De La Rue Cash Processing Solution Pvt. ... vs Acit, Gurgaon on 3 July, 2018

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'I-2' NEW DELHI

BEFORE SHRI R. K. PANDA, ACCOUNTANT MEMBER
AND
MS SUCHITRA KAMBLE, JUDICIAL MEMBER

I.T.A .No. 5017/DEL/2012
(ASSESSMENT YEAR-2007-08)

I.T.A .No. 2671/DEL/2013
(ASSESSMENT YEAR-2008-09)

CPS Cash Processing Solutions Private Ltd. [Formerly known as-De La Rue Cash Processing Solutions India Pvt. Ltd. 1404, 14th Floor, Tower-B, Signature Towers, South City-1 Gurgaon 122001, Haryana AAACD6217H (APPELLANT)	Vs	DCIT Circle-1(1), Gurgaon (RESPONDENT)

Appellant by Sh. Rohit Tiwari, ADv
Respondent by Sh. Sanjay Kumar Yadav, Sr. DR

Date of Hearing 04.06.2018
Date of Pronouncement 03.07.2018

ORDER

PER SUCHITRA KAMBLE, JM

These two appeals are filed by the assessee against the order dated 15/5/2012 passed by the CIT(A)-15, Mumbai for Assessment Year 2007-08 & Assessment Order dated 28/02/2013 passed by ACIT Circle-1(1), Gurgaon for Assessment Year 2008-09.

5017/Del/2012

2. The grounds of appeal are as under:-

I.T.A .No. 5017/DEL/2012 (A.Y 2007-08)

1. That on the facts and in the circumstances of the case and in law, the Commissioner of Income Tax (Appeals)-15, Mumbai [herein referred to as "the CIT(A)"] erred in upholding disallowance of Rs. 1,76,90,014/- on account of warranty provision, which was estimated at 10% of the sales.

1.1That on the facts and in the circumstances of the case and in law, the CIT(A) erred in not appreciating that reversal of substantial part of warranty provision in the succeeding year is no reason to conclude that the provision made was not reasonable more so because the year in question was first full year of operation of the Appellant.

2. That on the facts and in the circumstances of the case and in law, the CIT(A) erred in upholding disallowance of Rs. 1,34,98,850/- being the liquidated damages provided on account of delay in supply of machines.

2.1. That on the facts and in the circumstances of the case and in law, the CIT(A) erred in not appreciating that damages were provided in terms of specific contractual obligation, which cannot be termed as unilateral deduction by the customers.

3. That on the facts and in the circumstances of the case and in law, the CIT(A) erred in upholding addition of Rs. 1,99,98,194/- being the unutilized countervailing duty, under section 145A of the Act for the reason that the same ought to have been added to the value of closing inventoiy.

3.1. That on the facts and in the circumstances of the case and in law, the CIT(A) erred in not appreciating that the exclusive method being regularly followed by the Appellant was in conformity with guidance note issued by Institute of Chartered Accountants of India and had no impact on net profit as per profit and loss account, even if the same is re-casted.

That the Appellant craves leave to add, alter, modify or amend all or any of the grounds of appeal before or at the time of hearing of appeal.

Additional Ground of Appeal (Application for admission of additional ground under Income- tax Appellate Tribunal Rules, 1963 filed on 29 5017/Del/2012 August 2013)

1. That on the facts and circumstances of the case and in law, the countervailing duty of Rs.1,84,25,285/- paid on imported machinery was permissible deduction in computing the total income for the assessment year 2007-08 and hence the Appellant is entitled to deduction of Rs.1,84,25,285/-.

ITA NO. 2671/Del/2013 (A.Y. 2008-09)

1. That on the facts and circumstances of the case and in law, the Asst. Commissioner of Income tax, Circle-l(l), Gurgaon, Haryana [briefly "the Assessing Officer"] has erred in completing the assessment at the total income of Rs.2,75,88,100/-, as against the declared income of Rs.2,04,83,810/-. The Appellant denies its liability to be assessed at the income of Rs.2,75,88,100/-.

2. That on the facts and circumstances of the case and in law, the Assessing Officer has erred in making addition of Rs.4,10,274/- on account of arm's length price for support services of employees deputed to associated enterprises.

2.1 That on the facts and circumstances of the case and in law, the Assessing Officer erred in not appreciating that mark-up of 5% was uncalled for because the Appellant in respect of support services had already charged more than the mark-up proposed by the Transfer Pricing Officer.

2.2 Without prejudice, the addition of Rs.4,10,274/- was made without application of mind inasmuch as the adjustment has been made on the basis of reasoning for proposed adjustment towards management charges, which was not agreed to by the DRP.

3. That on the facts and circumstances of the case and in law, the Assessing Officer has erred in disallowing provision of liquidated damages of Rs.8,50,077/- being 1% to 3% of sale price of desk top note sorting out machines, for delay in supply of machines to the banks, which liability was provided on the basis of terms of purchase orders agreed upon by the Appellant.

3.1. That on the facts and circumstances of the case and in law, the Assessing Officer has erred in holding that expenditure of Rs.8,50,077/- was not incurred wholly and exclusively for the purposes of business because the Appellant did not comply with time schedule for supply of machines and the banks did not suffer any loss on account of delayed supply.

5017/Del/2012 3.2 That the reason recorded by the Assessing Officer for disallowance of liquidated damages of Rs.8,50,077/- are contrary to the reasons recorded by the DRP.

4. That on the facts and circumstances of the case and in law, the Assessing Officer has erred in making addition of Rs.28,15,543/- being the un-utilized MODVAT Credit comprising Countervailing Duty (CVD) and service tax allegedly for the reason that the method of accounting was not in accordance with the provisions of section 145A of the Act.

4.1. That on the facts and circumstances of the case and in law, the Assessing Officer has erred in not appreciating that the exclusive method for Cenvat Credit regularly followed by the Appellant was inconformity with guidance note issued by Institute of Chartered Accountant of India and had no impact on net profit as per profit & loss account.

4.2. Without prejudice, on the facts and circumstances of the case and in law, the Assessing Officer has erred in not following the directions of DRP and hence, not making consequential adjustment of Rs.2,38,06,391 in the value of opening stock, which would have resulted in relief to the Appellant.

