

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

**BEFORE SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER  
AND**

**MS. SUCHITRA KAMBLE, JUDICIAL MEMBER**

ITA No.3367/AHD/2016 & ITA No. 110/SRT/2017

Assessment Year(s):2009-10 & 2010-11

The Assistant Commissioner of Income Tax, Circle-2, Hari Kunj, 2 <sup>nd</sup> Floor, Income Tax Office, Station Road, Bharuch-392001, Gujarat	v.	Heubach Colour Pvt. Ltd, Plot No. 9003-9010, Phase-VI, GIDC Industrial Estate, Ankleshwar- 393002, Gujarat
		<b>PAN:AAACH2578P</b>
(Appellant)		(Respondent)

Assessee by:	Sh. Milin Mehta, AR
Revenue by:	Sh. Atul Pandey, Sr. D.R.
Date of hearing:	18.01.2024
Date of pronouncement:	10.04.2024

**ORDER**

**PER SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER:**

These two appeals, filed by Revenue, arising out of the two separate appellate orders passed by learned Commissioner of Income-Tax (Appeals), Vadodara ( hereinafter called “ the CIT(A)) dated 05.09.2016(Appeal No.CAB/(A)-2/151/16-17) and 07.06.2017(Appeal No. CAB-1/242/2015-16) for the assessment year 2009-10 and 2010-11 respectively , the appeals before ld. CIT(A) has arisen from two separate assessment orders , firstly dated 14.03.2013 for assessment year 2009-10 passed by ld. Assessing Officer(hereinafter called “the AO”) u/s 143(3) of the Income-tax Act, 1961 and secondly dated 31.03.2014 passed by the AO u/s 143(3) for assessment year 2010-11 .

2. The assessee has raised following grounds of appeal in Memo of Appeals filed with Income Tax Appellate Tribunal , for assessment year(s) 2009-10 and 2010-11, respectively:-

### **GROUND OF APPEALS: A.Y. 2009-10**

*“1. On the facts and in the circumstances of the case and in law, the Ld. CIT (Appeals) erred in deleting the disallowance of sales commission of Rs.2,32,04,000/- paid to two Associated Enterprise (AE) being foreign entities without appreciating the fact that the assessee failed to discharge the primary onus placed on it to establish the legitimate requirement for its business and genuineness of the payment by submitting relevant documentary proof.*

*2. On the facts and in the circumstances of the case and in law, the Ld. CIT (Appeals) erred in holding that necessary documentary evidence in the form of sales commission agreement was given by the assessee, which do not narrate the nature of services to be rendered by the two foreign entities so that the AE become entitle for sales commission, as such the business requirement for this payment was not established.*

*3. The appellant craves to add to, amend or alter the above grounds as may be deemed necessary.*

#### **Relief claimed in appeal**

*The order of the CIT(A) on the above issue be set aside and that of the Assessing Officer be restored.”*

### **GROUND OF APPEALS: A.Y. 2010-11**

*“1. Whether the Ld. CIT(A) erred in deleting the addition on account of decrease in value of Closing Stock of Rs. 8,65,735/-of Aluminium Hydorxide by holding that the assessee had correctly valued the same disregarding that the value does not correspond to the value of Opening Stock of Aluminium Hydorxide shown by the assessee.*

*2. Whether the Ld. CIT(A) erred in deleting the addition on account of decrease in value of Finished Stock of Rs. 1,58,28,535- of Bet Blue by holding that the assessee had correctly valued the same disregarding that the value does not correspond to the value of WIP of Beta Blue shown by the assessee.*

*3. Whether the Ld. CIT(A) erred in deleting the addition on account of revaluation of Red Pigment 254 of Rs. 41,94030/-by holding that by showing the overhead rates lower for finished goods, the assessee has shown higher profits, disregarding the fact the value does not correspond to the value of Opening Stock of Red Pigment 254.*

*4. Whether the Ld. CIT(A) erred in deleting the addition on account of revaluation of Red Pigment of Rs. 7,11,994/- by holding that by showing the overhead rates lower for finished goods, the assessee has shown higher profits, disregarding the fact the value does not correspond to the value of Opening Stock of Red Pigment.”*

3. First, we will take up appeal of the Revenue for assessment year 2009-10 in ITA no. 3367/Ahd/2016. The brief facts of the case are that the assessee company filed its return of income on 30.09.2009 declaring total loss of Rs. 89,02,854/-. The return of income was revised by the assessee on 11.08.2010 , declaring loss of Rs. 6,50,27,347/-. The case of the assessee was selected by Revenue for framing scrutiny assessment under CASS. The AO issued notices under 143(2) and 142(1) to the assessee, which was claimed by the AO to have been duly served on the assessee. The assessee company is engaged in manufacturing of pigment and chemicals. The assessee company is a 100% Export Oriented Unit (EOU) having commenced production activity during the previous year 1994-95 (ay:1995-06). The assessee company was having transactions with Associated Enterprise(AE), the case of the assessee was forwarded to TPO, and order under section 92CA(3) of the 1961 Act was passed by TPO on 14.12.2012 approving the transactions at Arm's Length Price with AE. The AO, during the course of assessment proceeding observed that the assessee has paid sales commission to two parties i.e. Heubach GMBH and Darlington Enterprises Ltd. The AO observed that the Heubach GMBH is an Associated Enterprise, and both the parties are foreign parties. The AO observed that in the case of AE, sale commission is an easy instrument to transfer tax liability from the AE situated in a country where tax rates are higher to another AE which is situated in a country where tax rates are favorable. The AO observed that the sales

commission can be easily shown as an expense without actual rendering of any services by the concerned party and in the case sales commission paid to foreign party, it is difficult to verify the same through third party enquiry under section 133(6). The AO asked the assessee to submit documentary evidences to prove the services being actually rendered in lieu of sales commissions payment and benefit derived from it by the assessee. In response, the assessee provided the copy of agreement with both the parties Heubach GMBH and Darlington Enterprises Ltd and vouchers. The AO observed that the agreement gave only terms and conditions under which the sales commission will be paid to those parties, But the assessee had failed to provide any documentary evidence to prove the services rendered in lieu of which sales commission was paid. The AO observed that onus to prove that services were infact rendered rests wholly on the part of the assessee which was not discharged. Therefore, the AO disallowed an amount of Rs. 2,32,04,000/- paid by the assessee towards sales commission and added back the same to the income of the assessee, vide assessment order dated 14.03.2013 passed by the AO u/s 143(3) of the 1961 Act.

