

**IN THE INCOME TAX APPELLATE TRIBUNAL
“A”BENCH: BANGALORE**

**BEFORE SHRI B. R. BASKARAN, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER**

ITA Nos.2046 to 2049/Bang/2019
AssessmentYear:2010-11, 2011-12, 2012-13 & 2014-15

M/s. Bharath Fritz Werner Ltd. No.14, HMT Factory Main Road Peenya, Yeshwanthpur Post Bangalore 560 022. PAN NO :AAACB5723A	Vs.	Deputy Commissioner of Income-tax Circle 11(2) Bangalore
APPELLANT		RESPONDENT

ITA Nos.2244 to 2247/Bang/2019
Assessment Year: 2010-11, 2011-12, 2012-13 & 2013-14

Deputy Commissioner of Income-tax Circle 11(2) Bangalore	Vs.	M/s. Bharath Fritz Werner Ltd. No.14, HMT Factory Main Road Peenya, Yeshwanthpur Post Bangalore 560 022.
APPELLANT		RESPONDENT

Appellant by	:	Shri S. Ramasubramanian, A.R.
Respondent by	:	Ms. Neera Malhotra, D.R.

Date of Hearing	:	07.07.2021
Date of Pronouncement	:	30.09.2021

O R D E R

PER BENCH:

Both the parties have filed appeals for assessment years 2010-11 to 2012-13. In addition to the above, the revenue has filed

Page 2 of 46

appeal for assessment year 2013-14 and the assessee has filed appeal for AY 2014-15. All the appeals are directed against the orders passed by Ld CIT(A)-1, Bengaluru. All the appeals were heard together and are being disposed of by this common order, for the sake of convenience.

2. The assessee is engaged in the business of manufacturing of machine tools. We shall deal with the appeals assessment year wise.

AESSESSMENT YEAR 2010-11

(A) REVENUE'S APPEAL - 2010-11

3. We shall take up the appeal filed by the **revenue** for Asst. Year 2010-11. The first issue urged in the appeal filed by the revenue relates to the disallowance of claim of loss arising from Inventory write off amounting to Rs.22,49,09,068/-, which was deleted by Ld CIT(A).

3.1 The facts relating to this issue are discussed in brief. During the course of assessment proceedings, the AO examined the copies of stock statements given to the Bank. The AO noticed that the value of inventory as on 31.3.2010 declared to the bank was Rs.70.62 crores, while the value of inventory shown in the Balance sheet stood at Rs.38.40 crores. Thus, there was difference between the stock value shown in books and bank statement to the extent of Rs.32.22 crores. The AO noticed that the above said shortage included a sum of Rs.22.49 crores written off by the assessee in its books of accounts as stock shortage/valuation difference. When questioned about the difference in stock values between books of accounts and bank statements, the assessee explained that the

Page 3 of 46

stock statements given to Bank were provisional statements and correct figures were later submitted to the bank through CMA data and audited Balance Sheet. It was explained that the stock shown in the Balance sheet was arrived at after taking inventory of physical stock.

3.2 The AO examined the Annual report furnished by the assessee and noted following points/also took following views: -

(a) The assessee has claimed "short fall in inventory" amounting to Rs.22,49,09,068/- below the line in the Profit and Loss account, but claimed the same as allowable expenditure while computing total income.

(b) No physical verification of stock was carried out during the year. However subsequent to 31.3.2010, physical verification of stock has been carried out in July, 2010. Material discrepancies were noticed at that time and the short fall in the value of inventory was arrived at Rs.22,49,09,068/-.

(c) The above amount was shown as prior period item in the Tax audit report. In the Profit and Loss account, it is shown as an Exceptional item.

(d) In view of the above, the AO took the view that the short fall in inventory is not "current year expense". He also observed that an item of missing asset becomes a loss of the year in which the loss was discovered. Accordingly, the AO held that the assessee cannot claim the loss in this year.

(e) Even if it is stated to be an item of prior period adjustment by the management/ in audited accounts/ audit report and tax audit report, yet it is not acceptable, since it is not explained as to why the same is written off in the Profit and Loss account for the year ending 31.3.2010.

3.3 The assessee explained that the shortfall in inventory has occurred for the reason that the inventory was overvalued in the past years and the same was found out only when the management carried out physical verification of stock in July, 2010. Hence, it was treated as an exceptional item of loss and accordingly shown separately in the profit and loss account. It was submitted that the shortfall in the stock was due to the over valuation in the raw materials and work in progress as detailed below:-

Raw materials	-	9,98,51,710
Work in Progress	-	12,50,57,358

Total		22,49,09,068
		=====

It was submitted that the above said amount was reduced from the Opening Stock and shown separately as an exceptional item. Accordingly, it was submitted that the treatment so given in accounts is revenue neutral. It was submitted that the closing stock value of preceding year is usually brought forward as opening stock of the next year, as held in the case of Chairup Sampatram Vs. CIT (24 ITR 481)(SC) and also some more cases cited before the AO. Accordingly, the closing stock shown as on 31.3.2009 was brought forward in the current year. However, the opening stock value was reduced by the shortage and shown as a separate exceptional item. Accordingly, it was submitted that the sum total of Opening stock and exceptional item tallies with the preceding year's closing stock. It was submitted that the shortfall in the value of inventory has been shown as exceptional item in order to meet the requirements of Accounting Standards and Generally Accepted Accounting Principles.

3.4 The AO was not convinced with the explanations given by the assessee. Accordingly, he disallowed the claim of Rs.22.40 crores with the following observations:-

(a) The assessee has failed to explain the reasons for such huge write off. It has not given any evidence as to the nature and reason for the difference.

(b) The assessee could not substantiate as to why the insurance claim was not made for the loss of inventory.

(c) An item of missing asset becomes a loss of the year in which it is discovered.

(d) The assessee company has not made available any report of physical verification and the outcome of such report, management replies and so on.

(e) The assessee company is not able to explain how such inventory shortfall of Rs.22,49,09,068/- was admitted by the Excise Department, VAT department.

(f) The assessee could not explain whether the said over valuation resulted in increase in profits in any of the year and whether it was offered to tax or not.

3.5 In the appellate proceedings, the Ld CIT(A) accepted the contentions of the assessee and held that the shortfall in the value of inventory amounting to Rs.22.49 crores is allowable as deduction. The revenue is aggrieved by this decision of Ld CIT(A).

3.6 The Ld CIT-DR supported the order passed by the AO on this issue. She submitted that the assessee did not carry out physical inspection of inventories during the financial year and it was carried out only in July, 2010. She submitted that the shortfall in the value of inventory was found out in July, 2010 only. The said item has been described as Prior period expenses in the tax audit

Page 6 of 46

report, but as an exceptional item in the Profit and Loss account. Accordingly, the AO has taken the view that it is not a current year expense. The Ld CIT-DR further submitted that the assessee has not furnished any evidence as to the nature and reason for the difference. Further, it has not furnished any report of physical verification and outcome of the same, management replies thereon etc. The assessee has also not explained as to how the shortfall was accepted by the authorities under other Statutes.

3.7 The Ld CIT-DR further submitted that the assessee has furnished before Ld CIT(A) a copy of Stock inspection report given by the auditors M/s Earnst & Young and hence the Ld CIT(A) has called for a remand report from the AO. However, before the AO, the assessee has not furnished full copy of report given by M/s Earnst & Young. On the contrary, it has furnished only a portion of the report and hence the AO could not furnish a proper remand report. However, the Ld CIT(A) has given his own observations on the report and hence the Ld CIT-DR contended that this issue should be restored to the AO for examining full report and then take a decision on this issue.

3.8 The Ld A.R, on the contrary, submitted that the order passed by Ld CIT(A) does not call for any interference. He submitted that the value of inventories was inflated year after year in the past. During those periods, the assessee was using one ERP software developed in-house. Under the above software, the purchase and inventory modules were not integrated. Hence it allowed creation/manipulation of stock receipt entries for quantities in excess of the Purchase order quantity or even without reference to any Purchase order. Further “use ids” were not captured while posting of entries in the earlier ERP software. Because of these

Page 7 of 46

lacunae, the book stock has been inflated by creating multiple entries, wrong postings, improper valuation etc., by the persons handling inventories and accounts. These mistakes happened in financial years 2005-06, 2006-07 and 2007-08 across multiple inventory accounts. During the current year, the assessee decided to migrate to SAP software. After migration to SAP software, these mistakes came to be noticed and hence the assessee decided to set right all mistakes. Hence the assessee appointed M/s Earnest & Young to investigate into this matter vis-à-vis actual physical stock. The Special auditors have conducted a thorough review of the internal control procedures, inventory accounting and valuation methods. After undertaking the above said exercises, they have quantified the shortfall in the value of inventory at 22.49 crores, which actually does not exist. Accordingly, he submitted that the difference in the value was arrived at in a scientific manner, which has been dealt with properly in the books of account.

