



* ***IN THE HIGH COURT OF DELHI AT NEW DELHI***

+ **ITA Nos. 645/2005, 742/2005, 796/2005, 817/2005 & 794/2006**

% **Date of Decision : January 30th 2012.**

COMMISSIONER OF INCOME TAX DEL Appellant
Through : Mr. Sanjeev Sabharwal, Adv.
versus

INDIAN SUGAR & GEN. INDUSTRY EXPORT IMPORT
.....Respondent
Through: Dr. C.S.Aggarwal, Sr. Adv. with
Mr. Prakash Kumar, Adv.

AND

+ **ITA Nos.71/2011, 1166/2011 & 1168/2011.**

COMMISSIONER OF INCOME TAX DEL Appellant
Through : Mr. Sanjeev Sabharwal, Adv.
versus

INDIAN SUGAR & GEN. INDUSTRY EXPORT IMPORT
Through : Dr. Rakesh Gupta and Ms. Rani
Kiyala, Adv.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE R.V. EASWAR

SANJIV KHANNA, J: (ORAL)

1. These appeals by the Revenue under Section 260A of the Income Tax Act, (Act, for short) in the case of Indian Sugar and General Industries Export Import Corporation Ltd. (now known as Indian Sugar



Exim Corpn.) arise out of different orders passed by the Income Tax Appellate Tribunal (Tribunal, for short) but the questions of law involved are identical and therefore are being disposed of by this common order.

2. By order dated 29.11.2005 the following two substantial questions of law were framed in ITA Nos. 645/2005, 742/2005, 796/2005, 817/2005:

“(i) Whether the findings of the Income Tax Appellate Tribunal that there was no change in the method of valuation of closing stock by the respondent-assessee during the assessment year 1993-94 is perverse?”

(ii) In case the answer to question No.1 above is in the negative whether the change in the method of valuation was bonafide?”

3. In ITA No.794/2006 the following substantial question of law was framed vide order dated 26.5.2006:

“Whether Income Tax Appellate Tribunal was correct in law in deleting the addition of Rs.3,64,584/- made by the Assessing Officer to the income of assessee on account of under valuation of closing stock by rejecting the change made by the assessee in the method of valuation of closing stock?”

4. In ITA Nos. 71/2011, 1166/2011 and 1168/2011 we frame the



following substantial questions of law:

“1. Whether on the facts and circumstances of the case the Income Tax Appellate Tribunal was correct in law and on facts in deleting the addition made by Assessing Officer on account of rejection of method of valuation of closing stock as followed by the assessee ?

2. In case the answer to question No.1 above is in the negative whether the change in the method of valuation was bonafide?”

5. After hearing the counsel for the parties, we are also inclined to formulate another question of law which is common to all appeals and the same reads as under:

“Whether the Income Tax Appellate Tribunal was right in accepting the net realizable value as declared by the respondent-assessee and was right in not adopting the cost price for computation of the closing stock?”

6. The respondent-assessee is a company and is engaged in the business of export of sugar. The respondent-assessee does not manufacture sugar but procures or purchases sugar from manufacturers. It did not engage itself in domestic sales (except sale of damaged stock) and was exporting sugar from India.

7. For the assessment year 1993-94, which is the base year and the



first year in which the controversy had arisen, the Assessing Officer examined the question of valuation of closing stock and made an addition of Rs.16,00,30,000/- holding, inter alia, that the assessee in the past years had been regularly following “the cost method” for valuing the closing stock. The reasons given by him in the assessment order read as under:-

“The assessee’s contention cannot be accepted for the following reasons:

