

आयकर अपीलिय अधिकरण, 'सी' न्यायपीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH, CHENNAI

श्री वी दुर्गा राव, न्यायिक सदस्य एवं श्री जी. मंजुनाथ, लेखा सदस्य के समक्ष
BEFORE SHRI V. DURGA RAO, JUDICIAL MEMBER AND
SHRI G. MANJUNATHA, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No.: 961/Chny/2018

निर्धारण वर्ष / Assessment Year: 2013-14

Gem Spinners India Limited,
78, Cathedral Road,
Chennai – 600 086.

[PAN: AACG-2498-K]

(अपीलार्थी/Appellant)

v. The Assistant Commissioner of
Income Tax,
Corporate Circle 2(1),
Chennai.

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by

: Shri. Philip George, Advocate

प्रत्यर्थी की ओर से/Respondent by

: Shri. M. Rajan, CIT

सुनवाई की तारीख/Date of Hearing

: 11.10.2022

घोषणा की तारीख/Date of Pronouncement

: 04.11.2022

आदेश / O R D E R

PER G. MANJUNATHA, ACCOUNTANT MEMBER:

This appeal filed by the assessee is directed against the order passed by the learned Commissioner of Income Tax (Appeals)-6, Chennai, dated 28.12.2017 and pertains to assessment year 2013-14.

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

1. *The Commissioner of Income Tax - Appeals has erred in confirming the addition of Rs 16,96,24,344 towards write off of inventory.*

2. *The Commissioner of Income Tax- Appeals ought to have deleted the addition made by the Deputy Com. of Income Tax on the facts of the case as the appellant had produced all the relevant records in support of its claim.*
3. *The Commissioner of Income Tax - Appeal ought to have allowed the appeal based on the material and evidences produced before him.*
4. *The Commissioner of Income Tax - Appeal ought to have allowed the depreciation as the appellant had temporarily suspended its' manufacturing operations.*
5. *The Commissioner of Income Tax - Appeal ought to have appreciated the fact that the appellant had enough unabsorbed brought forward business / depreciation loss and adjusted the same against the income.*
6. *The Appellant craves leave to add, amend, alter and withdraw any of the grounds of appeal."*

3. The brief facts of the case are that, the assessee company is in the business of manufacturing of cotton yarn and knitted fabrics, filed its return of income for the assessment year 2013-14 on 22.09.2013, declaring net loss of Rs. 2,55,24,649/-. The case was taken up for scrutiny, and during the course of assessment proceedings, the Assessing Officer noticed that during the financial year relevant to assessment year 2013-14, the assessee is having only trading activity. The gross receipt from trading was at Rs. 10.46 crores, as against this, the assessee claimed trading expenses of Rs. 9.93 crores. It was further noted in addition to trading receipts, the assessee has claimed huge amount of other

expenses. Therefore, called upon the assessee to furnish necessary details and nature of expenses debited under the head 'other expenses'. In response, the assessee submitted that during the year, the company has written off unusable stock of cotton valuing Rs. 16,96,24,334/-, and said cotton was purchased way back in the year 2004-05. Since, the cotton was not used for manufacturing knitted fabric or yarn, it was unusable and thus, the management has taken a decision to write off said stock as scrap and debited to profit and loss account.

4. The AO, however was not convinced with the explanation furnished by the assessee and according to the Assessing Officer, the assessee could not satisfactorily explain how closing stock of cotton has become unusable. The assessee neither furnished necessary certificate from expert to prove that such stock became obsolete and unusable nor filed any evidences to prove its claim that in earlier year also unusable and obsolete stock was written off. The AO has analyzed the claim of the assessee in light of movement of stock of cotton right from financial years 2003-04 to 2011-12 and observed that, although the assessee claims to have written off stock

which was purchased in the financial years 2004-05 & 2005-06, but on perusal of stock statement filed by the assessee, the closing stock of cotton as on 31.03.2006 was only at Rs. 11.34 crores, whereas the assessee had debited an amount of Rs. 16.96 crores, which means the assessee has made purchase year after year. Therefore, he opined that claim of the assessee that amount debited under the head stock write off is not backed by any evidence and also to offset income derived from sale of asset computed under the head 'Long Term Capital Gains' (LTCG) and thus, rejected the arguments of the assessee and disallowed the claim of loss on account of written off inventory amounting to Rs. 16,96,24,334/-. The relevant findings of the AO are as under:

2.2 *The assessee's submissions were carefully considered. The following points emanate from the annual report, financial statement and papers & submissions filed by the assessee :*