3.9 The Ld A.R submitted that though the shortage of stock was found out only in July, 2010, yet it was found that the mistakes have happened prior to 31.3.2009. He submitted that the closing stock shown on 31.3.2009 shall become opening stock as on 1.4.2009. The Hon'ble Supreme Court has also reiterated this view in the case of V.K.J Builders and Contractors P Ltd vs. CIT (2009)(318 ITR 204). Hence the closing stock as on 31.3.2009 came to be overvalued by Rs.22.49 crores. Accordingly, while bringing the same in FY 2009-10, i.e., on 1.4.2009, the assessee has reduced the opening stock of raw materials and work in progress with the value of shortage of inventory and disclosed the same as an exceptional item in the Profit and Loss account, i.e., the sum total of opening stock as on 1.4.2009 and "exceptional item" would tally with the value of closing stock declared on 31.3.2009. He

Page 8 of 46

submitted that the assessee has only disclosed the value of opening stock in a different manner in order to have better disclosure of events, i.e., in order to have fair presentation of its financial affairs. Hence, the above said method of disclosure did not have any impact on the profit disclosed by the assessee. He further submitted that there is no difference in Sales turnover reported by the assessee and hence other departments like Excise and VAT are not concerned with the difference in the valuation of stock.

3.10 The Ld A.R submitted that the AO has accepted the closing stock as on 31.3.2010 disclosed by the assessee. He submitted that the closing stock of inventory is valued at cost or market value whichever is lower. Even, if the assessee had not disclosed the shortfall as an exceptional item, the same would have got subsumed in the value of closing stock shown by the assessee. The AO has accepted the value of closing stock as on 31.3.2010 shown by the assessee. Accordingly, the Ld A.R submitted that the AO should not have rejected the method of disclosing the opening stock, which was done with the purpose of giving true and fair disclosure as per Accounting Standards and accounting principles.

3.11 The Ld A.R submitted that the report on “shortage in the value of closing stock” was furnished by the Special auditors M/s Earnst &Young in July, 2010. The mistakes relating to stock inventory were found to be related to the earlier years. He submitted that AS-4 mandates that the adjustments to assets and liabilities should also be made for events occurring after the Balance sheet date but before the date on which the financial statements are approved, if those adjustments relate to the period prior to the Balance Sheet date. Accordingly, he submitted that the shortfall in the value of inventory pertained to the period prior

Page 9 of 46

to 31.3.2010 and hence, even if it is found only in July, 2010, the same is required to be given effect to on 31.3.2010 as per AS-4. Accordingly, the A.R submitted that the assessee has booked this as expenditure on 31.3.2010 as an exceptional item in compliance with Accounting Standards. With regard to the report of the special auditors M/s Earnst and Young, the Ld A.R submitted that the Ld CIT(A) has captured the relevant portion of the report, which clearly describes the circumstances which led to the over valuation of stock.

3.12 In the rejoinder, the Ld CIT-DR reiterated that the assessee has not furnished full copy of report of the special auditors.

3.13 We have heard rival contentions and perused the record. The issue under consideration is whether the Ld CIT(A) was justified in deleting the disallowance of shortage in the value of inventory? In order to address this issue, in our view, following points have to be examined: -

- (a) Whether the loss of Rs.22.49 crores was properly ascertained and quantified?
- (b) Whether the treatment given by the assessee in its accounts is justified.
- (c) Whether the claim of the assessee is allowable during the year under consideration.

3.14 We have noticed earlier that the discrepancy in the valuation of inventories have been found out by the management and hence a Special auditor, viz., M/s Earnst & Young was appointed to determine the actual difference in the value of stock. They have submitted the report in July, 2010. This fact has been noted by the

Statutory auditors in their audit report for the year ending 31.3.2010 as under:-

“(ii) No physical verification of inventory was carried out during the year, but subsequent to the year-end, major part of inventory has been physically verified. Certain material discrepancies were noticed on such physical verification carried out subsequent to the year end which has been properly dealt with in the accounts.....”

The Management has reported this discrepancy in the Annual Report in point 5(a) of the Notes to Accounts as under:-

“5(a) During the year ended March 31, 2010, certain instances of impropriety by an ex-employee were noticed wherein the said ex-employee has recorded certain irregular and non-substantiated entries relating to over statement of inventories over past few years. The management has conducted detailed investigation in respect of aforesaid irregularity and concluded that inventories were over stated to the extent of Rs.22,49,09,068/-. Further, the management is evaluating legal recourse, if any against the said ex-employee. Accordingly, the opening stock of inventory to the extent of Rs.22,49,09,068/- has been written off as an exceptional item in the current year.”

3.15 We have noticed earlier that the assessee has engaged the services of a Special Auditor, viz., M/s Earnst & Young to investigate and quantify the discrepancies. The relevant portion of the report of the special auditor has been extracted by Ld CIT(A) in his order.

3.16 The Special auditor has reported that the inflation of value of stock has happened over a period of time , i.e., from 31.3.2005 onwards and it has also been stated that the employee concerned has manipulated the inventory statement by adding dummy entries

Page 11 of 46

with codes like “999999”, not pertaining to any item. Thus, it is established that the inventory, all along relied upon by the assessee, had dummy entries which resulted in declaring higher stock than the physical stock.

3.17 The AO has expressed the view that the assessee has failed to explain the reasons for such huge write off and the assessee has not given any evidence as to the nature and reason for the difference. The above said observation of the AO is contrary to the facts available on record. The discussions made in the earlier paragraphs would show that there was shortage in the value of stock due to manipulation done by an earlier employee and the same has resulted in declaration of higher value of stock over the years. Hence, the assessee has engaged the services of a leading professional, who has investigated the matter, found out the methodology adopted for inflating the stock and finally quantified the difference in the value of stock. Hence, we are of the view that the shortage in the value of stock has been ascertained by the assessee in a systematic manner.

3.18 The next question is whether the treatment given by the assessee in the accounts is justified or not. As noticed earlier, the assessee has accounted the loss in the profit and loss account for the year ending 31.3.2010, even though the loss was quantified, vide report given by the Special auditor in July, 2010. The AO has expressed the view that an item of missing asset becomes a loss of the year in which it is discovered. Accordingly, he has stated that the loss is a Prior Period loss. However, the assessee has shown the loss as an “exceptional item” in the profit and loss account, by reducing corresponding amount from opening stock. In support of

the said accounting treatment, the assessee has taken support of Accounting Standard-4.

3.19 The Accounting Standard-4 titled as “Contingencies and Events Occurring After the Balance Sheet Date” states as under:-

“8. Events Occurring after the Balance Sheet Date

8.1 Events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure.

8.2 Adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. For example, an adjustment may be made for a loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.

8.3 Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. An example is the decline in market value of investments between the balance sheet date and the date on which the financial statements are approved. Ordinary fluctuations in market values do not normally relate to the conditions of the investments at the balance sheet date, but reflect circumstances which have occurred in the following period.”

3.20 In the instant case, the special auditors have reported that the manipulation in the value of stock has happened from FY 2004-05 onwards. Hence the shortage of stock quantified relate to the conditions existing as on 31.3.2010 and it materially affects the determination of value of assets as on Balance Sheet date. Accordingly, as per AS-4, the effect of the same needs to be given as on 31.3.2010, even though the report of special auditors has been received only in July, 2010. Hence, it cannot be considered as a prior period expenditure as opined by the AO. It should be considered as current year loss only, since effect of shortage could be given in this year only. Accordingly, the assessee was justified in accounting the shortage during the year ending 31.3.2010.

3.21 Another important point to be noted is that the assessee has split the opening stock as on 1.4.2009 into two items, viz., opening stock and exceptional expenditure, i.e., the shortage has not been separately accounted for in the books of accounts. It has been duly disclosed in the Profit and Loss account by making corresponding reduction in the Opening stock value. There should not be any dispute that the closing stock of the preceding year is carried forward as opening stock of the current year. Having accepted the closing stock of preceding year, the opening stock value of current year also requires to be accepted.