3. Aggrieved by the assessment framed by the AO, the assessee filed first appeal with ld. CIT(A). The ld. CIT(A) observed that the assessee has filed copy of agreement and other details to justify the payment of commission before the AO, and the AO has mainly disallowed the same on the ground that there was no evidence to prove the services rendered. The ld. CIT(A) observed that the AO has noticed that the commission was paid to foreign parties namely Heubach GMBH and Darlington Enterprises Limited , and the first party is AE ad such payments to AE are normally made to transfer tax liabilities. The ld. CIT(A) observed that the similar commission was paid even in the earlier years and in the immediately preceding years, the amount of commission paid was Rs. 2,21,21,000/-. There is no material on

the record that commission was disallowed in any of the earlier year. The Id. CIT(A) observed that the AO has disallowed the entire commission even without verifying the details of commission paid. The Id. CIT(A) observed that the assessee has paid commission during the year under consideration to as many as 16 parties and the commission paid to foreign parties mentioned by the AO in the assessment order was Rs. 1,48,14,533/- to Heubach GMBH and Rs. 26,50,823/- to Darlington Enterprises Ltd . The Id. CIT(A) observed that the disallowance of commission paid to other party without any discussion and basis hence the same was deleted by the Id. CIT(A). Thus, the Id. CIT(A) observed that disallowance of commission paid to other parties was totally without any discussion as well as basis and the same was deleted by the Id. CIT(A). With respect to Darlington Enterprises Ltd., the Id. CIT(A) observed that the assessee has entered into an agreement dated 01.04.2004 in which the detailed terms and conditions were recorded as the assessee has filed the details of services rendered , and the parties to whom sales were made and debit note were issued for the commission expenses. The Id. CIT(A) observed that Darlington Enterprises was paid commission since assessment year 2005-06 and in the immediately preceding assessment year, the commission paid was Rs. 1,94,46,030/-. Thus, Id. CIT(A) observed that the Darlington Enterprise was a genuine concern and has rendered services in foreign countries to the assessee. With respect to the commission paid to Heubach GMBH(AE) at Rs.1,48,14,533/-, the Id. CIT(A) observed that the commission was paid as per the terms and condition of the agreement dated 14.06.2007. The Id. CIT(A) observed that other supporting evidences were also furnished by the assessee in this regard. It was also observed by Id. CIT(A) that the payment of commission to Heubach GMBH(AE) was also reflected in the audit report furnished in the Form No.3CEB as per section 92E relating to international transactions. The Id. CIT(A) observed that the TPO has examined this international transaction, and passed an order dated 14.12.2012 under section

92CA(3) of the Act without any adjustment. Thus, the ld. CIT(A) observed that this fact clearly establishes that the payment of commission to above concern were genuine. The ld. CIT(A) further observed that even in subsequent assessment years 2010-11 and 2012-13, the AO has completed the assessment under section 143(3) without making any disallowance of commission in payments. Thus, in view of above, the ld. CIT(A) observed that there was no basis for disallowance of commission , and hence the disallowance of commission as were made by the AO was deleted by ld. CIT(A) vide appellate order dated 05.09.2016.

4. Aggrieved by the appellate order dated 05.09.2016 passed by ld. CIT(A), the Revenue has filed second appeal with ITAT. The ld. DR opened arguments before the Bench, and drew our attention to the assessment order. It was submitted that the commission was paid to foreign parties. It was submitted that the assessee has filed details/submissions before the ld. CIT(A). The assessee also filed additional evidences before ld. CIT(A). No Remand report was called by ld. CIT(A). The ld. DR submitted that there is no details available on record as to the commission paid for the earlier year. He drew attention to the agreement with the parties and which is placed at paper book at page no. 93. The ld. DR relied upon the assessment order of the AO.

4.2 The Ld. Counsel for the assessee submitted that with respect to Heubach GMBH, the transaction was referred by AO to TPO who has not made any adjustment and accepted the international transaction. It was submitted that there is an agreement with Heubach GMBH and they are promoting the sales of the company outside India. The assessee does not have any establishment outside India. With respect to Darlington Enterprise Limited, the ld. Counsel for the assessee submitted that it is non AE and it was allowed in the preceding year as well as subsequent year.

5. We have considered rival contentions and perused the material on record. We have observed that the assessee is in the business of manufacturing of Chemicals. The assessee has achieved turnover of Rs. 224.27 crores., out of which FOB value of Exports are to the tune of Rs. 192.55 crores (Refer PB/page 23 and 26-audited financial statements) . The assessee has paid total commission on sales to the tune of Rs. 2.32 crores(PB/page 20), which translates into total sales commissions paid being around 1% of the sales. In the immediately preceding year also, the assessee paid sales commission to the tune of Rs. 2.21 crores on the total sales of Rs. 187.43 crores. The AO has disallowed sales commissions to the tune of Rs.2,32,04,000/- on the grounds that the sale commission was paid to two foreign parties namely Heubach GMBH and Darlington Enterprises Limited. It is admitted position that the assessee vide reply dated 11.02.2013 has provided before the AO the copy of agreement with both the afore-stated parties and the vouchers. We have gone through the reply dated 11.02.2013 furnished by the assessee before the AO which is placed in paper book at page 91-136. The AO vide questionnaire dated 06.07.2011 had asked the assessee vide question number 11 to submit details of sales commissions paid by the assessee to the tune of Rs. 2,32,04,000/-. While submitting the details before the AO, the assessee did forward the copies of agreements with Heubach GMBH and Darlington Enterprises Limited as well other documents such as some of the invoices raised by these two parties. But, however, the assessee never furnished before the AO complete details of the sales commission paid by the assessee, as the sale commissions paid to Heubach GMBH and Darlington Enterprises Limited were in aggregate Rs. 1,74,64,837/- as against total sales commission of Rs. 2,32,04,000/- paid by the assessee. Thus, the assessee never furnished the details before the AO w.r.t. sales commission to the tune of Rs. 57,39,163/- which also included sales commission to both domestic parties as well foreign parties namely Heucotech Limited, Edward Kellar(Philippines) Inc. ,

Diethelm & Co.(SE Asia) Limited , Fuji Kasei Trading Corporation etc.. The AO mistook the entire commission of Rs. 2,32,04,000/- as being paid to the afore-stated two foreign parties. Thus, the sales commission to the tune of Rs. 57,39,163/- was never verified by the AO as the assessee never submitted complete details of sales commission , despite being called upon by the AO to explain the same. The Id. CIT(A) gave relief on account of sales commission to the tune of Rs. 57,39,163/- without calling remand report from the AO, as additional evidences were filed by the assessee w.r.t. the aforesaid sales commission paid by the assessee which were not forwarded by Id. CIT(A) to the AO for comments/remand report. Thus, there is a breach of Rule 46A of the Income-tax Rules, 1962, and the matter needs to be restored back to Id CIT(A) for adjudicating again sales commission to the tune of Rs. 57,39,163/- . Rule 46A is not an empty formality. Thus, ground of appeal raised by Revenue so far as allowability of sales commission to the tune of Rs. 57,39,163/- by Id. CIT(A) which was earlier disallowed by the AO, is allowed for statistical purposes