- *It was stated that the inventory of cotton written off were procured during the years 2004 to 2006- The assessee was asked to submit details of material consumed from 2004 onwards. The relevant statement is annexed to this order. It can be seen that there was a steady movement of the inventory viz., cotton right from 2004 till 2011. The stock at close as on 31.3.2005 and 31.3.2006 were only Rs.11.52 crores and Rs.11.34 crores respectively, If the inventory of cotton purchased during 2004 to 2006 remained unutilized, then the closing stock of these years would be more or at least equal to Rs. 16.96 crores and cannot be less than Rs.16. 96 crores.*
- *Further, in consumption of inventory, particularly that of perishable items like cotton, First-in-First-out (FIFO) method would be followed. from the annexure, it can be seen that during the year ended 01.3.2005 and 31.3.2009, the consumption was much higher than the purchases during the year. This implies that stock at commencement*

was fully consumed in these years, as per FIFO method. The stock at close as on 31.3.2009 was Rs.11.32 crores. Thus, there is no force in the assessee's argument that inventory of cotton procured during 2004 to 2006 to the tune of Rs.16.96 crores remain unutilized.

- The assessee claims that production of yarn was suspended in July 2011. However during that year, viz., 2011-12, purchases were claimed to be made to the tune of Rs.8.09,38,321, inspite of opening stock of Rs.15.34 crores. After consumption to the tune of Rs.6.80 crores. the closing stock as on 31.3.2012 was arrived at Rs.16.96 crores. Any supporting materials for purchase of cotton to the tune of Rs.8.09 crore. was not furnished.
- As per the details filed by the assessee, inventory of cotton and yarn to the tune of Rs.20 crores were insured by Oriental insurance company limited for the period from April 2012 to March 2013. At the time of accepting the insurance, the insurance company would have verified the condition of stock. When the stock was in good condition at the beginning of the year and also insured, it is not clarified as to how the stock suddenly lost its utility in the same year.
- The assessee has also not clarified as to why any claim was not made before Insurance company for settlement against the policy taken for inventory.
- A perusal of the P & L A/c shows that the assessee declared revenue of Rs. 19,49,238/- from sale of waste in the immediately preceding year. However, when there is a huge write off of stock in the relevant previous year, no receipts from sale of waste or scrap has been shown.
- The assessee was asked if any write off of stock was made in earlier years. The assessee has not stated about any write off of stock in the earlier years. The write off of stock in relevant previous year is therefore a solitary case.
- Vide order sheet entry dated 04.03.2016, the AR of the assessee was asked, besides other information, to produce stock registers for raw cotton and other materials for the FYs · 2010-11 to 2012-13. Though the AR filed the replies to other queries, stock registers were not produced.
- Further, in the Annual Report- Annexure to the Independent Auditor's Report, it is stated by the Auditors as under:

2(i) Inventories have been physically verified during the year by the management at reasonable levels.

(ii) In our opinion, the procedures of physical verification of inventory followed by the management are reasonable and adequate in relation to the size of the company and the nature of its business.

(iii) In our opinion, the company is generally maintaining proper records of its inventories and no

material discrepancies were noticed on physical verification ... "

It can be seen that there is no mention in the Auditor's Report about write off of the entire inventory, which is a significant event.

- *Most importantly, the assessee company is a widely held company, listed in stock exchange. The alleged write off of inventory to the tune of Rs.16.96 crores is a major significant event which is required to be reported to the shareholders in the Annual Report. There is no such mention about write off/ of inventory in the Report to Shareholders.*

2.3. The reason for such a write off of stock is not far to seek. During the relevant previous year, the assessee sold two pieces of vacant land at Chengalpattu for a total consideration of Rs.22,83,02,899. After reducing indexed cost of acquisition, the net long term capital gains was arrived at Rs.21,24,10,447. This long term capital gain was entirely set off against current year's business loss of Rs.23,79,35,096. And a substantial portion of the current year business loss is due to the alleged write off of stock of Rs. 16,96,24,334. Many gaping holes have been punched into the theory of the assessee that leave me with the conclusion that the write off of stock is an unproven claim. The write off of stock is only an attempt to offset the legitimate taxes due on the windfall profit arisen to the assessee on sale of land. In view of the above, it is held that the assessee has not satisfactorily proved the genuineness of write off of inventory to the tune of Rs. 16.96 crores and the same is rejected."

5. Being aggrieved by the assessment order, the assessee preferred an appeal before the CIT(A). Before the CIT(A), the assessee has filed detailed written submissions on the issue which has been reproduced in page no. 2 to 10 of Ld. CIT(A) order. The sum and substance of arguments of the assessee before the CIT(A) are that the company has written off obsolete and unused stock, when it came to know that said

stock is not suitable for manufacturing knitted fabric and yarn. The CIT(A), after considering relevant submissions of the assessee and also taken note of various facts, rejected arguments of the assessee and sustained the additions made towards disallowance of loss on account of written off of inventory, on the ground that the appellant could not produce necessary evidences to prove its claim that written off of inventory is unusable and obsolete and further, there was no reporting to the authorities concerned, even though the assessee is a listed company which required to report major events to various authorities including SEBI etc. The relevant findings of the CIT(A) are as under:

4.5 I have considered the submissions of the AR and the reasoning of the assessing officer. The appellant had closing stock of Rs. 169.96 lakhs of cotton and bought yarn as on 31.03.2012. The normal accounting procedure is to take the closing stock of the earlier year as opening stock of the subsequent year and value the dosing stock at the end of the year at cost or realizable value. If that procedure is followed, the appellant should have shown the opening stock at RS. 16.96 lakhs and the closing stock at NIL for these cotton. Instead it has shown the stock written off under other expenses, But for the scrutiny of the assessment and calling for details of other expenses the fact that the appellant had written off the stock could not be known at all. The fact that the stock in 2005 was very much less than the stock written off would clearly prove that the stock written off was not out of the stock lying in 2005 especially when there were production subsequent to 2005 and the stock lying would have been consumed in the subsequent years. Though the appellant denies the method of FIFO followed it did not say the method followed by it. The appellant had not furnished

the details of stock written off countwise to cross verify whether the said count of yarn was used subsequently or whether it was not fit for use. Though the insurance was against fire accident, whether the Insurance authorities inspected the stock and got satisfied with the value of Rs.20 cr. was not made clear. The appellant was not able to state as to what really happened to the alleged stock written off; whether it was destroyed or sold as scrap etc. The shareholders of the company which is listed company were not informed about the write off or such huge sum. Though in the advertisement for the Q3 published it was claimed to have stated the write off, similar statement is absent in the final accounts submitted to the shareholders in the Annual general body meeting. The Company Secretary was authorized to report the fact of write off to the stock exchange and Company Law Board according to the appellant but whether the Company Secretary had in fact reported the matter or not was not known. The appellant could not produce the stock book on the plea that there was theft in the factory premises. Copy of the complaint filed only show theft of some motors and not accounts books or stock book. Details of unabsorbed depreciation available for set off against business loss were also not furnished though stated. When the appellant stopped production in 2011 itself, there was no reason given as to why the stock was not sold as on 31st. March, 2012 atleast for a realizable value when they were aware that the stock could not be used further without waiting till 31' March, 2013. The intention of the appellant to write off in the year 2013 is made very clear by the assessing officer in his order that the write off was made only to offset the huge capital gains derived on sale of land. All things considered, it is clear that the appellant had tried to write off the amount to avoid tax on the capital gains and the write off was not genuine. Therefore confirm the disallowance of Rs. 16,96,24,334/- being write off of stock made by the Assessing Officer. The grounds on this issue are dismissed."

6. The Ld. Counsel for the assessee, submitted that Ld. CIT(A) erred in not appreciating fact that the assessee has stopped manufacturing activity in mid 2011 and thus,

whatever stock held by the company became obsolete and unusable by effluxion of time. Ld. Counsel for the assessee further submitted that raw cotton is perishable on effluxion of time, which loses its original character and become unusable. Since, the assessee stopped production activity, and unused cotton for many months, therefore because of various reasons it became obsolete stock. The assessee after considering the quality of stock came to the conclusion that it is no longer suitable for manufacturing activity and thus, after obtaining necessary approvals from the Board of Directors, written off inventory and debited to profit and loss account. The assessee had also reported loss on account of written off inventory in the annual accounts. Although, the AO and CIT(A) claims that there is no information on reporting to the concerned authorities, and also there is no qualified observations from the auditors of the company on this major issue, but what is required to be seen is whether any adverse comments has been made by the auditors on stock written off or not. In this case, the auditor of the company had given clean report without any adverse comments, which means there is no issue with regard to write off of inventory and consequent loss. Therefore, the AO and CIT(A) completely gone wrong in

observing that the assessee could not file necessary evidence to prove the claim of loss on inventory written off.

7. The Ld. DR on the other hand supporting the order of the CIT(A), submitted that facts brought out by the AO and CIT(A) clearly prove the intent of the assessee as per which for the impugned financial year relevant to assessment year 2013-14, the assessee has derived LTCG from sale of property and to offset said capital gains, the assessee has declared business loss by debiting written off inventory. Therefore, the AO and CIT(A) clearly held that the assessee has made tax planning to avoid payment of tax on capital gains and thus, their order should be upheld.

