

IN THE INCOME TAX APPELLATE TRIBUNAL “A” BENCH: KOLKATA
[Before Shri M. Balaganesh, AM & Shri K. Narasimha Chary, JM]

I.T.A No. 2043Kol/2013
Assessment Year: 2007-08

Income-tax Officer, Wd-4(3), Kolkata. Vs. M/s. AMCL Machinery Ltd.
(formerly known as ACC Machinery
Company Ltd)
(PAN: AAACA0202B)

(Appellant) (Respondent)

Date of hearing: 26.07.2016
Date of pronouncement: 03.08.2016

For the Appellant: Shri Sallong Yaden, Addl. CIT
For the Respondent: Shri D. S. Damle, FCA

ORDER

Per Shri M. Balaganesh, AM:

This appeal by revenue is arising out of order of CIT(A), Central-II, Kolkata vide appeal No. 244/CC-X/CIT(A)C-II/10-11/Kol dated 31.03.2013. Assessment was framed by DCIT-1(1), Mumbai u/s. 143(3) of the Income tax Act, 1961 (hereinafter referred to as the “Act”) for AY 2007-08 vide his order dated 18.12.2009.

2. At the outset, we find that there is a delay of 23 days in filing the appeal before us by the revenue which is supported with condonation petition. In view of the concession given by the Id AR for condonation of delay, we hereby condone the delay and admit the appeal of the revenue for adjudication.

3. The first issue to be decided in this appeal is as to whether the Id CITA is justified in deleting the disallowance u/s 14A of the Act in the facts and circumstances of the case.

3.1. The brief facts of this issue is that the assessee is engaged in the business of manufacture of tyre, rubber machinery, bulk transporters, blowers, cement machinery etc. The Id AO observed that the assessee had claimed exempt income towards dividend of Rs. 32,09,476/- and was accordingly asked to explain as to why the disallowance u/s 14A should not be made as per Rule 8D of the Rules for expenses incurred in earning the income

claimed as exempt from taxation. The assessee replied before the Id AO that it had made short term investments in mutual funds and the same were also sold out before the end of the previous year and accordingly there was neither opening balance nor closing balance of investments in the audited financial statements. The assessee taking strength from its financial statements submitted that the borrowed funds outstanding as on 31.3.2006 consists of deferred sales tax loans, which is interest free funds. Hence the assessee does not have any interest bearing funds, which could have been utilized for making investments. All the investments in mutual funds were made out of surplus funds lying in the current account of the assessee which were converted into mutual funds at the instance of the banker such as "LIC Liquid Fund-Dividend" which are realizable / redeemable "on call", for better returns to the assessee. Absolutely no expenditure was incurred by the assessee either for making these investments in mutual funds or for earning dividend income. It was claimed that no bank charges or collection charges for earning of dividend were incurred by the assessee. It was also submitted that the provisions of Rule 8D would be applicable only from Asst Year 2008-09 and hence not applicable for the year under appeal. The Id AO observed that the assessee had totally paid interest expenditure of Rs. 3.87 crores on its borrowed funds which were invested for earning dividend income. The amount of dividend income constitutes 2.59% of net income of the assessee. Hence the Id AO disallowed the expenditure u/s 14A of the Act by applying 2.59% on interest payment of Rs. 3,87,00,000/- and arrived at the disallowance figure of Rs. 10,02,330/-. Before the Id CITA, it was submitted that the total interest (net) incurred is only Rs. 3,87,000/- and not Rs. 3,87,00,000/- which could be evident from the audited financial statements of the assessee company. This interest expenditure included a sum of Rs. 1.35 lacs paid towards interest on cash credit facility and Rs. 2.93 lacs incurred towards export bill discounting facility charges. The interest on cash credit was paid entirely in connection with working capital requirements of the business and the export bill discounting charges have nothing to do with the investment activities as they are paid to the bank for discounting the export bills of the assessee. The Id CITA observed that the assessee had totally paid interest on cash credit of Rs. 1,35,000/- and bill discounting charges of Rs. 2,93,000/- and received interest income of Rs. 41,000/- and hence the net interest is Rs. 3,87,000/-. This interest paid on borrowed funds were not utilized for making any investment and hence there is no question of making any disallowance u/s 14A of the Act on an estimated basis towards disallowance of interest

assuming it to be made out of borrowed funds. Accordingly the entire disallowance u/s 14A of the Act was directed to be deleted. Aggrieved, the revenue is in appeal before us on the following ground:-

“1. That on facts the Ld. CIT(A) erred in deleting the disallowance u/s. 14A entirely though there is provision in section 14A & 14A(3) to determine the amount of expenditure incurred in relation to the earning of exempt income, even if the assessee claims that no expenditure has been incurred in relation to income which does not form part of the total income.”