5. That on the facts and circumstances of the case and in law, the Assessing Officer has erred in disallowing Rs. 1,08,930/- being the custom duty on leased machine allegedly for that leased machine was a capital asset and custom duty thereon ought to have been capitalized.

6. That on the facts and circumstances of the case and in law, the Assessing Officer has erred in disallowing deduction of Rs.2,07,03,4927- being the Countervailing Duty (CVD) paid in earlier years and shown as asset in the balance sheet, written off during the relevant year.

6.1. Without prejudice, on the facts and circumstances of the case and in law, the Assessing Officer has erred in not admitting the alternate plea of allowing deduction in the years in which CVD was actually paid.

That the appellant craves leave to add, alter, amend or vary any of the 5017/Del/2012 ground either at or before the hearing of the appeal.

Firstly, we are taking up facts for Assessment Year 2007-08

3. The assessee is engaged in the business of Trading and Servicing of Automatic Bank Note Sorting Machines. The e-return of income declaring total income of Rs.5,92,628/- was filed on 31/10/2007. The return was processed u/s 143(1) of the Act. The case was selected for scrutiny and notice u/s 143(2) was issued on 17/09/2008 and duly served on the assessee on 18.09.2008. Subsequently notices u/s 142(1) along with detailed questionnaire was issued on various dates requiring the assessee to file details and produce evidence in support of the claims made in the return. In response to the said notices issued, subsequently, the assessee's representative C.A attended and filed details and explanations.

4. During the year under consideration, the assessee entered into an international transaction with its Associate Enterprise M/s. De La Rue Cash System Group of companies based at Hong Kong, USA, Malaysia, Switzerland, UAE and UK. The assessee filed form No.3CEB reporting therein the details of such transactions which are valued at Rs.20,20,13,747/-. During the assessment proceedings a reference u/s.92CA(1) of the Act was sent to the Transfer Pricing Office having jurisdiction over assessee's case on 25.08.2009. The TPO vide order dated 22.10.2010 determined and suggested Transfer pricing adjustment at Rs.52,16,996/-. The assessee was asked to show cause as to why an amount of Rs.52,16,996/- should not be added to the returned income being the value of adjustment to Arms Length Price involved in the international transaction with Associate Enterprise. In response to the above assessee's representative did not make any submissions. In view of the above and, as per the provisions of section 92CA(4) r.w.s 92C(4) of the Act, it is 5017/Del/2012 mandatory for the Assessing Officer to tax the adjustment to Arms length Price as determined by the Transfer Pricing Officer as assessee's income for the year. Accordingly made an additions of Rs.52,16,996/- to the returned income of the assessee.

5. The Assessing Officer made disallowance of provisions for warranty expenses amounting to Rs.2,08,11,781/-. The Assessing Officer further made disallowance of Rs.1,34,98,850/- for liquidated damages. As regards to adjustment made u/s 145A r.w.s. 145 (1) & 145(3) of the Act, the Assessing

Officer disallowed an amount of Rs.47,44,677/-.

6. Being aggrieved by the assessment order, the assessee filed appeal before the CIT(A). The CIT(A) partly allowed the appeal of the assessee.

7. As regards to disallowance of Provision for Warranty amounting to Rs. 17,690,014/- i.e. Ground No. 1 and 1.1, the Ld. AR submitted that as per the purchase orders and agreements for sale of cash sorting and counting machines, the Company is under obligation to provide warranty on sale of machines which varies from one to three years. Thus, the Company is obliged to meet its obligations for warranty and provide free service which requires the incurrence of expenses on various accounts. During the year, the Company made provision for warranty. The Ld. AR submitted that the CIT(A) vide its order dated 15 May 2012 partly allowed the Company's claim for provision for warranty to the extent of 1.50% of the sales as against the provision made at 10% and held that it is considered fair & reasonable that warranty provision to the extent of 1.50% of the sales (i.e. Rs. 3,121,767) would be justifiable and the remaining provision needs to be added back. The Ld. AR submitted that the warranty obligation is inbuilt in the purchase order/ agreement as per Clause 6 & 3 and the liability on account of warranty is integral part of the sales revenue. Since the entire sales revenue is accounted as revenue, therefore, corresponding deduction for warranty 5017/Del/2012 provision should also be allowable. The Ld. AR submitted that Warranty provision is not a contingent liability and it is quite certain that expenses would be incurred in meeting the warranty obligation linked to the sales of the current year in the following year. Also such provision is not an ad- hoc provision but is made in a systematic and scientific manner. On the basis of sound accounting principles, all matching liabilities for the matching revenues have to be provided for. Thus, to reflect fair profits of the business, warranty provision is required to be made. AY 2007-08 being virtually the first full year of operations (AY 2006-07 only had about six months of operations), there were no historical trends to rely on for the purposes of making warranty provision. The Company based on a careful estimate by the management and their experience in the industry considered that the provision required to be made should be 10% of the sales amount of machines sold during the year. Accordingly, warranty provision was made of Rs. 20,811,781.This percentage was arrived at after considering various factors including the life of machines, the value of the machines, expected values of those warranty services during paid service periods and estimates of expenses to be incurred in providing these services.

8. The Ld. AR relied upon the decision of the Hon'ble Supreme Court in the case of Bharat Earth Movers vs CIT [2000] 245 ITR 428 wherein is held that if a business liability has arisen in an accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. The Ld. AR also relied upon the decision of the Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd. v. CIT [2009] 314 ITR 62 wherein the Hon'ble Supreme Court has inter alia laid down the following criteria for determining the deductibility for provision of warranty:

- An enterprise has an obligation as on the date of sale, if the past 5017/Del/2012 experience or past event so suggests;

• There is probability that there will be an outflow of resource required, to settle the obligation;

• Reliable estimate of the amount of the obligation can be made, having regard to the past experience or past event.

