

आयकर अपीलीय अधिकरण, 'बी' न्यायपीठ, चेन्नई
**IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH, CHENNAI**

श्री जॉर्ज जॉर्ज के, उपाध्यक्ष एवं श्री एस.आर.रघुनाथा, लेखा सदस्य के समक्ष
**BEFORE SHRI GEORGE GEORGE K, VICE PRESIDENT AND
SHRI S.R. RAGHUNATHA, ACCOUNTANT MEMBER**

आयकर अपील सं./ITA No.:1617/Chny/2025

निर्धारण वर्ष / Assessment Year: 2015-16

Abdulrahman Liyakathali, No.30/3, Bhavani Main Road, B.P.Agraharam, Erode – 638 005.	vs.	ACIT, Circle-1, Erode.
[PAN: ABAPL-5028-J] (अपीलार्थी/Appellant)		(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by : Shri. N. Arjun Raj, Advocate

प्रत्यर्थी की ओर से/Respondent by : Ms. Gouthami Manivasagam, J.C.I.T.

सुनवाई की तारीख/Date of Hearing : 01.09.2025

घोषणा की तारीख/Date of Pronouncement : 25.11.2025

आदेश / O R D E R

PER S. R. RAGHUNATHA, AM :

The present appeal of the assessee is directed against the order dated 16.05.2025 of the Learned Commissioner of Income Tax (Appeals), National Faceless Appeal Centre, Delhi [hereinafter referred to as the "Ld.CIT(A)"], which in turn arises out of the assessment order dated 27.12.2017 passed u/s.143(3) of the Income-tax Act, 1961 [hereinafter referred to as "the Act"] by the Assistant Commissioner of Income Tax, Circle-1, Erode [hereinafter referred to as the "AO"], pertaining to the Assessment Year [in short "AY"] 2015-16.

2. The brief facts of the case, as emanating from the record, are that the assessee is an individual carrying on business as a sole proprietor under the

name and style of M/s.Lead Leathers, engaged in the trade of hides/wet blue leather. For the A.Y.2015-16, the assessee filed the return of income on 24.09.2016 declaring a total income of Rs.25,39,504/-. The case was selected for limited scrutiny assessment to verify the following specific issues: -

- i. Large business loss set off against other heads of income*
- ii. Large amount not credited to Profit and Loss account as per schedule A-OI of return*
- iii. Large deduction claimed under section 54B/54C/54D/54G (schedule CG of ITR)*

3. Pursuant thereto, the AO issued notice u/s.143(2) of the Act on 04.07.2017, followed by subsequent notices issued u/s.142(1) of the Act calling for various details.

4. During the assessment proceedings, the AO observed that the assessee had declared a business loss of Rs.1,00,63,869/-. The AO further noted that the opening stock of hides/wet blue as on 01.04.2014 was valued at Rs.1,650/- per unit, whereas the purchases during the relevant previous year were made at a rate higher than the value assigned to the opening stock. However, the closing stock was valued at Rs.300/- per unit. The opening stock and closing stock quantities stood at 25,537 units and 10,464 units, respectively.

5. On verification of sales records, the AO noticed that 2,521 units were sold to M/s.Hope Leather on 29.04.2014 as per the sale invoices. However, the corresponding outflow recorded in the stock register reflected 2,921 units, resulting in a discrepancy of 400 units. In the opinion of the AO, such discrepancy either represents unaccounted sales or undervaluation of closing stock.

6. Further, on examination of transactions with related concerns, the AO observed that sales to such parties were made at a discounted price compared to prevailing rates. Based on the above findings, the AO concluded that the books of account did not present a true and correct picture of the assessee's

business affairs. Accordingly, the AO proposed to reject the books of account and estimate the business income.

7. The assessee objected to the proposal of the AO and submitted that the loss declared from business operations resulted from valuation of closing stock on the basis of net realizable value. It was contended that the assessee has consistently been following the method of valuation of closing stock at the lower of cost or net realizable value in compliance with the provisions of section 145A(a)(i) of the Act.

8. The assessee further submitted before the AO that the business was in the process of closure and, consequently, the finished leather had lost its marketability on account of fungal deterioration. It was stated that approximately 40% of the opening stock remained unsold and continued as closing stock. The assessee explained that during the period under consideration, saleable stock was disposed of at prevailing market prices, while damaged stock was sold at reduced rates, and the balance was valued at its net realizable value in accordance with accounting principles.