3.2. The Ld DR argued that though initially the Id AO proceeded to invoke the provisions of Rule 8D , on hearing the submissions of the assessee sought to drop the same , but proceeded to make disallowance u/s 14A of the Act by taking into account the interest expenditure and disallowing the same on the proportion of exempt income to the total income. This was done in view of the fact that the provisions of section 14A of the Act were brought in the statute with retrospective effect from 1.4.1962. In response to this, the Id AR vehemently relied on the order of the Id CITA.

3.3. We have heard the rival submissions and perused the materials available on record. The facts stated hereinabove remain undisputed and hence the same are not reiterated for the sake of brevity. We find that the Id AO had resorted to make disallowance u/s 14A of the Act on a notional basis by assuming that the borrowed funds were utilized for making investments. But from the aforesaid facts, we find that it is clearly established that the investments were purely made only out of surplus funds lying in the current account at the instance of the bankers. The disallowance of interest on notional basis is contemplated only in Rule 8D(2)(ii) which is admittedly not applicable for the year under appeal. Hence there cannot be disallowance of any interest u/s 14A of the Act. The basic premise of the Id AO that the borrowed funds were utilized for making investments and correspondingly disallowance u/s 14A of the Act is to be made, stands defeated in view of the aforesaid finding. Hence we find no infirmity in the order of the Id CITA in this regard. Accordingly, the ground no. 1 raised by the revenue is dismissed.

4. The last ground to be decided in this appeal is as to whether the Id CITA is justified in deleting the addition made on account of valuation of closing stock of work in progress in the sum of Rs. 1,68,57,093/- in the facts and circumstances of the case.

4.1. The brief facts of this issue is that the Id AO observed that on perusal of the details filed in respect of inventory of closing stock, it revealed that the assessee has shown the value of work in progress at Rs.2,28,16,020/-. During the course of assessment proceedings, the AR of the assessee was required to submit the details of work in progress, indicating the names of the parties whose work are in progress indicating advances received for the orders. The Ld. AR of the assessee was also required to submit the basis of arriving at the figure of closing work in progress in order to cross check the correctness of the closing work in progress. The Ld. AR of the assessee was also required to submit copy of sales ledger for the month of April 2007. The Id AO observed that the perusal of the sales ledger of 2007 revealed that the assessee company has effected sales at higher rate than the value of work in progress disclosed in the balance sheet. The discrepancies noticed in respect of 3 parties are reproduced as under:-

Sr. No.	Name of the party	Closing work in progress shown	Advanced Received	Sales		Differences
				Date	Amount	
1.	Birla Tyres Ltd.	9,45,651	1,76,93,500	15.04.07	28,79,386	35,17,809
				19.04.07	14,39,693	
				30.04.07	<u>1,44,381</u>	
				Total	<u>44,63,460</u>	
2.	Mangalam Cement Works	47,13,930	20,95,482	05.04.07	14,11,362	2,86,39,334
				13.04.07	19,06,056	
				14.04.07	19,77,682	
				17.04.07	84,02,407	
				20.04.07	90,11,277	
				21.04.07	16,39,858	
				29.04.07	6,08,870	
				30.04.07	85,48,535	
				30.04.07	<u>6,05,217</u>	
				Total	<u>2,91,11,264</u>	
3.	ACC, Wadi	85,67,625	43,22,302	20.04.07	10,79,770	76,43,331
				24.04.07	39,59,155	
				30.04.07	89,86,083	
				30.04.07	32,960	
				30.04.07	13,497	
				30.04.07	20,58,491	
				30.04.07	<u>81,000</u>	
				Total	<u>1,62,10,956</u>	
					<u>TOTAL</u>	
	<u>3,93,00,474</u>					

The Id AO observed that on perusal of the above, it transpired that the assessee company has shown manufacturing goods much more than the value of closing work-in-progress shown as at 31.03.2007. In this context, he further observed that the assessee manufactured various items such as bulker tanks, transit mixer, blower, casting etc. which are mainly used for

