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News Alert  
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## **Provisions of section 145A of the Income-tax Act should be scrupulously followed for valuing inventory to determine the correct taxable income**

### **In brief**

In a recent decision in the case of Hercules Pigment Industry<sup>1</sup> (the assessee), the Income-tax Appellate Tribunal (the Tribunal), Mumbai held that provisions of section 145A of the Income-tax Act, 1961 (the Act) should be scrupulously followed while valuing the inventory in order to determine the correct taxable income. The Tribunal also held that the valuation of closing stock cannot be a source of income or profit<sup>2</sup>.

<sup>1</sup> Hercules Pigment Industry v. ITO [TS-218-ITAT-2013(Mum)]

<sup>2</sup> While this decision deals with other issues also, this news alert covers only the issue pertaining to the applicability of section 145A of the Act on valuation of closing stock.

### **Facts**

- The assessee was a partnership firm in the business of manufacturing and marketing organic pigments according to international standards.
- The assessee stated that it had valued its closing stock including all taxes, as mandated by section 145A of the Act. Furthermore, the assessee took excise duty paid on purchases and recovered on sales to a Central value added tax (CENVAT) credit account.
- During the assessment, the assessing officer (AO) disallowed the balance in the unutilised CENVAT Credit Account (UCC A/c) of INR 1.39 million stating that

it had an impact on the valuation of inventory according to section 145A of the Act.

- On appeal, the Commissioner of Income-tax (Appeals) (CIT(A)) confirmed the order of the AO. However, the CIT(A) allowed relief of INR 0.339 million to the assessee.
- The assessee appealed against the CIT(A) order before the Tribunal, Mumbai.

### Issues before the Tribunal

- Whether the assessee has correctly determined the profit and the operating results for the relevant assessment year irrespective of following the exclusive or inclusive method of accounting?

### Assessee's contentions

- The assessee has followed the inclusive method of accounting as mandated by section 145A of the Act and hence there should not be any enhancement or change in income.
- The amount outstanding in the unutilised CENVAT credit account (UCC account) in the books of accounts is a different aspect of the matter and need not be correlated with section 145A.

### Revenue's contentions

- According to section 145A of the Act, the profit disclosed by the assessee should be enhanced by the amount outstanding in the unutilised CENVAT credit account.
- The CIT(A) has already allowed relief to the extent that the assessee could ostensibly show a double effect

### Tribunal Ruling

- Section 145A of the Act is only an accounting prescription which is consistent with the accepted accounting principles of valuation of inventories. The valuation of inventories is relevant because they help in determining the correct profit and they cannot be a source of income or profit.
- CIT(A) has not allowed relief to the assessee on account of unutilised CENVAT credit but only directed adjustments to the extent that excise duty is included in the valuation of closing stock.
- The Tribunal referred to the Supreme Court of India (the SC) rulings in Chainrup Sampatram<sup>3</sup>, Chowringhee sales Bureau Pvt. Ltd.<sup>4</sup> and Sinclair Murray & Co. Pvt. Ltd.<sup>5</sup>, wherein it was held that it was the nature and quality of receipts or payments that are relevant in determining its taxability, and not its accounting treatment.
- The assessee has not followed the accounting treatment as prescribed by section 145A of the Act, as the purchases were not accounted for at gross of duties but were taken into a separate account called UCC account.
- If the books are maintained on an exclusive basis, i.e. recording payment or recovery of duties in a separate account, then a separate profit and loss account in terms of section 145A of the Act should be prepared for tax purposes.
- The Tribunal referred to the SC ruling in Indo Nippon Chemicals Co. Ltd.<sup>6</sup> wherein it was held that the assessee could follow any of the two methods, i.e. gross or net method of accounting, for reporting taxable profits, provided they lead to the same results and pass the test of under section 145A of the Act. This

<sup>3</sup> Chainrup Sampatram v. CIT [1953] 24 ITR 481 (SC)

<sup>4</sup> Chowringhee sales Bureau Pvt. Ltd. v. CIT [1973] 87 ITR 542 (SC)

<sup>5</sup> Sinclair Murray & Co. Pvt. Ltd v. CIT [1974] 97 ITR 615 (SC)

<sup>6</sup> CIT v. Indo Nippon Chemicals Co. Ltd [2003] 261 ITR 275 (SC)

was reiterated by the SC in the case of Shri Ram Honda Power Equipment Ltd.<sup>7</sup> wherein it was held that both the gross method and the net method were at par.

- Also, in Raj Petro Specialties Pvt. Ltd.<sup>8</sup>, the Tribunal held that sections 43B and 145A of the Act were non-obstante provisions and were to be read in harmony, there being no conflict between these two sections. Therefore, any deduction in respect of excise duty payable to the central government on value addition will only be on actual payment according to section 43B of the Act.
- Only adopting all figures at the correct values would lead to the correct profit as per section 145A of the Act. The balance in UCC account could not be taken as a surrogate measure of excise component in the inventories, since it did not represent the un-utilized credit available on goods held as stock in trade. It allows full adjustment of the excise liability on the removal of goods. Hence, the UCC account thus prepared was not consistent with the accounting principles.
- The assessee needs to draw a profit and loss statement in accordance with section 145A of the Act, confirming that the amount of excise duty is included in the value of opening stock, purchases and closing stock in such a way that the CENVAT credit account is effectively incorporated in the profit and loss account and correct profit has been determined.

## Conclusion

- The Tribunal has examined in detail the difference between the gross basis and the net basis of accounting in terms of section 145A of the Act.
- Recommending a periodic reconciliation between accounts and excise records, the Tribunal has reiterated the primacy of section 145A of the Act.
- The provision becomes tax neutral only when duty is paid on value addition.

<sup>7</sup> CIT v. Shri Ram Honda Power Equipment Ltd. [(2013) 258 CTR 329 (SC)]

<sup>8</sup> Raj Petro Specialties Pvt. Ltd. [ITA 7260&7261/Mum/2010 dated 15 March 2013]

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