In the present case these criteria are fulfilled as described in the Company's aforementioned submissions. The warranty provision being recorded in respect of sales that have occurred during the period AY 2007-08, there is an obligation to provide warranty and services resulting from those sales and the value of the provision has been calculated as a percentage of sales to estimate the expected warranty and service costs. The Ld. AR submitted that in the year of rendering of warranty services, the actual expenses incurred are debited under the following heads of expenses in the P&L a/c and the corresponding warranty provision gets reversed:

• Service expenses:

- Spares consumed;
- Salary
- Travelling

The warranty provision is written back on the expiry of the warranty period and included in the taxable income of respective assessment year(s). The Ld. AR pointed out that the expenses incurred by the Company for providing warranty services to its customers is more than the actual provision made. The Ld. AR further submitted that from the records it is evident that expenses incurred on providing warranty services is more than the provision made by the Company. The CIT(A) in his order based on the CIT(A) order passed for AY 2006-07 has only allowed 1.5% of the sales as warranty 5017/Del/2012 provision whereas the actual expenses incurred is more than the warranty provision. The Ld. AR pointed out that the ITAT, Delhi on this issue in the Company's own case for AY 2006-07 has ruled in favour of the Company. Therefore, in view of the above facts, case laws and ITAT's order in Company's own case, the Ld. AR it is submitted that the provision is not arbitrary, ad-hoc and is based on management's best estimated and hence be allowed as a deduction u/s 37(1) of the Act.

9. The Ld. DR relied upon the orders of the TPO/AO and the CIT(A).

10. We have heard both the parties and perused all the records. Ground No. 1 and 1.1 is relating to disallowance of Rs.1,76,90,14/- on account of warranty provisions which was estimated at 10% of sales. It is settled position that provisions for warranty is a business necessity and such provision is an allowable expenses. The CIT(A) in 2006-07 held that the warranty provision provided at 10% of

sales was actually utilized only to the extent of 1.16% by the Company and the rest was reversed. Thus, the CIT(A) held that it is considered fair and reasonable that warranty provision to the extent of 1.50% of the sales would justifiable and remaining provision needs to be added back. The contention of the Ld. AR that warranty obligation is inbuilt in the purchase order/agreement as mentioned in Clause 6 & Clause

3. Thus, the liability on account of warranty is integral part of the sales revenue. Since, the entire sales revenue is accounted as revenue by the assessee. Therefore, corresponding deduction for warrant provision who also be allowed. The Tribunal for A.Y. 2006-07 being ITA No.7056/Del/2010 order dated 02.02.2016 held as under:

> "6. We have considered the submissions of both the parties and perused the records of the case. We are in agreement with the reasoning given by Ld. CIT(A) for which he has given reasons in his order, 5017/Del/2012 enumerated above. Merely because the assessee had written back the provision in subsequent year cannot be a basis for disallowing the assessee's claim in the current year, particularly when assessee had given specific basis for making this warranty provision. Assessee's claim is fortified by the decision relied upon by Ld. CIT(A). Accordingly, we see no reason to interfere in the order of Ld. CIT(A) on the issue in question. Accordingly, order of Id. CIT(A) is upheld."

After looking to the order of the ITAT for Assessment Year 2007-08, the ITAT have dismissed appeal of the Revenues by holding that merely because the assessee had returned back the provisions in subsequent year cannot be a basis for disallowing the assessee's claim in the current year, particularly when the assessee had given specific basis for making warranty provisions. The Hon'ble Apex Court in case of Rotork Controls India (P) Ltd. (supra) has given the criteria which are fulfilled by the assessee herein. Thus, issue is squarely covered in favour of the assessee and, therefore, Ground No. 1 and 1.1 of the assessee's appeal is allowed.

11. Ground No. 2 and 2.1 is relating to disallowance of Liquidated Damages ('LD') u/s 37(1) of the Act amounting to Rs.13,498,850. The Ld. AR submitted that as per the purchase orders/ agreements the Company is liable to pay LD for failure to supply the machines to banks as per the agreed delivery schedule. Accordingly, during the year the Company had debited LD amounting to Rs. 13,498,850 in its P&L A/c for delay in supply of machines to banks. During the course of assessment proceedings, the AO disallowed Company's claim for LD. The Ld. AR submitted that the Company enters into contract for sale of machines with the customers who are mainly Public Sector Banks. A detailed order is received from the customer clearly indicating the date on which the goods should be delivered. In case, there is a delay in delivery of machines by the Company, then LD can be levied by the 5017/Del/2012 banks as per the terms of the agreement. Such damages are levied at the rate of 0.5% to 1% per week of the contract price of the machine and in case where the delay is beyond eight weeks, the banks have the right to cancel the contract. The Assessee submitted party-wise details of liquidated damages incurred, Sample purchase orders/ agreements containing the liquidated damages clause as well as Sample copies of correspondences received by the Company from banks on levy of LD to the Assessing Officer. The Ld. AR submitted that LD is provided for

based on the actual details received from the sales team and as per the terms of contract/ agreement of sale. Hence it can be concluded that LD is an actual liability/ loss suffered during the year. The Ld. AR further submitted that the entry for LDs is not a provision made on an ad-hoc basis but is made in a systematic manner based on the delay in the delivery of the machines to the banks and incurred as per contractual obligation and hence allowable as deduction. Since the customers are mainly Public Sector Banks and the orders are accepted via tender contracts, there is no scope for negotiation with them on the conditions of the contract including delivery of the products. The Ld. AR further submitted that in any case the disallowance of accrued liability as per terms of contract cannot be disallowed on irrelevant considerations. Many of the machines are required to be delivered to various branches of the banks at various remote areas / interiors of the country. Accordingly, adhering to the time lines gets tough leading to delays on several occasions. As can be seen from the sample agreements, the average rate of LDs is 1 % per week of delay upto maximum of 8% of the sale price beyond which the bank has the right to cancel the sales order. Accordingly the banks on delay beyond 8 weeks continue with the contract and levy LD at the rate specified in the contract. The accounting of the LDs do not depend on trends or past history but on actual delays in the delivery of machines and it is the actual amount of liability as per contract. The delay in delivery of the machines has occurred only on some occasions during the year and not in respect of each and every delivery of 5017/Del/2012 machines. The Ld. AR submitted provision for LD is required to be made when time is the essence of the contract and any delay in the delivery of the goods would result in the liability to pay damages. In the present case, the stipulation in the contract clearly showed that the liability for liquidated damages was certain, accrued and was not to depend upon the happening of any event other than delay in deliveries. The liability to pay LD arose at the point of time when the Company failed to deliver the machines on the due date and at that point of time the liability accrued which as a prudent trader it could quantify and take into account by means of a provision. The Ld. AR submitted that the CIT(A) has misdirected in law in disallowing the provision for LD on a misconceived notion that the LD were unilaterally deducted by the customers. He has failed to appreciate that LD incurred by the Company and accordingly deducted by the customers from payment of sale proceeds is as per the agreed terms of the contract and hence not unilateral. The amount of LD incurred and deducted by the customers have been accepted by both the customers and the Company as the same is as per terms of agreed contract. Therefore, the LD is an allowable deduction.