3.22 The AO has observed that the assessee has not made any insurance claim. Since it is a case of excess valuation of stock, the question of lodging any insurance claim does not arise. The Ld A.R submitted that the Excise department and VAT department are concerned with the sales turnover only. Further, the question of making any claim before them for the inflation in the value of stock does not arise. The AO has also observed that the assessee has not given report of the special auditor. We have noticed that the assessee has furnished the same before the Ld CIT(A) and hence the Ld CIT(A) has called for a remand report. According to Ld A.R, the relevant portion of the report was given before the AO, but the AO refused to give any remand report on the reasoning that full report was not given. It is the case of the Ld A.R that, what was important was the final portion of the report quantifying the loss and the Ld CIT(A) has extracted the relevant portion in his order, which is self-explanatory. The Ld CIT(A) has also observed in paragraph 4.2.6 of his order that full report was submitted before him and the report in Chapter 7 has dealt extensively the reasons for the stock shortage. The AO has also observed that the assessee could not

Page 14 of 46

explain whether the said over valuation resulted in increase in profits in any of the year and whether it was offered to tax or not. The Ld A.R submitted that the inflation in valuation of stock had automatically increased the profits of earlier years. The ld CIT(A) has observed as under on this aspect:-

“4.2.8 From the above, it is seen that the appellant due to the above stock manipulation ended up disclosing more closing stock, in the result offered more income for the respective years. Considering the same, there is no loss of revenue in this case in adopting the actual value of stock as per the physical inventory as on 31.3.2010. This can be well understood by hypothetically reversing the so called inflated figures and visualizing the impact on the net income of each of these years; income disclosed in the P&L account would have been less by that amount by which the closing stock has been reduced by eliminating the inflated entry. Thus, I am of the view that the appellant has ended up paying more taxes in the preceding years (Prior FY 2005-2009). If, as claimed by the appellant, it is not allowed to adopt the actual physical stock so as to correct itself, it would be unfair, as the appellant has already returned increased income based on the inflated figures during the previous years. Considering the same, it is entitled to brought forward the closing stock as on 31.3.2009 to 01-04-2009.”

3.23 We notice that the Ld CIT(A) has concluded as under:-

“4.2.10 Considering the above, I am of the view that the closing stock of the previous year should be considered as opening stock without any adjustment as per Hon’ble Supreme Court rulings quoted above. As stated earlier, the reduction of opening stock and disclosure of the same amount as exceptional item is only to meet the disclosure requirements of the Accounting Standards and the above accounting disclosure is revenue neutral and accordingly addition of Rs.22.49 crores on account of shortfall of inventory is deleted.”

3.24 Another important aspect, which is relevant for this issue is the valuation of closing stock as on 31.3.2010. As noticed earlier, the assessee has split the opening stock brought forward from 31.3.2009 and disclosed one portion as “Opening stock” and the remaining portion as “exceptional item”. It is an undisputed fact that the assessing officer has accepted the value of “closing stock as

Page 15 of 46

on 31.3.2010". Even if the above said exercise has not been carried out, the assessee is required to value the actual physical stock at lower of cost or net realisable value", which is the accounting policy followed by the assessee as reported in clause (j) of Note 2 given under Schedule Q: Notes to Accounts in its Annual report. In that case, the shortage in the value of stock shall get subsumed itself, which has actually happened in this case. Hence, the AO, having accepted the value of closing stock, could not have questioned the "exceptional item", which was split up figure of opening stock value.

3.25 In view of the foregoing discussions, we are of the view that there is no reason to interfere with the decision taken by Ld CIT(A) on this issue. Accordingly, we hold that the Ld CIT(A) was justified in deleting the addition of Rs.22.49 crores relating to shortfall in the value of inventory.

4.0 The next issue contested by the revenue relates to the partial relief granted by the Ld CIT(A) in respect of interest disallowance of Rs.27,31,656/- made u/s 36(1)(iii) of the Act. The assessee is also contesting the decision rendered by Ld CIT(A) in partially sustaining this disallowance.

4.1 The facts relating to this issue are stated in brief. The AO noticed that the assessee has raised foreign currency loans to the tune of Rs.18.64 crores and short term loans of Rs.10 crores from banks. The AO also noticed that the assessee has purchased fixed assets worth Rs.6.03 crores during the year under consideration. Hence the AO took the view that the interest expenditure attributable to the purchase of fixed assets should have been capitalised by the assessee. Accordingly he proposed to disallow interest on borrowed loans computed @ 12% p.a. on the value of

fixed assets acquired during the year. The same worked out to Rs.36,21,236/-.

4.2 Before AO, the assessee submitted that the fixed assets have been acquired out of interest free funds and hence no disallowance is called for out of interest expenditure. The AO did not accept the explanations of the assessee and accordingly disallowed a sum of Rs.36,21,236/- out of interest expenditure.

4.3 Before Ld CIT(A), the assessee contended that the disallowance contemplated under proviso to 36(1)(iii) of the Act is in respect of 'acquisition of asset for **extension of existing business**'. It was submitted that the loans have been used for normal course of business and not for extension of business. It was submitted that the net addition to fixed assets was only Rs.1.48 crores, while the aggregate value of net block of assets was Rs.71.78 crores. Accordingly, it was contended that the above said addition has not resulted in any extension of business. It was also submitted that the assessee is having adequate own funds as on 31.3.2010, i.e. Rs.91.30 crores. It was submitted that the amount of Rs.6.03 crores included opening work in progress of Rs.4.55 crores and hence the net addition to assets made during the year was only Rs.1.48 crores. It was submitted that the assessee was having cash and balance of Rs.25.51 crores as at the beginning of the year, i.e., as on 1.4.2009. Accordingly, it was contended that the disallowance u/s 36(1)(iii) is not warranted.

4.4 *The Ld CIT(A) gave a finding that the addition to fixed assets has not resulted in extension of business.* The Ld CIT(A) also accepted that the net addition made during the year was Rs.1.48 crores only. The assessee had put up an alternative contention

Page 17 of 46

before the Ld CIT(A) that the disallowance, if any, should be restricted on the value of net addition to the capital assets, i.e., on Rs.1.48 crores . The ld CIT(A) accepted the alternative contention of the assessee and accordingly directed the AO to restrict the disallowance of interest expenditure on the above said amount of Rs.1.48 crores.

4.5 Both the parties are aggrieved by the decision so rendered by Ld CIT(A) on this issue.

4.6 We heard the parties on this issue and perused the record. The AO has made the impugned disallowance apparently invoking the proviso to sec.36(1)(iii) of the Act. The then existing proviso read as under:-

*“Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset **for extension of existing business** or profession (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use shall not be allowed as deduction.”*

Hence, in order to invoke the proviso, there should be a finding that the acquisition of asset has resulted in extension of business. We have noticed that the Ld CIT(A) has given a finding that the additions made to the capital asset has not resulted in any extension of business.

4.7 We have noticed that the net addition made to the fixed assets during the year was Rs.1.48 crores only, as per the finding given by Ld CIT(A), i.e., the Ld CIT(A) has noticed that major part of the addition to assets, i.e., out of Rs.6.03 crores a sum of Rs.4.55 crores have been spent in the earlier years. Further the Foreign currency loans and other borrowings have not been taken

Page 18 of 46

specifically for acquiring the assets, in which case, these funds become fungible and gets mixed with own funds. The own funds available with the assessee as on 31.3.2010 was Rs.91.30 crores. As per cash flow statement furnished in the Annual report, which is available at page 14 of the paper book, the assessee has generated net cash of Rs.28.33 crores, while the net investment made in acquisition of capital asset was only Rs.1.48 crores. Hence, as per the decision rendered by the decision rendered by Hon'ble Karnataka High Court in the case of Micro labs Ltd (383 ITR 490), it can safely be presumed that the acquisition of fixed assets has been funded out of own funds only.

4.8 In view of the above, we set aside the order passed by Ld CIT(A) and direct the AO to delete entire disallowance of Rs.36,21,236/- made out of interest expenditure.

5.0 The next issue urged by the revenue relates to disallowance of Rs.9,59,265/- out of interest expenditure as relatable to interest free loans given to associate concerns. The AO noticed that the assessee has advanced interest free funds to its associated companies and hence proposed to disallow part of interest expenses. The assessee submitted that it has got sufficient interest free funds and the advances to associated companies have been given out of interest free funds. It was further submitted that an identical disallowance made in AY 2008-09 has since been deleted by ITAT. However, the AO noticed that the assessee has accepted an addition of Rs.9,59,265/- in its written submissions. Accordingly, he disallowed the same.

Page 19 of 46

5.1 The Ld CIT(A) deleted the disallowance by following the decision rendered by the Tribunal in the assessee's own case in AY 2008-09 in ITA No.1185/Bang/2011.

5.2 The Ld D.R submitted that the assessee has not proved that the interest free funds have been given to associate companies out of own funds only. Accordingly, she supported the order passed by the AO. On the contrary, the Ld A.R submitted that the assessee has got sufficient interest free funds and hence as per the decision rendered by Hon'ble Karnataka High Court in the case of Micro labs Ltd (supra) and the decision rendered by Hon'ble Supreme Court in the case of Reliance Industries Ltd (supra), no interest disallowance is called for.

