A.L.A. Firm vs Commissioner Of Income Tax, Madras on 21 February, 1991

Equivalent citations: 1991 SCR (1) 624, 1991 SCC (2) 558, 1991 AIR SCW 849, 1991 (2) SCC 558, (1991) 1 SCR 624 (SC), (1991) 1 COMLJ 406, (1991) 93 CURTAXREP 133, (1991) 189 ITR 285, 1991 KERLJ(TAX) 243, (1991) 55 TAXMAN 497, 1991 UPTC 2 918, (1991) 5 CORLA 254, (1991) 2 JT 7 (SC)

Bench: N.M. Kasliwal, S.C. Agrawal

PETITIONER:
A.L.A. FIRM

Vs.

RESPONDENT:
COMMISSIONER OF INCOME TAX, MADRAS

DATE OF JUDGMENT21/02/1991

BENCH:
RANGNATHAN, S.
BENCH:
RANGNATHAN, S.
KASLIWAL, N.M. (J)
AGRAWAL, S.C. (J)

CITATION:
1991 SCR (1) 624 1991 SCC (2) 558
JT 1991 (2) 7 1991 SCALE (1)364

ACT:
Income Tax Act, 1961 : Section 147(b)-Scope of-Assessment year 1961-62-Reassessment-Interpretation and meaning of the word "information"-Material coming to the notice of the Income Tax Officer subsequent to original assessment-Meaning of the word "Escape".

Dissolution of Firm-Valuation of closing stoc-Principles-In continuing business closing stock to be valued at cost or market price which ever is lower-Where business is discontinued, the closing stock to be valued at market price.

HEADNOTE:
The Appellant-Assessee, a partnership firm was engaged mainly, in Malaya, in money lending business since 1949 and

incidental to this business was also doing the business of sale and purchase of house properties, gardens and estates. It was reconstituted under a deed dated 26.3.1960. The firm was dissolved on 13.3.1961 and closed its accounts with effect from that date. In its income-tax return filed on 10.4.1962 for the assessment year 1961-62 it had filed a profit and loss account wherein amount of $.1,01,248 equivalent of Rs.1,58,057 was shown as "difference on revaluation of the estates, gardens and house properties" on the dissolution of the firm. In the memo of adjustment for income-tax purposes this amount was deducted as being not assessable either as revenue or capital. The Income Tax Officer issued notice under section 23(2) of the Act on that very day and completed the assessment also on the same day after making a petty addition of Rs.2088 paid as property tax in Malaya.

When for the subsequent year 1962-63, the assessee filed its return showing nil income stating in the forwarding letter that the Firm had been dissolved on 13.3.1961, the I.T.O. wrote to the assessee that the revaluation difference of Rs.1,58,057 should have been brought to tax in the previous year. The assessee replied that no profit or loss could be assessed on a revaluation of assets, that the assessee was gradually winding up its business in Malaya, the surplus would be only capital

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gains and that revalutation had been at the market price prevalent since 1954 and thus no capital gains were chargeable to tax. Not satisfied, the I.T.O. issued a notice under section 148 read with Section 147(b) of the Income Tax Act, 1961. The assessee filed objections. Overruling all the objections, the Income Tax Officer completed reassessment of the assessee Firm adding back the sum of Rs. 1,58,057 to the previously assessed income. Having failed right upto the High Court, the assessee came in appeal before this Court.

Dismissing the appeal, affirming the decision of the High Court, this Court.

HELD: (1) The proceedings u/s 147(b) were validly initiated. The facts of this case squarely fall within the scope of propositions (2) and (4) enunciated in Kalyanji Mavji's case. Proposition (2) may be briefly summarised as permitting action even on a "mere change of opinion". This is what has been doubted in the IENS case. But, even leaving this out of consideration, there can be no doubt that the present case is squarely covered by proposition (4) set out in Kalyanji's case. This proposition clearly envisages a formation of opinion by the Income-Tax Officer on the basis of material already on record provided the formation of such opinion is consequent on "information" in the shape of some light thrown on aspects of facts or law which the Income Tax Officer had not earlier been conscious of. [636G-637B]

The difference between the situations envisaged in propositions (2) and (4) of Kalyanji Mavji is this, that proposition (4) refers to a case where the Income Tax Officer initiates reassessment proceedings in the light of "information" obtained by him by an investigation into material already on record or by research into the law applicable thereto which has brought out an angle or aspect that had been missed earlier. Proposition (2) no doubt covers this situation also but it is so widely expressed as to include also cases in which the Income Tax Officer, having considered all the facts and law, arrives at a particular conclusion, but reinitiates proceedings because, on a reappraisal of the same material which had been considered earlier and in the light of the same legal aspects to which his attention had been drawn earlier, he comes to a conclusion that an item of income which he had earlier consciously left out from the earlier assessment should have been brought to tax. [637F-H]

It is true that the return was filed and the assessment was completed on the same date. Nevertheless, it is opposed to normal human

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conduct than an officer would complete the assessment without looking at the material placed before him. It is not as if the assessment record contained a large number of documents or the case raised complicated issues rendering it probable that the Income Tax Officer had missed these facts. It is a case where there is only one contention raised before the Income Tax Officer and it is, we think, impossible to hold that the Income-Tax Officer did not at all look at the return filed by the assessee or the statements accompanying it. The more reasonable view to take would, in our opinion, be that the Income-Tax Officer looked at the facts and accepted the assessee's contention that the surplus was not taxable. But, in doing so, he obviously missed to take note of the law laid down in Ramachari which there is nothing to show, had been brought to his notice. when he subsequently became aware of the decision, he initiated proceedings under section 147(b). The material which constituted information and on the basis of which the assessment was reopened was the decision in Ramachari. this material was not considered at the time of the original assessment. Though it was a decision of 1961 and the Income Tax Officer could have known of it had he been diligent, the obvious fact is that he was not aware of the existence of that decision then and, when he came to know about it, he rightly initiated proceedings for reassessment. [639E-640B]