12. The Ld. AR submitted that LD is an allowable expense under section 37(1) of the Act as it was as per the contractual agreements between the parties; it was wholly and exclusively incurred for the Company's business; it was incurred out of commercial expediency and in the normal course of business; it was not incurred for any purpose which was infraction of law; and it did not related to any statutory breach of contract. In this regard, the Ld. AR relied upon the following case laws wherein liquidated damages have been allowed as deduction:

> • CIT(A) Vs. Ahmedabad Cotton Mfg. Co. Ltd., [1994] 205 ITR 163 (S.C). • FL Simdth Mineral (P) Ltd. [20130] 36 taxmann. Com 72 (Madras Hon'ble High Court) 5017/Del/2012 • Huber + Suhner Exletroncis (P) Ltd. Vs. DICT, [2013] 34 taxmann.com 149 (Delhi Tribunal) • K.C.P. Ltd Vs. ITO, [1990] 34 ITD 50 (Hyderbad Tribunal Special Bench)

13. The Ld. DR relied upon the orders of the TPO/AO and the CIT(A).

14. We have heard both the parties and perused all the relevant records. Ground No. 2 and 2.1 is regarding disallowance of Rs. 1,34,98,850/- being the liquidated damages provided on account of delay and supply of machines. It is pertinent to note that as per the purchase orders agreements, the company is liable to pay liquidated damages for the failure to supply the machines to the banks as per the agreed delivery schedule. During the present Assessment Year the assessee company had debited liquidated damages amounting to Rs.1,34,98,850/- in its profit and loss account for delay in supply of machines to banks. During the course of assessment proceedings, the assessee company has submitted party wise details of liquidated damages incurred along with sample purchase orders/agreements containing the liquidated damages clause and also sample copies of correspondences received by the company from banks on levy of liquidated damages all these documents were produced before the Assessing Officer but the same was not properly verified by the Assessing Officer. The Clause prescribing the liability to pay liquidated damages arose at the point of time when the Company fail to deliver the machines on the due date and at that point of time the liability agreed which is a prudent trader it could quantify and take into account by means of trader. The Assessing Officer as well as the CIT(A) has not taken correct cognizance as to liquidated damages incurred by the company and accordingly deducted by the customers from the payment of sale proceeds is as per the agreed terms and contract. All these factors have not been properly assessed by the Assessing Officer as well as CIT(A). The Ld. AR's contention that these provisions have been set off in the 5017/Del/2012 next Assessment Year i.e. 2008-09 the same has to be verified at the level of the Assessing Officer. Therefore, we direct the Assessing Officer to verify all these documents along with the claim of set off of this claim in the year 2008-

09. Therefore, this issue is restored to the file of the Assessing Officer. Needless to say, the Assessing Officer has to give proper opportunity of hearing to the assessee by following principles of natural justice. Therefore, Ground No. 2 and 2.1 is partly allowed for statistical purpose.

15. Ground No. 3 and 3.1 are relating to adjustment made u/s 145A of the AC amounting to Rs.19,998,194/-. The Ld. AR submitted that during the course of assessment proceedings, the Company was asked to explain why the accumulated balance of unutilized MODVAT credit amounting to Rs. 23,806,391 (shown as "Balance with custom and excise authorities" under the head "Loans and advances" recoverable in the Balance Sheet) be not included in the valuation of closing stock and why the same should not be treated as income for the subject year. The AO did not accept the Company's submissions and added the unutilized MODVAT credit of Rs. 23,806,391 appearing in the Balance Sheet to the income of the Company by adding the whole of amount to the value of closing stock by referring to section 145 A of the Act. The CIT(A) upholding the order of the AO held that whether the Company follows inclusive or exclusive method of accounting, the valuation of the closing stock has to be done in accordance with the provisions of section 145 A of the Act. However, the CIT(A) directed that the corresponding adjustment should be made in the opening stock. Accordingly, the CIT(A) in its order directed to reduce the value of opening CVD (Rs. 3,808,198) as on 01.04.2006 from the value of the closing balance as on 31.03.2007 (Rs. 23,806,392). The CIT(A) thus allowed partial relief of Rs. 3,808,198 to the Company. The Ld. AR submitted that the Company is a trader of machines/ goods and not a manufacturing concern. It

5017/Del/2012 pays custom duty at the time of import of goods and collects sales tax on sale of goods. The custom duty consists of Basic Custom Duty, Countervailing Duty and Additional Custom duty. Basic Custom Duty and additional Custom Duty not being eligible for set-off against any taxes/ duties payable by the Company are debited to the Profit and Loss account and also added to the value of the closing inventory. Countervailing Duty is eligible for set-off against taxes / duties payable such as service tax payable and hence not debited to the Profit and Loss account but debited to MODVAT credit under the head "Loans and Advances" in the Balance to be set off against the service tax liability if any. At the time of import, the Countervailing on which Cenvat credit is available for set off against service tax liability is directly transferred to the "Loans and Advances Account" under the sub-head "Balance with custom and excise authorities" in the Balance Sheet. Therefore, this amount is not included in the purchases and does not form a part of closing stock as well in the books of accounts. The Ld. AR pointed out that the Company also undertakes Annual Maintenance Contracts for maintenance of machines after expiry of warranty period and the income is reflected in the Profit and Loss account under the head 'Service Income' and is liable to pay service tax on the same. As mentioned above, Cenvat credit of the Countervailing Duty paid is taken against this service tax liability and is also reflected in the service tax return filed with the department. The unutilized Countervailing Duty is reflected in the Balance Sheet under the head "Loans and Advances". During the subject year, out of the total amount of Rs. 23,806,391 shown as "Balance with custom and excise authorities" in the Balance Sheet, Rs. 23,019,210 pertains to CVD paid on import of goods and Rs. 787,181 pertains to Service Tax paid on input services. The Service Tax paid on input services can be adjusted against service tax liability on maintenance services being provided by the Company. In view of the above facts, the Ld. AR submits that Section 145A of the Act provides that the valuation of purchase and sale of goods and inventory for the purpose of computation of income from business or profession shall be 5017/Del/2012 made on the basis of the method of accounting regularly employed by the Company but this shall be subject to certain adjustments. These adjustments are as follows:

- Any tax, duty, cess or fee actually paid or incurred on inputs should be added to the cost of inputs (raw-materials, stores, etc.), if not already added in the books of account.

