

आयकर अपीलीय अधिकरण, राजकोट न्यायपीठ
**IN THE INCOME TAX APPELLATE TRIBUNAL,
RAJKOT BENCH, RAJKOT
(Conducted through E-Court)**

**BEFORE SHRI WASEEM AHMED, ACCOUNTANT MEMBER
And
SHRI TR SENTHIL KUMAR, JUDICIAL MEMBER**

आयकरअपीलसं./ITA No. 46/Rjt/2020

निर्धारणवर्ष/Asstt. Year:2016-2017

Krunal Vasantray Babariya, National Export Industries, Upleta Road, Dhoraji, Gujarat-360410. PAN: AGTPB2925Q	Vs.	Assistant Commissioner Income Tax-2(1), Rajkot.
(Applicant)		(Respondent)

Assessee by :	Shri Kuldeep K. Adesara, A.R
Revenue by :	Shri Ashish Kumar Pandey, Sr. DR

सुनवाईकीतारीख/**Date of Hearing** : **11/09/2023**

घोषणाकीतारीख/**Date of Pronouncement**: **08/12/2023**

आदेश/ORDER

PER WASEEM AHMED, ACCOUNTANT MEMBER:

The captioned appeal has been filed at the instance of the assessee against the order of the Ld. Commissioner of Income Tax (Appeal), Rajkot-2, arising in the matter of order passed under Section 143(3) of the Income Tax Act, 1961 (here-in-after referred to as "the Act") relevant to the Assessment Year 2016-17.

2. The interconnected issue raised by the assessee vide ground Nos. 1 to 5 of his appeal is that the learned CIT(A) erred in confirming the addition on account of valuation of the stock in trade.

3. The facts in brief are that the assessee, an individual, is deriving income from business and Income from other sources. The assessee in the year under consideration has shown closing stock in trade at Rs. 13,27,989/- only. During the assessment proceedings, the assessee claimed the stock was to be valued based on FIFO method at Rs. 16,96,924/- only.

4. However, the AO found that the assessee has not furnished evidence in support of method of valuation, therefore the AO rejected the claim of the assessee. The AO thereafter valued the stock in trade at Rs. 20,52,032/- on weighted average cost method. Thus, the difference being the amount of Rs. 7,24,043/- (Rs. 20,52,032 – 13,27,989/-) was added to the total income of the assessee on account of undervaluation of closing stock.

5. The aggrieved assessee preferred an appeal before the learned CIT(A) and submitted that he has been following FIFO method for several years for the valuation of stock in trade. The method consistently applied cannot be changed merely for the reason the changed method will generate increased income. As per the FIFO, the value of stock is at Rs. 16,96,924/- and the difference amount of Rs. 368935/- (Rs. 16,96,924 - Rs. 13,27,989) arising due to price variation as price per share was not taken as per FIFO method, hence there was no intention of suppression of stock. The assessee accordingly prayed that the addition made for Rs. 7,24,043/- by the AO merely by changing the method should be deleted. The learned CIT(A) after considering the facts in totality confirmed the addition made by the AO by observing as under:

I have considered the detailed written submission on the issue and also the appellant argument made during the appellate proceeding. The Appellant as such could not prove before the appeal authority that he has rightly followed FIFO method for arriving to value of a closing stock because by FIFO method the valuation comes to Rs. 16,96,924/- whereas in the books of accounts the assessee is showing closing stock at a value of Rs. 13,27,989/-. Moreover, before the AO the appellant could not prove that in past many years the FIFO has been consistently followed by the assessee. Therefore, I upheld the action of the Assessing Officer to bring to tax under valuation of the closing stock at Rs.7,24,043/- arrived at by adopting weight and average method. The ground of appeal on this issue is accordingly dismissed.

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

7. The learned AR before us filed a paper book running from pages 1 to 213, synopsis of arguments having 17 pages and submitted that the assessee has been following FIFO method for the valuation of the stock consistently. Therefore, there was no valid reason for the revenue to disregard method adopted by the assessee for the valuation of closing stock and use weighted average method.

8. On the other hand, the learned DR contended that there was no consistency adopted by the assessee for valuation of the closing stock. The learned DR vehemently supported the order of the authorities below.

9. We have heard the rival contentions of both the parties and perused the materials available on record. Before we go into the controversy to decide what should be the method of valuation of closing stock for the year in dispute, we find it pertinent to note that any adjustment in the closing stock for the year in dispute would be tax neutral. It is for the reason that the closing stock of one year becomes the opening stock of subsequent year, meaning thereby if we increase the closing stock of the year in dispute, certainly the income is going to increase of the assessee but simultaneously the increased value of closing stock will become the opening stock of the next year which will certainly result reduction in the income of the assessee in the years in which such opening stock would be sold-out. However, the assessee is not expected to value the stock according to his understanding. As such whatever the base has been adopted by the assessee for the valuation of the stock, the same should be continued for all the upcoming years until and unless the situation warrants otherwise.