5.2 So far as sales commission to the tune of Rs. 1,48,14,014/- paid by the assessee to the foreign entity Heubach GMBH is concerned, the said party is Associated Enterprise of the assessee. The AO referred the matter to TPO for transfer pricing report, and TPO accepted the international transaction of payment of sales commission paid by the assessee to Heubach GMBH, and transfer pricing adjustment made by TPO was Nil. The AO has commented that the assessee has not provided the documentary evidences to prove the services rendered. We have gone through the documentary evidences filed by the assessee before the AO which are placed in the paper book, and we have observed that the assessee has duly provided the copy of the agreement between the assessee and Heubach GMBH as well some of the debit notes raised by the said party. These debit notes clearly demonstrate the sales

effected through Heubach GMBH and the sales commission charged by Heubach GMBH. The AO never asked /show caused the assessee to produce any further documents to prove rendering of services , nor found any defect in these debit notes dehors the books of accounts and other records maintained by the assessee. The assessee has discharged its primary burden by placing all relevant documents, and it was for the AO to have made further necessary enquiries/investigations such as issuing summons to the Directors/sales manager etc. of the assessee to record their statement but the AO did not made any further enquiries. The books of accounts were also not rejected by the AO, and also no specific defect is pointed out by the AO except that the assessee failed to provide documentary evidence to prove rendering of services. The AO is both the investigator as well adjudicator. Thus, in view of the above, we are of the considered view that the assessee has discharged its onus and now it was for the Revenue to have brought on record cogent material to disallow the sales commission paid by the assessee to its AE Heubach GMBH , which department failed to do so Thus, ground of appeal raised by Revenue so far as allowability of sales commission paid to Heubach GMBH by Id. CIT(A) which was earlier disallowed by the AO, is dismissed as we donot find any defect in the appellate order passed by Id. CIT(A) on this issue. We order accordingly..

5.3 With respect to sales commission paid to Darlington Enterprises, the AO has commented that the assessee has not provided the documentary evidences to prove the services rendered. We have gone through the documentary evidences filed by the assessee before the AO which are placed in the paper book, and we have observed that the assessee has duly provided the copy of the agreement between the assessee and Darlington Enterprises as well some of the debit notes raised by the said party. These debit notes clearly demonstrate the sales effected through Darlington Enterprises Limited and the sales commission charged by Darlington

Enterprises Limited. The AO never asked /show caused the assessee to produce any further documents to prove rendering of services , nor found any defect in these debit notes dehors the books of accounts and other records maintained by the assessee. The assessee has discharged its primary burden by placing all relevant documents, and it was for the AO to have made further necessary enquiries/investigations such as issuing summons to the Directors/sales manager etc. of the assessee to record their statement but the AO did not made any further enquiries. The books of accounts were also not rejected by the AO, and also no specific defect is pointed out by the AO except that the assessee failed to provide documentary evidence to prove rendering of services. The AO is both the investigator as well adjudicator. Thus, in view of the above, we are of the considered view that the assessee has discharged its onus and now it was for the Revenue to have brought on record cogent material to disallow the sales commission paid by the assessee to Darlington Enterprises Limited, which department failed to do so Thus, ground of appeal raised by Revenue so far as allowability of sales commission paid to Darlington Enterprises Limited by Id. CIT(A) which was earlier disallowed by the AO, is dismissed as we donot find any defect in the appellate order passed by Id. CIT(A) on this issue. We order accordingly.

6. Thus, in nut-shell the appeal of the Revenue for assessment year 2009-10 is partly allowed for statistical purposes. We order accordingly.

**Now , we will take up appeal of the Revenue for assessment year 2010-11 in ITA No. 110/SRT/2017**

7. The assessee company has e-filed return of income for A.Y. 2010-11 on 27.09.2010 , declaring total income at Rs. Nil after adjusting brought forward unabsorbed depreciation. The same was processed by Revenue under Section

143(1). The case was selected by Revenue for framing scrutiny assessment. Notice under section 143(2) and 142(1) were issued by AO to the assessee, and were claimed by AO to have been duly served on the assessee. The AO observed that the assessee is engaged in the business of manufacturing of Chemicals. The AO also observed that the Gross Profit during the year declared by the assessee was 20.43% as against in the preceding year , GP rate of 31.18% and there has been a fall in the Gross Profit Ratio.

6.2 The AO observed during the course of scrutiny assessment proceedings on perusal of the quantitative details in respect of Production, Stocks and Turnover given in Notes to Financial Statement at Note no. 7.b to Schedule 21 of the Audit Report that the closing stock of **Aluminum Hydroxide** was lower than the opening stock. The AO asked the assessee to explain the same as under:-

*"On perusal of the Quantitative details in respect of "production, Stocks & Turnover" given in Notes to Financial Statement at Note no. 7.b to Schedule 21 of the Audit Report, the figures of Aluminum Hydroxide, have been incorporated as under, from which value per kg has been worked out:*

<i>Aluminum Hydroxide</i>	<i>Quantity in Kgs</i>	<i>Value</i>	<i>Value per Kg</i>
<i>i. Opening Stock</i>	<i>25286</i>	<i>1429</i>	<i>56.51</i>
<i>ii. Sales</i>	<i>1244486</i>	<i>76111</i>	<i>61.16</i>
<i>iii. Closing Stock</i>	<i>152150</i>	<i>7733</i>	<i>50.82</i>

*As such it is seen that the average value per Kg of closing stock of Aluminum Hydroxide is Rs.50.82 per kg, which is observed to be lower than the opening stock which is Rs.56.51 per kg. While the average value of Sales which is worked out at Rs.61.16 per Kg. As such you are requested to explain as to why the value of the closing stock of Aluminum Hydroxide be not adopted at minimum of opening value of stock at Rs.56.51 and accordingly [152150 X 5.69 1.E (56.51-50.82) Rs.8,65,735/-] an addition of Rs.8,65,735/- be not paid on account of undervaluation of closing stock of "Aluminum Hydroxide."*

6.3 In response to SCN issued by the AO, the assessee submitted before the AO as under:-

*"4. Vide Para No.8 your office has mentioned that the average value per KG of closing stock of finished goods of Aluminum Hydroxide ("ATH") is Rs.50.82 which is lower than the value of Rs.56.51 per kgs of opening stock. Your office has therefore asked us to explain as to why the value of closing stock of ATH should not be taken at Rs.56.51 and accordingly why an addition of Rs.8,65,735/- be not made on account of undervaluation of closing stock of ATH.*

*5. In respect of the same, we submit that the Assessee regularly follows Accounting Standards-2 (AS-2) for valuation of inventories as notified under the Companies Act, 1956. As per AS-2, inventories are required to be valued at cost or net realizable value (NRV) whichever is lower. Further as per Para No.16 of the AS-2, the cost of inventories is to be ascertained on FIFO basis or weighted average method by taking into consideration all cost of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and conditions.*

*6. Here we invite your kind attention Note No.1 (b) of Schedule 21 to the audited annual account wherein such method of accounting for valuation of inventories has been prescribed. As stated therein the cost of work in progress and finished goods is valued at Material cost plus appropriate share of labour, manufacturing and other overhead. The cost of material is valued on weighted average method. For your ready reference detailed valuation of opening stock and closing stock of ATH and its net realizable value is enclosed as Annexure-2 along with necessary supporting evidences. Based on such information, the average cost of production of ATH as on 31.03.2010 is arrived at Rs.60.62 per kgs. The NRV (being average sales value of ATH for the month of March 2010) is computed to Rs.50.82 per kgs.*