- Any tax, duty, cess or fee actually paid or incurred on sale of goods should be added to the sales, if not already added in the books of account.

Any tax, duty, cess or fee actually paid or incurred on the inventory (finished goods, work- in-progress, raw materials, etc.) should be added to the inventories, if not already added while valuing the inventory in the accounts. Net/ exclusive method of accounting for CENVAT credit is followed by the Company as recommended by the Accounting Standard - 2 on 'Valuation of Inventories' issued by the Institute of Chartered Accountants of India ('ICAI'). The Ld. AR submitted that under the net/ exclusive method, customs duty creditable CVD paid on purchase of traded goods is debited to a separate account. As and when CENVAT credit is actually utilized against other taxes payable, an appropriate accounting entry is made to adjust the duty paid out of the separate account. Therefore, the purchase cost of the traded goods is net of

CVD in the books of account. Accordingly, the traded goods are reflected in the books of account on the basis of purchase cost accounted net of CVD. Further, the Ld. AR submitted that if the element of CENVAT credit is added to the value of closing stock in the books of account, it will distort the profits of the Company as the purchases would be exclusive of CENVAT in the books of account and the closing stock would be inclusive of CENVAT credit in the books of account. The Ld. AR submitted that inclusion of tax, duty, etc. in the purchase, sale and inventory as per provisions of section 145 A of the Act does 5017/Del/2012 not require any adjustment in the books of account of the Company. Thus, even if outside the books of account and in compliance with section 145A of the Act, CENVAT credit is added to the value of closing stock, it will require a corresponding addition to the value of opening stock as well as purchases. This will result in a Nil impact on the Profit & Loss Account of the Company. The Guidance Note on Tax Audit under section 44AB of the Act issued by the ICAI has provided two illustrations, one under 'exclusive method' and other under 'inclusive method', explaining the proposition that there will be no difference in the profit irrespective of the method of accounting followed by the Company. Thus, following the provisions of section 145A of the Act and the Guidance Note on Tax Audit under section 44AB of the Act, there shall be no change in the profit both under inclusive as well as exclusive method thus resulting in a Nil impact on the Profit and Loss Account of the Company. The Ld. AR further submits that for the purposes of valuing the closing stock as per the provisions of section 145 A of the Act, the AO should have followed the guidelines as prescribed by the Accounting Standards issued by the ICAI. The fact that methodology as prescribed by the Accounting Standards issued by the ICAI must be followed has been upheld by various appellate authorities including the Hon'ble Supreme Court in the case of CIT v. Woodward Governor India P. Ltd. [2009] 312 ITR 254 (SC). In view of the above facts and submissions, the Company submits that the addition made by the Ld. AO to the closing stock of the Company on account of CVD and Service Tax credit u/s 145A of the Act amounting to Rs.23,806,391/- is unwarranted and merits to be deleted.

CIT(A) Vs. Indo Nippon Chemicals Co. Ltd [2003] 130 Taxmann 179 (S.C) Aditya Birla Nuvo Ltd. Vs. ACIT, [2015] 56 taxmann.com 168 (Mumbai Tribunal) CIT V. Avery Cycle Inds Ltd. [2015] 56 taxman.. com 459 (Punjab & 5017/Del/2012 Haryana H.C) Westd Coast Paper Mills Ltd. Vs. ACIT [2014] 52 taxmann. Com 268 (Mumbai Tribunal)

16. Without prejudice to the above submissions, the Ld. AR submitted that the provisions of section 145A of the Act are not applicable to service tax input services. The Ld. AR submitted that the provisions of section 145A of the Act are applicable only to transactions involving purchases, sale and stock of inventory such as raw materials, finished goods. This does not apply to transactions involving service taxes and accordingly, the AO erred in applying the provisions of section 145 A of the Act to the service tax CENVAT credit (Rs. 787,181) forming part of "Loans and Advances" under the Balance Sheet. Even if it is alleged that unutilized MODV AT credit should be added to the total income of the Company, then it is submitted that the addition should be restricted only to the extent

of MODVAT credit available on closing stock of goods and not the entire MODVAT balance as at the end of the year. Consequential relief be given to the opening stock of AY 2008-09 of the Company on account of addition made to the closing stock of the Company on account of CVD and Service Tax credit and the taxable income for AY 2008-09 be reduced by that extent.

17. The Ld. DR relied upon the order of the TPO/ AO and the CIT(A).

18. We have heard both the parties and perused all the records. As related to Ground No. 3 & 3.1 regarding addition of Rs. 1,99,98,194/- being the unutilized Countervailing duty u/s 145A of the Act for the reason that the same duty to have been added to the value of closing inventory. The Ld. AR submitted that the accounting and the valuation of the closing stock has to be done in accordance with the provisions of Section 145A of the Income Tax Act. The Company is a trader of machines/goods and not the manufacturing company. Thus, it pays custom duty at the time of import of goods and 5017/Del/2012 collects sales tax on sale of goods. The custom duty consists of basic custom duty, countervailing duty and additional custom duty. At the time of import, the Countervailing Duty on which Cenvat credit is available for set off against service tax liability is directly transferred to the "loans and advance account"

> under the sub-head "balance with custom and excise authorities" in the balance sheet. Therefore, this amount is not included in the purchases and does not form part of closing stock as well in the books of account. The Ld. AR's contention that during the subject year out of the total amount of Rs.2,38,06,391/- shown as "balance with custom and excise authorities" in the balance-sheet, Rs.2,30,19,210/- pertains to Countervailing Duty paid on import of goods and Rs.7,87,181/- pertains to service tax paid on the input services. Section 145A of the Income Tax Act provides that the valuation of purchase and sale of goods and inventory for the purpose of computation of income from business or profession shall be made on the basis of the method of accounting regularly employed by the company but this shall be subject to certain adjustment. After going through the contention of the Ld. AR on the provisions of Section 145A, it is found that the Assessing Officer as well as the CIT(A) has not taken the cognizance of the actual calculation relating to the counter valley duty and service tax paid by the assessee. Therefore this needs to be examine at the level of the Assessing Officer. We direct the Assessing Officer to look into this aspect as per the provisions of Section 145A as well as in the light of the provisions of given under the Income Tax Act and decide this issue afresh. Needless to say, the assessee be given opportunity of hearing by following principles of natural justice. Thus, Ground No. 3 and 3.1 are partly allowed for statistical purpose.

19. As regards additional Ground regarding addition of Countervailing Duty paid on imported goods amounting to Rs.18,425,285/-, the Ld. AR submitted that the Assessing Officer while completing the assessment proceedings for the immediately succeeding assessment year i.e. AY 2008-09 disallowed deduction 5017/Del/2012 of Rs. 20,703,492 being custom duty and the same is reflected as asset written off. The Ld. AR submitted that custom duty on purchase of imported goods consists of Basic Customs Duty, Add. Custom Duty and Countervailing Duty. The Company under the belief that

Countervailing Duty is creditable against other duties/ taxes payable did not claim deduction of Countervailing Duty of Rs. 2,278,207/- and Rs. 18,425,285/- paid in AY 2006-07 and AY 2007-08 respectively. The same was treated as an 'asset' and was accordingly reflected in the Balance Sheet. The Ld. AR submitted that during AY 2008-09, the Company had internal discussions/ deliberations and ultimately wrote off the entire amount of Countervailing Duty reflected as asset in the Balance Sheet to the extent it was not eligible for credit against service tax liability. In this regard, the Company had consulted with a Tax Consultant and confirmed its understanding that Countervailing Duty would be creditable only for that portion of Countervailing Duty paid on the goods which are actually used to provide services and not on all the goods imported and sold. The asset written off i.e. Countervailing Duty of Rs. 35,000,000/- comprised of following:

(i) Assessment Year 2006-07 Rs. 2,278,207/-

(ii) Assessment Year 2007-08- Rs.18,425,285/-

(iii) Assessment Year 2008-09- Rs.14,296,507/-

The Ld. AR submitted that in the assessment order passed for AY 2008-09, though deduction of Rs. 14,296,507/- was allowed, however Countervailing Duty of Rs. 20,703,492/- paid in AY 2006-07 and 2007-08 on purchase of imported Automatic Notes Sorting Machines was disallowed for the reason that the same pertained to AY 2006-07 and AY 2007-08 respectively. The Ld. AR submitted that though Countervailing Duty of Rs. 2,278,207/- and Rs. 18,425,285/- paid in AY 2006-07 and 2007-08 was allowable deduction in the respective assessment years, however, the Company could not claim the 5017/Del/2012 same in computing the total income for the AY 2006-07 and AY 2007-08 under erroneous misconception that the same was creditable against other duties / taxes payable. The Ld. AR submitted that the law is well settled that if an assessee, under a mistake, misconception or on not being properly instructed is over assessed, then the lawful right of the assessee to claim that he was not liable to tax cannot be denied for the tax can be levied and collected only in accordance with law. The Courts have repeatedly held that even if an assessee declares an income in the return, the Assessing Officer cannot assess it merely on that basis and that he has to consider its taxability in the light of other circumstances de hors the admission made in the return. Reference is made to SR Kosti v. CIT [2005] 276 ITR 165 (Gujarat HC) and CIT v. Bharat General Reinsurance Co. Ltd, [1971] 81 ITR 303 (Delhi HC). The Ld. AR submitted that since Countervailing Duty of Rs. 18,425,285/- is legitimate deduction in computing the total income for A.Y. 2007-08 therefore, the same deserves to be allowed. The issue whether CVD of Rs. 18,425,285/- paid on imported machinery is an allowable deduction is not in doubt because deduction of similar duty paid in Assessment Year 2008-09 was allowed by the Assessing Officer.

20. The Ld. DR relied upon the orders of the TPO/A.O and the CIT(A).

21. We have heard both the parties and perused all the relevant records. As regards the additional ground regarding Countervailing Duty of Rs.1,84,25,285/- paid on imported machinery is permissible deduction in accounting the total income for the ay 2007-08 and hence the assessee is entitled to deduction of Rs. 1,84,25,285/-. This ground was not at all taken before the lower

authorities at any stage. Therefore, this is a factual ground which cannot be entertained at this stage and therefore, the additional ground is rejected.

22. In result, the appeal of the assessee being ITA No. 5017/Del/2012 for 5017/Del/2012 A.Y. 2007-08 is partly allowed for statistical purpose.

23. Now we take up the appeal for A.Y. 2008-09. The e-return of income of Rs. 2,04,83,810/- was filed on 15.01.2009. The return was processed u/s 143(1) of the Act on 15.07.2009. The case was selected for scrutiny and notice u/s 143(2) was issued on 11.09.2009 and duly served on the assessee. Subsequently notices u/s 143(1) along with detailed questionnaire were issued on various dates requiring the assessee to file details and produce evidence in support of the claims made in the return. In response to the said notices, the Assessee's Representatives attended the proceedings and filed the details and explanations. During the year under consideration the assessee entered into an International Transaction with its Associate Enterprise M/s. De La Rue Cash System Group of companies based at Hong Kong, USA, Malaysia, Switzerland, UAE and UK. The assessee filed form No. 3CEB reporting therein the details of such transactions which are aggregately valued at more than 15 crores. During the Assessment Proceedings, a reference u/s 92CA(1) of the Act was sent to the Transfer Pricing Officer. The TPO vide order dated 20.10.2011 has determined and suggested transfer pricing adjustment at Rs. 17,33,201/-. A draft order u/s 144C(iii) of the Act was issued by the Assessing Officer vide order dated 19.12.2011. The Assessee filed objections before the DRP. The DRP issued directions dated 06.09.2012. The Assessing Officer vide order dated 28.02.2013 made addition of Rs.4,10,274 was made in respect of Transfer Pricing adjustment. The Assessing Officer also made disallowance of Rs. 8,50,077/- for provisions for Liquidated damages. The Assessing Officer further made adjustments of Rs. 28,15,543/- u/s 145A r.w.s. 145(1) and 145(3) of the Act. The Assessing Officer further made disallowance of lease out of one Kalebra Machine to the extent of Rs. 1,08,930/-. The Assessing Officer also made disallowance on account of doubtful advances "written off of Rs. 3,50,00,000". The Assessing Officer reduced Rs. 1,77,84,027 being warranty provisions already disallowed 5017/Del/2012 during the A.Y. 2007-08.

