

CTR ENCYCLOPAEDIA ON INDIAN TAX LAWS

COMMISSIONER OF INCOME TAX vs. INDO NIPPON CHEMICALS CO. LTD.

SUPREME COURT OF INDIA

Mrs. Ruma Pal & B.N. Srikrishna, JJ.

Civil Appeal Nos. 2158 *, 2161, 2162, 2163 **, 2164, 2165, 8505 to 8508 & 8632 of 2002

23rd January, 2003

(2003) 71 CCH 0085 ISCC

(2003) 182 CTR 0291 : (2003) 261 ITR 0275 : (2003) 130 TAXMAN 0179

Legislation Referred to

S 4, 145

Case pertains to

Asst. Year 1989-90

Decision in favour of:

Assessee

Accounts—Valuation of stock—Modvat credit—It is not permissible for the AO to adopt different methods of valuation of excise duty paid raw material when purchased and the unconsumed raw material on hand at the end of the year—AO was not justified in adopting the "gross method" at the time of purchase and the "net method" of valuation at the time of valuation of stock on hand—Merely because Modvat credit is an irreversible credit available to the manufacturers upon purchase of duty paid raw material, it would not amount to income which is liable to be taxed

Held :

Whatever method the AO adopts, the method has to be consistent with the accepted principles of accountancy. It is not open to the AO to treat outgoings as income under s. 145. It is not possible to accept the view of the AO that merely because Modvat credit is an irreversible credit available to the manufacturers upon purchase of duty paid raw material, it would amount to income which is liable to be taxed under the Act. The assessees have all uniformly adopted the "net method", namely, valuing the raw materials at the purchase price minus Modvat credit. This method was also adopted by them while valuing the unconsumed raw materials and the work-in-progress at the end of the year. Their method of valuation was not wrong. The AO adopted the "gross method" at the time of purchase, and the "net method" of valuation at the time of valuation of the stock on hand. By this method, which is wholly erroneous, he assumed that the income, to the extent of the Modvat credit on the unconsumed raw material, was generated, which was not reflected in the accounts and attempted to bring it to charge under the Act. The High Court has correctly appreciated the arguments and rendered a judgment which is unexceptionable.—[CIT vs. Indo Nippon Chemical Co. Ltd.](#) (2000) 164 CTR (Bom) 78 : (2000) 245 ITR 384 (Bom) and [CIT vs. Antifriction Bearings Corpn. Ltd.](#) (2001) 165 CTR (Bom)

126 : (2000) 246 ITR 295 (Bom) affirmed; [Collector of Central Excise & Ors. vs. Dai Ichi Karkaria Ltd.](#) (1999) 156 CTR (SC) 172 : (1999) 7 SCC 448 and Eicher Motors Ltd. vs. Union of India (1990) 106 ELT 3 distinguished.

(Paras 3, 5 & 6)

Conclusion :

It is not permissible for the AO to adopt different methods of valuation of excise duty paid raw material when purchased and the unconsumed raw material on hand at the end of the year and therefore he could not adopt the "gross method" at the time of purchase of duty paid raw material and the "net method" of valuation at the time of valuation of stock on hand.

In favour of :

Assessee

Income—Chargeability—Modvat credit—Modvat credit available to manufacturers upon purchase of duty paid raw material, though irreversible, does not amount to chargeable income—AO was not justified in adopting 'gross method' at the time of purchase and 'net method' of valuation at the time of valuation of stock on hand and assuming that income was generated to the extent of Modvat credit on the unconsumed raw-material

(Paras 5 & 6)

Conclusion :

Modvat credit available to manufacturers upon purchase of duty paid raw material, though irreversible, does not amount to chargeable income.

In favour of :

Assessee

Counsel appeared:

M.L. Verma with Preetish Kapur, Rajiv Tyagi, K.C. Kaushik & B.V. Balram Das, for the Appellant : P.J. Pardiwala, Atul Y. Chitale, S. Balakrishnan, Ravikesh K. Sinha, Ms. Suchitra A. Chitale, Rajan Narain, Ms. Bina Gupta & S. Sukumaran, for the Respondents

BY THE COURT:

*From the judgment and order dt. 14th Aug., 2000, of the Bombay High Court in IT Appeal No. 191 of 2000, reported as CIT vs. Indo Nippon Chemical Co. Ltd. (2000) 164 CTR (Bom) 78 : (2000) 245 ITR 384 (Bom).

**From the judgment and order, dt. 8th Sept., 2000 of the Bombay High Court in IT Appeal No. 397 of 2000, reported as CIT vs. Antifriction Bearings Corpn. Ltd. (2001) 165 CTR (Bom) 126 : (2000) 246 ITR 295 (Bom).

Order

In all these appeals, the pivotal issue involved is : Is it permissible for the AO under the IT Act to adopt different methods of valuation of excise duty paid raw material when purchased and the unconsumed raw material on hand at the end of the year ?

