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IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'D': NEW DELHI

BEFORE SHRI C.L. SETHI, JUDICIAL MEMBER &
SHRI SHAMIM YAHYA, ACCOUNTANT MEMBER

ITA no. 1466/Del/2009
Assessment Year : 2005-06

M/s. Jindal Drilling & Industries Ltd.,
Suit No. 101, 70/B, Shivaji Marg,
New Delhi
PAN: AAACJ 0797 L
(Appellant)

Vs. Add. Commissioner of Income Tax,
Range - 4,
New Delhi
(Respondent)

Appellant by : Shri Ved Jain, CA and
Ms. Rano Jain, CA
Respondent by : Shri I.P.S. Bindra, Sr. DR

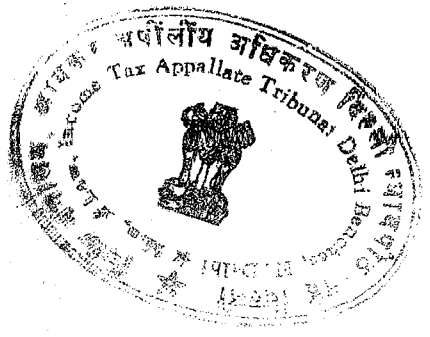
ORDER

PER: C.L. SETHI, J.M.

The assessee is in appeal against the order dated 30.01.2009 passed by the ld. CIT(A) in the matter of an assessment made u/s. 143(3) of the Income Tax Act, 1961 ("the Act") dated 31.12.2007 by the AO for the A.Y. 2005-06.

2. The first issue raised in this appeal is as under:-

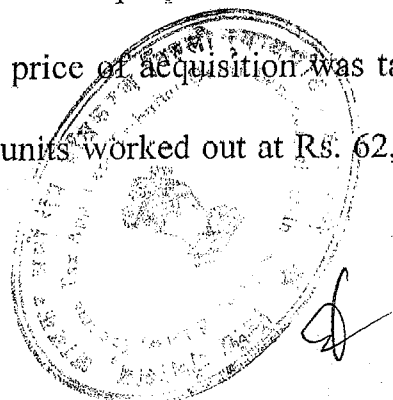
"2(i) On the facts and circumstances of the case, the ld. AO has erred both on facts and in law in confirming the disallowance of an amount of Rs. 60,25,742/- on account of short term capital loss.



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(ii) That the above said disallowance has been made by taking Rs. 1,12,129/- as against Rs. 61,37,871/- loss claimed by the assessee."

3. Briefly stated, the relevant facts leading to the aforesaid issue may be stated that in the course of assessment proceedings, it was noticed by the AO that the assessee has shown short-term capital gain at Rs. 9,39,671/-, which amount has been arrived at after setting off of short-term capital loss of Rs. 61,37,871/- incurred on transaction relating to TATA Gilt Securities Fund. The assessee was asked to furnish the details thereof. From the details filed by the assessee, it was revealed that a sum of Rs. 1.25 crores was invested on 23.11.2004 to purchase 53116.996 units. Subsequently, on 01.03.2005, bonus @ 1:1 was issued and thus, the assessee acquired further 53116.90 units by way of bonus. The assessee sold original holding for Rs. 63,62,129/-. The assessee stated before the AO that short-term capital loss was calculated on the transaction of sale of units using FIFO method, but the profit in the books was arrived at by using average price method. The assessee stated that the original units acquired for 1.25 crores was sold for an amount of Rs. 63,62,129/-, and, thus, the assessee has incurred loss of Rs. 61,37,871/-, and for the purpose of assessment, the loss was claimed though in the books the price of acquisition was taken at average price of original units and bonus units worked out at Rs. 62,50,000/-, and, thus, the profit of



Rs. 1,12,129/- (Rs. 63,62,129/- (-) Rs. 62,50,000/-) was shown in the books of accounts.

