

PETITIONER:
COMMISSIONER OF INCOME TAX, CALCUTTA

Vs.

RESPONDENT:
BRITISH PAINTS INDIA LTD.

DATE OF JUDGMENT 13/12/1990

BENCH:
THOMMEN, T.K. (J)
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THOMMEN, T.K. (J)
PUNCHHI, M.M.

CITATION:
1991 AIR 1338 1990 SCR Supl. (3) 525
1992 SCC Supl. (1) 55 JT 1990 (4) 694
1990 SCALE (2) 1261

ACT:

Income Tax Act 1961: Section 145--Valuation of stock--Principle to be followed--Cost or market value--Whichever is lower--Assessing officer--Whether entitled to add over head charges.

Method of accounting--Consistent practice--To disclose true picture of profits and gains--Assessing Officer--Entitled to and has duty to adopt appropriate computation to determine true income.

HEADNOTE:

The respondent-assessee a limited liability company engaged in the business of manufacture and sale of paints, had a consistent practice to value its goods in process and finished products exclusively at cost of raw materials and totally excluding overhead expenditure. The justification for this practice, the assessee contended was that the goods being paints had limited storage life and if not quickly disposed of were liable to lose their market value.

The Income Tax Officer rejected the aforesaid contention of the assessee observing that at no time had the assessee claimed any deduction on account of deterioration or damage to goods and that there was no justification to recognise a practice as claimed by the assessee of valuing its stock otherwise than in accordance with the well recognised principle of accounting which require the stock to be valued at either cost (raw material plus expenditure) or market value whichever was lower. Recalculating the value of the opening and closing stocks by adding the overhead expenditure, the Income-tax Officer made an addition of Rs.1,04,417 for the assessment year 1963-64, and allowed a deduction of Rs.3338 for the assessment year 1964-65. These orders were confirmed by the Appellate Assistant Commissioner.

On appeal, the Income Tax Appellate Tribunal held that there was no evidence to show that the goods in stock deteriorated in value and that there was no justification for excluding the overhead expenditure in valuing the stock; and if it was in the interest of the business to value stock solely with reference to cost of raw materials and without including the overhead expenditure, such valuation was not appro-

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priate to the computation of income chargeable under the Income Tax Act.

The High Court, in a reference at the instance of the Revenue noticed that though there was no evidence of deterioration of the goods in stock, came to the conclusion that having regard to the consistent practice of the assessee, the Tribunal was not justified in rejecting the assessee's method of valuation of its stock-in-trade. It accordingly reversed the Tribunal's decision.

In the appeals by the Revenue to this Court, it was contended on behalf of the assessee that for a number of years the Revenue did not question the method of accounting regularly employed by the assessee, that it was during the assessment years in question that the objection was raised for the first time on the ground that overhead expenditure was not included in the value of the stock, that the Assessing Officer had exceeded his jurisdiction by adding the overhead expenditure to the cost of raw material, especially because of the short durability of paint and that the Assessing Officer has not appreciated that the method adopted by the assessee is a well recognised method among accountants of repute.

Allowing the appeals and setting aside, the judgment of the High Court, this Court,

HELD: 1. The Income Tax Act does not contain any specific provision for the valuation of stock, Income, profits and gains must, however, be computed in the manner provided by the Act. It is the duty of the Officer to determine the profits and gains of a commercial adventure according to the correct principle of accounting. In doing so, he might, dependent on the nature of the business and its special character, allow certain adjustments, but his primary purpose and duty is to deduce the correct income, profits and gains, and this he cannot do without taking into account the value of the stock-in-trade at the beginning and at the end of the year and by ascertaining the difference between them. [537G-538B]

P.M. Mohammed Meerakhan v. Commissioner of Income-Tax, Kerala, [1969] 73 I.T.R. SC 735, referred to.

2. The object of stock valuation is the correct determination of the profits and loss resulting from a year's trading. [538B]

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Whimster & Co. v. Commissioners of Inland Revenue,, [1926] 12 Tax Cases 813, 827; Chainrup Sampatram v. Commissioner of IncomeTax, West Bengal, [1953] 24 I.T.R. 481, 485-486; Patrick (Inspector of Taxes) v. Broadstone Mills Ltd., [1954] 25 I.T.R. 377, 395; Russell v. Town & County Bank, [1888] 13 App. Cas. 418, 424; 4 TLR. 500 and Minister of National Revenue v. Anaconda American Brass Ltd., [1956] A.C. 85; (1956) I.T.R. 84, 99, referred to.