The material on which the Income Tax Officer has taken action is a judicial decision. This had been pronounced just a few months earlier to the original assessment and it is not difficult see that the Income Tax Officer must have missed it or else he could not have completed the assessment as he did. Indeed it has not been suggested that he was aware of it and yet chose not to apply it. It is therefore, much easier to see that the initiation of reassement proceedings here is based on definite material not considered at the time of the original assessment. [640D-E]

(2) The stock-in-trade of a firm at the time of its disolution, has to be assessed at a fair value. there can be no manner of doubt that, in taking accounts for purposes of dissolution, the firm and the partners, being commercial men, would value the assets only on a real basis and not at cost or at their other value appearing in the books. The real rights of the partners cannot be mutually adjusted on any other basis. This is what happened in Ramachari. Indeed, this is exactly what the partners in this case have done and, having done so, it is untenable for them to contend that the valuation should be on some other basis. Once this principle is applied and the stock-in-trade is valued at market price, the surplus, if any, has to get reflected as the profits of the firm

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and has to be charged to tax. The view taken by the High Court has held the field for about thirty years now and we see no reason to disagree even if a different view was possible. [642B-D, 647E,648A-C]

Popular Automobiles v. Commissioner of Income-Tax, [1989] 179 I.T.R. 632; Sunil Siddharthbhai v. Commissioner of Income Tax, [1985] 156 I.T.R. 509; Pupular Workshops v. Commissioner of Income-Tax [1987] 166 I.T.R. 348; Malabar Fisheries Co. v. Commissioner of Income Tax, [1979] 120 I.T.R. 49; Indian & Eastern Newspaper Society v. Commissioner of Income Tax, [1979] 119 I.T.R. 996; Kalyanji Mavji & Co. v. Commissioner of Income Tax, [1976] 102 I.T.R. 287; M/s A.L.A. Firm v. The Commissioner of Income Tax, Madras [1976] I.T.R. 622; Commissioner of Income Tax v. Hind Construction Ltd., [1972] 83 I.T.R. 211; Commissioner of Income Tax v. Birla Gwalior (P) Ltd., [1973] 89 I.T.R. 266; Anandji Haridas & Co. (P) Ltd. v. S.P. Kushare, Sales Tax Officer, [1968] 21 S.T.C. 326; Commissioner of Income Tax v. Dewas Cine Corporation, [1968] 68 I.T.R. 240; Ramachari & Co. v. Commissioner of Income Tax, [1961] 41 I.T.R. 142; Maharaj Kumar Kamal Singh v. Income Tax Officer, [1954] 35 I.T.R. 1 S.C.; Commissioner of Income Tax v. A Raman & Co., [1968] 67 I.T.R. 11 S.C.; Salem Provident Fund Society Ltd. v. Commissioner of Income Tax, [1961] 42 I.T.R. 547; Commissioner of Income Tax v. Rathinasabapathy Mudaliar, [1964] 51 I.T.R. 204; Addanki Narayanappa v. Bhaskara Krishnappa, [1966] 3 S.C.R. 400; Commissioner of Income Tax v. Bankey Lal Vaidya [1971] 79 I.T.R. 594; Kikabhai Premchand v. Commissioner of Income Tax, [1953] 24 I.T.R. 506 (S.C.); Commissioner of Income tax v. K.A.R.K. Firm, [1934] 2 I.T.R. 183; Chainrup Sampathram v. Commissioner of Income Tax, [1953] 24 I.T.R. 481; Commissioner of Income Tax v. M/s. Shoorji Vallabhadas & Co., [1962] 46 I.T.R. 144,

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Commissioner of Income Tax v. Krishnaswamy Muldaliar, [1964]
53  I.T.R. 122; Commissioner of Income Tax v. Ahmedabad  New
Cotton  Mills  Co. Ltd., [1930] L.R. 57  I.A.  21;  Muhammad
Hussain  Sahib  v. Abdul Gaffor Sahib, [1950] 1  M.L.J.  81.
reffered to.
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JUDGMENT:
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CIVIL APPELLATE JURISDICTION: Civil Appeal No. 570 of 1976.

Appeal by Certificate from the Judgment and Order dated 9.2.1976 of the Madras High Court in Tax Case No. 104 of 1969.

T.A. Ramachandran, P.N. Ramaligam and A.T.M. Sampath for the Appellant.

V.Gauri Shanker, Manoj Arora, S. Rajappa and Ms.A.Subhashini for the Respondent.

The Judgment of the Court was delivered by RANGANATHAN, J. This is the assessee's appeal form a judgment of the Madras High Court dated 10.1.1975 answering three questions referred to it by the Income-tax Appellate Tribunal in favour of the Revenue and against the assessee. The reference related to the assessment year 1961-62, the previous year in respect of which commenced on 13.4.1960. The judgment of the High Court is reported as (1976) 102 I.T.R.622.