cement manufactures. It is evident from the record and details filed by the assessee that these products require substantial time for manufacturing. Accordingly he concluded that the sales shown immediately after the end of the financial year prima facie appears to be suppressed and accordingly, the value of closing work-in-progress in as at 31.03.2007 prima facie appeared to be suppressed as there are excessive sales in the subsequent month of April, 2007. In view of this discrepancy, the AR of the assessee was required to furnish the basis of arriving at the value of closing work-in-progress along with supporting documents. He observed that the AR of the assessee had expressed his inability to furnish such details stating that the assessee company had not maintained item wise work-in-progress and the purchases and consumption are common for all products. The Id AO did not accept the contention of the assessee in view of the fact that the assessee company has made substantial purchases in the month of March, 2007 itself totaling to Rs.11,78,65,760/- and has consumed raw materials to the tune of Rs.5,54,81,740/-. On the one hand, assessee has claimed expenses on account of purchase of raw materials and on the other hand, it has reduced the value of stock of raw materials as the same had been claimed to have been consumed. Further, the assessee company by showing lesser value of work-in-progress had inflated the cost of production. Since the AR of the assessee has not been able to substantiate their arguments with supporting evidences and had not been able to contradict the value of sales made immediately after the end of the FY as depicted hereinabove, he concluded that the difference in the value of closing work-in-progress with sales of April, 2007 is to be considered as total value of closing work-in-progress as at 31.03.2007. Accordingly, the difference of Rs.3,98,00,474/- is considered as correct value of work-in-progress and deducting therefrom gross profit, turnover ratio as per annexure 'Q' of Audit report which works out to 0.32% is calculated at Rs.1,27,361/-. Thus, the correct WIP after adjusting gross profit margin works out to Rs.3,96,73,113/-. Accordingly, difference of Rs.1,68,57,093/- i.e. (Rs.3,96,73,1134/- minus Rs.2,28,16,020/-) being the suppressed value of WIP, is added to the total income of the assessee.

4.2. The assessee submitted before the Id CITA that on receipt of the information requisitioned on 9.12.2009, the Id AO required the assessee to furnish information with regard to invoices raised on the customers in April 2007, whose orders were under execution on March 31, 2007. The said statement was also submitted subsequent to 9.12.2009. On receipt of the said information, the Id AO then required the assessee to

reconcile the value of closing WIP with the total cost incurred on executions of the orders leading to sales executed in April, 07. At this stage the assessee requested the Id AO to grant sufficient time to furnish the required information because the relevant information was to be obtained from Nagpur where the stock records were maintained. The Id AO however, expressed his inability to grant time as assessment was getting barred by limitation on December 31, 2009. In the circumstances, when the Id AO was not granting sufficient time to furnish the evidences in support of its working, the AR expressed his inability to furnish the required information in the prescribed format. The impugned order was passed on 18.12.2009. The assessee submits that it was never its case that it did not maintain details of job/order wise particulars of material consumption or item wise WIP. It was only because of the paucity of time and lack of adequate opportunity of being heard, the assessee could not substantiate the explanations & details furnished in support of value of closing WIP as on 31.3.07. The assessee was always in possession of the evidences to substantiate its explanations, reconciling the value of WIP with the sales value realised from the customers, on raising of the invoices in the subsequent financial year. If the Id AO had granted sufficient time to furnish the required information then the assessee would have certainly furnished the same. The Id CITA appreciating the various submissions of the assessee observed as under:-

“16. I have considered the submissions of the appellant and perused the assessment order. I have also gone through the details and documents filed by the appellant, the remand report submitted by the AO and the counter comments of the appellant. On examination of assessment order, it appears that the AO had made the addition to the closing value of WIP primarily for the reason that he was of the opinion that compared with the sale value realized by the appellant in April, 2007, the value of the work in progress disclosed by the appellant as on 31.03.2007 was substantially low. The wide variation between the said two figures i.e. the sale value in April, 2007 and the WIP as on 31.03.2007, prompted the AO to initiate enquiry about valuation of the WIP. In the assessment order, he selected three parties namely Birla Tyres Ltd., Mangalam Cement Works and ACC, Wadi. In these three cases he compared the closing WIP shown by the appellant in the financial statements vis-a-vis sales made to them in April, 2007. According to him the sales made to these parties in the month of April, 2007 was aggregating to Rs.4,97,85,680/- whereas the value of WIP shown as on 31.03.2007 shown in these cases was Rs.1,42,27,206/-. Hence, he was of the opinion that there is difference in the value of WIP vis-a-vis the sale value of Rs.3,55,58,474/-. However, in the assessment order he worked out the difference at Rs.3,98,00,474/- which was due to arithmetical mistake. The said mistake was later on rectified by the AO u/s 154 of the Act vide order dated 31.01.2012. But, in the assessment order the addition to the value of WIP was made by considering the difference of Rs.3,98,00,474/- only. The AO considered the difference of Rs.3,98,00,474/- as the correct value of the WIP. From this amount, he reduced the gross profit amounting to Rs.1,27,361/- which was calculated by him by adopting the GP rate at 0.32%. Thereafter, the AO arrived on the value of WIP at Rs.3,96,73,113/- i.e. (Rs.3,98,00,474 - Rs.1,27,361). Since, the appellant had disclosed the value of WIP at Rs.2,28,16,020/-, he made addition of differential amount of Rs.1,68,57,093/- i.e. (Rs.3,96,73,113 - Rs.2,28,16,020). However, in the course of appellate proceedings as well as the remand proceedings, the appellant proved that