9.1 Be that as it may be, we find that the year in dispute before us is the assessment year 2016-17 and if we give any finding qua the valuation of closing

stock, the same is going to have a bearing on the opening stock of the next year and likewise in all the assessment years until and unless the value of closing stock is sold-out. In other words, we are afraid to hold to change any valuing of the closing stock in the given case as it will have cascading effect on the next various assessment years and there will not be any extra tax burden on the assessee except to the extent that the income of one year will become the income of another year.

9.2 However, what is important is this that none of the authorities below, the AO or Id. CIT-A has given any finding to change the opening stock of the assessee of the next year on account of change in the valuation of closing stock for the year under consideration. Thus, in such a situation, if we confirm the order of the authorities below, that will lead to the double addition which is not desirable under the provisions of law. Accordingly, we are not inclined to uphold the order of the authorities below. Hence, we set aside the finding of the learned CIT-A and direct the AO to delete the addition made by him. Hence the ground of appeal of the assessee is hereby allowed.

10. **The next** issue raised by the assessee is that the learned CIT(A) erred in confirming the disallowance of interest expenditure under section 36(1)(iii) of the Act.

11. The AO during the assessment proceedings observed that the assessee has made an investment in the equity shares of M/s Synnova Gears & Transmission Pvt Ltd. The fund for such investment was out of the borrowing sourced from the firm namely "National Export Industries" in which assessee is a partner. The assessee on impugned borrowings incurred interest expense of Rs. 13,45,351/- and claimed the same as business expenses under section 36(1)(iii) of the Act. The assessee claimed that the investment was made for business purposes therefore interest cost on the borrowing should be allowed. The assessee in this

regard also relied on the judgment of Hon'ble Supreme court in the case of SA Builders Ltd vs. CIT reported in 288 ITR 1.

12. The AO disagreed with the contention of the assessee on the reasoning that investment in the shares of a private company is going to generate dividend income which cannot be treated as business activity of the assessee. Accordingly, the interest cost incurred cannot be held for the purposes of the business. The AO also found that the facts in the case of SA Builders Ltd vs. CIT (supra) are different from the facts of the present case. Therefore, the principles laid down in said case cannot be applied in the case of the assessee. Hence, the AO made the disallowance of interest expense of Rs. 13,45,351/- and added to the total income of the assessee.

13. On appeal by the assessee, the learned CIT(A) also confirmed the finding of the AO by observing as under:

I have carefully gone through detailed written submission supra through the various case laws of the Apex court relied upon by the appellant supra and it is found that same are clearly distinguishable on facts of the assessee's case. In the assessee's case assessee has not advanced money by way of loan as such assessee has invested in the equity of shares of a private company. Assessee do not have deep interest in a company where investment in the form of share capital has been made by the assessee as it is evident from the fact that assessee is merely holding 8.45% of shares in the equity of private company Synnova Gears & Transmission Pvt. Ltd., thus, by no stretch of evidence commercial expediency could be established. In light of this fact I upheld the action of the Assessing Officer to disallow interest expenditure of Rs.13,45,351/- under section 36(1)(iii) by treating it as incurred for non business purpose. The ground of appeal on this accordingly dismissed.

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

15. The learned AR before us contended that the disallowance with respect to the dividend income has to be made under the provisions of section 14A of the Act and the same cannot be made under the provisions of section 36(1)(iii) of the Act.

16. On the other hand, the learned DR vehemently supported the order of the authorities below.

17. We have heard the rival contentions of both the parties and perused the materials available on record. From the preceding discussion, we note that the assessee has borrowed funds from the partnership firm which was utilized for making the investment in a private limited company. The controversy arises for our adjudication whether interest cost incurred on the borrowed fund used for the purpose of the investment is eligible for deduction under section 36(1)(iii) of the Act. The provisions of section 36(1)(iii) of the Act mandate the deduction of the interest expenses on the capital borrowed if it is used for the purpose of the business. In the present case what we find is this that the money has been used for the purpose of investment in a private limited company. Undeniably, the assessee is engaged in the business of making investments in securities. Therefore, the assessee has made investment out of the borrowed fund in a business asset. Accordingly, we are of the view that such an interest expense cannot be disallowed as deduction to the assessee under the provisions of section 36(1)(iii) of the Act. As such when the assessee generates any exempted income, then if any disallowance of interest is warranted that will be made under the provisions of section 14A of the Act. As such, the provisions of section 14A read with rule 8D of Income Tax Rules cannot be adopted while deciding the issue under the provisions of section 36(1)(iii) of the Act. Thus, we do not find any reason to uphold the order of authorities below. Hence, the ground of appeal of the assessee is hereby allowed dismissed.

18. In the result, the appeal of the assessee is hereby allowed.

Order pronounced in the Court on 08/12/2023 at Ahmedabad.

Sd/-
(TR SENTHIL KUMAR)
JUDICIAL MEMBER

Sd/-
(WASEEM AHMED)
ACCOUNTANT MEMBER

(True Copy)

Ahmedabad; Dated 08/12/2023

Manish, Sr. PS