4. The AO stated that the assessee was not a trader in securities nor a share broker. The investment in the securities were made as investment and the securities did not form as stock in trade. The AO spreaded over the cost of original units over the original units and bonus units. The AO, therefore, stated that the method of FIFO could have been resorted to by the assessee if the investment were held as stock in trade. The AO, therefore, disallowed the loss of Rs. 61,37,871/- as against which he assessed the income by taking the profit from the transaction at Rs. 1,12,129/- as short-term capital gain on the transaction of sale of units of TATA Gilt Securities Fund.

5. On an appeal, the CIT(A) confirmed the AO's action by observing that where bonus shares are issued and some of the original shares are sold subsequently, their actual cost has to be reckoned only on the basis of average value. In this connection, the CIT(A) had made a reference to the decision of Delhi High Court in the case of Escorts Farms (Ramgarh) Ltd. vs. CIT (1983) 143 ITR 749, the decision of Hon'ble Gujarat High Court in the case of Alembic Chemical Works Company Ltd vs. CIT (1962) 194 ITR 497, 501 (Guj.), decision of Hon'ble Supreme Court in the case of Escorts Farms (Ramgarh) Ltd. vs. CIT (1996) 222 ITR 509, 522 and in the case of

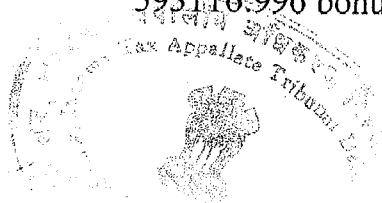


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CIT vs. Dalmia Cement Co. Ltd. (1964) 52 ITR 567 (SC). The CIT(A), therefore, uphold the findings of the AO that the short-term capital gain/loss has to be worked by taking a difference between full consideration of the sale of share less the value as on the date of acquisition calculated on the spread over principle i.e. acquisition of original share has to be determined on the basis of average cost of original shares over the original shares and the bonus shares.

6. Being aggrieved, the assessee is in appeal before us.
7. We have heard both the parties and have carefully gone through the orders of the authorities below. We have deliberated upon the position of law contained in that behalf.
8. There is no dispute in saying that the Hon'ble Supreme Court in the case of Escorts Farms (Ramgarh) Ltd. vs. CIT (supra) followed its earlier decision in the case of CIT vs. Dalmia Cements Co. Ltd. (supra) and had taken a view that the correct method of valuing the cost to a person of bonus shares allotted to him in consideration of his holding of original shares is to spread the cost of the original share over the original and bonus shares collectively, and to find out the average price of all the shares, and this rule applies whether the assessee is a dealer or investor. However, an amendment was brought in the Income Tax Act by inserting clause (aa) to

sub-section (2) of section 55 of the Act, where it has been provided that the cost of the bonus shares will be taken as NIL for computation of capital gain on sale of bonus shares, and this would not affect the cost of original shares. This procedure is applicable to shares or securities within the meaning of clause (h) of section 2 of the Securities Contract (Regulation) Act, 1956, which have been referred to as "financial assets" for the purpose of section 55(2)(aa) of the Act. Hence, in the present case, the cost of units originally acquired would be the amount of purchase or cost paid by the assessee at the time when the same were acquired and the same would not be spreaded over the original units and the bonus units. The position in this respect applicable from the A.Y. 1996-97, is thus, different from the years prior to that, and thus, the decision of Hon'ble Supreme Court in the case of CIT vs. Dalmia Cement Co. Ltd. (supra) and in the case of Escorts Farms (Ramgarh) Ltd. vs. CIT (supra) shall have no application to the present case, which is covered by the provisions of section 55(2)(aa) inserted from A.Y. 1996-97. We, therefore, hold that, in the present case, the cost of the original 593116.996 units sold by the assessee during the year under consideration shall be taken at Rs. 1.25 crores, being the cost of acquisition of original 593116.996 units, and this cost of Rs. 1.25 crores shall not be spreaded over the original 593116.996 units and 593116.996 bonus units, and the cost of 593116.996 bonus units shall be taken at NIL. Be it stated here as and when



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the bonus units shall be sold or transferred, the cost thereof shall be taken at NIL as so provided u/s. 55(2)(aa) of the Act.