24. Being aggrieved by the Assessment Order, the assessee is before us.

25. The Ld. AR submitted that Ground No. 1 is general in nature. Ground No. 2 to 2.2 are relating to addition on Transfer pricing adjustment regarding addition of Rs. 4,10,274 on account of arms' length price for support services of employees deputed to associated enterprises. The Ld. AR submitted that during F.Y. 2007-08, the Company incurred certain expenses on behalf of its Associated Enterprises ('AEs') which were subsequently cross charted to AEs. These expenses include salary cost of dedicated employees, salary cost of ad- hoc support staff, travel and telephone expenses incurred by the Company on behalf of the AEs. The Ld. AR further submitted that the TPO contended that there was an element of service involved in the above mentioned services and the amount has been recovered on cost to cost basis proposed a mark-up of 5% on the value of such services of Rs.82,05,477/- and proposed an adjustment of Rs.4,10,274. The DRP confirmed the above addition by giving the reasons that Head of expenses show that the Company did render services to its AE, for which, in hired party situations, mark-up would have been inevitable. The DRP further held that despite submitting various documents, the Company failed to establish that

by incurring these expenses, the Company did not render any services to its AEs. The Ld. AR further submitted that the amount charged in respect of the support services were much higher than the cost incurred by the Company. The DRP ignored the cost break up and the hourly rate at which the amount is cross charged from AEs. The cost incurred in respect of the said recovery was Rs.25,23,692/- and the break-up of the total amount was given the lower authorities. The Ld. AR further submitted that recovery of expenses such as travel, telephone expenditure of Rs.2,54,531 are third party costs and hence no mark up is required. Further, in relation to support of dedicated employees and ad-hoc support sample cases of salary cost of employees and 5017/Del/2012 the corresponding amount recovered from AEs below shows that a markup of more than 5% was charged. Thus, based on the above analysis, the Ld. AR submitted that the Company has earned a high mark up over the salary cost paid by the Company to its employees.

26. The Ld. DR relied upon the orders of the TPO/AO and the directions of the DRP.

27. We have heard both the parties and perused all the relevant records. Ground No. 1 is general in nature, hence dismissed. It is pertinent to note that recovery of expenses such as travel, telephone expenditure of Rs.2,54,531 are third party costs and hence no mark up is required as per the Transfer Pricing Provisions. In relation to support of dedicated employees and ad-hoc support sample cases of salary cost of employees and the corresponding amount recovered from AEs below shows that a markup of more than 5% was charged. The Company has earned a high mark up over the salary cost paid by the Company to its employees. These contentions of the Ld. AR are supported by the documentary evidences and were not taken into cognizance by the TPO/Assessing Officer as well as DRP. Therefore, Ground Nos. 2 to 2.2 are allowed.

28. Ground No. 3 to 3.2, the Ld. AR submitted that these grounds are identical to the Ground No. 2 and 2.1 of the Assessment Year 2007-08. The Ld. DR relied upon the orders of the TPO/AO and directions of the DRP.

29. We have heard both the parties and perused all the records. The issue is identical with the Ground No. 2 and 2.1 for the A.Y. 2007-08, we therefore give same directions in the present appeal as well. We direct the Assessing Officer to verify all these documents along with the claim of set off of this claim in the year 2008-09. Therefore, this issue is restored to the file of the Assessing Officer. Needless to say, the Assessing Officer has to give proper 5017/Del/2012 opportunity of hearing to the assessee by following principles of natural justice. Thus, Ground No. 3 to 3.2 are partly allowed for statistical purpose.

30. As regards Ground No. 4 to 4.1, the Ld. AR submitted that these grounds are identical to the Ground Nos. 3 to 3.1 for the Assessment Year 2007-08. The Ld. DR relied upon the orders of the TPO/AO and directions of the DRP.

31. We have heard both the parties and perused all the records. The issue is identical with the Ground No. 3 and 3.1 for the A.Y. 2007-08, we therefore give same directions in the present appeal as well. We direct the Assessing Officer to verify all these documents along with the claim of set off of this claim in the year 2008-09. Therefore, this issue is restored to the file of the Assessing Officer.

Needless to say, the Assessing Officer has to give proper opportunity of hearing to the assessee by following principles of natural justice. Thus, Ground No. 4 to 4.2 are partly allowed for statistical purpose.

32. As regards the Ground Nos. 5 and 5.1, the Ld. AR submitted that the disallowance of Rs. 1,08,930/- being the custom duty on leased machine is not proper on behalf of the Assessing Officer. The Ld. AR submitted that during the year under consideration, the assessee company sold one machine on installment basis to UCO bank, Kolkata. The machine was sold at Rs. 6,21,990 over 18 installments. In the books of accounts, the purchase of the machine inclusive of custom duty was capitalized at Rs. 5,28,788 by the assessee and depreciation was claimed thereon. The assessee company recognized revenue in the books to the extent of the installments received during the relevant year i.e. A.Y. 2008-09 for Rs. 2,07,330/-. However, at the time of audit, the auditors qualified the audit report by stating that the sale should be treated as a regular sale in the books of accounts. Therefore, while 5017/Del/2012 filing the return the assessee company stated that income erroneously declared in excess by the company in the return to the extent of Rs. 1,14,128/-. The Ld. AR submitted that the DRP has observed that if the contention of the assessee company that capitalization of machine was inclusive of taxes and custom duty, then the basis of addition by the Assessing Officer did not stand. The Ld. AR submitted that the company capitalized the value of the machine in the books of accounts inclusive of customs duty. Since the customs duty paid by the company was never debited to the P&L account, the question of disallowing such customs duty did not arise.

33. The Ld. DR relied upon the orders of the TPO/AO and directions of the DRP.

34. We have heard both the parties and perused all the relevant material. It is pertinent to note that the assessee the company capitalized the value of the machine in the books of accounts inclusive of customs duty. Therefore, the customs duty paid by the company was never debited to the P&L account, and thus, disallowing customs duty is not proper on behalf of the Assessing Officer. Therefore, Ground No. 5 and 5.1 are allowed.