1. The rationale and the basis for changing the method of valuation of closing stock is to account for the true profits of the year and to ensure that inflation or deflation of profit or loss is avoided. Ordinarily a company or assessee changes the method of valuation of inventories so that it can show the reasonable profits from its business. For example if it has been valuing stocks at market realizable price, it changes it to cost method so that profit attributable to the sale of stocks, at market prices in future is avoided. This is because the possibility of sale of its stock at market price is uncertain. Hence the assessee desires to avoid showing uncertain profits on account of this before actual sale of the stocks. In such a situation the assessee’s claim is justified for the above reason. However in the case of the assessee company i.e. Indian Sugar, the export of sugar has always been at loss due to the difference in international price and the procurement price of sugar, the former being always less than the later. Hence there is no scope for profit. This fact is also recognized by the sugar Act. & the sugar mills which is evident from the arrangement between the sugar mills and the Assessee company whereby all loss earned by the assessee company is to be borne by the sugar mills through reimbursement. The assessee has consistently been showing the said reimbursement as an item



of income over the years. Since the losses are to be fully reimbursement by the mills. There is no question of justification for the revaluation of the stocks since losses are to be reimbursed by the sugar mills. Hence the very basis or justification of the claim of change in method of valuation of closing stocks is absent in its case.

2. Secondly the assessee's contention that the stock for F.Y. 90-91 & 91-92 were valued at cost since on the closing date the domestic prices were higher than the cost price is apparently wrong statement. The assessee has in the past been valuing its stocks at cost method which is clear from the note 3 of schedule I notes containing significant accounting policies in the annual report for A.Y. 92-93 which reads as under:-

“The inventories are valued at cost”

In the note no. 4 of schedule I notes contains significant accounting policies annexed at page 27 of Annual report for the A.Y.93-94 it has mentioned as under.

“The inventories are valued from this year at cost or net realizable value whichever is lower”

This clearly goes to show that the assessee's contention regarding the reasons for change of valuation of stock is not the fluctuation in domestic prices of sugar & the cost price. It has changed the method of valuation of stock only to reduce the profits of the year and therefore the change is not bona-fide. This being so the assessee cannot be allowed to change the method of valuation of closing stock and hence the amount of Rs.16.003 crores stands added back.”

8. Similar additions have been made by the Assessing Officer in the



other assessment years.

9. In assessment year 1993-94 the CIT (Appeals) confirmed the said addition and observed as under:-

“Regarding the contention at point number (1) the assessee has filed a chart where assessee has attempted to show that even in assessment year 1992-93 the some method of valuation of closing stock was followed. I have examined the factual position carefully. In assessment year 1990-91 there were no stocks. In assessment year 1991-92, the valuation was done at cost which was in any case lower than NRV. The auditors also stated in the balance sheet that inventory was valued at cost. In assessment year 1992-93, the assessee has given the details of valuation under three items. The first item is that of stock where assessee had received orders at the price of Rs. 10,952/- per M.T. The second type of stock is where no such order was received and as such the NRV is taken at a lower value. The third item is actually the damaged stock of sugar. In the first item the cost is in any case lower and as such it does not prove the case of the assessee. The case of the assessee would be proved if the NRV was lower and the same was taken. In the second item, the cost and the NRV are same and as such the valuation of this stock also does not support the case of the assessee that the same method of valuation was followed in assessment year 1992-93 also. Item No.3 is important because it is here that assessee has shown the NRV lower than the cost. The cost is shown at Rs. 7,540 where as the NRV is shown at 6,588/- and the assessee has adopted in the valuation the rate



of Rs. 6,588/-. However, I am of the opinion that even this does not prove the case of the assessee in as much as there is inconsistency in the method of valuation as depicted by the assessee that same type of sugar as valued differently depending upon whether orders for purchase were received by the assessee or not. Where such orders were received, the assessee has taken higher NRV. Where no orders were received, the assessee has taken the NRV at the cost itself. In my view the picture given by the assessee, therefore, is unclear. As regards the third item relating to the valuation of the damaged stock of sugar, I am of the opinion that even assuming that this stock was valued at NRV which is lower than the cost, still it does not follow that assessee was following the system of cost, still it does not follow that assessee was following the system of cost or NRV which ever is more. This is for the reason that the damaged stock cannot be valued a cost because that will result in distortion. According to the mercantile systems of accounting the assessee had to book the loss whenever it became ascertained. In other words, the valuation of damaged stocks even at NRV is not inconsistent with the method of valuation of stock followed by the assessee at cost. I accordingly reject the contention of the assessee.”

