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IN THE INCOME TAX APPELLATE TRIBUNAL  
(DELHI BENCH : 'F' NEW DELHI)  
BEFORE SHRI R.V. EASWAR AND SHRI RAJENDRA SINGH

ITA No.4532/Del./03  
(Assessment Year : 1995-96)

M/s Beekay Appliances (P) Ltd.,  
16/5, Mathura Road,  
Faridabad.

Vs.

DCIT, Range-I,  
Faridabad.

(Appellant)

(Respondent)

Assessee by : Shri Ved Jain & Smt. Ramo Jain  
Revenue by : Shri Santanu Dhamija

ORDER

PER R.V. EASWAR, VP

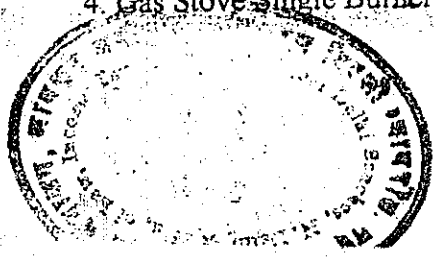
This appeal by the assessee relates to the AY 1995-96. The assessee is a company engaged in the manufacture of gas stoves.

2. The first and seventh grounds are general and require no decision.

3. Ground nos. 2 to 5 are directed against the addition of Rs.23,68,264 on account of difference in stock as per the assessee's books and the statement of stock submitted to the bank. The brief facts in this connection are that in the assessee's balance-sheet as on 31.3.1995, the stock of finished and semi-finished goods were shown as nil. However, the raw materials were shown at Rs.22,30,550 and the packing material were shown at Rs.4,20,895. The total stock thus came to Rs.26,51,445. According to the information collected by the AO from Bareilly Corporation Bank Ltd., Faridabad from whom the assessee was enjoying credit facilities against the hypothecation of stock, the assessee had submitted the statement of stock as on 31.3.1995 to the bank disclosing the following position:

"SEMI-FINISHED GOODS:

1. Gas Stove 4 Burner S.S.	415 Nos.	980.00	406,700.00
2. Gas Stove 3 Burner S.S.	638 Nos.	418.00	266,684.00
3. Gas Stove Double Burner SS	3953 Nos.	385.00	1521,905.00
4. Gas Stove Single Burner SS	935 Nos.	185.00	172,975.00
			<u>2368264.00</u>



RAW MATERIAL

Stock Components of the stoves	<u>1030,670.00</u>
	3398,934.00
Less: Sundry Creditors:	<u>804,635.00</u>
	2594,299.00
Less: Margin 35	<u>908,005.00</u>
	<u>1686,294.00"</u>

Noticing the difference between the stock shown in the assessee's balance-sheet and the stock shown to the bank, the AO called upon the assessee to explain the difference. In particular, he noticed that whereas the value of semi-finished goods comprising of gas stoves of different varieties was shown to the bank at Rs.23,68,264, no such stock was shown in the balance sheet.

4. In response to the AO's query, the assessee wrote to the AO a letter containing its explanation. The same is not reproduced here for the sake of brevity. It is reproduced in the assessment order. In brief what the assessee stated was that while preparing the balance sheet the entire stock (semi-finished goods) was converted into components and treated as raw material. In other words, it was the assessee's claim that the same stock which was shown as raw material in the balance sheet at Rs.22,30,550 was shown to the bank as semi-finished goods at Rs.23,68,264 inclusive of the margin of profit. It was the assessee's case that the raw material for the gas stoves consisted of different components which were being outsourced by the assessee and that a very small process of merely assembling the components was required in order to arrive at the semi-finished stage and thus there was substantially no difference between the components and the semi-finished stage of the gas stoves. It was also submitted that all the quantitative information with respect to the stock, purchases and sales were given to the AO and the valuation has been done accordingly to the method consistently followed by the assessee and that the accounts of the assessee were audited and the auditors have not found any major discrepancies between the physical stock and the book stock. It was prayed that in these circumstances, there was no justification to treat the difference as income of the assessee.

5. The AO rejected the explanation in the following words:

"The assessee's reply has been considered and is not acceptable. It's plea that the stock in the statement submitted to the bank was inflated in order to get the maximum credit facilities, cannot be relied upon since the details of the different

items manufactures by it have been mentioned in the said statement. Relying on the cases of Coimbatore Spinning & Weaving Co. Ltd. vs. CIT (1974), 95 ITR 375 (Mad.), Gaidawal Honda & Sons vs. CIT (1980), 18 CTR (P&H) 210, and Swadeshi Cotton Mills Co. Ltd. vs. CIT (1978), CTR (All.) 349, the book results are rejected and the stock as shown to the bank is taken as the true stock with the assessee."