8. We have heard both the parties, perused materials available on record and gone through orders of the authorities below. The AO had given various reasons to disallow loss incurred on account of inventory written off, and according to the Assessing Officer, the claim of the assessee that stock of cotton pertains to purchases made in the years 2004-05 & 2005-06, is not supported by any evidence. The AO had also discussed the issue in light of fire insurance taken by the

assessee to cover up on account of damages on fire which includes stock in trade or inventory. However, there was no claim from the assessee before the insurance company, even though the assessee claims that stock of inventory has become obsolete and unusable. The AO had also discussed the issue in light of reporting requirements of the assessee to various statutory authorities and auditors report in the impugned financial year and opined that although, the assessee has incurred huge loss on account of inventory written off, there is no proof of reporting to shareholders or concerned regulatory bodies. Further, there is no observation with regard to major events of inventory write off by the auditors in the report. Therefore, the AO came to the conclusion that the assessee has devised a tax avoidance plan to offset capital gains derived from sale of property and thus, declared current year business loss by showing inventory write off. It was an argument of the assessee before the AO and CIT(A) that the AO had disallowed loss on account of inventory write off on hypothetical and suspicion manner. In other words, the assessee claims that it has furnished necessary evidences to prove its claims of loss on account of inventory written off.

9. We have given thoughtful consideration to reasons given by the AO to disallow loss on account of inventory written off in light of various arguments advanced by the Ld. Counsel for the assessee, and we ourselves did not subscribe to the arguments of the Ld. Counsel for the assessee for the simple reason that the assessee is a listed company, is under strict control of regulatory bodies. The assessee is required to take necessary approvals from the Board of Directors and also required to report major events to the stock exchange and SEBI, to inform the shareholders about any adverse events which cause huge financial burden or loss. Further, although the assessee claims that inventory write off pertains to purchase of cotton made in the financial years 2004-05 & 2005-06, but on perusal of statement of movement of stock filed by the assessee, the closing stock of cotton as on 31.03.2006 was only at Rs. 11.34 crores, whereas, the value of stock written off for the impugned assessment year is at Rs. 16.96 crores. Therefore, the argument of the assessee that the inventory of stock written off pertains to financial years 2004-05 & 2005-06 is *devoid* of merits. Further, the assessee has written off 100% inventory of cotton held and the value of

said inventory is very high. When the assessee is taking such a drastic decisions which impacts its financial decision, it needs to report to the concerned authorities and also required to take approval from the Board of Directors and audit committee. In this case, although assessee claims that it has reported inventory write off to the shareholders in published quarterly financial report, but the CIT(A) recorded categorical findings that similar statement is absent in the final accounts submitted to shareholders in the annual general body meeting. Further, there is no iota of observations by the auditors in their auditors report submitted to the Board of Directors for the financial year 2012-13, even though, there is a requirement of law to report any adverse movement in inventory valuation. The CIT(A) made further observations that the assessee could not file any evidence to prove that whether any report has been submitted to stock exchange and SEBI on this issue. We further noted that the assessee has taken an insurance coverage for loss of stock and other asset. Even though, the assessee claims stock written off became obsolete and unusable, there is no proof of claim before the insurance company. Further, when such a huge chunk of inventory was written off, obviously there will be a revenue

from sale of scrap. However, there is no iota of evidence with the assessee to prove its claim that whether any revenue is generated from sale of scrap. The assessee also could not able to furnish any evidence whether obsolete/unusable stock is still lying with the assessee or any further action is taken to sell or disburse the stock. Therefore, we are of the considered view that the assessee could not satisfactorily explain with necessary evidence the loss claimed on account of write off inventory, but is only to offset capital gain derived from sale of property as brought out by the AO and CIT(A). The Assessing Officer in their order in para 2.3 observed that during the financial year relevant to assessment year 2013-14, the assessee shows two pieces of vacant land and computed LTCG of Rs. 21,24,10,447/- and set off LTCG against current year business loss of Rs. 23,79,35,096/-. The AO further noted that substantial portion of the current year business loss is due to alleged write off of inventory amounting to Rs. 16,96,24,334/-. Therefore, from the above, it is very clear that the assessee has devised a tax planning to offset capital gains derived from sale of property by claiming set off current year business loss.

10. Therefore, we are of the considered view, that there is no error in the reasons given by the AO as well as the CIT(A) to make additions towards disallowance of loss on account of write off inventory of cotton. Hence, we are inclined to uphold the findings of the CIT(A) and reject the grounds taken by the assessee.

11. In the result, the appeal filed by the assessee is dismissed.

Order pronounced in the court on 04th November, 2022 at Chennai.

Sd/-
(वी दुर्गा राव)
(V. DURGA RAO)
न्यायिकसदस्य/Judicial Member

Sd/-
(जी. मंजुनाथ)
(G. MANJUNATHA)
लेखासदस्य/Accountant Member

चेन्नई/Chennai,

दिनांक/Dated: 04th November, 2022

JPV

आदेश की प्रतिलिपि अग्रेषित/Copy to:

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|------------------------|--------------------------|------------------------------|
| 1. अपीलार्थी/Appellant | 2. प्रत्यर्थी/Respondent | 3. आयकर आयुक्त (अपील)/CIT(A) |
| 4. आयकर आयुक्त/CIT | 5. विभागीय प्रतिनिधि/DR | 6. गार्ड फाईल/GF |