10. For the other assessment years, the CIT(A) confirmed the additions for some assessment years, while deleting the additions in the other years. Subsequently, the assessee/Revenue preferred further appeals which have been disposed of in favour of the respondent-assessee. The details are in



the chart indicated below:-

Sl No	ITA No.	AY	Assessment Order dated	CIT (Appeals)	ITAT Order
1.	645/205	1993-94	31/10/1995	Addition confirmed by Order dated 08/04/1996	Deleted by Order dated 24/01/2005
2.	742/2005	1995-96	5/12/1997	Addition confirmed by Order dated 05/03/1998	Deleted by Order dated 24/01/2005
3.	796/2005	1996-97	6/12/1998	Addition confirmed by Order dated 14/03/2001	Deleted by Order dated 24/01/2005
4.	817/2005	1997-98	24/03/2000	Addition confirmed by Order dated 15/03/2001	Deleted by Order dated 24/01/2005
5.	794/2006	1998-99	29/01/2001	Addition confirmed by Order dated 30/05/2001	Deleted by Order dated 07/10/2005
6.	496/2010	2001-02	29/01/2004	Confirmed by Order dated 07/01/2005	Deleted by Order dated 05/12/2008



7.	1168/2011	2002-03	31/01/2005	Deleted by Order dated 09/11/2005	Order of CIT (A) confirmed by order dated 29/4/2011
8.	71/20141	2003-04	29/11/2005	Deleted by Order dated 03/10/2006	Order of CIT(A) confirmed by Order dated 19/03/2010
9.	1166/2011	2004-058	27/11/2006	Deleted by Order dated 24/12/2007	Order of CIT(A) confirmed by order dated 29/04/2011

11. The Tribunal in the order for the assessment year 1993-94 referred to the reasoning given by the CIT (Appeals) and has recorded that there was no change in the method of computing/valuation of the closing stock for the Assessment Year 1993-94. Specific reliance was put on the observations of the CIT (Appeals) quoted above in paragraph 9 with reference to valuation of damaged closing stock of sugar at Net Realizable Value and not at the cost price. On reading the CIT (Appeals)'s order, it appears to be ambiguous and not clear. He has



accepted that the assessee had adopted Net Realizable Value for valuation of closing stock at least in respect of damaged stock. Similarly for stock, where orders had been received, Net Realizable Value method as per price indicated was adopted in past.

12. With regard to the assessment year 1990-91 the respondent/assessee had stated and it has been accepted that the valuation was done at “cost” which was less than the Net Realizable Value. In the assessment year 1991-92, it is an admitted position that damaged sugar was valued at Net Realizable Value. After examining the accounts, the Tribunal recorded the aforesaid findings in the impugned order and observed:

“We have considered the rival submissions and also perused the relevant material on record. Before us the learned counsel for the assessee has filed a statement giving details of closing stock for the immediately preceding year i.e. assessment year 1992-93 and has demonstrated satisfactorily from the values given therein that the stock was valued by the assessee in that year on the basis of cost of NRV whichever is lower. He has pointed out that value of first two items was taken at cost since the same was lower than NRV at the relevant time whereas value of third item was taken at NRV since the same was lower than its cost. It is observed from



the impugned order of learned CIT (A) that this aspect was explained on behalf of the assessee before him as well and even was accepted by him, but still he declined to accept that the method adopted by the assessee in the earlier year was cost or NRV whichever is lower and not cost. It appears that the reasons given by the learned CIT (A) to draw such inference were quite flimsy and irrelevant because having accepted that the valuation of stock items was done by the assessee at NRV wherever it was lower than cost. There was no justification in saying that such items being in damaged conditions, valuation of the same at NRV was inconsistent with the method of valuation adopted by the assessee. i.e. cost. In our opinion, the observations recorded by the learned CIT (A) in this context were self-contradictory and his action in rejecting the contention of the assessee that stock was being valued at cost even in the earlier year was not well founded. It is also pertinent to note here that the issue relating to change in method of valuation of stock by the assessee in the year under consideration was raised by the Assessing Officer on the basis of comments made by the Auditors in their report whereas the Auditor themselves vide their certificate dated 30/10/95 (copy placed at page no. 52 of assessee's paper book) clarified subsequently that these comments were based on misconception/mis-understanding and that the method of valuation of stock followed by the assessee even in the earlier year was cost or market price whichever is lower and not cost as wrongly understood or reported by them. It is thus clear that the method of valuation of stock adopted by the assessee in the earlier years was the same as in the year under consideration i.e. cost or market price (NRV) whichever is lower and there was no change in