9. In the light of the view we have taken above, we, therefore, hold that the assessee had incurred a loss of Rs. 61,37,871/- i.e. difference between sale consideration of 593116.996 units of Rs. 63,62,129/- and the cost of its acquisition of Rs. 1.25 crores. We, therefore, direct the AO to allow the assessee's claim of loss on sale of units claimed at Rs. 61,37,871/- and modify the assessment order accordingly. Thus, the ground no. 2 raised by the assessee is allowed.

10. The next ground raised by the assessee is directed against the CIT(A)'s order in confirming the disallowance of Rs. 25,85,942/- on account of unusable old raw material.


11. It was noticed by the AO that in the profit and loss account, the assessee had shown an amount of Rs. 25,85,942/- under the head "loss of unusable old raw material" in the category of materials and operations charges. The assessee submitted before the AO that this loss relates to stock of C.S. pipes, which had become rusted and useless and opening stock of Rs. 60.74 lacs of CS pipes was there, at the beginning of the year, out of which sale of Rs. 4 lacs was made during the year. The balance stock was valued by the assessee at Rs. 30,88,188/-, and after deducting the sale of Rs. 4 lacs,



a loss of Rs. 25.86 lacs was claimed on account of unusable raw material. Before the AO, the assessee had submitted a report of Shri R.K. Aggarwal, Government Registered Valuer, who valued the scrap and found it to be useless and estimated their value at Rs. 18,000/- per tonne. The valuer determined the value thus at Rs. 30,88,188/-. However, this explanation of the assessee was not accepted by the AO by observing that the report of the valuer is dated 09.05.2005 i.e. subsequent to the closing of the financial year, and that the assessee could not substantiate as to why scrap material valued at Rs. 30,88,188/- could not be sold at the price more than that. The AO also observed that accept the valuer's report, no other details were furnished by the assessee. Considering the valuer's report as estimated figure, the AO disallowed the assessee's claim and made the addition of Rs. 25,84,942/-.

12. On an appeal, the CIT(A) confirmed the addition by observing as under:

"Rival contentions have carefully been considered. After considering the rival submissions I find that the appellant company is a big company having the annual turn over of more than Rs. 100 crores which by normal practice of business may result in yielding some scrap or unusable material. This feature is an annual feature. However, I find that the valuation of such unusable material has not been adopted on annual basis as a continuous accounting practice. I fail to understand that why the unusable material should be valued in a particular year which is a deviation from the accounting practice followed



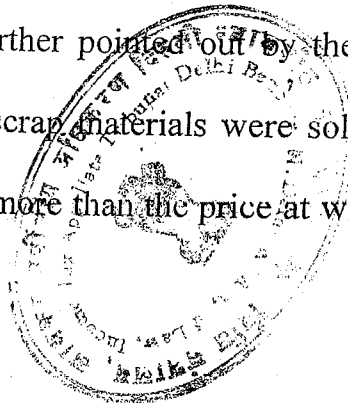
by it consistently. Such unusable material, is in fact, saleable. Therefore, whenever the same is sold out, the consideration of the same should have been credited in its sale proceed. If the same is discarded, the same effect should have been given in its opening stock and closing stock. Furthermore, I am of the view that a loss or gain can be worked out only when there is a sale of a particular material and not on the basis of the valuation. On the basis of the valuation of stock, the effect can be given only in its trading account by substituting the value of the closing stock. Since the method of computation of the loss in the said transaction is not in conformity with the accounting practice followed by it for last several years, I uphold the findings of the Assessing Officer in disallowing the loss of Rs. 25,85,942/- claimed by it which is merely a notional loss and not the actual loss. Therefore, the appellant's appeal on this ground also stand dismissed."

13. Still aggrieved, the assessee has raised this issue in this appeal before

us.

14. The ld. counsel for the assessee has submitted that the assessee has been following method of valuing the closing stock at cost or market price, whichever is lower. The assessee got the closing stock of scrap pipes valued from the registered valuer, who valued the same at market price and, accordingly, the assessee adopted the same and determined the profit or loss, as the case may be, accordingly. He further submitted that the goods in question were four years old and were very much deteriorated in the quality.