5.3 We heard rival contentions on this issue and perused the record. We have noticed earlier that the own funds available with the assessee as on 31.3.2010 was Rs.91.30 crores and the interest free loans given to sister concerns was around Rs.6.43 crores. We notice that the co-ordinate bench has already deleted an identical addition made in AY 2008-09 following the decision rendered in the case of Reliance Utilities and Power Ltd. In any case, the binding decision rendered Hon'ble jurisdictional Karnataka High Court in the case of Micro Labs Ltd (supra) also holds that no interest disallowance is called for when the own funds available with the assessee is more the amount of interest free advances given. Under these set of facts, we find no reason to interfere with the decision rendered by Ld CIT(A) on this issue.

6.0 The next issue relates to the disallowance of expenditure claimed on loose tools. The assessee has claimed Rs.1,99,96,112/- as expenditure towards loose tools. It is submitted that the loose

Page 20 of 46

tools, grinding wheels and cutting wheels purchased by the assessee are written off over a period of 2 years, i.e., 50% of the cost is written off in the year of purchase and the remaining 50% is written off in the succeeding year. However, the AO took the view that the assessee should have followed systematic method of inventory management for consumption of loose tools etc and the expenditure should be claimed on the basis of actual consumption. Accordingly, the AO disallowed the above said claim of the assessee.

6.1 The Ld CIT(A) noticed that an identical disallowance made by the AO in AY 2008-09 has been deleted by the Tribunal in the assessee's own case in ITA No.1185/Bang/2011 dated 21.12.2012.

6.2 We heard the parties on this issue and perused the record. The Ld D.R submitted that the assessee had furnished purchase and consumption of details of loose tools etc., before the AO in AY 2008-09. However, the assessee has not furnished those details during the year under consideration. Accordingly, she submitted that the decision rendered in AY 2008-09 is distinguishable. On the contrary, the Ld A.R submitted that the assessee has been following above said method of writing of loose tools is followed by the assessee for the past 20 years. The same was not accepted for the first time only in AY 2008-09. However, the ITAT has accepted the method followed by the assessee and deleted the disallowance. He submitted that the furnishing of details was not an issue before the Tribunal in AY 2008-09.

6.3 We notice that the co-ordinate bench of ITAT has deleted an identical disallowance made in AY 2008-09 with the following observation:-

Page 21 of 46

“14. Having heard both the parties and having considered their rival contentions, we find that the Revenue has not disputed the incurring of expenditure by the assessee in purchase of the tools. The only reason for the disallowance is that it is not revenue in nature but is of capital in nature. It is also not disputed that the assessee is following the said method of accounting for the past 14 years and no disallowance has been made in the previous years. As rightly pointed out by the learned counsel for the assessee, the Revenue effect would be very minimal whether the expenditure is treated as revenue in nature or treated as capital in nature and depreciation allowed thereon. Therefore, taking the totality of the facts into consideration, we hold that revenue ought to have allowed the revenue expenditure claimed by the assessee. The ground of appeal is accordingly allowed.”

6.4 We notice that the Ld CIT(A) has followed the decision rendered by the Tribunal in AY 2008-09 and hence we do not find any reason to interfere with the decision rendered by him on this issue.

(B) ASSESSEE’S APPEAL – AY 2010-11

7. Following issues are urged by the assessee in this year:-

- (a) Disallowance of deduction claimed u/s 35(2AB) of the Act.
- (b) Disallowance of provision made towards “Erection and Commissioning” expenses.
- (c) Disallowance of interest relating to fixed assets treating it capital expenses.
- (d) Depreciation claim on the amount so capitalised, if the disallowance of interest expense is confirmed (Alternative claim).
- (e) Non-adjudication of ground relating to Capital gains by Ld CIT(A)

7.1 The first issue relates to the disallowance of claim made u/s 35(2AB) of the Act. The assessee had claimed weighted deduction of Rs.3,62,73,927/- u/s 35(2AB) of the Act @ 150% of the actual expenditure incurred on Research and Development. The AO took

Page 22 of 46

the view that the assessee has not complied with the conditions prescribed in Rule 6(7A) of I T Rules, i.e., it did not furnish the approval to DG (Exemptions) in Form 3CL and audited accounts. Accordingly, he disallowed the entire claim of Rs.3,62,73,927/-. Later the AO passed a rectification order u/s 154 of the Act, wherein he allowed the actual expenses and disallowed only the enhanced amount (weighted portion).

7.2 The Ld CIT(A) held that furnishing of Form 3CL is mandatory for claiming weighted deduction. In this regard, the Ld CIT(A) took support of decision rendered by Hon'ble Karnataka High Court in the case of Tejas Network Ltd vs. DCIT (2015)(60 taxmann.com 309)(Kar). Accordingly, the Ld CIT(A) confirmed the disallowance.

7.3 The Ld A.R submitted that the co-ordinate bench has held in the case of Mahindra Electric Mobility (ITA No.641/Bang/2017 dated 14.09.2018) that Form no.3CL was not mandatory for claiming deduction u/s 35(2AB) of the Act. Further the co-ordinate bench has considered in the case of Kumar Organic Products Ltd vs. DCIT (ITA Nos. 1057 to 1062/Bang/19 dated 19-07-2019) and held that the decision in the case of Tejas Network Ltd (supra) has been rendered by Hon'ble Karnataka High Court on a different point and accordingly distinguished the same. Further, following the decision rendered in the case of Mahindra Electric Mobility (supra), the Tribunal held that Form no.3CL is not mandatory for claiming weighted deduction for the year under consideration. In these cases that Form 3CL has become mandatory with effect from 1.7.2016 only and prior to that date, there is no legal sanctity for Form 3CL. Accordingly the Ld A.R submitted that the disallowance of weighted claim is not in accordance with law.

7.4 The Ld D.R, on the contrary, supported the order passed by Ld CIT(A) on this issue. Further, the Ld D.R placed here reliance on the following case laws and contended that Form No.3CL has been held to be mandatory in these cases for claiming weighted deduction u/s 35(2AB) of the Act.

(a) Tejas Network Ltd vs. DCIT (2015)(60 taxmann.com 309)(Kar)

(b) Electronics Corporation of India Ltd vs. ACIT (2012)(28 taxmann.com 280)(Hyd)

(c) PCP Chemicals Ltd vs. ITO (2017)(88 taxmann.com 5)

7.5 We heard rival contentions on this issue and perused the record. We notice that an identical issue was considered in the case of Kumar Organic Products Ltd (supra) by the co-ordinate bench. After considering the decision rendered by Hon'ble Karnataka High Court in the case of Tejas Network Ltd (supra), the Tribunal held as under:-

“9. On careful consideration of the rival contentions, we hold that the CIT(A) had in para 6.2 has recorded that he differs from the decisions of the Bangalore and Pune benches of Tribunal on this issue. This is not permissible. Judicial discipline mandates that the Ld CIT(A) should have followed the proposition of law laid down by the ITAT on this issue. This sentence also makes it clear that the issue is squarely covered in favour of the assessee by the decision of jurisdictional Tribunal in the case of M/s Mahindra Electric Mobility Ltd (supra). We also find that the submission that the assessee has not furnished copy of the agreement with the prescribed authority is factually incorrect. It is also factually incorrect to submit that the Assessing Officer has not allowed deduction on R & D as revenue expenditure. Even on R & D expenditure on fixed asset, the quantum of expenditure, i.e. the cost of acquisition is not doubted by the Assessing Officer, as depreciation has been granted on the cost of acquisition. We also find that the decision of the jurisdictional High Court in the case of Tejas Networks Ltd (supra) is not on the issue that arises in this appeal. It deals with a situation where the prescribed authority has allowed certain expenditure in Form 3CL and the Assessing Officer sought to tinker with it. The Court held that it is beyond the jurisdiction of the Assessing Officer change the figure of given by the prescribed authority in Form no.3CL.

10. *The jurisdictional Tribunal in the case of M/s Mahindra Electric Mobility Ltd (supra) held as follows:-*

'13. We have heard the rival submissions. The learned DR relied on the order of the AO/CIT(A). The learned counsel for the Assessee reiterated submissions as were made before the revenue authorities and placed reliance on some judicial precedents on identical issue rendered by various benches of ITAT and Hon'ble High Courts.

14. For AY 2012-13, the previous year is FY 2011-12 i.e., the period from 1-4-2011 to 31-3-2012. The facts on record go to show that the Assessee's in-house R & D facilities was approved by the DSIR, Govt. of India, Ministry of Science and Technology for AY 2012-13 vide their letter dated 20-5-2009, a copy of which is placed at Page-30 of the Assessee's paper book. The approval is for the period 1-4-2009 upto to 31-3-2012. Therefore, the condition for allowing deduction u/s.35(2AB) of the Act has been fulfilled by the Assessee. The claim of the revenue, however, is that the approval by the prescribed authority in form No. 3CM is not final and conclusive and the quantum of expenditure on which deduction is to be allowed is to be certified by DSIR in form No. 3CL. There is no statutory provision in the Act which lays down such a condition. We shall therefore examine what is Form No. 3CL.