The appellant-assessee is a partnership firm. Since 1949, it was carrying on, in Malaya, a money lending business and, as part of and incidental to the said business, a business in the purchase and sale of house properties, gardens and estates. It had been reconstituted under a deed dated 26.3.1960. The firm's accounts for the year 1960-61, which commenced on 13.4.60, would normally have come to a close on or about the 13th April, 1961. However, the firm closed its accounts as on 13.3.1961 with effect from which date it was dissolved. Along with its income-tax return for the assessment year 1961-62 filed on 10th April 1962, the assessee filed a profit and loss account and certain other statements. In the profit and loss account, a sum of $ 1,01,248 was shown as "difference on revaluation of estates, gardens and house properties" on the dissolution of the firm on 13.3.61, such difference being $ 70,500 in respect of "house properties" and $ 30,748 in respect of estates and gardens. In the memo of adjustment for income-tax purposes, however, the above sum was deducted on the ground that it was not assessable either as revenue or capital. A statement was also made before the officer that partner Ramanathan Chettiar, forming one group and the other partners forming another group, were carrying on business separately with the assets and liabilities that fell to their shares on the dissolution of the firm.

The Income-tax Officer (I.T.O.) issued a notice under section 23(2) on the same day (10.4.1962) posting the hearing for the same day and completed the assessment also on the same day, after making a petty addition of Rs. 2083 paid as property tax in Malaya, and recording the following note:

> "Audit assessment-Lakshmanan appears-return filed- I.T. 86 acknowledged in list of books-scrutinised- order dictated".

For the subsequent assessment year 1962-63, the assessee filed a return showing nil income along with a letter pointing out that the firm had been dissolved on 13.3.1961. Thereafter, on 3.9.63, the I.T.O. wrote a letter to the assessee to the effect that the revaluation difference of $ 1,01,248 should have been brought to tax in the assessment year 1961-62 in view of the decision of the Madras High Court in Ramachari & Co. v. C.I.T., [1961] 41 I.T.R. 142. He called for the basis for the valuation and also for the assessee's objections. The assessee sent a reply stating that no profit or loss could be assessed on a revaluation of assets. Relying on a circular of the Central Board of Revenue dated 21.6.1956, it was urged that the assessee was gradually winding up its business in Malaya and that therefore, the surplus would only be capital gains. It was urged that the revaluation had been at a market price prevalent since 1.1.1954 and that, therefore, no capital gains were chargeable to tax. The I.T.O. followed up his letter by a notice under S. 148 read with S. 147(b). The assessee objected to the reassessment on two grounds: (1) that the circumstances did not justify the initiation of proceedings under S. 147(b); and (2) that no assessable profits arose to the firm on the revaluation of assets on the eve of the dissolution of the firm. Overruling these objections, the I.T.O. completed a reassessment on the firm after adding back the sum of Rs.1,58,057 (the equivalent of $ 1,01,248) to the previously assessed income. The assessee's successive appeals to the Appellate Assistant Commissioner and the Appellate Tribunal and reference, at its instance, to the High Court having failed,the assessee is before us.

Three questions of law were referred to the High Court by the Tribunal. These were:

> "1. Whether, on the facts and circumstances of the case, the reassessment made on the assessee firm for the assessment year 1961-62 under section 147 of the Income-tax Act is valid in Law?
>
> 2. Whether, on the facts and circumstances of the case, assessment of the sum of $ 1,01,248 as revenue profit of the assessee firm chargeable to tax for the assessment year 1961-62 is justified in law?
>
> 3. Whether, on the facts, and circumstances of the case, the Appellate Tribunal is right in law in sustaining the assessment of the sum of $ 1,01,348 after having found that the Department Officers are bound by the Circular of the Central Board of Revenue?"

We may deal at the outset with the third question. Though the High Court has dealt with this question at some length, we do not think any answer to this question can or need be furnished by us for the following reasons. First, the assessee has not been able to place before us the circular of the Board on which reliance is placed. It is not clear whether it is a circular or a communication of some other nature. Second, the circular, to judge from its purport set out in the High Court's judgment, seems to have been to the effect that the surplus arising from the sale of properties acquired by a money-lender in the course of his business would be in the nature of capital gains and not of income. Obviously such a proposition could not have been intended as a broad or general proposition of law, for the nature of the surplus on sale of assets would depend on the nature of the asset sold and this, in turn, would depend on the facts and circumstances of each case. In this case, no material was placed at any stage to show that the assets in question constituted the capital assets of the firm and not its stock-in-trade. Third, the plea of the assessee which was in issue all through was that there was no sale of assets by the firm when its assets are distributed among its partners and that no profits-whether capital or revenue- could be said to arise to the firm merely because, at the time of the dissolution, the firm revalued its assets on the basis of market value or any other basis, for adjusting the mutual rights and liabilities of the partners on the dissolution of the firm. The terms of the circular, as set out in the order of the High Court, cannot therefore be of any assistance to the assessee in answering the issues in this case. We, therefore, do not answer the third question posed by the Tribunal.

Turning now to the first question, the relevant facts have already been noticed. The following relevant and material facts viz. (i) the dissolution of the firm, (ii) the revaluation of its assets, (iii) the distribution thereof among two groups of its partners, and (iv) the division and crediting of the surplus on revaluation to the partner's accounts were not only reflected in the balance sheet, the profit and loss account and the profit and loss adjustment account but were also mentioned in the statement filed before the I.T.O. along with the return. Clearly, action u/s 148 read with clause (a) of s.147 could not be initiated in these circumstances but is action under clause

(b) of that section also impermissible? That is the question.

We may now set out the provisions of clause (b) of section 147 for purposes of easy reference. This clause- which corresponds to s. 34(1)(b) of the Indian Income-tax Act, 1922 (`the 1922 Act') permits-initiation of reassessment of proceedings, "notwithstanding that there has been no omission or failure as mentioned in clause (a) on the part of the assessee" provided "the Income-tax Officer has, in consequence of information in his possession, reason to believe that income chargeable to tax has escaped assessment".