not only there was arithmetical mistake of Rs.42,42,000/- in working out the difference as mentioned above, but there was also mistake in the GP rate adopted by the AO to make the addition. The correct GP rate as per the audited accounts was 32% and not 0.32% as adopted by the AO. If the aforesaid mistakes are taken into account then even on the basis of opinion formed by the AO and methodology adopted by him, the addition should have been of Rs.13,63,742/- only whereas he made addition of Rs.1,68,57,093/-. The correct difference between the value of WIP vis-a-vis the sale value in respect of three parties selected by the AO was Rs.3,55,58,474/-. Considering the GP rate at 32%, the amount of GP comes to Rs.1,13,78,712/-. Thus, as per the working of the AO, the correct value of the WIP should have been at Rs.2,41,79,762/- i.e. (Rs.3,55,58,474 - Rs.1,13,78,712). Since, the appellant had disclosed the closing WIP at Rs.2,28,16,020/-, the difference comes to Rs.13,63,742/- i.e. (Rs.2,41,79,762 - Rs.2,28,16,020). However, considering the submission of the appellant, documents produced and the verification made by the AO in the course of remand proceedings, I am of the opinion that no addition at all can be made to the value of the WIP disclosed by the appellant because if the contention of the AO as per the assessment order is accepted then it would mean that the appellant had not done any value addition to the WIP after 31.03.2007 and the goods were sold in the month of April, 2007 as such without any further manufacturing process. If it was so, then as on 31.03.2007, the WIP shown by the appellant was nothing but the stock of finished goods which was sold as it is. But, it is not factually correct. The appellant company had made further value addition to the WIP to manufacture the finished goods before selling them. This fact was verified by the AO during the remand proceedings with reference to the submission made by the appellant in the course of appellate proceedings. Further, as on 31.03.2007, the appellant had disclosed the WIP at Rs.2,28,16,020/- as admitted by the AO in the assessment order. However, to make an addition to the value of closing WIP, the AO considered the WIP of only three parties namely Birla Tyres Ltd., Mangalam Cement Works and ACC, Wadi in whose cases the closing WIP was aggregating only Rs.1,42,27,206/- i.e. (Rs.9,45,651 + Rs.47,13,930 + Rs.85,67,625). The AO made the addition considering the WIP of three cases-only whereas there was WIP of other customers also. Therefore, the very basis of making addition to the value of WIP was incorrect. The AO's primary premise for making the addition was that the machineries which the appellant sold to Birla Tyres Ltd., Mangalam Cement Works and ACC Wadi in April 2007 were substantially completed by 31.03.2007 and the sale was made by the appellant without further incurring any costs or without consuming any further materials. However, before drawing such inference the AO did not bring on record any material on the basis of which he could hold that in April, 2007 either the appellant did not carry on manufacturing or processing of the WIP or that no- further materials were consumed and the material as in its existing state as on 31.03.2007, itself got sold. From the details of sales effected as set out in the order, it is observed that the sales to 3 parties were effected mostly in the 3rd & 4th week of April 2007. In the circumstances, apparently it could not be held by the AO that by 31.03.2007 itself the production of the machines was complete and the appellant had no obligation to incur further expenses or that the appellant did not further consume materials for production of the machineries till its dispatch. On the contrary, the appellant placed on record documentary evidences which showed that even after 31.03.2007 the appellant continued with manufacturing process of these machines and for that purpose raw-materials were issued for production. Besides the appellant also incurred production over-heads to complete the manufacture of machine. Detailed workings of the materials consumed together with the supporting evidences were filed. In the Remand proceedings the AO conducted examination of these evidences but he was not able to point out any specific infirmity in the evidences filed. Under the circumstances, I am of the considered opinion that the AO was not justified in making addition to the value of closing WIP.