the said method in the year under consideration as presumed/alleged by the Department.”

13. During the course of arguments before us our attention was drawn to the notes of accounts enclosed with the Auditor’s report. The relevant portion thereof reads as under:-

“Stock has been valued during the year at lower of cost or realisable price as recommended by Accounting Standard (As-2) on valuation of inventories as against cost price valuation followed upto last year. This results in reduction in income and stock valuation by Rs. 1600.30 lac during the year.”

XXXXX

XXXXXXXX

XXXXXX

“Inventories :

The inventories are valued from this year at cost or net realization value, whichever is lower.”

14. The contention of the respondent is that the statutory auditor had issued certificate dated 20.01.1996 explaining the aforesaid notes. In the certificate, he had mentioned that unshipable sugar was valued at realization value and not on cost. Other sugar, forming part of the closing stock, was valued at cost. In two more certificates dated 20.01.1996, the Chartered Accountant had stated that as on 31.03.1991 and 31.03.1994,



the value of closing stock of sugar was done at the cost or realization value, whichever was lower. Whether or not this letter was an afterthought can be debatable. The contention of the respondent assessee is that the aforesaid notes on the Auditor's report are not universal affirmative or universal negative but they state the position in the said years. They do not indicate that till the last year, the respondent assessee was valuing the closing stock at cost price alone and not on any other basis.

15. The tribunal has examined the aforesaid aspect and considered the notes and the auditor's report, the auditor's explanation and the accounts for the years in question. The CIT (A) has given a categorical finding that for the assessment year 1992-93, the assessee had valued the closing stock in respect of subject matter of export orders on Net Realizable Value and not on the cost basis with regard to the balance stock, the order of the CIT (Appeals) is vague and hazy. Similarly it has been accepted that there was no document or material to contradict that prior to 1989-90 the State Trading Corporation was the canalizing agency for export of sugar and



that the respondent/assessee were merely handling agents of State Corporation Trading. All sales, purchases and exports were accounted for by the State Trading Corporation. The respondent-assessee started export of sugar on their own in 1990-91. In the said year there was no closing stock and therefore valuation of closing stock did not arise.

16. Before us the Revenue has not been able to demonstrate and show that in the earlier Assessment Years, the respondent had valued the closing stock at cost and not on Net Realizable Value basis. No accounts have been filed by the Revenue before us and the Revenue has not shown or established that what is stated and averred in the impugned order passed by the tribunal is factually incorrect. In view of above factual position, it is not possible to hold that the order of the Tribunal is perverse. The Revenue has not placed evidence or material before us to justify their allegation and stand.

17. The next question is whether the respondent-assessee could have adopted Net Realizable Value method for valuation of the closing stock and whether it was mandatory to value the closing stock on cost basis.



This issue is no longer res integra and was settled by the Supreme Court in **Chainrup Sampatram v. Commissioner of Income-Tax, West Bengal**, (1953) 24 ITR 481 (SC) wherein it has been held as under:-