In the present case, on the information already on record and in view of the decision in Ramachari & Co. v. C.I.T., [1961] 41 I.T.R. 142, there can be no doubt that the I.T.O. could reasonably come to the conclusion that income, profits and gains assessable for the assessment year 1961-62 had escaped assessment. But is that belief reached "in consequence of information in his posession"? The assessee's counsel says "no", for, says he, it is settled law that the "information" referred to in clause (b) above, should be "information" received by the I.T.O. after he had completed the original assessment. Here it is pointed out that all the relevant facts as well as the decision in Ramachari (supra) had been available when the original assessment was completed on 10.4.1962. Action cannot be taken under this clause merely because the I.T.O., who originally considered the surplus to be not assessable, has on the same facts and the same case law which had been available to him when he completed the assessment originally, changed his opinion and now thinks that the surplus should have been charged to tax.

The validity of the assessee's argument has to be tested in the light of the decisions of this Court which have interpreted S. 147(b) of the 1961 Act or its predecessor S. 34(1)(b) of the 1922 Act and expounded its parameters. We may start with the decision in Maharaj Kumar Kamal Singh v. I.T.O., [1954] 35 I.T.R. 1 S.C. In this case it was held that the word "information" would include information as to the true and correct state of the law and would also cover information as to relevant judicial decisions. In that case the I.T.O. had re-opened the assessment on the basis of a subsequent decision of the Privy Council and this was upheld. Referring to the use of the word "escape" in the section, the Court observed.

> "In our opinion, even in a case where a return has been submitted, if the income-tax Officer erroneously fails to tax a part of asessable income, it is a case where the said part of the income has escaped assessment. The appellant's attempt to put a very narrow and artificial limitation on the meaning of the word "escape" in section 34(1)(b) cannot, therefore, succeed."

(underlining ours) The meaning of the word "information" was again explained thus in C.I.T. v. A. Raman & Co., [1968] 67 I.T.R. 11 SC:

> "The expression `information' in the context in which it occurs must, in our judgment, mean instruction or knowledge derived from an external source concerning facts or particulars, or as to law relating to a matter bearing on the assessment........
>
> Jurisdiction of the Income-tax Officer to reassess income arises if he has in consequence of information in his possession reason to believe that income chargeable to tax has escaped assessment. That information, must, it is true, have come into the possession of the Income-tax Officer after the previous assessment, but even if the information be such that it could have been obtained during the previous assessment from an investigation of the materials on the record, or the facts disclosed thereby or from other enquiry or research into facts or law, but was not in fact obtained, the jurisdiction of the Income-tax Officer is not affected."

(underlining ours) We may next refer to Kalyanji Mavji & Co. v. C.I.T., [1976-102] I.T.R. 287. It is unnecessary to set out the facts of this case. It is sufficient to refer to the enunciation of the law regarding the scope of section 34(1)(b) as culled out from the earlier decisions of this Court on the subject. At page 296 the Court observed:

> "On a combined review of the decisions of this Court the following tests and principles would apply to determine the applicability of section 34(1)(b) to the following categories of cases:
>
> (1) where the information is as to the true and correct state of the law derived from relevant judicial decisions;

> (2) where in the original assessment the income liable to tax has escaped assessment due to oversight, inadvertence or a mistake committed by the Income-tax Officer. This is obviously based on the principle that the taxpayer would not be allowed to take advantage of an oversight or mistake committed by the taxing authority;
>
> (3) where the information is derived from an external source of any kind. Such external source would include discovery of new and important matters or knowledge of fresh facts which were not present at the time of the original assessment; (4) where the information may be obtained even from the record of the original assessment from an investigation of the materials on the record, or the facts disclosed thereby or from other enquiry or research into facts or law."

Before applying the above principles to the facts of the present case, we may refer to two earlier decisions of the Madras High Court which have been followed in the judgment under appeal. In Salem Provident Fund Society Ltd. v. C.I.T., [1961] 42 ITR 547, the Income-tax officer, in calculating the annual profits of an insurance company, had, under the statute to work out the difference between the deficiencies as shown in the actuarial valuation of the company in respect of two successive valuation periods. At the time of original assessment, the Income-tax Officer, by mistake, added the two deficiencies instead of subtracting one from the another. This mistake he committed not in one assessment year but in two assessment years. Subsequently, he discovered his mistake and initiated proceedings under section 34(1)(b). The contention urged on behalf of the assessee was that all the statements, on the basis of which the re-assessment proceedings were taken, were already on record and that, in such a case, there was no `information' which would justify the reassessment. An argument was also raised that the rectification, if any, could have been carried out only under section 35 and not under section 34. These contentions were repelled. In regard to the former objection, the High Court pointed out:

> "We are unable to accept the extreme proposition that nothing that can be found in the record of the assessment, which itself would show escape of assessment or under-assessment, can be viewed as information which led to the belief that there has been escape from assessment or under-assessment. Suppose a mistake in the original order of assessment is not discovered by the Income-tax Officer himself on further scrutiny but it is brought to this notice by another assessee or even by a subordinate or a superior officer, that would appear to be information disclosed to the Income-tax Officer. if the mistake itself is not extraneous to the record and the informant gathered the information from the record, the immediate source of information to the Income-tax Officer in such circumstances is in one sense extraneous to the record. It is difficult to accept the position that while what is seen by another in the record is `information' what is seen by the Income-tax Officer himself is not information to him. In the latter case he just informs himself. It will be information in his possession within the meaning of section 34. In such cases of obvious mistakes apparent on the face of the record of assessment that record itself can be a source of information, if that information leads to a discovery or belief that there has been an escape of assessment or under-assessment.