3. Section 145 of the Income Tax Act, 1961 confers sufficient power upon the officer-nay it imposes a duty upon him-to make such computation in such manner as he determines for deducing the correct profits and gains. This means that where accounts are prepared without disclosing the real cost of the stock-in-trade, albeit on sound expert advice in the interest of efficient administration of the company, it is the duty of the Income Tax Officer to determine the taxable income by making such computation as he thinks fit. [539E]

4. Even if the assessee had adopted a regular system of accounting, it was the duty of the Assessing Officer under section 145 of the Income Tax Act 1861, to consider whether the correct profits and gains could be deduced from the

accounts so maintained. If he was of the opinion that the correct profits could not be deduced from the accounts, he was obliged to have recourse of the proviso to section 145 of the Income Tax Act 1961. [536C, G]

Commissioner of Income-Tax, Bombay v. Sarangpur Cotton Manufacturing Co. Ltd., [1938] 6 ITR 36; Commissioner of IncomeTax, Madras v. A. Krishnaswami Mudaliar & Ors., [1964] 53 I.T.R. 122, 128 and 132; Commissioner of Income-Tax v. Mc-Milan & Co., [1958] 33 I.T.R. 182; S.N. Namasivayam Chettiar v. Commissioner of Income-tax, Madras, [1960] 38 I.T.R. 579, 588 and Commissioners of Inland Revenue v. Cock, Russell and Co. Ltd., [1949] 29 Tax Cases 387, 392, referred to.

5. Any system of accounting which excludes, for the valuation of the stock-in-trade, all costs other than the cost of raw material for the goods in process and finished products, is likely to result in a distorted picture of the true state of the business for the purpose of computing the chargeable income. Such a system may produce a comparatively lower valuation of the opening stock and the closing stock, thus showing a comparatively low difference between the two. In a period of rising turnover and rising prices, the system adopted by the assessee, as found by the Tribunal, is apt to diminish the assessment of the taxable profit

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of a year. The profit of one year is 'likely to be shifted to another year which is an incorrect method of computing profits and gains for the purpose of assessment. [539F-G]

6. Each year being a self-contained unit, and the taxes of a particular year being payable with reference to the income of that year, as computed in terms of the Act, the method adopted by the assessee has been found to be such that the income cannot properly be deduced therefrom. It is, therefore, not only the right but the duty of the Assessing Officer to act in exercise of his statutory power, for determining what, in his opinion, is the correct taxable income. [539H-540A]

7. The question to be determined by the Assessing Officer in exercise of his power under section 145 is whether or not income can properly be deduced from the accounts maintained by the assessee, even if the accounts are correct and complete to the satisfaction of the Officer and the income has been computed in accordance with the method regularly employed by the assessee. What is to be determined by the Officer is a question of fact i.e. whether or not income chargeable under the Act can properly be deduced from the books of account, and he must decide the question with reference to the relevant material and in accordance with the correct principles. [531D-F]

8. It is a well recognised principle of commercial accounting to enter in the profit and loss account the value of the stock-in-trade at the beginning and at the end of the accounting year at cost or market price, whichever is the lower. [533G-H]

Whimster & Co. v. The Commissioners of Inland Revenue, [191726] 12 Tax Cases, 813,823 referred to.

(9) Where the market value has fallen before the date of valuation and at that date the market value of the article is less than its actual cost, the assessee is entitled to value the articles at market value and thus anticipate the loss which he will probably incur at the time of the sale of goods. Valuation of the stock-in-trade at cost or market value, whichever is the lower, is a matter entirely within the discretion of the assessee, but whichever method he adopts, it should disclose a true picture of his profits and

gains. If, on the other hand, he adopts a system which does not disclose the true state of affairs for the determination of tax, even if it is ideally suited for other purposes of his business, such as the creation of a reserve, declaration of dividends, planning and the like, it is the duty of the Assessing Officer to adopt any

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such computation as he deems appropriate for proper determination of the true income of the assessee. [534E-F]

This is not only a right, but a duty that is placed on the Officer, in terms of the first proviso to section 145 which concerns a correct and complete account, but which in the opinion of the Officer does not disclose a true and proper income. [534G]

B.S.C. Footwear v. Ridgway (Inspector of Taxes), [1971] 2 W.L.R. 1313, referred to.

(10) It is not only the right, but the duty of the Assessing Officer to consider whether or not the books disclose the true state of accounts and the correct income can be deducted therefrom. It is incorrect to say, as contended on behalf of the assessee, that the Officer is bound to accept the system of accounting regularly employed by the assessee the correctness of which had not been questioned in the past. There is no estoppel in these matters, and the Officer is not bound by the method followed in the earlier years. [535G]

(11) What is the profit of a trade or business is a question of fact and it must be ascertained, as all facts must be ascertained, with reference to the relevant evidence, and not on doctrine or theories. [539C]

JUDGMENT: