

Karnataka High Court Commissioner Of Income-Tax vs Pandavapura Sahakara Sakkare ... on 16 October, 1992 Equivalent citations: 1993 201 ITR 56 KAR, 1993 201 ITR 56 Karn Author: K S Bhat Bench: K S Bhat, R Ramakrishna JUDGMENT K. Shivashankar Bhat, J. 1. These references under 256(2) of the Income-tax Act, 1961, involve consideration of the following question : “(1) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in upholding the order of the Commissioner of Income-tax (Appeals) who deleted the additions of Rs. 1,62,248 and Rs. 1,58,547 for the assessment years 1978-79 and 1979-80, respectively, made by the Income-tax Officer towards the credit made to the Molasses Storage Fund by the assessee ? (2) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in upholding the order of the Commissioner of Income-tax (Appeals) who directed the Income-tax Officer to give the assessee deduction of the sum of Rs. 8,03,130 claimed as difference in stocks ?” 2. The questions arose out of assessment proceedings for the assessment year 1978-79 and 1979-80. The assessee credited some amounts to the Molasses Storage Fund and claimed deduction because these amounts were to be utilised for erection of adequate storage facilities in accordance with the orders issued by the Government; the amounts in question were diverted out of the assessee’s income by virtue of the statutory order governing the assessee. The Commissioner (Appeals) and the Appellate Tribunal held that these sums did not become the income of the assessee in view of their diversion at the very moment of their accrual. Hence, the first question. 3. In CIT v. Pandavapura Sahakara Sakkare Kharkane Ltd. [1992] 198 ITR 690 (I. T. R. C. No. 46 of 1990, dated September 11, 1991), this court has already upheld a similar view taken by the Appellate Tribunal in the very assessee’s case. It was held by this court that, “the right to the fund got diverted from the hands of the assessee by virtue of the Molasses Control Order”. Following the aforesaid decision, the first question is answered in the affirmative and against the Revenue. 4. A sum of Rs. 8,03,130 was disallowed by the assessing authority of the assessment year 1978-79. This amount was claimed by the assessee as the difference in the value arrived at by virtue of a change in the method of valuing the closing stock of the previous year and the opening stock of the assessment year. The facts are brought out by the assessing authority in the following words : “A sum of Rs. 8,03,130 is debited to the profit and a loss account as being the difference in value of stores and spares between the book value and the actual value. This is said to be arrived at by physical verification. It is stated that hitherto the assessee-society was valuing the stock as at the end of the year on the basis of simple average method. But this year the stock is said to be valued on the basis of first in and first out method. On this basis a sum of Rs. 8,03,130.26 has been arrived at being the difference in value of actual stock and the value as per books. This difference in value of Rs. 8,03,130.26 has been debited to the profit and loss account. It is admitted by the assessee’s representative that this sum of Rs. 8,03,130 represents difference in valuation of stock relating to assessment year 1958-59 to 1977-78. In the first place, it has to be pointed out that the assessee has all along been following mercantile (sic) should have been properly claimed in the respective assessment years and

in any case it is not a charge on the current year's profit." 5. Consequently, he disallowed the claim of the assessee. 6. The Commissioner of Income-tax (Appeals) accepted the contention of the assessee and the Appellate Tribunal upheld his view. There is no dispute that all along, during the previous years, the assessee (which is a co-operative society) used to take inventor of the stores and value them as per the average cost. This was objected to by the statutory auditor who insisted that the stock should be valued on "first in and first out" basis, which only would reflect the real value. By shifting to this method, the book value got reduced by Rs. 8,03,130 which was charged to the profit and loss account. The Appellate Assistant Commissioner found the change adopted by the Assessee as bone fide, and under statutory compulsions. This altered method would continue to be adopted during the future years also. 7. The Appellate Tribunal, while upholding the order of the Commissioner, observed : "We have seen paragraph 22 of the audit report of the year 1976-77 in which it has been noted that the accounts in respect of valuation of stocks which were being maintained in the ledger have been discontinued and are now being maintained through data processing system. This shows that there was bona fide change in the method of accounting and that the new method has been devised for the purpose of reflecting the correct income." 8. Thus it is clear that the change in the mode of valuation was a bona fide change and in fact, this change brought out the real income. 9. Mr. Raghavendra Rao contended that, between 1958-59 to 1977-78, stocks were being valued by applying the "average value" method and the change has actually resulted in altering the valuation of the stocks held during those years and, therefore, the difference arrived at by the assessee during the current assessment year is actually a difference attributable to the previous years and if so, the difference should be spread over during these years since the assessee has been following the mercantile system of accounting. 10. The above contention overlooks the facts that the opening stock of the current year is the closing stock of the previous year and the stock carried forward thus is the current year's stock-in-trade. If the assessee purchases new articles of trade during the current year, the same would also form part of his stock. Valuing the closing stock on the basis of average price would not actually reflect the real value of the stock held because, the lower cost incurred in respect of the stock obtained at an earlier date would dilute the cost incurred subsequently while obtaining fresh stock or vice versa. The "first in and first out" basis reflects the real worth of the goods found at a given moment of time. No doubt, a sudden change in the method of valuation would affect that year's taxable income; but this is inevitable; a change, if effected for bona fide reasons has to be permitted as inevitable. 11. Learned counsel for the Revenue contended that, under section 145 it is primarily for the Income-tax Officer to accept or not to accept the change in the method of accounting and, in the instant case, the assessing authority held that this changed method would not reflect the real income for taxation. The decision of the Supreme Court in CIT v. British Paints India Ltd. AIR 1991 SC 1338: [ 1991 ] 188 ITR 44 ( SC ), was relied on in support of the contention that, if the method of accounting adopted by the assessee does not disclose a true picture of the profits and gains, it should