He accordingly added the value of the ~~sum~~<sup>same</sup> by way of unaccounted stock. The assessment was completed accordingly and semi-finished goods shown to the bank at Rs.23,68,264 as the assessee's income

6. On appeal, the addition was confirmed by the CIT(A) who relied on the judgment of the Madras High Court in the case of Coimbatore Spinning & Weaving Co. Ltd. Vs. CIT, 95 ITR 375

7. The assessee is in further appeal. We have considered the facts and the rival contentions. The arguments of the Ld. Representative for the assessee were -

- (a) there is a difference between hypothecation of stock and pledge of stock in the sense that in the case of hypothecation the goods remain with the assessee whereas in the case of pledge the goods remain in the custody of the bank and, therefore, the certificate of valuation is given by the bank and it enjoys more credibility and that in the present case it is not a case of pledge, but it is a case of hypothecation where the stock statement is given by the assessee in which some inflation in order to enjoy more facility cannot be ruled out.
- (b) The certification given to the assessee by the bank can at best only be a starting point for further enquiry and cannot by itself justify the addition.
- (c) The AO was not justified in rejecting the book result without finding any defect in the books.
- (d) The assessee is liable to excise duty and it has maintained all the records liable to be maintained under the Excise Duty Law and the excise authorities not having found any defect in these records, the rejection of book result was not justified.
- (e) The comparison of the gross profit rate between the year under appeal and the earlier years shows a favourable position in the sense that whereas for the AYs 1993-94 and 94-95, the gross profit rate was 20.84% and 20.30%, it improved to 21.94% for the year under appeal which is a prime facie indication that the book result were fair and reasonable. In this context, it was further pointed out that the addition made for the stock would raise the gross profit rate to fantastic level which is impossible to achieve.



- (f) The accounts of the assessee are audited u/s 44AB of the Act and the tax auditors have furnished complete quantitative particulars of stock of raw material, finished and semi-finished goods and the packing material (pages 12-14 of the paper book) and these details have not been found to be incorrect of manipulated.

Our attention was drawn to the judgment of the Hon'ble P&H High Court, which is the jurisdictional High Court insofar as the present assessee is concerned, in the case of CIT(A) vs. Sidhu Rice & General Mills (2004) 192 CTR 349 as also the judgment of the Allahabad High Court in CIT vs. Khan & Sirohi Steel Rolling mills (2006) 200 CTR 595. It was submitted that the P&H High Court has held that where the AO has not brought any material on record except the stock statement furnished by the assessee to the bank, to show that the assessee in fact possessed a larger quantity of stock, the view taken by the Tribunal that the addition was not justified is a possible view and cannot be held to be perverse. In the case of the Allahabad High Court it was pointed out that there is a distinction between hypothecation of stock and pledge of stock and where the stock statement furnished by the assessee in the case of hypothecation has not been verified by the bank officials, no addition can be made on account of difference in the stock, ~~record~~ being held to the prevailing practice of inflating the stock for availing of higher credit facilities. It was further submitted that the judgment of the P&H High Court in the case of Devgon Rice & General Mills vs. CIT, 263 ITR 391 is not against the assessee.

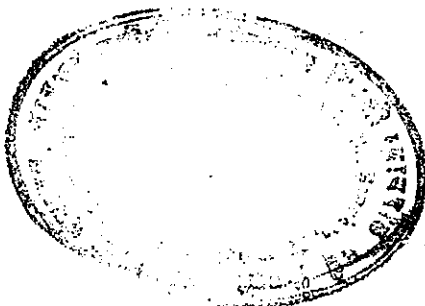
8. On the other hand, the Ld. Sr. DR, Mr. Santanu Dhamija submitted as under:

- (a) the addition can be stated to be incorrectly made only if it is a pure estimate or pure work, which is not the case.
- (b) the AO has clearly established that there is a difference in quantity of stock and not mere price differences which could be a matter of opinion.
- (c) there is no explanation from the assessee as to why the semi-finished goods, though shown in the certified to the bank was not shown in the balance sheet or in the return of income.
- (d) there is a value addition to the stock at very stage of assembling the product which has not been recognized by the assessee which is a major flaw. It is not as if the components when assembled do not gain in value. The value of the final product which is the gas stove is not the same as the sum total of the values of the components which go to make it. This principle has not been recognized in the accounts of the assessee.