15. DSIR has framed guidelines for approval u/s.35(2AB) of the Act. The guidelines as on May, 2010 which is relevant for AY 2012-13, in so far as it is relevant for the present appeal, was as given below.

- (i) As per guideline 5 (iv) of the guidelines so framed, every company which has obtained an approval from the prescribed authority should also submit an undertaking as per Part C of Form No. 3CK to maintain separate accounts for each R&D centre approved under section 35(2AB) by the Prescribed Authority, and to get the accounts duly audited every year by an Auditor as defined in sub- section (2) of section 288 of the IT Act 1961. (The statutory auditors of the Company should audit the R&D accounts. To facilitate this audit separate books of accounts for R&D should be maintained. Also, the statutory auditors should sign the auditors' certificate in the details required to be submitted as per annexure- IV of the guidelines to facilitate submission of Report in Form 3CL).*
- (ii) As per guideline 5(vi) of the guidelines, the audited accounts for each year maintained separately for each approved centre shall be furnished to the Secretary, Department of Scientific & Industrial Research by 31st day of October of the succeeding year, along with information as per Annexure-IV of the Guidelines.*

- (iii) *As per guideline 5(ix) Expenditures, which are directly identifiable with approved R&D facility only, shall be eligible for the weighted tax deduction. However, expenditure in R&D on utilities which are supplied from a common source which also services areas of the plant other than R&D may be admissible, provided they are metered/measured and subject to certification by a Chartered Accountant.*
- (iv) *As per guideline 5 (x) Expenditure on manpower from departments, other than R&D centre, such as manufacturing, quality control, tool room etc. incurred on such functions as attending meetings providing advice/directions, ascertaining customer choice/response to new products under development and other liaison work shall not qualify for deduction under section 35(2AB) of I.T. Act 1961.*
- (v) *As per guideline 10 Documents required to be submitted by 31 st October of each succeeding year of approved period to facilitate submission of Report in Form 3CL (2 sets) are Complete details as per annexure-IV of DSIR guidelines.*

16. The Assessee applied for issue of Form No. 3CL to the appropriate authority on 24-3-2017, after the order of the CIT(A). The application so made by the Assessee is at page 43 to 65 of the Assessee's paper book. According to the Assessee, it has complied with all the requirements of the guidelines for issue of Form No. 3CL, but the DSIR has issued Form No. 3CL dated 5-4-2018 for AY 2014 & 15 & 2015-16 but no Form No. 3CL was issued for AY 2012-13. Though there has been no communication to the Assessee in this regard, the learned counsel for the Assessee submitted that since the audited accounts were not submitted by 31st October of the succeeding AY, as is required under Guideline 5 (vi), the Assessee's application would not have been considered by the DSIR.

17. Rule-6(7A)(b) of the Rules specifying the prescribed authority and conditions for claiming deduction u/s.35(2AB) of the Act has been amended by the Income-tax (10 th Amendment) Rules, 2016 w.e.f. 1-7-2016, whereby it has been laid down that the prescribed authority, i.e., DSIR shall quantify the quantum of deduction to be allowed to an Assessee u/s.35(2AB) of the Act. Prior to such substitution, the above provisions merely provided that the prescribed authority shall submit its report in relation to the approval of in-house R & D facility in Form No. 3CL to the DGIT (Exemption) within 60 of granting approval. Therefore prior to 1-7-2016 there was legal sanctity for Form No. 3CL in the context of allowing deduction u/s.35(2AB) of the Act.

18. The issue as to whether deduction u/s.35(2AB) of the Act can be denied for absence of Form No. 3CL by the DSIR was subject matter of several judicial decisions rendered by various Benches of ITAT.

- (i) The Pune ITAT in the case of *Cummins India Ltd. v. DCIT* in ITA No. 309/Pun/2014 for AY 2009-10 order dated 15-5-2018 had an occasion to consider a case where part of the claim for deduction u/s.35(2AB) of the Act was claimed supported by Form No. 3CL but part of it was not supported by Form No. 3CL. The Pune ITAT held as follows:-

"45. The issue which is raised in the present appeal is that whether where the facility has been recognized and necessary certification is issued by the prescribed authority, the assessee can avail the deduction in respect of expenditure incurred on in-house R&D facility, for which the adjudicating authority is the Assessing Officer and whether the prescribed authority is to approve expenditure in form No. 3CL from year to year. Looking into the provisions of rules, it stipulates the filing of audit report before the prescribed authority by the persons availing the deduction under section 35(2AB) of the Act but the provisions of the Act do not prescribe any methodology of approval to be granted by the prescribed authority vis-à-vis expenditure from year to year. The amendment brought in by the IT (Tenth Amendment) Rules w.e.f. 1-7-2016, wherein separate part has been inserted for certifying the amount of expenditure from year to year and the amended form No. 3CL thus, lays down the procedure to be followed by the prescribed authority. Prior to the aforesaid amendment in 2016, no such procedure/methodology was prescribed. In the absence of the same, there is no merit in the order of Assessing Officer in curtailing the expenditure and consequent weighted deduction claim under section 35(2AB) of the Act on the surmise that prescribed authority has only approved part of expenditure in form No. 3CL. We find no merit in the said order of authorities below.

46. The Courts have held that for deduction under section 35(2AB) of the Act, first step was the recognition of facility by the prescribed authority and entering an agreement between the facility and the prescribed authority. Once such an agreement has been executed, under which recognition has been given to the facility, then thereafter the role of Assessing Officer is to look into and allow the expenditure incurred on in-house R&D facility as weighted deduction under section 35(2AB) of the Act. Accordingly, we hold so. Thus, we reverse the order of Assessing Officer in curtailing the deduction claimed under section 35(2AB) of the Act by Rs. 6,75,000/-. Thus, grounds of appeal No.10.1,

10.2 and 10.3 are allowed."

- (ii) *The Hyderabad ITAT in the case of M/S. Sri Biotech Laboratories India Ltd. v. ACIT ITA No. 385/Hyd/2014 for AY 2009-10 order dated 24-9-2014 took the view (vide Paragraph-13 of the order) that when the Assessee's R & D facility is approved the deduction u/s.35(2AB) of the Act cannot be denied merely on the ground that prescribed authority has not submitted report in Form 3CL.*

19. The question of allowing deduction u/s.35(2AB) of the Act was considered by the Hon'ble Delhi High Court in the case of CIT v. Sadan Vikas (India) Ltd. [\[2011\] 335 ITR 117 \(Del\)](#) where AO refused to accord the benefit of the weighted deduction to the assessee under s. 35(2AB) on the ground that recognition and approval was given by the DSIR in February/September, 2006, i.e., in the next assessment year and, therefore, the weighted deduction cannot be allowed. The CIT(A) confirmed the order of the AO. The Tribunal held that the assessee would be entitled to weighted deductions of the aforesaid expenditure incurred by the assessee in terms of the s. 35(2AB) of the Act and in coming to this conclusion, the Tribunal relied upon the judgment of Gujarat High Court in CIT v. Claris Lifesciences Ltd. [326 ITR 251 \(Guj\)](#). In its decision the Hon'ble Gujarat High Court held that the cut-off date mentioned in the certificate issued by the DSIR would be of no relevance. What is to be seen is that the assessee was indulging in R&D activity and had incurred the expenditure thereupon. Once a certificate by DSIR is issued, that would be sufficient to hold that the assessee fulfils the conditions laid down in the aforesaid provisions. The Hon'ble Delhi High Court followed the decision of the Hon'ble Gujarat High Court and upheld the decision of the Tribunal. The Hon'ble Delhi High Court quoted the following observations of the Hon'ble Gujarat High Court and agreed with the said view:

"7. ... The lower authorities are reading more than what is provided by law. A plain and simple reading of the Act provides that on approval of the research and development facility, expenditure so incurred is eligible for weighted deduction.

8. The Tribunal has considered the submissions made on behalf of the assessee and took the view that section speaks of : (i) development of facility; (ii) incurring of expenditure by the assessee for development of such facility; (iii) approval of the facility by the prescribed authority, which is DSIR; and (iv) allowance of weighted deduction on the expenditure so incurred by the assessee.

