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IN THE HIGH COURT OF DELHI AT NEW DELHI**I.T.A. 446/2008**Judgment delivered on: July 28,2010**THE COMMISSIONER OF INCOME TAX****..... APPELLANT**

Through:

Ms. Rashmi Chopra, Advocate

INDOMAG STEEL TECHNOLOGY LTD.**.....RESPONDENT**

Through:

Mr. Rajan Bhatia, Advocate

CORAM:**HON'BLE MR. JUSTICE A.K.SIKRI****HON'BLE MS. JUSTICE REVA KHETRAPAL****A.K. SIKRI, J. (ORAL)**

1. Notice in this appeal was issued limited to the proposed question of law referred to in paragraph 2 (c) of the appeal which reads as under:-

“WHETHER on the facts and in the circumstances of the case, the Ld. ITAT erred in law and on merits, in deleting the addition of Rs, 2,18,03,931/- made by the AO and upheld by the CIT (A) on account of traveling costs to be included in the valuation of work in progress”

2. The company has changed the method of ascertainment of allowable overheads to the project from the assessment year 1996-97, which is the subject matter of the present appeal. With the change in method, the traveling costs hitherto considered had not been included in such allocation. The Assessing Officer did not accept the change in the accounting method and thus added the traveling cost of Rs.2,18,931/- as attributable to the work in progress, and as a



The CIT (A) confirmed this order of the Assessing Officer. However, the Income Tax Appellate Tribunal has reversed the orders of the CIT (A) and the Assessing Officer and has directed the deletion of the aforesaid amount from the total income of the assessee.

3. As already pointed out above, the aforesaid additions were made by the assessee due to change in the method of valuation of the work in progress. The explanation of the assessee was that it had been allocating indirect traveling cost amongst its various projects under progress. However, the necessity to change the accounting method arose while keeping in view of the accounting method prescribed by the Institute of Chartered Accountants of India. It was explained that the assessee was earlier following completed contracts method of accounting in the light of Accounting Standard-7 (AS-7) promulgated by the Institute of Chartered Accountants of India. In terms of AS-7, all expenses incurred by the company in relation to a contract were being kept under work-in-progress and consolidated expenditures in relation to all pending projects at the end of the year were shown under inventories, in the Profit & Loss Account as well as in the Balance Sheet. All the direct costs attributable to the contract works have been debited to work-in-progress. The assessee had, however, switched over from the conventional method to a more rational method prescribed by AS-2. It was also the explanation of the assessee that as per AS-2, the indirect travel cost was not to be added to the work-in-progress. It was also the contention of the assessee before the Tribunal that a change in the method of stock valuation, if *bona fide*, has to be accepted for the purposes of assessment and for its proposition, the assessee relied upon the following judgments:-

- (i) CIT Vs. Mopeds India Limited [173 ITR 347 (AP)]



- (iv) CIT Vs. Mahalakshmi Sugar Mills Co Ltd. [68 Taxman 1 (Del)]
- (v) CIT Vs. British Paints India Ltd. [188 ITR 44 (SC)]

4. The assessee also pointed out that for all the subsequent orders, the assessee had followed the aforesaid AS-2 and even the Department had accepted this method of accounting adopted by the assessee while assessing the income of the assessee in all these assessment years. On that basis also, the contention of the assessee was that when the revenue has accepted the accounting method followed by the assessee for all the subsequent years, there was no reason to deny this for the assessment year in question. For this proposition as well, the assessee took the support of the following judgments:-

- (i) Chellapalli Sugars Ltd. Vs. CIT [98 ITR 167 (SC)]
- (ii) Manilal Kher Ambalal and Co. Vs. ITO [176 ITR 253 (Bom)]
- (iii) Triveni Engineering Works Ltd. Vs. CIT [167 ITR 742)

5. After considering all these aspects, the Tribunal arrived at a finding that the change in the accounting system brought out by the assessee was on a sound basis; it was more rational method adopted by the assessee; the change was *bona fide*; and that this change was accepted by the revenue of all the subsequent years. These findings are contained in the following passage of the decision of the Tribunal:-

“It is in the light of the above situation brought in by the AS-2 that the assessee has made change in the valuation of work-in-progress. We are of the considered view that the assessee had brought the change on a sound basis. The assessee is in fact switched over from the conventional method to a more rational method prescribed by AS-2. Therefore, it is to be seen that the change brought in by the assessee in the valuation of work-in-progress is genuine. Further, it is to be seen that the changed



the facts and circumstances of the case, we find that the decision of the lower authorities on this point is not justified.”

6. Having regard to the aforesaid factual position as well as of legal position, we are of the opinion that no substantial question of law arises for the consideration. We may, however, discuss one argument addressed by the learned counsel for the Department. It is submitted that even as per AS-2, the traveling cost was to be included in the cost of inventories. The learned counsel referred to the para 6 of AS-2 which reads as under:-

“6. The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.”

7. It is, thus, submitted that the cost incurred in bringing the inventories to their present location and condition is to be included in the cost of inventories and that would clearly imply that the cost of traveling has to be added. The learned Counsel for the assessee on the other hand referred to para 13 of the AS-2 and submitted that it is only direct cost of traveling which is to be included while computing the cost of inventories and indirect cost is not to be added. Para 13 reads as under:-

“Exclusions from the Cost of Inventories

13. In determining the cost of inventories in accordance with paragraph 6, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred. Examples of such costs are:

- (a) abnormal amounts of wasted materials, labour, or other production costs;
- (b) storage costs, unless those costs are necessary in the production process prior to a further production stage;



their present location and condition; and

(d) selling and distribution costs.”

9. This position could not be disputed by the learned counsel for the revenue. Therefore, what remains to be ascertained is as to whether the assessee had added, in the cost of inventory, direct traveling cost and it is only indirect traveling cost which was not included. We may point out that even before the CIT (A) it was specifically argued by the counsel for the assessee that travel costs directly charged had been charged off as an expenditure in the Profit & Loss Account in the year in which the same was incurred and it is only indirect traveling cost which was not included. This very plea was raised before the CIT (A) and Tribunal has accepted the same. However, at the same time, we find that there is no verification of this plea because of the reason that the Assessing Officer did not go into this question and he had made addition in respect of entire cost without going into the question as to whether it was direct or indirect cost.

10. Thus, while we do not find any error in the order of the Tribunal and are of the opinion that the indirect travel cost is not to be included in the cost of inventory as per AS-2, we direct the Assessing Officer to give the benefit of the judgment of the Tribunal to the assessee after verifying the same.

11. The appeal is accordingly dismissed, subject to the aforesaid direction.

(A.K.SIKRI)
JUDGE

(REVA KHETRAPAL)
JUDGE

JULY 28, 2010