It was further pointed out by the ld. counsel for the assessee that closing stock of scrap materials were sold subsequently in the following year, and the price more than the price at which it was valued could not realized. He,

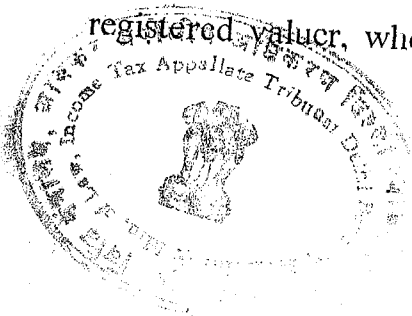


therefore, submitted that the value of closing stock adopted by the assessee by the end of the year is supported by sale of the same materials sold in the immediate next year.

15. The Id. DR, on the other hand, supported the order of the authorities below to contend that the authorities below were very much justified in rejecting the assessee's claim of loss on account of valuation of closing stock in as much as the closing stock valued by the assessee was not correct having regard to the method of accounting regularly and consistently followed by the assessee.

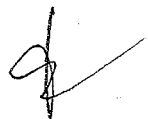
15. We have heard both the parties and have carefully gone through the orders of the authorities below.

16. The assessee had an opening stock of seamless pipes which were purchased for utilizing the same for manufacturing purposes in earlier years but could not be utilized. This has resulted in the degradation in quality of the pipes. The pipes were ultimately sold as scrap in the F.Y. 2005-06 relevant to the A.Y. 2006-07. The assessee was following the method of valuing the closing stock at cost or market price, whichever is lower. To determine the market value as at the end of the year ended on 31.03.2005 relevant to the A.Y. 2005-06, the assessee got the materials valued by registered valuer, who valued the stock of materials at Rs. 30,88,188/- as



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against opening value of Rs. 60,74,180/- less Rs. 4,00,050/- sold during the year. The assessee has produced the sale invoices of the pipes sold during the next year which indicates that the pipes were sold subsequently at the rate of Rs. 18,000/- per metric ton, the same rate at which the registered valuer valued the pipes as on 31.03.2005. From the details of sale of pipes sold subsequently and from the report of the registered valuer, it is established that the realizable value of the seamless pipes lying in stock with the assessee was only Rs. 30,88,188/-. Since the closing stock was being valued at cost or net realizable value or market price, whichever is lower, the assessee was justified in valuing the closing stock at market rate, which was determined by the valuer at Rs. 30,88,188/-. The AO has nowhere brought any material on record to say that the realizable market price of the closing stock was more than the amount at which the assessee valued the same. The AO has rejected the valuer's report merely because it was dated 09.05.2005. However, it is pertinent to note that the valuer valued the value of closing stock as on 31.03.2005 vide his report dated 09.05.2005. Therefore, rejecting the valuer's report on this account by the AO is not found to be justified. Further, it is also pertinent to note that in the subsequent years when the goods were sold at Rs. 30,88,188/-, the AO has not adopted the opening value at Rs. 60,74,180/- and allowed the loss in the next year. Since in the next year, the sale value has been accepted at Rs. 30,88,188/-



alongwith the opening value of Rs. 30,88,188/-, the question of taking the value of closing stock at Rs. 60,74,180/- in the current year would not arise. Therefore, on this count, the loss disallowed by the AO is otherwise not justified. In this view of the matter, we, therefore, set aside the orders of the authorities below on this issue, and direct the AO to allow the loss of Rs. 25,85,942/- on account of valuation of unusable old seamless pipes. We order accordingly.

17. In the result, the appeal filed by the assessee is allowed.

18. This decision is pronounced in the open court on 31st March, 2010.

(SHAMIM YAHYA)
ACCOUNTANT MEMBER

(C.L. SETHI)
JUDICIAL MEMBER

Dated: 31st March, 2010
*Nitasha

Copy to:

1. Appellant
2. Respondent *Adds. CIT, Range 4, MD*
3. CIT
4. CIT(A)
5. DR, ITAT, New Delhi.

By Order
Assistant Registrar
Deputy Registrar
Income Tax
Delhi Division, New Delhi