*7. Based on the above working your office may kindly note that the average cost of production of closing stock comes to Rs.60.62 which is higher than the average cost of opening stock of ATH of Rs.56.51 per kgs. Since ATH is required to be valued at lower of cost or NRV as per AS-2, the Assessee has valued such product at Rs.50.82 per kgs. Based on the same we submit that the Assessee has correctly valued the closing stock of such product by following the prescribed accounting standard on year to year basis. Further, the valuation in respect of the above has been accepted in past years also. Your office may further note that ATH is not the major product but a product manufactured from various by-products generated from Green and Blue Plants. Hence the selling price of such products is always lower than its cost. Your office may note that the opening value of such stock is also valued at NRV which was less than its cost. We therefore request your office not to make any adjustment for valuation of closing stock of Aluminum Hydroxide.*

*8. Your office may further appreciate that the books of account of the Assessee has been audited under the Companies Act, 1956 as well as under the Act. The Auditor in his Auditor's Report has also accepted the valuation of inventories done as per AS-2, by stating the annual accounts comply with the accounting standards referred under the Companies Act, 1956. We therefore submit that no adjustment can be made in valuation of closing stock as explained in the above Para since the valuation is done us per applicable accounting standard. In case your office requires any further information or documents, we shall be pleased to submit the same on hearing from your kind office to do so."*

6.4 The AO rejected the contention of the assessee , by holding as under:-

*"5.33 It is pertinent to note that the assessee is basically harping on pushing its claim to be right more so that the accounts of the Assessee has been audited under the Companies Act, 1956 as well as under the Act, and that the Auditor in his Auditor's Report has also accepted the valuation of inventories done as per AS-2, by stating that the annual accounts comply with the accounting standards referred under the Companies Act, 1956.*

*5.34 However on perusal of Annexure-2, it is seen that the sale bill dated 27/03/2010 to M/s. Pharma Care is at Rs.62.00 Per Kg, while on the immediately following date i.e bill dated. 28/3/2011 to M/s. Zacfa Chemicals, the sale is at Rs.30/- per Kg. in less than half the price. Further in the Bill dtd 28/03/2010 the narration of the goods is "Dried Aluminum Hydroxide Gel IP where as goods sold on 27/03/2010 at less than half the price is with the narration" Aluminum Hydroxide Technical".*

*5.35 The above observation clearly indicate that the goods which has been sold on two immediate dates with a difference of selling price of more than 100%, clearly indicate that the goods sold at half the price is definitely a waste or of poor/inferior in quality. Accordingly same being considered for deriving the NRV, is definitely erroneous.*

*5.36 Secondly on perusal Annexure-2, the Raw Material Cost, Packing Material and overheads figures have been adopted at Rs.26.82/- Rs.0.94/- and Rs.32.86/- per unit respectively. However the assessee was categorically asked to furnish the working of the same, which it has failed to do so.*

*5.37 It is to be understood, principle of accountancy revolves around one aspect and that is to give a true income of the business. Assessee has an option to adopt either FIFO method of WAM (Weighted average method), but the same should be such, which should not distort the real income of the business. As such*

*while taking the average of the cost of Raw Material for the month of March, if there are purchases made whose price as compared to other purchases made in the same month are not normal, and likely to create distorted results, the same should have been excluded while working out the average cost of purchases. It is in fact on account of having strictly and blindly following a methodology without analyzing the anomalies that is being created, has resulted in such a distorted result.*

*5.38 In view of the above observation, it is amply clear that the assessee has failed miserably in bringing out facts and figures in support of its claim of valuation of closing stock of Aluminum Hydroxide. Accordingly as pointed out in the show cause notice an amount of Rs.8,65,735/- is added to total income being undervaluation of same. Penalty proceedings u/s. 271(1)(c) are separately initiated for concealment of income and for furnishing of inaccurate particulars.”*

#### **Undervaluation of finished stock of Beta Blue:**

7. The AO asked assessee to furnish inventory of Opening stock of Finished goods, WIP, Raw Material & Packing material as well as closing stock inventory of Finished goods WIP, Raw Material & Packing material and Packing Material and it was observed by the AO that finished stock of **Beta Blue 15.3** has been valued at Rs. 245.70 PER KG less as compared to opening WIP of Blue-15.3 which has been valued at Rs. 2069.58. The AO issued SCN to the assessee to explain the same as under:-

*“As regards list of 2291.11 lakhs, 60750 Kg of Beta Blue-15.3 has been valued at Rs.167.85 laks which works out to Rs.276.30 per Kg. However the Finished stock of Beta Blue-15.3 has been valued at Rs.245.70 PER KG (622629 Kg valued at Rs, 1529.78 lakhs), whereas opening WIP of Blue-15.3 has been valued at Rs.2069.58.*

*Please explain why the value of Finished stock of Beta Blue be not adopted at Rs.276.30 per Kg (minimum) (though the overheads expenses in regards to WIP is generally adopted at half of that adopted for Finished stock), and an amount of Rs. 1,90,52,447/-[(276.30 - 245.70 ) X 622629] be not added to total income.”*

7.2 The assessee submitted its reply to SCN issued by the AO, as under:-

*“11. Vide Para No. 10 (ii) your office has noted that the closing WIP of Beta Blue-15.30 is valued at 276.30 per kg whereas the finished stock of Beta Blue-15.30 is valued at Rs.245.70 per kgs. Your office has therefore stated that the value of finished stock of the same products cannot be lower than the value of closing WIP of the same product. Your office has therefore proposed to make addition of Rs.1,90,52,447/- [(276.30-245.70) x 622629 qty]. In respect of the same we submit that your office has not computed the average value of closing WIP correctly. The correct average value of such WIP comes to Rs.258.39 per kgs. Your office has considered only one product viz. Beta Blue 15.WB-Dried Powder and not the other 3 types of Beta Blue 15.30. Further the average value of closing stock of finished goods is Rs.233.66 per kgs and not Rs.245.70 per kgs The detail of the same along with working average cost of Rs.258.39 & 233.66 is given vide Annexure-5. Based upon such working your office may note that the valuation of WIP is carried out at higher value as compared to the finished goods value. This is on account of reason that while computing RMC cost [for inclusion in WIP], the Assessee has considered the latest month moving average cost whereas while computing the RMC for inclusion in Finished Goods), the Assessee has considered weighted average cost of entire year. Further your office may appreciate that the qty. of finished stock is 6,40,054/- whereas the total qty. of WIP is 77,496. Since the qty. of finished goods is higher the Assessee has considered the yearly average cost of RMC to correctly compute the value of finished goods as compared to monthly moving average cost to compute the correct value of WIP. We therefore submit that the Assessee has correctly computed the closing stock of WIP and Finished Goods and hence no addition can be made.”*

7.3 The AO rejected the contention of the assessee by holding as under:-

*“5.43 On perusal of the reply, it is seen that the contention of the assessee is firstly there has been error in working of average value of closing stock of WIP, by the undersign. If the contention of the assessee is accepted still by assessee's own contention, the assessee has now claimed to have the correct working according to which the correct average value of WIP is stated to be at Rs.258.39, per Kg while the average value of closing stock of finished stock is Rs.233.66 per kg. However the fact remains that the Finished stock has been valued at lesser price than the WIP, which was the basic query.*

*5.44 The explanation of the assessee company, when perused, it is gathered that the same is on account of the fact that*

1. While computing RMC cost, for inclusion in WIP, the Assessee has considered the latest month moving average cost.

2. while computing the RMC for inclusion in Finished Goods, the Assessee has considered weighted average cost of entire year.