“While we agree with the conclusion that no part of the profits of the firm in the accounting year can be said to have accrued or arisen at Bikaner, the reasoning by which the learned Judges arrived at that conclusion seems to us, with all respect, to proceed on a misconception. It is wrong to assume that the valuation of the closing stock at market rate has, for its object, the bringing into charge any appreciation in the value of such stock. The true purpose of crediting the value of unsold stock is to balance the cost of those goods entered on the other side of the account at the time of their purchase, so that the cancelling out of the entries relating to the same stock from both sides of the account would leave only the transactions on which there have been actual sales in the course of the year showing the profit or loss actually realised on the year's trading. As pointed out in paragraph 8 of the Report of the Committee on Financial Risks attaching to the holding of Trading Stocks, 1919, " As the entry for stock which appears in a trading account is merely intended to cancel the charge 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 recognised 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 results a greater amount of profit than the



difference between the actual sale price and the actual cost price of the goods in question " (extracted in paragraph 281 of the Report of the Committee on the Taxation of Trading Profits presented to British Parliament in April 1951). While anticipated loss is thus taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account, as no prudent trader would care to show increased profit before its actual realisation. 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. As truly observed by one of the learned Judges in *Whimster & Co. v. Commissioners of Inland Revenue (1)*, " Under this law (Revenue law) the profits are the profits realised in the course of the year. What seems an exception is recognised where a trader purchased and still holds goods or stocks which have fallen in value. No loss has been realised. Loss may not occur. Nevertheless, at the close of the year he is permitted to treat these goods or stocks as of their market value."

18. This decision and other decisions in *A.L.A. Firm v. CIT [1991] 189 ITR 285 (SC)* and *Sakthi Trading Co. v. CIT 250 ITR 871 (SC)* were



considered by the Supreme Court in the case of Sanjeev Woolen Mills v. CIT Mumbai (2005) 279 ITR 434 (SC) and it has been observed that closing stock can be valued on cost price or at market price, if the market price is less than the cost. However, the said principle does not apply if the market value of the closing stock is more than the cost, as profits cannot be brought to tax on notional basis. In view of the aforesaid legal position there cannot be any doubt that the respondent-assessee was entitled to value the closing stock at cost price or market price whichever is lower. The respondent/assessee were admittedly exporting sugar and in view of the findings recorded above, closing stock could be valued at cost or market price, if it was lower than the cost price. The second question is accordingly answered in affirmative and in favour of the respondent-assessee and against the Revenue.

19. The third common question raises a separate issue. The question is whether the reimbursement payable by the manufactures should be included in the Net Realizable Value. This is a different aspect and relates to computation of Net Realizable Value. We have quoted the reasoning given by the Assessing Officer in the assessment order in the



assessment year 1993-94. He has stated that the international price of sugar was lower than the domestic price and therefore when the respondent/assessee had incurred losses on exports. The Assessing Officer has not disputed or stated that the international price cannot be the criteria to compute or calculate the market value. International price is not disputed. This is not the contention of the Revenue. The Assessing Officer in his reasoning has mentioned that the respondent assessee was receiving reimbursement of the loss on export from the sugar manufacturers and losses were reimbursed. Therefore, the respondent/assessee should compute the closing stock on cost basis i.e. Net realizable Value plus reimbursement, which is nothing but the cost price.

20. We have considered the said contention of the Revenue but are unable to agree with them for several reasons.

21. The Tribunal in the order for the assessment year 1993-94 has specifically recorded as under:-



“However, as explained by the learned counsel for the assessee before us, such loss in export of sugar was not fully and necessarily recoverable from the sugar mills which is evident from fact that was decided in the general meeting held on 26/3/93 that no export loss be recovered by the assessee from the sugar mills. This make it abundantly clear that the basis given by the Revenue to hold that the method of valuation of stock i.e. cost or market price whichever is lower adopted by the assessee was not proper in its case was factually incorrect.”