9. With regard to the discrepancy arising from excess recording of 400 units in the stock register, the assessee submitted that the same occurred due to a clerical error. In view thereof, the assessee agreed to an addition of Rs.5,20,800/- towards undervaluation of closing stock.

10. It was further contended that, considering the closure of business, valuation of closing stock at net realizable value was justified, as taxation cannot be levied on unrealized income. The assessee, therefore, submitted that the proposed adjustment by the Assessing Officer was not warranted.

11. The AO, however, was not satisfied with the explanation furnished by the assessee. The AO observed that although the assessee claims to maintain regular books of account, such books do not present a true and correct picture

of the financial affairs of the business, particularly in view of the assessee's own admission of undervaluation of closing stock to the extent of 400 units valued at Rs.5,20,800/-. The AO further noted that the assessee failed to substantiate, with any cogent evidence, the basis for valuation of closing stock at a rate substantially lower than the corresponding purchase price.

12. The AO additionally recorded that sales made to related parties were effected at prices below prevailing market rates without any justification or documentary support. It was further observed that the assessee, unlike in earlier years where profits were declared, returned a substantial business loss in the year under consideration. In the opinion of the AO, the loss declared appeared to be intentional and aimed at setting off capital gains.

13. The AO also held that no prudent businessman would retain perishable goods for an extended duration. According to the AO, since the goods involved undergo processing to enhance durability, the possibility of such goods deteriorating in quality to the extent claimed is negated.

14. On the cumulative strength of the above observations, the AO rejected the books of account of the assessee and concluded that the correct profits could not be deduced therefrom. The AO thereafter proceeded to estimate the income by applying the average net profit rate of 5.48%, based on the preceding three assessment years, thereby determining the business income for the year at Rs.29,60,398/-. Consequently, the AO made an addition of Rs.29,60,398/- to the returned income by disregarding the business loss declared by the assessee. Apart, the AO has also made other additions which are not a subject matter of dispute before us. Thus, the assessment of the assessee was completed u/s.143(3) of the Act vide order dated 27.12.2017, assessing the total income at Rs.1,59,02,862/-.

15. Aggrieved by the assessment order wherein the AO determined the business income of the assessee at Rs.29,60,398/- on the basis of estimation,

the assessee preferred an appeal before the Ld.CIT(A) challenging the said determination.

16. During the course of appellate proceedings before the Ld.CIT(A), the assessee submitted that the AO had erred in determining the business income on an estimated basis, without duly considering the business loss declared by the assessee and without proper appreciation of the documentary evidence furnished during the assessment proceedings. It was contended that the business loss arose on account of revaluation of closing stock, which was adversely affected due to fungal infestation, resulting in deterioration and reduction in the realizable value thereof. The assessee further submitted that such treatment was in conformity with the Accounting Standard-2 relating to valuation of inventories and was also in accordance with the provisions of section 145A(i) of the Act. The assessee therefore argued that the rejection of books of account by the AO and consequent estimation of income was unjustified and contrary to law.

17. The Ld.CIT(A) vide the impugned order dated 16.05.2025, upheld the action of the AO in rejecting the books of account and in estimating the business income, and accordingly dismissed the appeal of the assessee. Being aggrieved by the aforesaid findings, the assessee has preferred the present appeal before this Tribunal.

18. The Ld.AR appearing on behalf of the assessee submitted that the assessee's books of account were duly audited u/s.44AB of the Act, and no specific discrepancies or defects have been identified by the AO during the assessment proceedings, despite the assessee furnishing complete details as called for. It was contended that the loss declared by the assessee for the relevant assessment year represents a genuine business loss and is not a notional or artificial loss as alleged by the AO. The Ld.AR argued that the AO has erred in concluding that the assessee intentionally created an artificial business loss to set off capital gains. It was further submitted that the closing

stock consisting of hides/wet blues was affected by fungal infection which resulted in deterioration of quality and reduction in market value, and therefore, the assessee valued such stock at its net realizable value in accordance with the regularly followed and accepted method of accounting. The Ld.AR submitted that despite adherence to accounting principles, the AO has rejected the books of account without establishing any defect and estimated the business income arbitrarily, which action has been erroneously upheld by the Ld.CIT(A).

19. In view of the above, the Ld.AR prayed that the impugned order of the Ld.CIT(A) sustaining the rejection of books and estimation of income be set aside and the appeal of the assessee be allowed.