5.45 It is therefore clear from the above that two different method i.e FIFO as well as Weighted Average Method has been adopted, resulting in adopting two different rates of RMC for valuation of WIP and that of Finished stock. The result of the same is that there is an illogical result of the finished stock being valued at a cost lesser than the WIP.

5.46 It is therefore imperative that whatever method adopted by assessee, if the same was adopted in respect of valuation of both WIP and Finished stock, such anomaly would not have arisen.

5.47 Further it is once again pointed out that though assessee was specifically asked to furnish the mathematical working, the same has not been Furnished. However on perusal of Annexure-5, enclosed along with its submission, following observations are made:

1. The Overheads expenses in respect of WIP is shown at Rs.4.06/-, Rs.1.066/-, Rs.4.09/- and Rs.23.40/-. But the same is not included in the average of Rs.258.39/-, now claimed to be correct by the assessee.

2. The overheads expenses determined for WIP and that of Finished stock (77.05/-) varies a lot.

3. There is no working furnished in respect of deriving the Overhead expenses in respect of WIP as well as finished stock, as shown in the chart.

4. It has been stated in reply to the query regarding Aluminum Hydroxide that:

"Your office may note that the opening value of such stock is also valued at NRV which was less than its cost. We therefore request your office not to make any adjustment for valuation of closing stock of Aluminum Hydroxide. "

However the NRV value of finished stock is shown at Rs.282.64 per Kg. in Annexure-5. While the average value stated to be correct is shown at Rs. 258.39/- per Kg.

5. Similarly the deriving of Packing material cost in respect of finished stock at Rs.2.53 has also not been extended.

5.48 In view of the above observations it is amply clear that there is an anomaly in the working of finished stock of Beta Blue, which has not been conclusively explained. The methodology presented in the course of scrutiny, clearly indicate that the same defies common logic of valuation of closing stock of finished stock

*at a lesser rate than that of its WIP. Accordingly the undervaluation of Finished stock of Beta Blue is worked at Rs. 1,58,28,535/- (258.39-233.66 X 640054), and the same is added to total Income. Penalty proceedings u/s.271(1)(c) is being initiated for concealment of income and for furnishing of inaccurate particulars.*

### **Undervaluation of Finished stock of Pigment Red 254**

8.1 The AO during assessment proceedings asked the assessee to furnish inventory of Opening stock of Finished, goods, WIP, Raw Material & Packing Material as well as closing stock of inventory of Finished goods; WIP, Raw Material & Packing material. On perusal of the same, it was observed by the AO that closing stock of inventory of finished stock of Red Pigment 254 has been valued at Rs. 1092.87 per kg less than that of the opening stock of Red Pigment 122, which was valued at Rs. 1273.49 per kg. The AO asked the assessee to explain the same by issuing show cause notice, as under:-

*"Finished stock of Pigment Red 254 consisting of 12292 Kgs has been valued at Rs134.33 lakhs (1092.87/- per Kg) while Pigment Red 122 consisting of 9808 Kgs has been valued at Rs124.90 lakhs (Rs.1273.49 per Kg). However the opening stock of Pigment Red has been valued at Rs1960.00 per Kgs.*

*Please explain why the value of Finished stock of Pigment Red 254 & Pigment Red 122 be not valued at Rs.1960.00 and an amount of Rs.1,73,92,052/-  $\{[(1960- 1092.87) \times 12292 = 1,06,58,762/-] + [(1960-1273.49) \times 9808 = 6733290/-]\}$  be not added to total income."*

8.2 The assessee replied to the show cause notice before the AO, as under:-

*"12. Vide Para No.10(iii) your office has stated that closing stock of finished stock of Red Pigment-254 has been valued at Rs. 1092.87 per kg and Red Pigment-122 has been valued at Rs.1273.49 per kgs Your office has also stated that the opening stock of Red Pigment has been value at Rs.1960.00 per kgs. Your office has therefore proposed to value closing stock of such Red Pigments at Rs.1960 per kgs. In respect of the same we submit that the value of Rs.1,960 per kgs stated by your office is not correct. We most respectfully submit that the average value per kgs of opening stock of Red Pigment-254 is Rs.1434.03 per Kg. and Red Pigment-122 is Rs.674.45 per kgs. For your ready reference the valuation of the same is submitted marked as Annexure-6 along with working of allocation of RMC cost and Overhead. Your office may kindly note that the valuation of closing stock of*

*Red Pigment-122 per kgs is higher as compared to its opening stock. Whereas the valuation of closing stock of Red Pigment-254 has been decreased from Rs. 1434.03 per kgs to Rs. 1092.83 per kgs Here we invite your attention to Annexure-6 wherein your office can observed that the RMC cost included in closing stock of such finished goods is higher as compare to RMC cost included in opening stock. However the allocation of overhead included in closing stock is lower as compared to overhead included in opening stock. This is on account of decrease in fixed overhead absorption rate of fixed overhead due to increase in production of Red production by 28%. During the F.Y.2008-09, the Assessee has produced 536,784 kgs of quantity of Red whereas the production of Red has been increased to 687,295 kgs of quantity of Red in F.Y.2009-10. In view of the same the fixed overhead is allocated over higher production.*

*13. We further submit that your office has not provided any working for calculating the value of Rs.1960 per kgs for opening stock of such pigments. We therefore request your office to provide us the working if any for considering value at Rs.1,960/- to enable the Assessee to file further submission. Without prejudice to the above; we further submit that the Assessee has valued the finished goods as per AS-2 and the valuation in respect of the same is enclosed as Annexure-6 with supporting working. Further the books of account of the Assessee are audited and the Auditor has accepted the valuation of closing stock while giving opinion on true and fair view of the books of accounts. We therefore submit that no adverse view can be taken in respect of valuation of finished goods. However in case your office requires any further clarification or submission on any specific valuation of finished goods we shall be pleased to provide the same on hearing from your kind office to do so."*

### 8.3 The AO rejected the contention of the assessee by holding as under:-

*"5.53 On perusal of the assessee's reply it is seen that according to the assessee, there appears to be mistake in working of value of Red Pigment 122, by the undersign, which according to the assessee, the opening stock of finished goods should be 674.45/- and since the closing stock is worked out at 1092.87 per kg, the same is higher than the opening stock. However by assessee's own working the opening stock of Red Pigment 254, has decreased from Rs.1434.03/- per kg to Rs.1092..83/- per Kg. The reason extended by assessee is that the RMC cost included in closing stock of such finished goods is higher as compare to RMC cost included in opening stock. However the allocation of overhead included in closing stock is lower as compared to overhead included in opening stock. This is on account of decrease in fixed overhead absorption rate of fixed overhead due to increase in production of Red production by 28%. During the F.Y.2008-*

09, the Assessee has produced 536,784 kgs of quantity of Red whereas the production of Red has been increased to 687,295 kgs of quantity of Red in F.Y.2009-10. In view of the same the fixed overhead is allocated over higher production.