Page 28 of 46

9. *The provisions nowhere suggest or imply that research and development facility is to be approved from a particular date and, in other words, it is nowhere suggested that date of approval only will be cut-off date for eligibility of weighted deduction on the expenses incurred from that date onwards. A plain reading clearly manifests that the assessee has to develop facility, which presupposes incurring expenditure in this behalf, application to prescribed authority, who after following proper procedure will approve the facility or otherwise and the assessee will be entitled to weighted deduction of any and all expenditure so incurred. The Tribunal has, therefore, come to the conclusion that on plain reading of s. itself, the assessee is entitled to weighted deduction on expenditure so incurred by the assessee for development of facility. The Tribunal has also considered r. 6(5A) and Form No. 3CM and come to the conclusion that a plain and harmonious reading of rule and Form clearly suggests that once facility is approved, the entire expenditure so incurred on development of R&D facility has to be allowed for weighted deduction as provided by s. 35(2AB). The Tribunal has also considered the legislative intention behind above enactment and observed that to boost up research and development facility in India, the legislature has provided this provision to encourage the development of the facility by providing deduction of weighted expenditure. Since what is stated to be promoted was development of facility, intention of the legislature by making above amendment is very clear that the entire expenditure incurred by the assessee on development of facility, if approved, has to be allowed for the purpose of weighted deduction."*

20. *From the above discussion it is clear that prior to 1-7-2016 Form 3CL had no legal sanctity and it is only w.e.f 1-7-2016 with the amendment to Rule 6(7A)(b) of the Rules, that the quantification of the weighted deduction u/s.35(2AB) of the Act has significance. In the present case there is no difficulty about the quantum of deduction u/s.35(2AB) of the Act, because the AO allowed 100% of the expenditure as deduction u/s.35(2AB)(1)(i) of the Act, as expenditure on scientific research. Deduction u/s.35(1)(i) and Sec.35(2AB) of the Act are similar except that the deduction u/s.35(2AB) is allowed as weighted deduction at 200% of the expenditure while deduction u/s.35(1)(i) is allowed only at 100%. The conditions for allowing deduction u/s.35(1)(i) of the Act and under Sec.35(2AB) of the Act are identical with the only difference being that the Assessee claiming deduction u/s.35(2AB) of the Act should be engaged in manufacture of certain articles or things. It is*

Page 29 of 46

not in dispute that the Assessee is engaged in business to which Sec.35(2AB) of the Act applied. The other condition required to be fulfilled for claiming deduction u/s.35(2AB) of the Act is that the research and development facility should be approved by the prescribed authority. The prescribed authority is the Secretary, Department of Scientific Industrial Research, Govt. Of India (DSIR). It is not in dispute that the Assessee in the present case obtained approval in Form No. 3CM as required by Rule 6 (5A) of the Rules. In these facts and circumstances and in the light of the judicial precedents on the issue, we are of the view that the deduction u/s.35(2AB) of the Act ought to have been allowed as weighted deduction at 200% of the expenditure as claimed by the Assessee and ought not to have been restricted to 100% of the expenditure incurred on scientific research. We hold and direct accordingly and allow the appeal of the Assessee.'

10. We find that the proposition of law laid down in this order of the ITAT applies on all fours to the facts of the case on hand. Hence we respectfully follow the order of the co-ordinate bench of ITAT on this issue."

7.6 We have gone through the case laws relied upon Ld CIT-DR. The decision rendered by Hon'ble Karnataka High Court in the case of Tejas Network has been distinguished by the co-ordinate bench in the above said case. The decision rendered by Hyderabad bench of Tribunal in the case of Electronics Corpn. Of India Ltd (supra) related to the amount of deduction to be granted. It was held therein that the weighted deduction has to be granted on the amount mentioned in Form 3CL, i.e., the quantum of R & D expenditure mentioned in Form 3CL cannot be tampered with by the Tribunal. Thus, the question whether Form 3CL is mandatory or not was the issue before the Hyderabad bench of Tribunal. In the case of PDP Chemicals (P) Ltd (supra), the issue before Mumbai bench of Tribunal was whether the deduction u/s 35(2AB) could be granted without an approval from the prescribed authority? Hence the issue considered by Mumbai bench of Tribunal is totally different.

Page 30 of 46

7.7 The assessment year under consideration is AY 2010-11 and hence the decision rendered by the co-ordinate bench in the case of Kumar Organic Products Ltd (supra) shall apply to the assessee for AY 2010-11. Following the same, we hold that Form No.3CL is not mandatory for the year under consideration and hence the weighted deduction claimed by the assessee cannot be rejected. Accordingly, we set aside the order passed by Ld CIT(A) and direct the AO to allow weighted deduction as claimed by the assessee.

8.0 The next issue contested by the assessee relates to the disallowance of provision made for erection and commissioning work.

8.1 The assessee created a provision for erection and commissioning work for a sum of Rs.50,27,685/-. It was submitted that the assessee enters into a composite contract for design, manufacture, supply, installation and erection. The assessee is recognising entire sale value as revenue. However, in respect of some of the manufactured goods, the work of installation and commissioning may be pending to be executed. Since the assessee is having obligation to perform erection and commissioning of machineries already sold, whose revenue has already been recognised, the assessee has provided estimated expenditure that may be incurred on erection and commissioning. According to the AO, the assessee has failed to furnish scientific basis for estimating the expenditure and accordingly the AO took the view that the provision for erection and commissioning expenditure is contingent in nature. Accordingly, he disallowed the above said claim.

8.2 The Ld CIT(A) noticed that the Tribunal has considered an identical issue in the assessee's own case in ITA

Page 31 of 46

No.211/Bang/2014 dated 3rd June, 2016 relating to AY 2009-10 and it has been decided against the assessee. Accordingly, the Ld CIT(A) confirmed the disallowance by following the decision rendered by Tribunal in AY 2009-10.

8.3 The Ld A.R submitted that the assessee had challenged the decision rendered by the Tribunal on an identical issue in AY 2009-10 by filing appeal before Hon'ble High Court of Karnataka. The Hon'ble High Court, vide its order dated 4th December, 2020 passed in ITA No.576 of 2016, has restored the issue to the file of Ld CIT(A) for adjudicating it afresh and it is pending adjudication. The Ld A.R submitted that the Tribunal has decided this issue in AY 2009-10 against the assessee mainly for the reason that the assessee has failed to demonstrate that the liability has accrued during the year and further substantial provision was reversed in the subsequent years. He submitted that the facts prevailing in this year are totally different.

8.4 The Ld A.R submitted that the assessee has furnished to the AO the details of machinery which have been sold, but whose erection and commissioning is pending as on 31.3.2010. He also invited our attention to the details placed in page 116 to 117 of the paper book, wherein the list of machineries whose erection and commissioning is pending as at the year end. He submitted that the assessee has also furnished sample copies of invoices, wherein it is clearly mentioned that Commissioning of machinery including freight shall be carried out at free of cost. He invited our attention to a copy of invoice, purchase order and commissioning report placed in page 118 – 123 of the paper book in support of the above said submission. He submitted that the assessee is making provision for erection and commissioning @ 1% to 3% of the sale

Page 32 of 46

value of machinery, depending upon the nature of machinery and the estimated expenditure that may be incurred on erection and commissioning. He submitted that the above said percentage has been determined by the assessee on the basis of past experience. Accordingly, he submitted that the assessee is following scientific method for making this provision. He submitted that the provision made as at the yearend is reversed in the succeeding year as per accounting principles. Accordingly he submitted the decision rendered in AY 2009-10 is not applicable to the year under consideration. He submitted that this disallowance needs to be deleted, since the assessee has furnished all the details to the AO.

8.5 The Ld CIT-DR submitted that an identical issue has been restored to the file of the Ld CIT(A) by the Hon'ble High Court of Karnataka and hence this issue should be restored to the file of Ld CIT(A) in this year also.

8.6 We heard rival contentions on this issue and perused the record. Admittedly, the assessee has furnished all the relevant details to the assessing officer during the course of the assessment proceedings of this year, whereas disallowance of an identical claim made in AY 2009-10 was confirmed by ITAT mainly for the reason that the assessee has failed to demonstrate that the liability has accrued during the year and further substantial provision was reversed in the subsequent years. From the copies of sample invoices furnished by the assessee, it is seen that the assessee has taken responsibility for erection and commissioning. Hence the assessee has shown the existence of liability on its shoulders. Further, the assessee has furnished the details of machineries whose erection and commissioning is pending on 31.03.2010. The assessee has also submitted that the provision for erection and

Page 33 of 46

commissioning is made @ 1% to 3% of the value of machinery, depending upon estimated expenditure. According to Ld A.R, the above percentages were arrived on the basis of past experience. In our view, the above said details furnished by the assessee distinguishes the case of the current year from that of the case prevailed in AY 2009-10. In our view, the terms and conditions of sale of machineries would show that the liability for erection and commissioning is placed upon the shoulders of the assessee. Further, it has been submitted that the provision rate of 1% to 3% has been determined on the basis of past experience. Accordingly, we are of the view that this claim of the assessee may be allowed after examining relevant sale bills and the computation of provision so created. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and restore this issue to the file of the AO for examining the claim of the assessee by duly considering relevant sales invoices and computation of quantum of provision so made.