20. Per contra, the Id.DR, appearing on behalf of the Revenue, submitted that the Ld.CIT(A) has correctly affirmed the action of the AO in rejecting the books of account and estimating the business income, as the books maintained by the assessee were found to be incomplete and incorrect. The Ld.DR contended that various discrepancies were noticed in the financial records, including mismatch in stock statements, undervaluation of closing stock, and sales made to related parties at prices lower than market value. It was further submitted that the assessee's abnormal business loss during the impugned assessment year, when compared to the profit declared in preceding years, clearly indicates manipulation of accounts with the intention to artificially inflate loss and set it off against capital gains. The Ld.DR argued that the AO has reasonably and judiciously adopted the profit rate of 5.48% based on the assessee's past financial history and business pattern. In view of these submissions, the Ld.DR prayed that the appeal filed by the assessee be dismissed and the order of the Ld.CIT(A) confirming the assessment be upheld.

21. We have heard the rival contentions, perused the material on record and accordingly the impugned issue is adjudicated as under.

22. We observe that the assessee is engaged in the business of trading in hides/wet blues and had filed the return of income for the year under consideration declaring a business loss of Rs.1,01,97,258/-, which was set off against capital gains earned during the relevant assessment year. During the course of assessment proceedings, the AO observed discrepancies in the stock register, inasmuch as 400 units of hides/wet blues sold by the assessee were not invoiced. Upon being confronted, the assessee accepted the discrepancy and agreed to an addition of Rs.5,20,800/- towards undervaluation. The AO also observed that the closing stock was valued at a rate significantly lower than the value adopted for the opening stock and the cost of purchases made during the year. Further, it was noticed that sales made to related parties were affected at prices lower than the prevailing market rates. The AO also noted that in earlier years the assessee had declared positive net profit, whereas in the impugned year a substantial business loss had been reported. According to the AO, the loss was deliberately shown with the sole intent of setting off taxable capital gains, and not due to any genuine business circumstances. In view of the above deficiencies and perceived manipulation, the AO rejected the books of account and proceeded to estimate the business income by applying a net profit rate of 5.48%, being the average net profit rate of the preceding three assessment years. Based on such estimation, the business income was computed at Rs.29,60,398/-. The principal contention of the assessee before the lower authorities as well as before us is that the closing stock had deteriorated due to fungal infestation and accordingly was valued at net realizable value, consistent with the method of accounting regularly followed by the assessee. The Ld.CIT(A) however, upheld the findings of the AO both with respect to rejection of books of account and estimation of income.

23. We observe that AO rejected the books of account primarily on the basis of discrepancies in stock valuation and alleged under pricing to related parties. The assessee, however, contends that the reduction in closing stock value was on account of fungus damage and therefore the stock was valued at net

realizable value in accordance with the consistent accounting policy followed in earlier years. We find that neither the AO nor the Ld.CIT(A) has examined or verified the assessee's claim regarding deterioration of stock or substantiation of net realizable value by way of independent evidence, technical reports, sale invoices or prevailing market data except stating that these goods were sold to the related parties at lower rates. In view of the above factual matrix and considering that proper verification has not been carried out by the lower authorities on the claim of stock deterioration and valuation method, we deem it appropriate to restore this issue to the file of the AO for fresh examination. The assessee shall produce necessary evidences in support of its claim and the AO shall decide the matter afresh in accordance with law after granting adequate opportunity of hearing. Accordingly, the impugned order is set aside on this issue and the grounds raised by the assessee are treated as allowed for statistical purposes.

24. In the result, the appeal of the assessee is allowed for statistical purposes.

Order pronounced in the court on 25th November, 2025 at Chennai.

Sd/-
(जॉर्ज जॉर्ज के)
(GEORGE GEORGE K)
उपाध्यक्ष /**VICE PRESIDENT**

Sd/-
(एस. आर. रघुनाथा)
(S. R. RAGHUNATHA)
लेखा सदस्य/**ACCOUNTANT MEMBER**

चेन्नई/Chennai,

दिनांक/Dated, the 25th November, 2025

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आदेश की प्रतिलिपि अग्रेषित/Copy to:

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकर आयुक्त/CIT– Chennai/Coimbatore/Madurai/Salem
4. विभागीय प्रतिनिधि/DR
5. गार्ड फाईल/GF