35. Ground No. 6 is relating to the disallowance of countervailing Duty paid in earlier years and shown as assets in the balance sheet in this year as written off for Rs. 2,07,03,492. The Ld. AR submitted that the assessee company during the year under consideration had written off custom duty amounting to Rs. 3,50,00,000. The amount written off comprised of following:

i)	A.Y. 2006-07	-	Rs. 22,78,207
ii)	A.Y. 2007-08	-	Rs.1,84,25,285
iii)	A.Y. 2008-09	-	Rs.1,42,96,507

The Ld. AR submitted that in the assessment order passed though deduction of Rs. 14,296,507/- was allowed, however the Assessing Officer disallowed the amounts (i.e. Rs. 20,703,492) pertaining to A.Y. 2006- 07 and A.Y. 2007-08. The reasons given by the Ld. AO for making the disallowance were that the Company had contended that the expense crystallized during the subject year and thus needed to be allowed as a deduction. However, it is important to note that the said payments were actually made in the AYs concerned (i.e. AY 2006-07 & AY 2007-08) and had crystallized in the concerned AYs itself. The Assessing Officer further held that there was no uncertainty regarding the liability and the question of it crystallizing in AY 2008-09 did not arise. The Assessing Officer held that since the expenditure pertaining to AY 2006-07 and AY 2007-08 had crystallized during the AY's concerned, the same are prior period expenditure and therefore cannot be allowed as deduction in the computing the total income of the subject year. The Ld. AR submitted that the DRP upheld the order of the Assessing Officer that the expenditures were of prior period were undisputed and accordingly, following basic principles of taxation, the expenditures could not be allowed during the present year. The Ld. AR submitted that custom duty on purchase of imported goods consists of BCD, ACD and CVD. The Company under a bonafide belief that CVD was creditable against other duties/ taxes payable did not claim deduction of CVD of Rs. 2,278,207/- and Rs. 18,425,285/- paid in AY 2006-07 and AY 2007-08 respectively. The same was treated as an 'asset' and was accordingly reflected in the Balance Sheet. The Ld. AR further submitted that during AY 2008-09, the Company had internal discussions/ deliberations and ultimately wrote off the entire amount of CVD reflected as asset in the Balance Sheet to the extent it was not eligible for credit against service tax liability. In this regard, the Company had consulted with a Tax Consultant and confirmed its understanding that CVD would be creditable only for that portion of CVD paid on the goods which are actually used to provide services and not on all the goods imported and sold. The Ld. AR pointed out that though CVD of Rs.

5017/Del/2012 2,278,207/- and Rs. 18,425,285/- paid in AY 2006-07 and 2007-08 was allowable deduction in the respective assessment years, however, the Company could not claim the same in computing the total income for the AY 2006-07 and AY 2007-08 under erroneous misconception that the same was creditable against other duties / taxes payable. The Ld. AR submitted that the law is well settled that if an assessee, under a mistake, misconception or on not being properly instructed is over assessed, then the lawful right of the assessee to claim that he was not liable to tax cannot be denied for the reason that tax can be levied and collected only in accordance with law. The Courts have repeatedly held that even if an assessee declares an income in the return, the Assessing Officer cannot assess it merely on that basis and that he has to consider its taxability in the light of other circumstances de hors the admission made in the return. The Ld. AR relied upon the decisions in cases of SR Kosti v. CIT [2005] 276 ITR 165 (Gujarat HC) and CIT v. Bharat General Reinsurance Co. Ltd, [1971] 81 ITR 303 (Delhi HC).

36. The Ld. DR relied upon the order of the TPO/AO and direction of the DRP.

37. We have heard both the parties and perused all the relevant material on records. It is pertinent to note that the Ld. AR made the submissions before us that the Company was under a bonafide belief that countervailing duty was creditable against other duties/ taxes payable did not claim deduction of countervailing duty of Rs. 2,278,207/- and Rs. 18,425,285/- paid in AY 2006- 07 and

AY 2007-08 respectively. The same was treated as an 'asset' and was accordingly reflected in the Balance Sheet. During AY 2008-09, the Company had internal discussions/ deliberations and ultimately written off the entire amount of countervailing duty reflected as asset in the Balance Sheet to the extent it was not eligible for credit against service tax liability. In this regard, the Company had consulted with a Tax Consultant and confirmed its 5017/Del/2012 understanding that countervailing duty would be creditable only for that portion of countervailing duty paid on the goods which are actually used to provide services and not on all the goods imported and sold. It was pointed out by the Ld. AR that though countervailing duty of Rs. 2,278,207/- and Rs. 18,425,285/- paid in AY 2006-07 and 2007-08 was allowable deduction in the respective assessment years, however, the Company could not claim the same in computing the total income for the AY 2006-07 and AY 2007-08 under erroneous misconception that the same was creditable against other duties / taxes payable. From the perusal of the submissions of the Ld. AR it can be seen that in this A.Y. 2008-09, the issue of countervailing duty was allowed by the Assessing Officer with the proper direction of the DRP. Therefore, there is no need to interfere with the same. Ground No. 6 is dismissed.

38. In result, the appeal being ITA No. 2671/Del/2013 for A.Y. 2008-09 is partly allowed for statistical purpose.

Order pronounced in the Open Court on 3rd July, 2018.

(R. K. PANDA) (SUCHITRA KAMBLE)
ACCOUNTANT MEMBER JUDICIAL MEMBER

Dated: 03/07/2018
R. Naheed *

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

5017/Del/2012

ASSISTANT REGISTRAR

ITAT NEW DELHI

Date of dictation	04.06.2018

Date on which the typed draft is placed before the 04.06.2018 dictating Member Date on which the typed draft is placed before the Other Member Date on which the approved draft comes to the Sr. PS/PS Date on which the fair order is placed before the Dictating Member for pronouncement Date on which the fair order comes back to the Sr. 03.07.2018 PS/PS Date on which the final order is uploaded on the 03.07.2018 website of ITAT Date on which the file goes to the Bench Clerk 03.07.2018 Date on which the file goes to the Head Clerk The date on which the file goes to the Assistant Registrar for signature on the order Date of dispatch of the Order