not be permitted. In the said case, the assessee was engaged in the business of manufacture and sale of paints; according to it, its consistent practice was to value the work-in-process and finished products exclusively at the cost of raw materials excluding overhead expenditure, because the goods being paints had limited storage life. It was found that at no time the assessee had claimed any deduction on account of deterioration or damage to its goods and that there was no justification to recognise a practice of valuing the stocks otherwise than in accordance with the well-recognised principle accounting which required to stock to be valued at either cost (raw material plus expenditure) or market price, whichever was lower. This finding of the Income-tax officer was upheld by the Tribunal. At page 50, the Supreme Court summarised the relevant facts and the question thus (at page 50 of 188 ITR) : “The facts are not in dispute. It is the assessee’s case that the stock-in-trade has been valued at 84.49 per cent., representing the actual cost of the raw materials. The overhead charges representing 15.51 per cent. of the total cost have been admittedly excluded from the assessee’s valuation of the stock. But, by the very method of accounting which the assessee has adopted, it is possible for the Income-tax Officer to make the necessary additions deductions so as to arrive at the correct value of the stock for the purpose of determining the chargeable income. The correctness of the accounts maintained by the assessee is not in question; nor is the system adopted by the assessee, except in so far as the stock is valued without taking into account the production expenditure. The question, therefore, is whether or not the Assessing Officer is justified in holding that the stock-in-trade of the assessee had necessarily to be valued, for the purpose of computing the income, at 100 per cent. of the cost, and not at 84.49 per cent., as the assessee has admittedly done.” 12. As to the method of valuing the right of the assessee to adopt a proper mode was recognised by the Supreme Court. In this regard, it was observed at page 52 : “Where the market value has fallen before the date of valuation and, on 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 the goods. Valuation of the stock-in-trade at cost or market value, which ever 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 such computation as he deems appropriate for the proper determination of the true income of the assessee. 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 the true and proper income. The correct principle of accounting is to enter the stock in the books of account at cost unless the value is required to be reduced by reason of the fall in the market value of those goods below their original cost. Ordinarily, therefore, the goods should not be written down

below the cost price except where there is an actual or anticipated loss. On the other hand, if the fall in the price is only such as it would reduce merely the prospective profit, there would be no justification to discard the initial valuation at cost.” 13. Therefore, the real test to be applied under section 145 is to find out whether the method followed by the assessee leads to the determination of his true income. Further, the stock has to be normally valued at cost. 14. Learned counsel for the Revenue emphasised the observations (at page 53) : “It is not only the right but duty of the Assessing Officer to consider whether or not the books disclose the true state of accounts and the correct income can be deduced 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 following in the earlier years.” 15. Again at page 56, was held : “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 doctrines or theories : ‘no assumption need be made unless the facts cannot be ascertained, and then only to the extent to which they cannot be ascertained. There is no room for theories as to flow of costs....’ Minister of National Revenue v. Anaconda American Brass Ltd. .” 16. The Supreme Court reversed the High Court decision and upheld the contention of the Revenue, because the method of valuation followed by the assessee in the said case excluded the ‘overhead charges’ from the value of the goods. Confining the value only to the cost of the raw material did not reflect the true and real cost of the goods and thus the income cannot be properly deduced by accepting such a method. 17. In the instant case before us, on facts, the Commissioner (Appeals) and the Appellate Tribunal found that the true picture of the assessee’s income is depicted by the method of a valuation now adopted by the assessee. In fact, this method of valuing the stock is more appropriate than the “average method” followed earlier; the present system reflected, more truly, the worth of the stock held, because the valuation is now directly based on the value of the particular stock held, denuding the value of the said stock, of the effect of the cost incurred regarding other goods not actually held in stock. 18. Assuming that section 145 is attracted to the facts of the case, under which the Income-tax Officer has power to determine the true income, this power is subject to scrutiny by the appellate authority who has found the method followed by the assessee quite reasonable in the circumstances. The Appellate Tribunal has given a definite finding that the new method has been derived for the purpose of reflecting the correct income. In other words, the ultimate fact-finding authority has found the method adopted by the assessee as resulting in disclosing the true picture of the assessee’s profits and loss. 19. In the view we have taken, it is unnecessary to consider the decision of this court in CIT v. Corporation Bank Ltd. [1988] 174 ITR 616, cited by Sri Ramabhadran, learned counsel for the assessee. 20. Consequently, we answer the second question in the affirmative and against the Revenue. 21. In the result, both the questions are answered against the Revenue. 22. The reference is answered accordingly.