlier year. No real time correspondence has been brought on record (which is an ordinary feature of e-governance of corporates these days) to suggest creation of non-moving and obsolete stock of such magnitude which represents nearly 10% of the total inventory. Prima Facie, the onus is on the assessee to establish that the stocks of staggering amount have lost its usable value. The issue is factual and while there can be no denial that assessee is entitled to claim loss towards obsolete stock in a given year, it is also the corresponding duty of the assessee to prove the existence of such obsolete material by direct or circumstantial evidences. The assessee has totally failed in its corresponding duties. The Auditor in the instant case while stating that, inventories have been physical verified by the management, have not pointed out such large scale recognition of obsolete item.

11.4 On conspectus of facts noted above, we find it difficult to entertain the claim of the assessee in entirety when tested on the touchstone of evidences in this regard. However, keeping in mind the narrative of the assessee and difficulty posed in furnishing objective justification of many items in practice, we consider it appropriate to assume loss on account of

obsolete item at 5% of the closing stock to be fair and plausible which works out to Rs.58,65,680/-. The assessee thus gets relief to this extent. It shall be open to the assessee to make amends in the opening stock of subsequent financial year in accordance with law. While holding so, we are not inclined to discuss various case laws cited on behalf of the assessee which are rendered in totally different facts.

12. Consequently, grievance of the assessee is partly accepted.

13. Ground Nos. 1 to 3 are thus partly allowed.

14. Ground No. 4 concerns disallowance of interest expenses under s.36(1)(iii) of the Act amounting to Rs.5,43,456/-.

14.1 The learned AR for the assessee fairly submitted that owing to the smallness of the amount, it does not seek to press the grievance.

14.2 Ground No.4 of the assessee's appeal is dismissed.

15. Ground No.5 concerns disallowance of bad debt written off amounting to Rs.2,68,465/- in respect of excise duty refund. With the assistance of the learned AR for the assessee, we find merit in the claim of the assessee. The excise duty received as refund naturally forms part of the revenue operations of the assessee. The version of the assessee has been confirmed by the Auditors requires to be ordinarily believed. The action of the Revenue authorities are accordingly reversed.

16. Ground No. 5 of the assessee is accordingly allowed.

17. Ground No.6 concerns disallowance of Rs.19,216/- under s.14A of the Act. In the light of the fact that the exempt income stands at Rs.1134/-, disallowance is restricted to the aforesaid amount in view of the decision of the Hon'ble Delhi High Court in Joint Investment 372 ITR 694 (Del).

18. Ground No.6 of the assessee's appeal is accordingly partly allowed.
19. Ground No.7 concerns adjustment to the book profit towards disallowance made under s.14A of the Act.
20. In view of the decision of the Special bench in *ACIT vs. Vireet Investments Ltd. 165 ITD 27 (SB)* and having regard to Clause (f) to Explanation below 115JB, the adjustment to the books profit is restricted to the extent of Rs.1134/- only.
21. Ground No.7 is accordingly partly allowed.
22. In the result, the appeal of the assessee is partly allowed.

**This Order pronounced in Open Court on 29/07/2019**

Sd/-  
(RAJPAL YADAV)  
JUDICIAL MEMBER  
Ahmedabad: Dated 29/07/2019

Sd/-  
(PRADIP KUMAR KEDIA)  
ACCOUNTANT MEMBER

True Copy

S. K. SINHA

आदेश की प्रतिलिपि अद्येषित / Copy of Order Forwarded to:-

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2. आवेदक / Assessee
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त- अपील / CIT (A)
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, अहमदाबाद /  
DR, ITAT, Ahmedabad
6. गार्ड फाइल / Guard file.

By order/आदेश से,

उप/सहायक पंजीकार  
आयकर अपीलीय अधिकरण, अहमदाबाद ।