

**IN THE INCOME TAX APPELLATE TRIBUNAL "B", BENCH MUMBAI
BEFORE SHRI R.C.SHARMA, AM
&
SHRI SANDEEP GOSAIN, JM**

**ITA No.3458/Mum/2013
(Assessment Year :2008-09)**

M/s. Novodigm Ltd., (Since amalgamated with Lupin Ltd.,) Lupin Limited 159, C.S.T. Road, Kalina Santacruz (E), Mumbai – 400 098	Vs.	ACIT (LTU)
PAN/GIR No.		AAACL1069K
Appellant)	..	Respondent)

Assessee by	Shri Rajan Vora with Shri Hemen Chandaria
Revenue by	Shri Neil Philip
Date of Hearing	19/07/2016
Date of Pronouncement	03/11/2016

आदेश / O R D E R

PER R.C.SHARMA (A.M):

This is an appeal filed by the assessee against the order of CIT(A) for the assessment year 2008-09 in the matter of order passed u/s. 143(3) of the IT Act.

2. The only grievance of assessee relates to addition made on account of loss on valuation of slow moving / non-moving items and old stock.
3. Rival contentions have been heard and record perused.
4. Facts in brief are that the assessee company is engaged in the business of developing, manufacturing and marketing advanced pharmaceutical intermediates. During the year under consideration, Lupin Limited acquired 100% stake in the Rubamin Laboratories Limited, the

assessee, a wholly owned subsidiary of Lupin Limited. With effect from 29 January 2008, a new name of Novodigm Limited was given to Rubamin Laboratories Limited. During the year, the assessee has claimed loss of Rs.2,90,45,101 on account of writing down the value of slow moving / old / obsolete inventory. During the course of scrutiny assessment, AO made additions on account of disallowance of loss claimed on valuation of slow moving items and old stock.

5. It was submitted before the AO that assessee M/s Novadigm Limited till 01.04.2009 was a 100% subsidiary of M/s Lupin Limited. It was further informed that vide its order dated 06.05.2010, the Honorable Gujarat High Court has given its sanction for the amalgamation of M/s Novadigm Limited with M/s Lupin Limited with effect from 01.04.2009. Pursuant to the Share Purchase Agreement dated 26/9/2007, Lupin acquired Rubamin Laboratories Limited (now known as Novodigm Ltd and since merged with Lupin Limited) by way of purchase of 100% equity of the company from its erstwhile promoters / owners.

6. In the course of the assessment proceedings, it was found that the main reason for the fall in the gross profit margin was that the new management of the company had valued inventories of raw materials and WIP of Rs.2,90,45,101 at ZERO. The AO did not accept the assessee's contention and declined loss on account of writing down the value of slow moving and old inventory.

7. By the impugned order, CIT(A) confirmed the action of the AO.

8. We have considered rival contentions and carefully gone through the orders of the lower authorities below. We have also taken into account judicial pronouncements referred by lower authorities in their respective order and cited by Ld. A.R and D.R during the course of hearing before us. From the record, we found that acquisition of Rubamin by Lupin was by way of purchase of its equity shares rather than sale / transfer of individual assets and liabilities. Accordingly, the identity, business profile, etc., of Rubamin was kept intact. In other words, the business of Rubamin continued without disturbing its structure / identity and only the shareholding changed from one hand to another hand.

9. The inventories which were unusable and unmarketable were revalued by the assessee by writing down the value of old / slow moving inventories, such obsolete / non-moving inventories went on losing their values. This change in the value of old and slow-moving or obsolete inventories has been made bonafide aimed at obtaining true business profits and such method of valuation has been continued in the subsequent assessment years. Thus, the assessee company's claim of loss was bonafide and proper. The issue under consideration is squarely covered by the decision of Hon'ble Supreme Court the case of Chainrup Sampatram v. CIT 24 ITR 481. 485. 487 (SC) wherein it was held that:-

"As the entry for stock which appears in a trading account is merely intended to cancel the charges for the goods purchased which have not been sold, it should necessarily represent the cost of the goods. If it is more or less than the cost, then the effect is to state the profit on the goods which actually have

been sold at the incorrect figure From this rigid doctrine one exception is very generally recognized on prudential grounds and is now fully sanctioned by custom. viz., the adoption of market value at the date of making up accounts, if that value is less than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of attributing to the following year's result a greater amount of profit than the difference between the actual sale price and actual cost price of the goods in question.