2. The assessees are manufacturing units liable to excise duty. Under the Modvat scheme, they get credit for the excise duty already paid on the raw-materials purchased by them and utilised in manufacture of excisable goods. When they manufacture the goods and sell them, the proportionate part of the Modvat credit is set off against their excise duty liability. In each of these cases, the AO took the view that the Modvat credit that is available should be treated as an income or an advantage in the nature of income, and, therefore, added back the said amount to the income of each of these assessees. The CIT(A), in some of the cases, agreed with the view of the AO, and, in some cases, differed. However, when the matter came to the Tribunal, the Tribunal uniformly took the view that the Modvat credit could not be added back to the income of the assessee.

3. Upon appeal to the High Court under s. 260A of the Act, the High Court addressed itself to the issue as to whether the value of the closing stock of the duty paid inputs, work-in-progress and finished goods must necessarily include the element of Modvat credit available. The High Court took the view that unless the AO acted under circumstances indicated in s. 145 of the Act, the AO is bound to adopt the method of computation of income regularly employed by the assessee. However, if he comes to the conclusion that the method of accounting employed by the assessee makes it impossible to correctly compute the income, then the AO is entitled to adopt any other suitable accounting method. We may add that, whatever method the AO adopts, the method has to be consistent with the accepted principles of accountancy. It is not open to the AO to treat outgoings as income under s. 145 of the Act.

4. The High Court has taken the several illustrations in the charts placed before it by both sides and demonstrated that there are two possible methods of valuation of stock. The first would be the "gross method", in which the stock is valued at cost price inclusive of the excise duty element. If this method is adopted, then the unconsumed stock also must necessarily be valued in the same manner. The other method is the "net method", in which the raw material purchased is valued at the actual cost, that is the actual purchase price and, on this, Modvat credit would be available. If this method is to be adopted, then uniformly the same method must be adopted while valuing the unconsumed stock at the end of the year. Whichever method one adopts, the result would be the same.

5. We are unable to accept the view of the AO that merely because Modvat credit is an irreversible credit available to the manufacturers upon purchase of duty paid raw material, it would amount to income which is liable to be taxed under the Act.

6. Mr. P.J. Pardiwala, learned counsel for the respondent in C.A. No. 2161 of 2002 and 2164-2165 of 2002, points out that the assessees have all uniformly adopted the "net method", namely, valuing the raw materials at the purchase price minus Modvat credit. This method was also adopted by them while valuing the unconsumed raw materials and the work-in-progress at the end of the year. We, therefore, do not think that their method of valuation was wrong. The AO adopted the "gross method" at the time of purchase, and the "net method" of valuation at the time of valuation of the stock on hand. By this method, which is wholly erroneous in our view, he assumed that the income, to the extent of the Modvat credit on the unconsumed raw material, was generated, which was not reflected in the act and attempted to bring it to charge under the Act.

7. The learned counsel for the Revenue referred us to the judgment of this Court in Collector of Central Excise, Pune & Ors. vs. Dai Ichi Karkaria Ltd. (1999) 156 CTR (SC) 172 : (1999) 7 SCC 448 and, particularly, the observations in para 25 to the following effect :

"We think it is appropriate that the cost of the excisable product for the purposes of assessment of excise duty under s. 4(1)(b) of the Act r/w r. 6 of the Valuation Rules should be reckoned as it would be reckoned by a man of commerce. We think that such realism must inform the meaning that the Courts give to words of a commercial nature, like cost, which are not defined in the statutes which use them. A man of commerce would, in our view, look at the matter thus :

'I paid Rs. 100 to the seller of the raw material as the price thereof. The seller of the raw material had paid Rs. 10 as the excise duty thereon. Consequent upon purchasing the raw material and by virtue of the Modvat Scheme, I have become entitled to the credit of Rs. 10 with the excise authorities and can utilise this credit when I pay excise duty on my finished product. The real cost of the raw material (exclusive of freight, insurance and the like) to me is, therefore, Rs. 90. In reckoning the cost of the final product I would include Rs. 90 on this account.'

This, in real terms, is the cost of the raw material (exclusive of freight, insurance and the like) and it is this, in our view, which should properly be included in computing the cost of the excisable product."

8. The learned counsel emphasised these observations to support his case. In our view, these observations have been misunderstood. This Court pointed out in the said judgment that a manufacturer who manufactures the goods would reckon the cost of the raw material as exclusive of the Modvat credit in reckoning the cost of the "final product". These observations do not deal with the manner of valuation of the unconsumed raw material or work-in-progress in hand. We have also been referred to the judgment in Eicher Motors Ltd. vs. Union of India (1990) 106 ELT 3. In our view, this judgment does not support the Revenue's case.

9. We are of the view that the High Court has correctly appreciated the arguments and rendered a judgment which is unexceptionable. There is no substance in the appeals of the Department. Hence, we dismiss these appeals, however, without any order as to costs.