> A similar question arose in CIT v. Rathinasabapathy Mudaliar, [1964] 51 I.T.R. 204. In that case the assessee, who was a partner in a firm, did not include in his return the income of his minor son admitted to the benefits of the partnership as required by section 16(3) of the 1922 Act. The minor son submitted a separate return and was assessed on this income. Subsequently, the Income-tax Officer "discovered" his error in not assessing the father thereon and started re-assessment proceedings. The re-assessment was upheld by the Madras High Court on the same logic as had been applied in Salem Provident Fund Society Ltd. case (supra). The above line of thinking has not only held the field for about thirty years now but has also received approval in Anandji Haridas and Co. (P) Ltd. v. S.P. Kushare, Sales Tax Officer, [1968] 21 S.T.C. 326.

This issue has further been considered in the decision of this Court in the case of Indian and Eastern Newspaper Society v. C.I.T. (the IENS case, for short) [1979] I.T.R.

996. In this case the income of the assessee derived by letting out certain portions of the building owned by it to its members as well as to outsiders was being assessed as business income. In the course of audit, an internal audit party expressed the view that the money realised by the assessee on account of the occupation of its conference hall and rooms should have been assessed under the head "income from property" and not as business income. The Income-tax Officer thereupon initiated re-assessment proceedings and this was upheld by the Tribunal. On a direct reference under s.257 of the Act, this Court held that the opinion of the audit party on a point of law could not be regarded as "information" and that the initiation of the reassessment proceedings was not justified. It was contended for the Revenue, that the reassessment proceedings would be valid even on this premise. Dealing with this argument, the Court observed:

> "Now, in the case before us, the ITO had, when he made the original assessment, considered the provisions of sections 9 and 10. Any different view taken by him afterwards on the application of those provisions would amount to a change of opinion on material already considered by him. The revenue contends that it is open to him to do so, and on that basis to reopen the assessment under s. 147(b). Reliance is placed on Kalyanji Mavji & Co. v. CIT, [1976] 102 I.T.R. 287, where a Bench of two learned, Judges of this Court observed that a case where income had escaped assessment due to the "oversight, inadvertence or mistake" of the ITO must fall within s. 34(1)(b) of the Indian Income Tax Act, 1922. It appears to us, with respect, that the proposition is stated too widely and travels farther than the statute warrants in so far as it can be said to lay down that if, on re- appraising the material considered by him during the original assessment, the ITO discovers that he has committed an error inconsequence of which income has escaped assessment, it is open to him to reopen the assessment. In our opinion, an error discovere on a reconsideration of the same material (and no more) does not give him that power. That was the view taken by this Court in Maharaj Kumar Kamal Singh v. CIT, [1959] 35 I.T.R. 1; CIT v. A. Raman & Co., [1968] 67 ITR 11 and Bankipur Club Ltd. v. CIT [1971] 82 ITR 831 and we do not believe that the law has since taken a different course. Any observation in

> Kalyanji Mavji & Co. v. CIT, [1976] 102 I.T.R. 287 suggesting the contrary do not, we say with respect, lay down the correct law."

(underlining ours) The Court proceeded further to observe:

> "A further submission raised by the revenue on s. 147(b) of the Act may be considered at this stage. It is urged that the expression "information" in s. 147(b) refers to the realisation by the ITO that he has committed an error when making the original assessment. It is said that, when upon receipt of the audit note the ITO discovers or realizes that a mistake has been committed in the original assessment, the discovery of the mistake would be "information" within the meaning of s. 147(b). The submission appears to us inconsistent with the terms of s. 147(b) Plainly, the statutory provision envisages that the ITO must first have information in his possession, and then in consequence of such information he must have reason to believe that income has escaped assessment. The realisation that income has escaped assessment is covered by the words "reason to believe", and it follows from the "information" received by the ITO. The information is not the realisation, the information gives birth to the realisation."

Sri Ramachandran submits that these decisions support his contention that reassessment proceeding can be validly initiated only if there is some information received by the I.T.O. from an external source after the completion of the original assessment but not in a case like the present where there is nothing more before the I.T.O. than what was available to him when the original assessment was completed. He also submits that the observations in the IENS case have cast doubts on the propositions enunciated in Kalyanji Mavji's case (supra) and reiterates the proposition that reassessment proceedings cannot be availed of to revise, on the same material, the opinion formed or conclusion arrived at earlier in favour of the assessee.

On the other hand, Dr. Gaurisankar, appearing for the Revenue, mentioned that the decision in the IENS case holding that the opinion of an audit party would not constitute `information' and qualifying the principles enunciated in Kalyanji Mavji is pending consideration by a larger Bench of this Court. He, however, submitted that the reassessment in this case would be valid even on the strength of the observations in the IENS case. We shall proceed to consider the correctness of this submission.

We have pointed out earlier that Kalyanji Mavji (supra) outlines four situations in which action under S.34(1)(b) can be validly initiated. The IENS case has only indicated that proposition (2) outlined in this case and extracted earlier may have been somewhat widely stated; it has not cast any doubt on the other three propositions set out in Kalyanji Mavji's case. The facts of the present case squarely fall within the scope of propositions 2 and 4 enunciated in Kalyanji Mavji's case. Proposition (2) may be briefly summarised as permitting action even on a "mere change of opinion". This is what has been doubted in the IENS case (supra) and we shall discuss its application to this case a little later. But, even leaving this out of consideration, there can be no doubt that the present case is squarely covered by proposition (4) set out in Kalyanji Mavji & Co. (supra). This proposition clearly envisages a formation of opinion by the Income-tax Officer on the basis of material already on record provided the formation of such opinion is consequent on "information" in the shape of some light thrown on aspects of facts or law which the I.T.O. had not earlier been conscious of. To give a couple of illustrations, suppose an I.T.O., in the original assessment, which is a voluminous one involving several contentions, accepts a plea of the assessee in regard to one of the items that the profits realised on the sale of a house is a capital realisation not chargeable to tax. Subsequently he finds, in the forest of papers filed in connection with the assessment, several instances of earlier sales of house property by the assessee. That would be a case where the I.T.O. derives information from the record on an investigation or enquiry into facts not originally undertaken. Again, suppose if I.T.O. accepts the plea of an assessee that a particular receipt is not income liable to tax. But, on further research into law he finds that there was a direct decision holding that category of receipt to be an income receipt. He would be entitled to reopen the assessment under s.147(b) by virtue of proposition (4) of Kalyanji Mavji. The fact that the details of sales of house properties were already in the file or that the decision subsequently come across by him was already there would not affect the position because the information that such facts or decision existed comes to him only much later.