(emphasis supplied)

22. In the assessment order for the year 1993-94, the Assessing Officer had made an addition of Rs.71.80 lakhs on the ground that the assessee had wrongly not included reimbursements that had not been paid under the head export loss reimbursement. The Assessing Officer held that reimbursements should be computed on accrual basis as the assessee was following mercantile system of accounting. The respondent-assessee had given the following explanation why reimbursements could not be brought to tax on accrual basis and should not be included/ added to income in the Assessment Year 1993-94. The explanation of the assessee which is recorded in the assessment order reads as under:-



“During the assessment proceeding it was noticed from the annual report in part B para 2 of significant accounting policy in schedule I notes at page 28 of the annual report, a sum of Rs.71.80 lacs is yet to be received on a/c of export loss reimbursement in respect of sugar export since the income in this head is being accounted in on receipt basis. The assessee’s representative was asked to show cause as to why this amount should not be added back to the assessee’s income on accrual basis. The assessee’s representative vide his letter date 30.10.1995 has submitted that the sugar export in variably result a loss due to domestic price being always higher than the international market price. While most of the factories have reimbursed the loss, sum of them have not done so. In case of any default there is no remedy available to the export agency. (i.e. assessee’s company) under the sugar export promotion act to initiate recovery proceedings. It is, therefore contended that the loss recoverable from the factories is booked under receipt basis.”

23. The aforesaid explanation was accepted by the CIT (A) in the appeal for the assessment year 1993-94 elucidating and holding as under:-

“In the appeal proceedings, it is submitted that is wrong to way that loss is actually a refund of advance. The amount represents compensation received by the assessee from the sugar mill for not honoring the export quote obligation as no advance was given. It is further stated that the amount is not recoverable as per any legal or contractual obligation but only to avoid penalty from Excise Deptt. For not honoring the export quota and as such it is not certain whether entire loss would be reimbursed or



only part of it. On the factual position it is informed that loss of Rs. 19.33 crores had occurred in assessment year 1992-93 only which was for the quota year May 1991 to April 1992 extended to June 1992. Out of this, Rs. 11.40 crores was shown in assessment year 1992-93 on receipt basis, Rs.7.21 crores in assessment year 1993-94 again on receipt basis and Rs. 19.83 lakhs in assessment year 1995-96 and the balance amount of Rs.71.80 lakhs is yet to be received. It is submitted that except in quota year 1991-92 which mostly related to assessment year 1992-93 where there was a loss in exports, in no other quota year there has been in loss to the assessee. From this facts it approve that it is loss of quota year 1991-92 which is being recovered and being shown as and when received. I accordingly accept the contention of the assessee that this refund has to be taxed only on the receipt basis.”

24. The Tribunal dismissed the appeal of the Revenue on the said aspect. The Revenue thereafter had preferred an appeal before this Court which has been dismissed vide order dated 12.10.2004 in ITA No.121/2003. It is clear from the aforesaid orders that there was no statutory or contractual obligation under which the respondent-assessee could have claimed reimbursement of export losses from the mills/manufacturers from whom it had procured/purchased sugar for export. The obligation, if any, was moral but non statutory or non



contractual. The facts recorded by the CIT (Appeals) in the first appellate order in the assessment year 1993-94 reveal that losses in some cases were not paid or were uncertainable as they might not be acceptable to the mills/manufacturers. In these circumstances, the third question of law and the question of law framed on 26.5.2006 in ITA No.794/2006 has to be answered in affirmative against the Revenue and in favour of the respondent-assessee.

Additional Question Issue in ITA No.1166/2011

25. In ITA No.1166/2011 an additional question of law has been raised by the Revenue. The contention of the appellant-Revenue is that the assessee is not entitled to depreciation in respect of lease hold rights in office/ flat, and car parking space etc. as the respondent/assessee was not the registered owner. We are not inclined to frame any question of law on the aforesaid question as this issue has to be decided against the Revenue and in favour of the respondent-assessee in view of the decision of the Supreme Court in Mysore Minerals v. CIT [1999] 239 ITR 775.

26. It is not the contention of the Revenue that the respondent-assessee



was not in possession of the property and had not acquired interest in the said property as per Section 53A of the Transfer of Property Act, 1882. Merely because the assessee did not have a registered sale deed cannot be a ground to deny depreciation under Section 32 of the Act, if other conditions are satisfied.

27. The appeals are accordingly dismissed. No costs.

SANJIV KHANNA, J

R.V.EASWAR, J

JANUARY 30, 2012
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