- (e) the fact that the gross profit rate shown by the assessee compares well with the rate shown in the earlier years is of no relevance to the dispute.
- (f) enough materials have been brought on record for rejecting the book result. And the assessee has not taken any specific ground against the rejection of the book result.
- (g) The judgment of the Hon'ble P&H High Court in the case of CIT vs. Sidhu Rice & General Mills (supra) has not laid down any legal proposition and that it is distinguishable on facts. It is submitted that the facts in the case of Coimbatore Spinning & Weaving Co. Ltd. (supra) are the same as in the assessee's case and hence rightly relied by the CIT(A).

9. The Ld.Sr.DR also cited the judgments of the Hon'ble P&H High Court in ITO vs. Emerson Paul Plastic Company and Others, 191 ITR 560 and CIT vs. Lal Chand Tirath Ram, 225 ITR 675 to contend that on similar facts penalty and prosecution proceedings were successfully launched by the department in these cases.

10. In our view, the addition is not justified. The assessee admits that there is a difference between the balance sheet and the stock statement furnished to the bank insofar as semi-finished goods are concerned. However, it seems to us that the assessee's explanation has not been appreciated in the correct perspective by the departmental authorities. It has stated that what was shown in the balance sheet as raw material was nothing but the components parts of the gas stove which, when assembled became semi-finished goods which were shown to the bank in the stock statement. It has to be appreciated that the assessee did not show any semi-finished goods in the balance sheet as on 31.3.1995. In other words, what was shown in the balance sheet as raw material was shown to the bank as semi-finished goods. The difference in value between the two represents the profit margin. This takes care of the argument of the Ld.Sr.DR that the value of the gas stove is more than the aggregate of the values of the components. The raw material has been valued in the balance sheet at Rs.22,30,550 whereas the semi-finished goods have been valued at Rs.23,68,264. It is also to be noted that whereas the packing materials were shown at Rs.4,20,895 in the balance sheet, no value was placed on them in the statement given to the bank.



11. Apart from the above, the AO has rejected the book result only because of the difference in the stock position as shown in the balance sheet and as reflected in the stock statement given to the bank. We are of the view that the book result cannot be rejected simply for this reason. As pointed out on behalf of the assessee, the alleged discrepancy between the balance sheet and the stock statement given to the bank can furnish the basis for a detailed enquiry into the accounts of the assessee and if upon enquiry it is found as a fact that the assessee did possess higher stock than what it declared in the balance sheet, then there would be strong basis for the addition. The assessee's accounts are audited under the Companies Act as well as u/s 44AB of the Income-tax Act. The tax auditors have given the complete stock particular in pages 12-14 of the paper book. The statutory auditors have also stated in the annexure to the report that the procedure of physical verification of stock followed by the management is reasonable and adequate and that no material discrepancies have been noticed on physical verification of the stock. Further, the rate of gross profit showed for the year under appeal at 21.94% compares well with the rate of gross profit shown for the immediately two preceding years at 20.30% and 20.84%. It was argued on behalf of the department that the gross profit rate was irrelevant to the dispute. We are unable to say that it is irrelevant because the addition of Rs.23,68,264 made as unaccounted stock would raise the gross profit rate to a fantastic level which an assessee in the business of manufacture of gas stove may not be able to achieve. The rate of gross profit declared by an assessee is generally accepted as an indicator of the reliability of the accounts. Even in the income tax assessment, generally, the starting point of any enquiry is the rate of gross profit and if there is a steep fall compared to the earlier year, the accounts are subject to closer scrutiny to find out if they are reliable and in case further defects in the maintenance of the accounts or the method of accounting are unearthed, the departmental authorities do reject the book results and estimate the profits. It cannot therefore, be said that the rate of gross profit is wholly irrelevant to the present issue. It furnishes a reliable guide to test the veracity or reliability of the accounts. In the present case apart from relying on the stock statement given to the bank, no other evidence has been brought on record to justify the rejection of the books. In the judgment of the Hon'ble P&H High Court in the case of CIT vs. Sidhu Rice & General Mills (supra) it has been held that mere reliance on the

stock statement furnished by the assessee to the bank, without any other material brought on record to show that the assessee in fact possessed a larger quantity of stock, cannot justify the addition for stock. In this case, the Hon'ble high Court has also taken note of the fact that the CIT(A) did observe that the assessee had merely hypothecated the stock without pledging the same and that there was no evidence that the stock was ever verified by the bank. The facts of the present case fall within the ruling of the Hon'ble jurisdictional High Court. The argument of the Ld. Sr. DR that this judgment does not lay down any law as it has merely dismissed the appeal u/s 260A in limine on the ground that there was no substantial question of law, cannot be accepted in the light of the legal position adumbrated by the Gujarat High Court in Nirma Industries (283 ITR 402). In this judgment, it has been held by the Gujarat High Court as follows:

"In the result, the effect of dismissal of a tax appeal by the High Court holding that no substantial question of law arises is that the order of the Tribunal on the issue which was agitated by the appellant before the High Court stands merged in the order of the High Court, and for all intents and purposes it is the decision of the high Court which is operative and which is capable of being given effect to. It is not open to any person to contend that there is no decision of the high Court and the subordinate forum is entitled to take a contrary view than the one adopted in the earlier proceedings which have been affirmed by the High Court by a process of dismissal of the appeal simpliciter."

12. In the light of the above position, we are unable to give effect to the argument of the Ld. Sr. DR that an order of the High Court dismissing an appeal u/s 260A in limine on the ground that no question of law arises, does not lay down any legal principle and does not have binding effect.

13. There is one more fact of considerable significance which needs to be adverted to. The assessee is subject to excise duty and is obliged to maintain records under the Excise Duty Law. In the stock statement dated 6.4.95 given to the bank, which is extracted in the letter written by the assessee to the AO which is reproduced in pages 2 & 3 of the assessment order, the assessee has given the break up of higher figures of stock given to the bank. The break up shows that the semi-finished goods included 415 of gas stoves of four burners and 638 numbers of gas stoves with three burners. In its letter dated 8.3.2002, written to the AO (pages 48-55 of the paper book) the assessee has stated that it never produced stoves with three or four burners and it never sold such stoves either in



the past or subsequently. It has further stated that this fact can be verified from the excise record maintained by the assessee and in fact the assessee produced the excise production record in original before the AO for verification. No adverse comment has been made by the AO with regard to this claim made by the assessee. In the letter the assessee has further stated that the sales tax assessment, also do not disclose any sale of gas stoves with three or four burners. The relevant sales-tax assessment order, were enclosed to the letter. The license issued by the Bureau of Indian Standards, was also attached to the letter which showed that the assessee company was licensed to produce only single and double burner stoves. All these claims were put forth before the AO along with the relevant evidence which have not been adversely commented upon by the AO. In fact, he has not adverted to such evidence at all. These claims were made to support the argument that the stock shown to the bank was inflated in order to get maximum credit facility. It, therefore, seems to us, having regard to the evidence referred to above, that the statement given to the bank has no credence.

14. In the light of the above, we hold that the addition is not justified. We delete the same <sup>and</sup> allow the grounds.

15. Ground no.6 is directed against the disallowance of R.12,160 on account of sales promotion expenses. The Ld.Representative for the assessee drew our attention to pages 38, 58 and 66-67 of the paper book to show that the items marked in these pages are not sales promotion at all. It is the assessee's claim that if these items are removed from consideration, there will be nothing to be disallowed as sales promotion expenses. WE find that these items are not on account of entertainment, but they relate mostly to purchase of gas lighters. Taking an over all view of the matter, we reduce the disallowance on account of entertainment element in the sales promotion element to Rs.5,000 and allow the ground in part.

16. In the result, the appeal of the assessee is partly allowed. No costs. Decision pronounced in court on 6<sup>th</sup> Oct, 2006.

*SKB*  
(RAJENDRA SINGH)  
ACCOUNTANT MEMBER  
Delhi, Dated, Oct. 06, 2006.  
SKB

*SKB*  
(R.V. EASWAR)  
VICE PRESIDENT



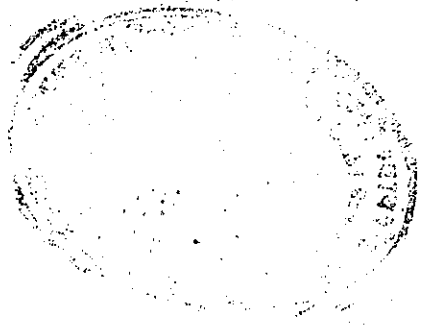


Copy forwarded to:

- 1. Appellant
- 2. Respondent
- 3. CIT
- 4. CIT(A), Faridabad.
- 5. CIT(ITAT), New Delhi.

*By hand,*

*17A4532/03.*



AR/ITAT

आसिस्टंट रेजिस्ट्रार  
Assistant Registrar  
आयकर विभाग  
Income Tax Department  
दिल्ली  
Delhi