What then, is the difference between the situations envisaged in propositions (2) and (4) of Kalyanji Mavji (supra)? The difference, if one keeps in mind the trend of the judicial decisions, is this. Proposition (4) refers to a case where the I.T.O. initiates reassessment proceedings in the light of "information" obtained by him by an investigation into material already on record or by research into the law applicable thereto which has brought out an angle or aspect that had been missed earlier, for e.g., as in the two Madras decisions referred to earlier. Proposition (2) no doubt covers this situation also but it is so widely expressed as to include also cases in which the I.T.O., having considered all the facts and law, arrives at a particular conclusion, but reinitiates proceedings because, on a reappraisal of the same material which had been considered earlier and in the light of the same legal aspects to which his attention had been drawn earlier, he comes to a conclusion that an item of income which he had earlier consciously left out from the earlier assessment should have been brought to tax. In other words, as pointed out in IENS case, it also ropes in cases of a "bare or mere change of opinion" where the I.T.O. (very often a successor officer) attempts to reopen the assessment because the opinion formed earlier by himself (or, more often, by a predecessor I.T.O.) was, in his opinion, incorrect. Judicial decisions had consistently held that this could not be done and the IENS case (supra) has warned that this line of cases cannot be taken to have been overruled by Kalyanji Mavji (supra). The second paragraph from the judgment in the IENS case earlier extracted has also reference only to this situation and insists upon the necessity of some information which make the ITO realise that he has committed an error in the earlier assessment. This paragraph does not in any way affect the principle enumerated in the two Madras cases cited with approval in Anandji Haridas, [1986] 21 S.T.C.

326. Even making allowances for this limitation placed on the observations in Kalyanji Mavji, the position as summarised by the High Court in the following words represents, in our view, the correct position in law:

> "The result of these decisions is that the statute does not require that the information must be extraneous to the record. It is enough if the material, on the basis of which the reassessment proceedings are sought to be initiated, came to the notice of the Income-tax Officer subsequent to the original assessment. If the Income-tax Officer had considered and formed an opinion on the said material in the original assessment itself, then he would be powerless to start the proceedings for the reassessment. Where, however, the Income-tax Officer had not considered the material and subsequently come by the material from the record itself, then such a case would fall within the scope of section 147(b) of the Act."

Let us now examine the position in the present case keeping in mind the narrow but real distinction pointed out above. On behalf of the assessee, it is emphasised (a) that the amount of surplus is a very substantial amount,(b) that full details of the manner in which it had resulted had been disclosed, (c) that the profit and loss account, the profit and loss adjustment account and statement made before the I.T.O. had brought into focus the question of taxability of the surplus and (d) that decision in Ramachari's case had been reported by 10.4.1962. No Income-tax Officer can be presumed to have completed the assessment without looking at all this material and the said decision. No doubt, some doubt had been thrown as to whether a statement had been given at the time of original assessment that the amount of surplus was not taxable as an income or a capital gain but the case has proceeded on the footing that such a statement was there before the officer. This, therefore, is nothing but a case of "change of opinion". On the other hand, the authorities and the Tribunal have drawn attention to the fact that the return, the S. 143(2) notice and assessment were all on the same day and counsel for the Revenue urged that obviously, in his haste, the I.T.O. had not looked into the facts at all. It is urged that no Income-tax Officer who had looked into the facts and the law could have failed to bring the surplus to tax in view of then recent pronouncement in Ramachari's case. Dr. Gaurishankar submitted that the Tribunal has found that the I.T.O. "had acted mechanically in accepting the return without bringing his mind to play upon the entry in the statement with reference to the distribution of the assets". He pointed out that there is no evidence of any enquiry with reference to this aspect and that, the amount involved being sufficiently large, the I.T.O., if he had been aware of the existence of the entry would certainly have discussed it. He urged that the question whether the I.T.O. had considered this matter at the time of the original assessment or not is purely a question of fact and the Tribunal's conclusion thereon having been endorsed by the High Court, there is no justification to interfere with it at this stage.

We think there is force in the argument on behalf of the assessee that, in the face of all the details and statement placed before the I.T.O. at the time of the original assessment, it is difficult to take the view that the Income-tax Officer had not at all applied his mind to the question whether the surplus is taxable or not. It is true that the return was filed and the assessment was completed on the same date. Nevertheless, it is opposed to normal human conduct that an officer would complete the assessment without looking at the material placed before him. It is not as if the assessment record contained a large number of documents or the case raised complicated issues rendering it probable that the I.T.O. had missed these facts. It is a case where there is only one contention raised before the I.T.O. and it is, we think, impossible to hold that the Income-tax Officer did not at all look at the return filed by the assessee or the statements accompanying it. The more reasonable view to take would, in our opinion, be that the Income-tax Officer looked at the facts and accepted the assessee's contention that the surplus was not taxable. But, in doing so, he obviously missed to take note of the law laid down in Ramachari which there is nothing to show, had been brought to his notice. When he subsequently became aware of the decision, he initiated proceedings under S. 147(b). The material which constituted information and on the basis of which the assessment was reopened was the decision in Ramachari. This material was not considered at the time of the original assessment. Though it was a decision of 1961 and the I.T.O. could have known of it had he been diligent, the obvious fact is that he was not aware of the existence of the decision then and, when he came to know about it, he rightly initiated proceedings for assessment.

We may point out that the position here is more favorable to the Revenue than that which prevailed in the Madras cases referred to earlier. There, what the I.T.O. had missed earlier was the true purport of the relevant statutory provisions. It seems somewhat difficult to believe that the I.T.O. could have failed to read properly the statutory provisions applicable directly to facts before him (though that is what seems to have happened). Perhaps an equally plausible view, on the facts, could have been taken that he had considered them and decided, in one case, not to apply them and, in the other, on a wrong construction thereof. In the present case, on the other hand, the material on which the I.T.O. has taken action is a judicial decision. This had been pronounced just a few months earlier to the original assessment and it is not difficult to see that the I.T.O. must have missed it or else he could not have completed the assessment as he did. Indeed it has not been suggested that he was aware of it and yet chose not to apply it. It is therefore much easier to see that the initiation of reassessment proceedings here is based on definite material not considered at the time of the original assessment.

In the above view of the matter, we uphold the High Court's view on the first question.

The second question raises a more difficult problem. There can be no doubt that the decision of the Madras High Court in Ramachari squarely covers the situation. Ramachari holds that the principle of valuing the closing stock of a business at cost or market at the option of the assessee is a principle that would hold good only so long as there is a continuing business and that where a business is discontinued, whether on account of dissolution or closure or otherwise, by the assessee, then the profits cannot be ascertained except by taking the closing stock at market value. Ramachari has subsequently been followed by the Kerala High Court in Popular Workshops v. Commissioner of Income-Tax, [1987] 166 ITR 348 and in Popular Automobiles v. Commissioner of Income-Tax, [1989] 179 ITR 632.

Shri Ramachandran contends that the decision in Ramachari does not lay down the correct law. He submits than, while it is no doubt true that the closing stock has to be valued, the well settled principle is that it should be valued, at cost or market whichever is lower and there is no justification for laying down a different principle for valuation of the closing stock at the point of discontinuance of business unless the goods are actually sold by the assessee at the time of discontinuance. Further, it has been held by a series of decisions of this Court that when a firm is dissolved and the assets are distributed among the partners, there is no sale or transfer of the assets of the firm to the various partners: vide, Addanki Narayanppa v. Bhaskara Krishnappa, [1966] 3 SCR 400; CIT v. Dewas Cine

Corporation, [1968] 68 ITR 240; CIT v. 2Bankey Lal Vaidya, [1971] 79 ITR 594; Malabar Fisheries Co. v. C.I.T., [1979] 120 ITR 49 and in Sunil Siddharthbhai v. C.I.T., [1985] 156 ITR 509. He submits that, in logical sequence, dissolution comes first and distribution of assets comes later. Therefore, revaluation of the assets of a firm, which is only for the division of the assets among the partners on a real and not a notional basis, is part of the division of the assets and therefore logically, in point of time, subsequent to the dissolution of the firm. Since the revaluation takes place after the dissolution no profits can be said to have accrued to the firm by the process of revaluation. The revaluation of the assets is not in the course of business and is not an activity which can partake of the nature of trade. Assuming but not conceding that it is possible to have a revaluation of the assets, for example, stock in trade before dissolution, any excess which arises on the revaluation is only an imaginary or notional profit and cannot be brought to tax for the following reasons:

> (i) As a result of such revaluation, there can be no profit, because the firm cannot make a profit out of itself: Vide Kikabhai Premchand v. C.I.T., [1953] 24 I.T.R. 506 (S.C.).
>
> (ii) The process of revaluation of stock by itself cannot bring in any real profits: vide C.I.T. v.

K.A.R.K. Firm, [1934]2 I.T.R. 183; Chainrup Sampatram v. C.I.T., [1953) 24 I.T.R. 481 and C.I.T. V. Hind Construction ltd., [1972] 83 I.T.R. 211; and

(iii) It is well settled that what is taxable under the income tax law is only real income vide C.I.T. v. M/s Shoorji Vallabhdas and Co., [1962] 46 I.T.R. 144 and C.I.T. v. Birla Gwalior (P) Ltd., [1973] 89 I.T.R. 266. There is, therefor, no principle by which the stock-in-trade can be valued at market price so as to bring to tax the notional profits which might in future be realised as a result of the sale of the stock in trade.

The question posed before us is a difficult one. We think, however, that the High Court was right in pointing out that the several decisions relied upon for the assessee as to the nature of the transaction by which a firm, on dissolution, distributes its assets among its partners, have no relevance in the present case. As the High Court rightly observed, those cases relate to what happens after or in consequence of the dissolution of a firm whereas we are here concerned with a question that arises before or at the time of dissolution. What we have to decide is the basis on which, in making up the accounts of a firm upto the date of dissolution, the closing stock with the firm as at a point of time immediately prior to the dissolution is to be valued. It is this principle that has been decided in Ramachari and the High Court decisions following it (including the one under appeal) and the question is whether they lay down the correct law.