5.54 The same is considered however it is not acceptable, since it has been categorically spelt out in the course of scrutiny, that whatever is the contention, the same is required to be backed by documentary evidence as also clear working. It is gathered that the assessee's claim is that the overheads expenses considered in the working of closing stock of Red Pigment 254, is less compared to that of opening stock. However in the working for overheads expenses in respect of Aluminum Hydroxide, in Annexure-2, the overheads expenses considered for closing stock is higher as compared to that of opening stock.

5.55 Hence the claim made is totally baseless and without any supporting evidence. In fact it can be assumed that the assessee has with purpose not extended such evidence, since it is aware that on account of which his contention would not stand the test of appeal. As pointed out the question that assessee needs to reply is that in respect of manufacturing of one item ie Aluminum Hydroxide, overheads expenses considered for closing stock is higher as compared to that of opening stock, than why the same is reverse in regards to this item under consideration. In view of this, the undervaluation of closing stock of Red Pigment 254 is worked out at Rs.41,94,030/- (Rs.1434.03/- - Rs.1092.87/-X 12292)and added to total income. Penalty proceedings u/s.271(1)(c) is being initiated for concealment of income and for furnishing of inaccurate particulars.”

**Undervaluation closing stock of Red Pigment:**

9. The AO observed from Note No. 7.b to Schedule 21 of the Audited Accounts wherein the quantitative and value detail of closing stock of “Red” is given. It was observed that the average value of opening stock of Red is Rs. 715.07 per kgs whereas the same is Rs. 554.60 per kgs for closing stock. The AO issued show cause notice to the assessee asking to explain the same , which is reproduced as under:-

“On perusal of the Quantitative details in respect of "production, Stocks & Turnover", given in Notes to Financial Statement at Note no 7.b to Schedule 21 of the Audit Report, the figures of "Red", have been incorporated as under, from which value per kg has been worked out:

“Red”	Quantity in Kgs	Value	Value per Kg
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i.Opening stock	74956	53599	715.07
ii.Sales	640540	389183	607.58
iii.Closing Stock	121711	67501	554.60

As such it is seen that the average value per Kg of closing stock of "Red" is Rs.554.60 per Kg, which is observed to be lower than the opening stock which is Rs.715.07 per kg. While the average value of Sales which is worked out at Rs.607.58 per Kg. As such you are requested to explain as to why the value of the closing stock of "Red" be not adopted at minimum of opening value of stock at Rs.715.07 and accordingly  $(121711 \times 160.47 \text{ I.E. } (715.07 - 554.60) = \text{Rs. } 1,95,30,964/-)$  an addition of Rs. 1,95,30,964/- be not made on account of undervaluation of closing stock of "Red".

9.2 The assessee replied to the aforesaid show cause notice , by submitting as under:-

"15. Vide Para No.9 your office has invited our kind attention to Note No.7.b to Schedule 21 of the Audited Accounts wherein the quantitative and value detail of closing stock of "Red" is given. Your office has stated that the average value of opening stock of Red is Rs.715.07 per kgs whereas the same is Rs.554.60 per kgs for closing stock. Your office has therefore asked us to show cause as to why the value of closing stock of Red be not adopted at minimum of opening stock at Rs.715.07 per kgs and accordingly why the addition of Rs. 1,95,30,964/- be not made on account of undervaluation of closing stock of Red. In respect of the same we most respectfully submit that there is no undervaluation of closing stock. The data reported in the annual accounts consists of different types of pigments of Red. The opening and closing stock of finished goods of "Red" consists of various types & grades of Red Products. For your ready reference we are submitting the complete break up of opening and closing stock of "Red" marked as Annexure-9. From the said annexure your office can verify that the Red consists of 6 different pigments of Red. The costing of each types of pigment "Red" is different due to consumption of different level of RMC & overheads. The breakup of the same is also given in the said Annexure. The working for valuation of RMC and Overhead along with supporting documents is enclosed as Annexure-10.

10. It would not be correct to compare the average cost of such six products since different products have different pricing components. Your office may kindly note that out of six products, the valuation of closing stock of two products is lower than its opening stock whereas the valuation of closing stock

*of balance four products is higher than its opening value. The major reason for decline in the average value of all the products is on account of valuation of Pigment Red 254 having higher quantity in the total stock of Red Quantity. The said pigment was valued at Rs.1434.03 per kgs as on 31.03.2009 whereas the valuation thereof as on 31.03.2010 is Rs.1092.83 per kgs. This is on account of lower absorption rate for fixed overhead due to increase in production from 50,338 kgs in F.Y.2008-09 to 1,25,294 kgs in F.Y 2009-10. If your office excludes this pigment, the average value of closing stock of Red per kgs would be higher than its opening stock. We therefore request your office to please refer to the detailed valuation of such closing stock given in this submission and not to make any addition by comparing average value of closing stock with average value of opening stock. The Assessee has correctly valued its closing stock as supported with necessary evidences. In case if your office has any further queries on such valuations, we shall be please to clarify the same on hearing from your kind office to do so.*

9.2 The AO rejected the contention of the assessee , by holding as under:-

*“5.63 On perusal of explanation it is gathered that there are in all six types of grades. The Annexure -7, furnished the working of closing stock of each varies of Red Pigment as on 31/03/2010, as also of the preceding year i.e. 31/03/2009. The closing stock of all except three i.e. Red Pigment 254, Red Pigment-2 and Violet has been valued at lesser rate than that of Opening stock. However the undervaluation of closing stock of Red Pigment 254 has already been discussed in para-5.4 above, and addition on that account has been considered. For the reasons as spelt out above in para 5.4, undervaluation of Red-2 Pigment is worked out to Rs.5,38,388/- (Rs.324.75/- Rs.309.20/- X 34623Kg).*

*5.64 Also it is seen that Violet grade of Red pigment had been valued at Rs.1424.58/- per Kg as per NRV, which is lesser than NRV value of the preceding year which was Rs.1538.87/-. It is pertinent to note that in the Anriexure-7, no working of adoption of Raw Material Cost, Packing material cost as also Overhead expenses in respect of this Grade has been furnished. The difference of Rs. 1,73,606/- (Rs.1538.87/- Rs.1424.58/-X 1519 Kg) is also added to the total income As such the total addition works out to Rs.7,11,994/-, Penalty proceedings u/s.271(1)(c) is being initiated for concealment of income and for furnishing of inaccurate particulars.”*

10. Aggrieved by the assessment order framed by the AO for assessment year 2010-11, the assessee filed first appeal and made detailed submissions before Id. CIT(A). The Id. CIT(A) also called for remand report from the AO. The contentions of

the assessee are recorded by Id. CIT(A) at page no. 17 to 26. The Id. CIT(A) called for the remand report. The AO submitted the remand report as under:-

*"2. During the course of appellate proceeding, the AR of the assessee before your honour has filed an application u/s. 46A for admission of additional evidences along with written/submission paper book. Hence, as directed by your honour, the additional evidences/ submissions made by the AR of the assessee before your honour has been verified. In this regard, I submit herewith the desired report as under:*