9.0 The next issue contested by the assessee relates to the decision of Ld CIT(A) in partially confirming disallowance of interest expenses by capitalising it. This issue has been examined and decided by us while adjudicating the ground raised by the revenue. We have held that the entire interest disallowance has to be deleted. Accordingly, the interest disallowance partially confirmed by Ld CIT(A) is liable to be deleted. We order accordingly.

10.0 In the next ground, the assessee has claimed that depreciation on the amount of interest capitalised should be allowed, if the interest disallowance is confirmed by Ld CIT(A). This ground has become infructuous, since we have deleted the interest disallowance.

Page 34 of 46

11. The last issue urged in this year relates to non-adjudication of grounds relating to Capital gains by Ld CIT(A). Since the Ld CIT(A) has not adjudicated this issue, we restore this ground to the file of Ld CIT(A) for adjudicating the same after affording adequate opportunity to the assessee.

ASSESSMENT YEAR : 2011-12

(C) REVENUE'S APPEAL - 2011-12

12.0 The first ground urged by the revenue in this year relates to disallowance of interest expenditure relatable to the interest free advances given to sister concerns.

12.1 The facts prevailing in this year are discussed in brief. The AO noticed that the assessee has advanced interest free loans to its sister concerns and a sum of Rs.44,47,571/- was outstanding as on 31.3.2011. The AO took the view that the assessee has diverted interest bearing loans to sister concerns interest free. Accordingly he disallowed a sum of Rs.3,47,409/- out of interest expenses.

12.2 The Ld CIT(A) noticed that the assessee is having own funds by way of capital and reserves aggregating to Rs.112.41 crores, whereas the outstanding loans given to sister concerns was only Rs.44 lakhs. Accordingly, following his decision rendered in AY 2010-11, he deleted the disallowance.

12.3 We have heard the parties on this issue and perused the record. Identical disallowance was made by the AO in AY 2010-11 and the Ld CIT(A) had deleted the disallowance. The order of Ld CIT(A) passed on this issue giving relief to the assessee has been upheld by us following the decision rendered by Hon'ble Karnataka

Page 35 of 46

High Court in the case of Micro labs Ltd (supra). In this year also, the own funds available with the assessee is in far excess of the loans advanced to the sister concerns. Hence the presumption is that the own funds have been lent to the sister concerns as held in the case of Micro Labs Ltd (supra). Accordingly, we confirm the order passed by Ld CIT(A) on this issue.

13.0 The next issue urged by the revenue in AY 2011-12 is disallowance of loose tools expenses treating as unproved expenses.

13.1 Identical disallowance has been made by the AO in AY 2010-11 and the Ld CIT(A) had deleted the disallowance by following the decision rendered by ITAT in AY 2008-09. In the instant year, the Ld CIT(A) deleted this disallowance following the decision rendered by him in AY 2010-11. In the earlier paragraphs, we have confirmed the decision of Ld CIT(A) in deleting this disallowance. As the facts are identical in this year also and since the Ld CIT(A) has followed the decision rendered by the Tribunal on an identical issue in AY 2008-09, we confirm the order passed by Ld CIT(A) on this year.

14.0 The last issue urged by the revenue in AY 2011-12 is disallowance of warranty provision. The assessee had created "Provision for Warranty" and claimed the same as expenditure. The net provision made during the year was Rs.66,77,354/-. The AO took the view that the assessee has not followed scientific method for making provision and accordingly disallowed the claim.

14.1 The Ld CIT(A) noticed that the assessee is making provision for warranties every year and the percentage of provision on sales work out to less than 1% and further they are very near each other.

Page 36 of 46

The Ld CIT(A) also referred to the decision rendered by Hon'ble Supreme Court in the case of Rotork Controls (314 ITR 62)(SC) in this regard. He further noticed that he had allowed identical disallowance made in AY 2010-11 and AY 2008-09. Accordingly, he deleted the disallowance made in AY 2011-12 also.

14.2 The Ld CIT-DR supported the order passed by the AO on this issue. The Ld A.R submitted that the Ld CIT(A) has given a finding that the provision created forms a fraction of the sales value. Further, the assessee has been making provision on a scientific basis every year and in the past years, the provision has been allowed.

14.3 Having heard rival contentions on this issue, we are of the view that the decision rendered by Ld CIT(A) on this issue does not require interference, since the Ld CIT(A) has followed his decision rendered in AY 2008-09 and 2010-11, which has since been accepted by the revenue. Further, the ld CIT(A) has given a finding that the provision for warranty made by the assessee is reasonable and on scientific basis. Accordingly we confirm his view on this issue.

(D) ASSESSEE'S APPEAL - 2011-12

15.0 The first issue contested by the assessee relates to the disallowance of expenditure claimed under the head "Provision for Erection and Commissioning works". As in last year, the AO disallowed the claim of Rs.34.65,200/- holding that the assessee has failed to furnish scientific basis for creation of such provision. The Ld CIT(A) also confirmed the disallowance by following his decision rendered in AY 2010-11, wherein he had followed the

decision rendered by ITAT in AY 2009-10. The ITAT had confirmed the disallowance in AY 2009-10.

15.1 Identical issue has been examined by us in AY 2010-11 and the matter has been restored to the file of AO with certain directions. Following the same, we set aside the order passed by Ld CIT(A) on this issue and restore the same to the file of AO with similar directions.

16.0 In the next ground, the assessee has claimed that depreciation on the amount of interest capitalised should be allowed, if the interest disallowance is confirmed by Ld CIT(A). This ground has become infructuous, since we have deleted the interest disallowance.

17.0 The next issue relates to disallowance voluntarily made by the assessee in respect of Exhibition charges u/s 40(a)(i) of the Act for failure to deduct tax at source from the payment.

17.1 This issue is being raised for the first time before the Tribunal. The assessee had incurred a sum of Rs.29,11,816/- towards exhibition charges for promoting its products during the year under consideration. The assessee did not deduct TDS u/s 195 of the Act and further, it voluntarily disallowed the above said expenditure u/s 40(a)(i) while computing returned income.

17.2 The AO initiated proceedings u/s 201(1) of the Act for failure of the assessee to deduct tax at source from the above said payments and held that the assessee is an assessee in default. Accordingly the AO raised demand u/s 201(1) and charged interest u/s 201(1A) of the Act. The assessee challenged the said order by

Page 38 of 46

filing appeal before Ld CIT(A), who disposed of the same, vide his order dated 11-03-2019 passed in ITBA No.10012/CIT(A-9)/2018-19. The Ld CIT(A) held that the above said payment does not fall within the purview of Royalty or FTS. He further held that the it constitutes business receipts in the hands of non-resident recipients and since they do not have permanent establishment in India, the same is not taxable in India as per Article 7 read with Article 5 of Indo-German DTAA. Accordingly, he set aside the order passed by the AO u/s 201(1) of the Act.

17.3 Relying on the above said decision of Ld CIT(A), the Ld A.R submitted that there is no liability to deduct tax at source from the exhibition charges and hence the voluntary disallowance made by the assessee on mistaken belief should be deleted.

17.4 The Ld D.R, on the contrary, submitted that the assessee is making fresh claim without filing revised return of income, which is contrary to the decision rendered by Hon'ble Supreme Court in the case of Goetz India Ltd (284 ITR 323)(SC).

17.5 We heard the parties on this issue and perused the record. The assessee is making a fresh claim for removal of disallowance voluntarily made u/s 40(a)(i) of the Act in the return of income filed by it. Even though the Hon'ble Supreme Court has held in the case of Goetz India Ltd (supra) that the assessee can make fresh claim only through revised return of income, yet the Hon'ble Supreme Court has specifically held that its order will not impinge the power of the Tribunal to admit additional claim. It is well settled proposition that there is no estoppel against law and hence there is no prohibition for claiming deduction of a sum wrongly disallowed by the assessee. Further, since it is a legal claim and the facts

Page 39 of 46

relating thereto are already available on record, we are of the view that it can be admitted. Accordingly we admit this claim of the assessee.

17.6 We notice that the AO had initiated proceedings u/s 201(1) for non-deduction of tax at source from the above said payment and raised demand u/s 201(1). In the appeal filed by the assessee, the Ld CIT(A) has deleted the demand with the following observations:-

“34. I have examined the payment which is in the nature of Exhibition Fees paid amounting to Rs.29,11,816. This does not come in the purview of Royalty or FTS.