While anticipated loss is thus taken into account. anticipated profit in the shape of appreciated value of the closing stocks is not brought into account as no prudent trader would care to show increased profit before its actual realization. This is the theory underlying the rule that closing stock is to be valued at cost or market price whichever the lower is, and it is now generally accepted as an established rule of commercial practice and accountancy.

This is the theory underlying the rule that the closing stock is to be valued at cost or market price, whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy. As profits for income-tax purposes are to be computed in conformity with the ordinary principles of commercial accounting, unless of course, such principles have been superseded or modified by legislative enactments, unrealised profits in the shape of appreciated value of goods remaining unsold at the end of an accounting year and carried over to the following year's account in a business that is continuing are not brought into the charge as a matter of practice though as already stated, loss due to a fall in price below cost is allowed even if such loss has not been actually realised.

It is a misconception to think that any profit "arises out of the valuation of the closing stock" and the situs of its arising or accrual is where the valuation is made. As already stated, valuation of unsold stock at the close of an accounting period is a necessary part of the process of determining the trading results of that period, and can in no sense be regarded as the "source" or such profits. Nor can the place where such valuation is made be regarded as the situs of their accrual. The source of the profits and gains of a business is indubitably the business, and the place of their accrual is where the business is carried on. As such profits can be correctly ascertained according to the method adopted by an assessee only after

bringing into the trading account his closing stock wherever it may exist the whole of the profits must be taken 10 accrue or arise at the place of carrying on the business."

Similarly, in the case of CIT v. British Paints (I) Ltd 188 ITR 44 (SC) pg 75-81 - pgs 5-10 of the compilation], it was held- "it is a well- recognised principle of commercial accounting to enter in the profit and loss account the value or stock-in-trade at the beginning and at the end of the accounting year at cost of market price, whichever is the lower. Where the market value has fallen before the date of valuation and. at that date, the market value of the article on that date is less than its actual cost, the assessee is entitled to value the articles at market value and thus anticipate the loss which he will probably incur at the time of the sale of the goods

10. From the record we found that inventories belonged to the assessee-company. The purchaser, Lupin Ltd, only acquired the shares of the assessee-company. The said purchaser chose not to value the aforesaid inventory for the purpose of valuation of the shares because according to him these inventories had no realisable value. In case, these inventories could at all be sold or used on or before 31/12/2007, the purchaser agreed to pay further consideration in the manner spelt out in Article 4.2 of the share purchase agreement. The act of both the parties, namely the seller and the buyer, lead to a conclusion that the inventory in question had no realizable value.

11. We also found that the assessee-company with the help of photographs, inventory statements of earlier years i.e., 31/3/2006 and 31/3/2007, destruction records of inventories, etc., has clearly demonstrated before the lower authorities that the inventories in question were partly old and unusable and mainly obsolete. The erstwhile

promoters / owners of the assessee-company also admitted to this fact by agreeing to receive reduced purchase consideration for sale of their shareholding.

12. Allegation of the AO is that some part of the inventory was sold in the succeeding year, for an amount of Rs.1,32,551/- which constituted only 0.456% of the non-moving inventory. We found that against the sale price no cost was claimed. The entire sale consideration was offered by assessee to tax in A.Y.2009-10. Therefore, there was no loss to the Revenue. We also found that the cost of inventory used in F.Y.2008-09 was just Rs.1,01,854/- and constituted a mere 0.351 % of the entire non-moving and old inventory. Further, this amount was not charged to the profit and loss account as the cost of material used was taken as zero. This ultimately increased the sales realization amount and thereby the profit of A.Y.2009-10. At the most to the extent of Rs.1,01,854/- loss in value of stock is not accepted in the A.Y.2008-09 under consideration subject to the condition that profit of assessee should be reduced by Rs.1,32,551/- in the subsequent Assessment Year 2009-10. We direct accordingly.

13. However, AO disallowed assessee's claim of loss on account of valuation of slow-moving items by observing that Lupin Ltd., being a leading pharmaceutical company in India before buying out 100% stake in Rubamin Laboratories Lid (Rubamin) must have discussed the modalities of stock purchase with the then management of Rubamin. The valuation aspect of inventories which were lying with Rubamin must have been

discussed when the negotiations for purchase of stake in Rubamin started.