*2.1. During the course of remand proceedings, an opportunity of being heard has been given to the assessee and in response, the AR of the assessee attended before the undersigned. During the course of remand proceedings, the AR of the assessee has stated that there are no additional evidences for the admission filed before your honour. It is submitted that papers relating to valuation of inventory was filed before the then AO, however, while passing the order the data considered by the then AO were erroneous or wrongly considered.*

*3. The fact from the record has been verified and have also gone through the submission made by the assessee. There are no changes in the data submitted by the assessee. However, the AO has made additions based on the merits of the case which may please be considered while deciding the appeal."*

10.2 The Id. CIT(A) deleted the entire additions by holding as under:-

*"6.3. I have considered the facts of the case, the submission of the appellant and the AO's observations. The addition of 2,16,00,294/- has been made by the AO by enhancing the value of closing stock of four finished goods being produced by the appellant company. The dispute is regarding the valuation of these closing stocks and there is no dispute so far as quantity of closing stock of raw material, work-in-progress, finished goods, stores and spares etc. are concerned. The AO has made his own working of the value of such finished goods which are part of the closing stock as on 31.03.2010 and accordingly has made additions. In the written submission filed during the appellate proceedings, the appellant's AR has pointed out several discrepancies in the working of the AO and the process adopted by him. This submission was forwarded to the AO for his comments. But as can be seen from the remand report reproduced above, the AO has not made any comment regarding such claims and has relied upon the observations made by him in the assessment order. Now, all the additions are discussed item wise as in following paragraphs:*

*6.4. The addition of ₹ 8,65,735/- on account of under valuation of Aluminum Hydroxide.*

*This addition has been made by the AO by observing that the average value per kg of closing stock was 50.82 per kg which was lower than the value of opening stock of 56.51 per kg. The average value of sales has been worked out by the AO at 61.16 per kg. Accordingly, the AO had show caused the appellant as to why the value of closing stock should not be adopted at the rate of opening value of 56.51 per kg. The appellant claimed before the AO that it was following the methods prescribed by accounting standards for valuation of inventories and has adopted weighted average method for the purposes of ascertaining the cost of material. All the appropriate share of labour, manufacturing and other overhead are added to reach the value of the closing stock. Based on this, the average cost of production of ATH as on 31.03.2010 was arrived at by the appellant at ₹ 60.62 per kg. The net realizable value was determined by the appellant being average sales value of ATH for the month of March, 2010 at 50.82 per kg. and accordingly, this rate was adopted for the valuation of the closing stock being lower of the cost of production and net realizable value. The AO pointed out that the appellant had sold the same products on 27.03.2010 at 62 per kg., while on immediately following date, the material was sold at Rs. 30 per.kg. He has also stated that in the bill dated 28 03.2010 the narration of the goods is "Dried Aluminium Hydroxide Gel IP," where as goods have been sold on 27.03.2010 at less than half the price with the narration "Aluminium Hydroxide Technical". Accordingly, he held that the goods sold at half price is definitely a waste product. Besides, he stated that the raw material cost, packing material cost and over head figures were adopted by the appellant, but, the working of the same were not given. By pointing out these defects, the AO adopted 56.51 per kg. as value of the closing stock and accordingly, made addition of ₹ 8,65,735/-.*

*6.4.1. During the course of the appellate proceedings, the appellant's AR has pointed out the difference between two products of ATH viz., 'Aluminium Hydroxide Technical' and 'Dried Aluminium Hydroxide Gel IP'. It was stated that these are two different grades of the same product the later being suitable for pharma based products and hence is sold at higher rates. Thus, none of the products is a waste material but are sold at different rates. It has also been submitted that vide reply dated 03.01.2014, the appellant had submitted the details of overheads Included in the stock which was checked by the AO during the course of the assessment and subsequent to the submission of the details, the AO did not ask for any further details. As already stated, all these contentions have been examined by the AO during the remand proceedings and no adverse comments had been made by him. Hence, it is held that the appellant had valued the closing stock as per the accounting procedures and proper records for the same has been maintained by it and has also been placed*

*before the AO. It has also been able to explain the difference in sale price of ATH sold via two different invoices. The valuation has been done on the basis of weighted average method which is one of the approved methods of valuation of closing stock. Hence, it is held that the addition made by the AO by increasing the value of closing stock of ATH is not proper and is accordingly, directed to be deleted.*

#### *6.5. Addition of ₹ 1,58,28,535/- on account of revaluation of Beta Blue*

*Again the AO has made addition because of the fact that the average value of work-in-progress was 276.30 per kg whereas, the closing stock of the finished goods had been valued at ₹ 245.70 per kg. The appellant had explained before the AO that while computing the raw material cost for inclusion in WIP, the latest monthly moving average cost was considered, whereas, for RMC for inclusion in finished goods, the weighted average cost of the entire year was considered. It was also stated that the average value of closing WIP was ₹ 258.39 and not 276.30 as stated by the AO in his show cause. The AO has stated that two different methods i.e. FIFO as well as WAM has been adopted for valuation of WIP and that of finished stock which is illogical and same method has to be adopted for valuation of both the products. He also observed that the overhead expenses in respect of WIP had not been included in the average of 258.39. Accordingly, the AO made addition of (₹258.39- Rs. 233.66) i.e. 24.73 per kg. Since, the total quantity of closing stock was 6,40,054 kgs, hence, total addition of ₹ 1,58,28,535/- was made.*

*6.5.1. In the submission made during the appellate proceedings, the appellant has explained that the quantity of WIP was 77,496 kgs., whereas, of the finished stock it was 6,40,054 kgs. Thus, the quantity of finished stock was much higher than the quantity of WIP. Further, it was stated that production cycle of Beta Blue was only 4 days. Thus closing WIP would represent only the stocks of the last batches produced. Accordingly, the appellant has adopted the weighted average cost of raw materials for the last month for the purposes of valuation of closing stock of WIP on account of the reason that the closing WIP of Beta Blue could represent only the monthly purchases which constitutes the major part of closing WIP. Whereas, in case of finished goods, raw material purchased and utilized in the beginning of the year as well as at any time thereafter would form part of such stock and hence, the weighted average method for the entire year was considered. The appellant has claimed that as per Para 17 of the Accounting Standard-2, depending upon, the circumstances, the average may be calculated on a periodic basis or as each additional shipment is received. The appellant has claimed that the method adopted by it has provided the fairest possible approximation to the cost Incurred in bringing the item to its present location and condition. Besides, It has also been stated that the value of ₹ 258.39 already Includes the overheads. Further, since, WIP is not the finished*

*products, hence, only a part of the overhead expenses have been included in WIP. It was also claimed that working of overheads was also submitted to AO vide submission dated 03.01.2014. Lastly, the appellant has claimed that the net realizable value of finished goods cannot be compared with the value of WIP since in case of Beta Blue, the net realizable value is 282.64 while the cost is ₹ 233.66. Hence, the lower of the two values i.e. 233.66 have been considered for valuing the closing stock. As already stated, the AO has not made any further comment on these arguments in the remand report.*