*35. Further, this being the business receipt cannot be held as the sum is chargeable to tax in India unless the recipient has PE in India. There was no permanent establishment of payee in India. I find that the income of foreign company for organizing fair outside India does not accrue or arise in India. Further, it cannot be deemed to accrue or arise in India. **Thus, the assessee cannot be treated as assessee in default u/s 201 of the Act.***

36. Amount paid to recipient is considered as business profit and recipient has not Permanent Establishment in India. Hence TDS is not applicable as per Article 7 read with Article 5 of Indo-German DTAA. The appellant relied on the decision of Hon'ble Supreme Court in the case of CIT vs. Kulandagan Chettiar (267 ITR 654) wherein it was held that in the absence of a PE, the tax cannot be levied in India. This is made amply clear in Article 7 of the treaty. The revision petition against this decision was dismissed by the Hon'ble Supreme Court in 300 ITR 5. The appellant also relied on the decision of Hon'ble Supreme Court in the case of DIT (International taxation) s. Morgan Stanley & Co Inc 292 ITR 417, the Hon'ble Supreme

Page 40 of 46

Court held that a non-resident cannot be taxed in respect of the business profits in India unless it has PE in India. In view of the above, I agree with the claim of the appellant.

37. Therefore, I do not find any reason for the appellant to deduct tax thereon. The grounds of appeal 4 & 6 are accordingly, allowed.”

17.7 Thus, we notice that the Ld CIT(A) has held in the proceedings initiated u/s 201(1) of the Act that the assessee is not liable to deduct tax at source from the payments made towards exhibition charges. In that case, there is no necessity to invoke provisions of sec.40(a)(i) of the Act. Accordingly, we direct the AO to delete the disallowance made by the assessee voluntarily u/s 40(a)(i) of the Act in respect of exhibition charges.

18.0 The next issue urged by the assessee by way of additional ground relates to claim of set off of short term capital loss brought forward from earlier year. Since this issue requires factual verification, we restore this issue to the file of the AO.

ASSESSMENT YEAR 2012-13

(E) REVENUE'S APPEAL - 2012-13

19.0 The first ground urged by the revenue in this year relates to disallowance of interest expenditure relatable to the interest free advances given to sister concerns.

19.1 The facts prevailing in this year are discussed in brief. The AO noticed that the assessee has advanced interest free loans to its sister concerns and a sum of Rs.21,40,68,782/- was outstanding as on 31.3.2012. The AO took the view that the assessee has diverted

Page 41 of 46

interest bearing loans to sister concerns interest free. Accordingly he disallowed a sum of Rs.54,53,449/- out of interest expenses.

19.2 The Ld CIT(A) noticed that the assessee is having own funds by way of capital and reserves aggregating to Rs.126.41 crores, whereas the outstanding loans given to sister concerns was only Rs.21.40 crores. Accordingly, following his decision rendered in AY 2010-11, he deleted the disallowance.

19.3 We have heard the parties on this issue and perused the record. Identical disallowance was made by the AO in AY 2010-11 and the Ld CIT(A) had deleted the disallowance. The order of Ld CIT(A) passed on this issue giving relief to the assessee has been upheld by us following the decision rendered by Hon'ble Karnataka High Court in the case of Micro labs Ltd (supra). In this year also, the own funds available with the assessee is in far excess of the loans advanced to the sister concerns. Hence the presumption is that the own funds have been lent to the sister concerns as held in the case of Micro Labs Ltd (supra). Accordingly, we confirm the order passed by Ld CIT(A) on this issue.

20.0 The next issue urged by the revenue in AY 2012-13 is disallowance of loose tools expenses treating as unproved expenses.

20.1 Identical disallowance has been made by the AO in AY 2010-11 and the Ld CIT(A) had deleted the disallowance by following the decision rendered by ITAT in AY 2008-09. In the instant year, the Ld CIT(A) deleted this disallowance following the decision rendered by him in AY 2010-11. In the earlier paragraphs, we have confirmed the decision of Ld CIT(A) in deleting this disallowance. As the facts are identical in this year also and since

Page 42 of 46

the Ld CIT(A) has followed the decision rendered by the Tribunal on an identical issue in AY 2008-09, we confirm the order passed by Ld CIT(A) on this year.

(F) ASSESSEE'S APPEAL 2012-13

21.0 The first issue contested by the assessee relates to the disallowance of expenditure claimed under the head "Provision for Erection and Commissioning works". As in last year, the AO disallowed the claim of Rs.65,02,352/- holding that the assessee has failed to furnish scientific basis for creation of such provision. The Ld CIT(A) also confirmed the disallowance by following his decision rendered in AY 2010-11, wherein he had followed the decision rendered by ITAT in AY 2009-10. The ITAT had confirmed the disallowance in AY 2009-10.

21.1 Identical issue has been examined by us in AY 2010-11 and the matter has been restored to the file of AO with certain directions. Following the same, we set aside the order passed by Ld CIT(A) on this issue and restore the same to the file of AO with similar directions.

22.0 In the next ground, the assessee has claimed that depreciation on the amount of interest capitalised should be allowed, if the interest disallowance is confirmed by Ld CIT(A). This ground has become infructuous, since we have deleted the interest disallowance.

23.0 The next issue urged by the assessee by way of additional ground relates to claim of set off of short term capital loss brought forward from earlier year. Since this issue requires factual verification, we restore this issue to the file of the AO.

ASSESSMENT YEAR 2013-14

(G) REVENUE'S APPEAL 2013-14

24.0 The first ground urged by the revenue in this year relates to disallowance of interest expenditure relatable to the interest free advances given to sister concerns.

24.1 The facts prevailing in this year are discussed in brief. The AO noticed that the assessee has advanced interest free loans to its sister concerns and a sum of Rs.21,40,68,782/- was outstanding as on 01.4.2012 and Rs.54,39,951/- as on 31.3.2013. The AO took the view that the assessee has diverted interest bearing loans to sister concerns interest free. Accordingly he disallowed a sum of Rs.20,07,881/- out of interest expenses.

24.2 The Ld CIT(A) noticed that the assessee is having own funds by way of capital and reserves aggregating to Rs.126.41 crores as at the beginning of the year and Rs.127.23 crores as at the end of the year. However, the outstanding loans given to sister concerns was only Rs.21.40 crores and Rs.54.39 lakhs as at the beginning and end of the year respectively. Accordingly, following his decision rendered in AY 2010-11, he deleted the disallowance.

24.3 We have heard the parties on this issue and perused the record. Identical disallowance was made by the AO in AY 2010-11 and the Ld CIT(A) had deleted the disallowance. The order of Ld CIT(A) passed on this issue giving relief to the assessee has been upheld by us following the decision rendered by Hon'ble Karnataka High Court in the case of Micro labs Ltd (supra). In this year also, the own funds available with the assessee is in far excess of the loans advanced to the sister concerns. Hence the presumption is

Page 44 of 46

that the own funds have been lent to the sister concerns as held in the case of Micro Labs Ltd (supra). Accordingly, we confirm the order passed by Ld CIT(A) on this issue.

25.0 The next issue urged by the revenue in AY 2013-14 is disallowance of loose tools expenses treating as unproved expenses.

25.1 Identical disallowance has been made by the AO in AY 2010-11 and the Ld CIT(A) had deleted the disallowance by following the decision rendered by ITAT in AY 2008-09. In the instant year, the Ld CIT(A) deleted this disallowance following the decision rendered by him in AY 2010-11. In the earlier paragraphs, we have confirmed the decision of Ld CIT(A) in deleting this disallowance. As the facts are identical in this year also and since the Ld CIT(A) has followed the decision rendered by the Tribunal on an identical issue in AY 2008-09, we confirm the order passed by Ld CIT(A) on this year.

ASSESSMENT YEAR 2014-15

(H) ASSESSEE'S APPEAL 2014-15

26.0 The first issue contested by the assessee relates to the disallowance of expenditure claimed under the head "Provision for Erection and Commissioning works". As in last year, the AO disallowed the claim of Rs.35,32,502/- holding that the assessee has failed to furnish scientific basis for creation of such provision. The Ld CIT(A) also confirmed the disallowance by following his decision rendered in AY 2010-11, wherein he had followed the decision rendered by ITAT in AY 2009-10. The ITAT had confirmed the disallowance in AY 2009-10.

Page 45 of 46

26.1 Identical issue has been examined by us in AY 2010-11 and the matter has been restored to the file of AO with certain directions. Following the same, we set aside the order passed by Ld CIT(A) on this issue and restore the same to the file of AO with similar directions.

27.0 In the next ground, the assessee has claimed that depreciation on the amount of interest capitalised should be allowed, if the interest disallowance is confirmed by Ld CIT(A). This ground has become infructuous, since we have deleted the interest disallowance.

28. In the result, all the appeals of the assessee are treated as allowed and all the appeals of the revenue are dismissed.

Order pronounced in the open court on 30th Sept, 2021

Sd/-
(Beena Pillai)
Judicial Member

Bangalore,
Dated 30th Sept, 2021.
VG/SPS

Sd/-
(B.R. Baskaran)
Accountant Member

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

**Asst. Registrar,
ITAT, Bangalore.**