17. I also find force in the submissions of the appellant that in working out the alleged suppression of the value of the WIP; the AO wrongly considered the invoiced value of sales which inter-alia included Sales Tax & Excise Duty for which liability arose only at the time of dispatch of goods in April 2007. In determining the value of WIP as on 31.03.2007; liability for the statutory levies was not includible. For example, in the case of machines supplied to Mangalam Cement Works invoiced value was Rs.3,41,24,965/-, but the basic sale price i.e. net

off Excise duty & VAT, was only Rs.2,80,11,940./-. Similarly, in the case of ACC Wadi the Invoice sale value was Rs.2,47,35,153/- whereas basic sales value net of taxes was only Rs.2,06,17,025/-. As regards sales to Birla Tyres, the Invoices value was Rs.87,82,739/-, whereas, basic sales value was only Rs.73,20,000/-. The above figures showed that for the purpose of making the comparison between the sales value of machineries and the WIP of the machineries as on 31.03.2007 the AO did not adopt appropriate figures and this also resulted in arbitrary increase in the addition.

18. I agree with the basic accounting principle and the methodology by which the AO proceed to value the inventory of WIP. Arithmetically, for arriving at the cost of manufactured goods one can reduce the basic sales value by the gross profit margin. It is for the simple reason that by reducing the direct material cost and production over-heads from the basic sales value one arrives at the gross profit margin. In the circumstances, if one reduces the gross profit margin from the basic sales value then one can theoretically arrive at the cost of manufactured goods. In the assessment order the AO himself adopted this methodology to arrive at the alleged value of WIP at Rs.3,96,73,113/-. However, while doing so the AO presumed that the gross profit margin of the appellant was only 0.32% whereas in the remand report the AO has admitted that the gross profit margin which the appellant actually disclosed in the audited accounts for AY 2007-08 was 31.52%. The appellant in its submissions had given comparative working of the gross profit margin which it earned on sale of machines to Mangalam Cement Works, ACC Wadi and Birla Tyres. In its working of gross profit margin the appellant took into account the value of WIP as on 31.03.2007, cost of materials consumed post 31.03.2007; over-heads incurred in April 2007 and the basic invoice value of goods sold. From the comparative figures made available by the appellant, it appeared that the net invoice value of machines supplied to 3 parties, amounted to Rs.5,59,48,965/- whereas the total cost of production in relation thereto was Rs.3,63,21,256/-; giving gross profit margin of Rs.1,96,21,710/-. In percentage terms; gross profit which the assessee disclosed worked out to 35.07%. In the remand report the AO admitted that since the WIP as on 31.03.2007 was sold by the assessee in FY 2007-08 the appropriate gross profit rate that needed to be considered in arriving at the value of WIP was G.P. rate for the FY 2007-08 which as per assessment records for AY 2008-09 was 36%. The G.P. rate disclosed for AY 2008-09 at 36% compares favourably with G P rate of 35.07% which the assessee disclosed in his comparative chart for the machines sold in April 2007. In view of above facts, I am of the opinion that there was no understatement of the value of WIP as on 31.03.2007 as observed by the AO and, therefore, no addition can be made to the value of WIP. The AO is directed to delete the addition made by him. The ground no. 5(a) to 5(d) are allowed.”

4.3. Aggrieved, the revenue is in appeal before us on the following ground:-

“2. That on facts and circumstances the Ld. CIT(A) erred in deleting the closing work in progress entirely, though admitting that the Assessing Officer adopted the correct methodology to value the inventory of WIP.”

4.4. The Ld DR vehemently relied on the order of the ld AO and the ld AR vehemently relied on the order of the ld CITA.

4.5. We have heard the rival submissions and perused the materials available on record including the detailed paper book filed by the assessee consisting of pages 1 to 143. We find that the ld CITA had given categorical findings with regard to the treatment given by the assessee in the valuation of closing stock of work in progress as on 31.3.2007. The ld DR was not able to controvert any of the findings given by the ld CITA before us. Under

these circumstances, we do not find it necessary to interfere with the order of the Id CITA in this regard. Accordingly, the ground no. 2 raised by the revenue is dismissed.

5. In the result, the appeal of the revenue is dismissed.

Order pronounced in the open court on 03.08.2016

Sd/-
(Shri K. Narasimha Chary)
Judicial Member

Sd/-
(M. Balaganesh)
Accountant Member

Dated :3rd Aug, 2016

Jd.(Sr.P.S.)

Copy of the order forwarded to:

1. APPELLANT – ITO, Ward-4(3), Kolkata.
2. Respondent –M/s. AMCL Machinery Ltd., A-1, MIDC Industries Area, Butlibori, Nagpur-441 122, Maharashtra.
3. The CIT(A), Kolkata
4. CIT , Kolkata
5. DR, Kolkata Benches, Kolkata

/True Copy,

By order,

Asstt. Registrar.