*6.5.2. The submissions made by the appellant during the appellate proceedings are acceptable. The appellant is following weighted average method for both the finished goods as well as work-in-progress. The finished goods have been rightly valued by taking weighted average of entire year where as the work-in-progress has been rightly valued by taking weighted average of the last month on account of the fact that it constituted of the raw materials acquired at the end of the year. Moreover, if the appellant had adopted weighted average method for the entire year for purpose of valuation of WIP also, then the cost of production of WIP could have been lower than 258.39 and would have been in the vicinity of cost of production of finished goods adopted at 233.66. Under such circumstances, the value of closing stock would have been lower than what has been disclosed by the appellant resulting into lower profit for the year under consideration. Hence, the AO's observations are not acceptable and it is held that the appellant has valued the closing stock by correctly following the method prescribed by the Accounting Standard AS2. Hence, this addition is also directed to be deleted.*

*6.6 The additions of 41,94,030/- on account of revaluation of Red Pigment 254 and of 7,11,994/- on account of revaluation of Red Pigment.*

*The basis for addition in the case of Red Pigment 254 is the same as ATH. The AO has stated that the valuation of opening stock is at the rate of 1,434.03 per kg, whereas, that of closing stock is of ₹1092.87 per kg. The appellant has submitted that the raw material cost included in closing stock of finished goods is higher as compared to RMC cost included in opening stock. Further, the allocation of overhead included in closing stock is lower as compared to overhead included in opening stock on account of higher production of this product during FY 2009-10 as compared to FY 2008-09. Besides, the figures of overhead expenditure have been accepted by the AO. The appellant has also contended that ATH and Red Pigment being two different products, and manufactured through totally different process, hence, overhead rates of both cannot be compared. The appellant's submissions are acceptable. In the remand report also nothing has been stated against the same. Moreover, by allocating the overhead expenses at lower rate to the manufactured goods, the*

*appellant has shown lower cost of finished goods sold during this year and hence, has shown higher profit also. Hence, just because the unit rate of closing, stock is lower than that of opening stock, the addition as made by the AO cannot be made. Hence, this addition is directed to be deleted.*

*6.6.1. So far as revaluation of Red Pigment is concerned, again, the AO has made the addition by stating that the average value of opening stock is higher than the closing stock. The appellant had submitted before the AO that opening and closing stock of finished goods of Red Pigment consists of various types of RED products. A complete break up was provided to show that the RED consist of different pigments of RED and costing of different type is different due to consumption of different level of RMC and overheads. This break up was also provided to the AO. But, the explanations have not been accepted by the AO by stating that the valuation of closing stock is lower than the opening stock. Since, the appellant has maintained complete records of stock and has provided the valuation of the closing stock as per the accounting standards, hence, the addition made by the AO is only based upon the fact that the rate of valuation of closing stock is lower than that of opening stock, cannot be upheld. Hence, this addition is also directed to be deleted including the disallowance of 1,73,606/- on account of lower value of net realizable value of violet grade of Red Pigment as compared to the earlier year.*

*6.6.2. Thus, the entire addition made by the AO by revaluing the closing stock is directed to be deleted.”*

11. Now, it is a turn of Revenue to be aggrieved by the decision of Id. CIT(A) and Revenue has filed an appeal with Tribunal. The Id. DR submitted that it is the valuation of stock which is a matter of dispute between the assessee and the Revenue. He drew our attention to the assessment order of the AO. The Id. DR would reply on the assessment order passed by the AO.

11.2. The Id. counsel for the assessee drew our attention to the appellate order passed by Id. CIT(A) and submitted that the assessee has consistently followed FIFO method by applying Weighted average method. He drew our attention to para 5.44 and 5.45 of the AO , and submitted that no additions are warranted. The Id. Counsel for the assessee relied upon the appellate order passed by Id. CIT(A).

12. We have considered rival contentions and perused the material on record. The whole controversy in this appeal filed by Revenue revolves around the valuation of closing stock of inventories as at the year end i.e. work in progress and finished stocks, with respect to methodology adopted by the assessee while valuing such closing stock. The assessee is engaged in manufacturing of chemicals. The assessee produces different grades of chemicals, which have different uses keeping in view technicalities and composition. The assessee has claimed to have followed Accounting Standard 2 prescribed by ICAI while valuing inventories, and it is claimed that the assessee has adopted FIFO method by applying weighted average cost. It is claimed that the same method is adopted consistently over the years, and the revenue has accepted the same. While valuing the Work-in-progress, monthly weighted average cost is applied, and while valuing finished goods, annual weighted average cost is applied. The AO has observed that the assessee has undervalued its stock as at year end both the finished goods as well as WIP which resulted in under-reporting of profits/income by the assessee. The assessee has explained that since there was an increase in production as compared to the preceding year, the fixed overhead got spread over higher production during the year which led to the lower valuation of WIP as well as finished goods at the year end. The assessee also gave an explanation that the products of different grades of the same chemical have utility in different industries and the price varies from product to product and grade to grade. The assessee gave an explanation before the AO as well as the Id. CIT(A). Even, the Id. CIT(A) called for the remand report from the AO. The Id. CIT(A) in its orders has rightly decided these issues in favour of the assessee, with which we concur. So far so good, however, we have observed that the assessee has applied weighted average cost method of the yearly costs while valuing finished stock, and weighted average cost method of monthly costs while valuing WIP. The assessee has itself stated that WIP is of 4 days, while we have observed that finished goods are held for different

products varies from 1-3 months. AS-2 clearly stipulates that formula used in determining the cost of an item of inventory needs to be selected with a view to providing the fairest possible approximation to the cost incurred in bringing the item to its present location and condition. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the enterprise. Thus, in view of prescription by AS-2, it requires to be determined the fairest possible approximation to the cost incurred in bringing the items to its present location and condition. The assessee need to explain this aspect of reasons for adopting yearly costs while valuing finished goods and adopting monthly costs while valuing WIP, and we are of the considered view that the assessee be given one more opportunity to justify before the AO reasons for adopting weighted average cost method of the yearly costs while valuing finished stock, and weighted average cost method of monthly costs while valuing WIP. The claim of the assessee that the assessee has consistently followed the same method while valuing inventory over the years and the same was accepted by Revenue also need verification. Thus, to this limited extent, we are setting aside the matter back to the file of the AO for adjudication afresh , after giving opportunity to the assessee. We order accordingly.

13. In the result, the appeal of the Revenue for assessment year 2010-11 is partly allowed for statistical purposes as indicated above.

*ITA No.3367/Ahd/2016  
AY:2009-10  
ITA No. 110/SRT/2017  
AY:2010-11  
Heubach Colour Private  
Limited*

14. In the result, both the appeals filed by Revenue for assessment year(s) 2009-10 and 2010-11 are partly allowed for statistical purposes as indicated above

Order pronounced on 10/04/2024 in Open Court at Ahmedabad, Gujarat

*Sd/-*

**[SUCHITRA KAMBLE]  
JUDICIAL MEMBER**

DATED: 10/04/2024

Sh

Copy forwarded to:

1. Appellant –
2. Respondent –
3. CIT DR , ITAT,
4. CIT,
5. The CIT(A)

*Sd/-*

**[RAMIT KOCHAR]  
ACCOUNTANT MEMBER**