14. A.O. also observed that it is also not understandable as to what happened during 31/08/2007 to 26/09/2007 that the value of raw materials and WIP fell so much so that the value of inventories valuing Rs. 2,90,45,101/- had to be taken at NIL at the end of the financial year on 31/03/2008.

15. The Ld. A.O. has further observed that the reduction of Rs. 2,65,88,000/- may have occurred due to conversion of W1P into finished products or due to use of raw materials in production or due to writing down the value of inventory to Zero between the interval of 31/8/2007 and 26/9/2007. But at the same time the Ld. A.O. also observed that it is unable to comprehend as to what happened during this period which prompted the new management to take the value of raw materials and inventory amounting to Rs 2,90,45,101 /- at Nil at the end of the financial year 31/3/2008 especially when these inventories were used for production in the subsequent assessment year.

16. It is a settled accounting principle that the valuation of inventory is made at cost or reliable value whichever is lower. Since the erstwhile management were of the opinion and belief that these inventories had net realisable value in excess of their cost and consequently, the value of these inventories were not written down / these inventories were written off in these assessment years by the erstwhile management of the assessee-company.

17. It is not in dispute that there was purchase of shares of the assessee-company and not its business or assets by the present owner. There is also no dispute to the fact that the inventory in question were valued at cost (being lower than the net realisable value) by the erstwhile management in all the preceding assessment years including the accounts prepared for the period ended on 31/8/2007. It was only when the due diligence was carried out by the present owner the erstwhile owner accepted that the inventory in question may not have the realisable value and accordingly they agreed to receive the further consideration only when the inventory in question was realised from sale or captively consumed on or before 31/12/2007.

18. From the record we found that the inventory in question was neither written off / written down nor shown as slow moving or old inventory in earlier assessment years including the accounts for the period ended on 31/08/2007 prepared by the erstwhile management. Since present management of the assessee-company and the auditors were of the opinion that since the inventory in question was slow / non-moving and old, its value was to be thus written down / the inventory was to be written off in the audited accounts for the period ended 26/09/2007, as it had no realisable value. And such write-off / writing down in the value to Zero on 26/9/2007 itself was strictly in accordance with Paras 20, 21 & 24 of the AS-2 and Para. 20 of AS-20.

19. From the record we also found that the assessee-company have submitted documentary evidences and effluent treatment records that the

inventory were partly destroyed through incineration and were partly transferred to scrap yard in AY 2009-10, and therefore, they were unusable and had no market value.

20. Loss has not been occasioned because any expenses were claimed under the provisions of Sections 30,31,35 to 37 of the Income Tax Act whereas loss on valuation of inventory or on account of writing off of inventory is claimed as business loss under Section 28 of the Act.

21. It is not the case of the AO that the assessee has not submitted any documentary evidence and the reasons for writing off the inventory in question. His case is that loss on inventory had already been incurred by the assessee in the earlier years when the erstwhile management of the assessee-company had shown the inventory in question as old and slow-moving stocks in the audited accounts for the year ended 31/03/2005,31/03/2006, 31/03/2007 and the accounts for the period ended on 31/08/2007. However, this loss was crystallised by valuation of non-moving and slow moving stock during the year under consideration, therefore assessee had correctly claimed the said loss during Assessment year 2008-09 under consideration.

22. Issue under consideration is also squarely covered by the decision of Jurisdictional High Court in case of Alpha Laval India Ltd., 133 Taxmann.com 740 wherein Hon'ble Bombay High Court held that valuation of obsolete items made by the assessee is allowable as a business loss.

23. In view of the above discussion, we do not find any justification for disallowing the loss claimed on account of valuation of obsolete/slow moving inventory. As we have decided the issue on merits, we are not going to decide the legal ground raised by the assessee to the effect that CIT(A) has erred in upholding the assessment of a company which has been dissolved / amalgamated u/s.391 and 394 of the Companies Act 1956.

24. In the result, appeal of the assessee is allowed in part.

Order pronounced in the open court on this 03/11/2016

Sd/-
(SANDEEP GOSAIN)
JUDICIAL MEMBER

Sd/-
(R.C.SHARMA)
ACCOUNTANT MEMBER

Mumbai; Dated 03/11/2016

Karuna Sr.PS

Copy of the Order forwarded to :

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

BY ORDER,

सत्यापित प्रति //True Copy//

(Asstt. Registrar)
ITAT, Mumbai