In the first place, it is settled law that the true trading results of a business for an accounting period cannot be ascertained without taking into account the value of the stock-in-trade remaining at the end of the period. Though, as pointed out by this Court in Chainrup Sempatram v. C.I.T., [1953] 24 I.T.R. 481 it is a misconception to think that any profit arises out of the valuation of closing stock, it is equally true that such valuation is a necessary element in the process of determining the trading results of the period. This is true in respect of any method of accounting and in C.I.T. v. Krishnaswamy Mudaliar, [1964] 53 I.T.R. 122 this Court pointed out that, even where the assessee is following the cash system of accounting, the valuation of closing stock cannot be dispensed with. In this decision, this Court quoted with approval the following observations in C.I.R. v. Cock, Russel & Co. Ltd. [1949] 29 T.C. 387:

> "There is no word in the statutes or rules which deals with this question of valuing stock-in-trade. There is nothing in the relevant legislation which indicates that in computing the profits and gains of a commercial concern the stock-in-trade at the start of the accounting period should be taken in and that the amount of the stock-in-trade at the end of the period should also be taken in. It would be fantastic not to do it: it would be utterly impossible accurately to assess profits and gains merely on a statement of receipts and payments or on the basis of turnover. It has long been recognised that the right method of assessing profits and gains is to take into account the value of the stock-in-trade at the beginning and the value of the stock-in trade at the end as two of the items in the computation. I need not cite authority for the general proposition, which is admitted at the Bar, that for the purposes of ascertaining profits and gains the ordinary principles of commercial accounting should be applied, so long as they do not conflict with any express provision of the relevant statutes."

Next the principles as to the method of valuation of the closing stock are equally well settled. Lord President Clyde set these out in Whimster & Co. v. C.I.R., (1925) 12 T.C. 813 in the following words:

> "In computing the balance of profits and gains for the purposes of income-tax,... two general and fundamental commonplaces have always to be kept in mind. In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and the expenditure laid out to earn those receipts. In the second place, the account of profit and loss to be made up for the purpose of ascertaining that difference must be framed consistently with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the Income-tax Act, or of that Act as modified by the provisions and schedules of the Acts regulating excess profits duty, as the case may be. For example, the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's manufacturer's business the values of the stock-in-trade at the beginning and at the end of the period covered by the account should be entered at cost or market price, whichever is the lower; although there is nothing about this in the taxing statutes."

The principle behind permitting the assessee to value the stock at cost is very simple. In the words of Bose, J. In Kikabhai Premchand v. C.I.T., [1953] 24 I.T.R. 506 S.C. it is this:

> "The appellant's method of book-keeping reflects the true position. As he makes his purchases he enters his stock at the cost price on one side of the accounts. At the close of the year he enters the value of any unsold stock at cost on the other side of the accounts thus cancelling out the entries relating to the sum unsold stock earlier in the accounts; and then that is carried forward as the opening balance in the next year's account. This cancelling out of the unsold stock from both sides of the accounts leaves only the transactions on which there have been actual sales and gives the true and actual profit or loss on his year's dealings."

As against this, the valuation of the closing stock at market value invariably will create a problem. For if the market value is higher than cost, the accounts will reflect notional profits not actually realised. On the other hand, if the market value is less, the assessee will get the benefit of a notional loss he has not incurred. Nevertheless, as mentioned earlier, the ordinary principles of commercial accounting permit valuation "at cost or market, whichever is the lower". The rationale behind this has been explained by Patanjali Sastri, C.J. in Chainrup Sampatram v. C.I.T., [1953] 24 I.T.R. 481, S.C. where an attempt was made to value the closing stock at a market value higher than cost. The learned Chief Justice observed:

> "It is wrong to assume that the valuation of the closing stock at market rate has, for its object, the bringing into charge any appreciation in the value of such stock. The true purpose of crediting the value of unsold stock is to balance the cost of those goods entered on the other side of the account at the time of their purchase, so that the cancelling out of the entries relating to the same stock from both sides of the account would leave only the transactions on which there have been actual sales in the course of the year showing the profit or loss actually realised on the year's trading. As pointed out in paragraph 8 of the Report of the Committee on Financial Risks attaching to the holding of Trading Stocks, 1919, "As the entry for stock which appears in a trading account is merely intended to cancel the charge for the goods purchased which have not been sold, it should necessarily represent the cost of the goods. If it is more or less than the cost, then the effect is to state the profit on the goods which actually have been sold at the incorrect figure.......... From this rigid doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, viz., the adoption of market value at the date of making up accounts, if that value is less, than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of attributing to the following year's results a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question"

(extracted in paragraph 281 of the Report of the Committee on the Taxation of Trading Profits presented to British Parliament in April 1951). While anticipated loss is thus taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account, as no prudent trader would care to show increased profit before its actual realisation. This is the theory underlying the rule that the closing stock is to be valued at cost or market price whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy."

From the above passage, it will be seen that the proper practice is to value the closing stock at cost. That will eliminate entries relating to the same stock from both sides of the account. To this rule custom recognises only one exception and that is to value the stock at market value if that is lower. But on no principle can one justify the valuation of the closing stock at a market value higher than cost as that will result in the taxation of notional profits the assessee has not realised. The High Court in Ramachari has, however, outlined another exception and seems to have rested this on two considerations. The first is the observation of Lord Buckmaster in C.I.T. v. Ahmedabad New Cotton Mills Co. Ltd., [1930] L.R. 57 I.A. 21 to the following effect:

> "The method of introducing stock into each side of a profit and loss account for the purpose of determining the annual profits is a method well understood in commercial circles and does not necessarily depend upon exact trade valuations being given to each article of stock that is so introduced. The one thing that is essential is that there should be a definite method of valuation adopted which should be carried through from year to year, so that in case of any division from strict market values in the entry of the stock at the close of one year it will be rectified by the accounts in the next year."

From these observations, the High Court inferred:

> "It is obvious from the above that the privilege of valuing the opening and closing stock in a consistent manner is available only to continuing business and that it cannot be adopted where the business comes to an end and the stock-in-trade has to be the disposed of in order to determine the exact position of the business on the date of closure. "

The second consideration which prevailed with the High Court is reflected in the following passage from the judgment:

> "It seems to us that none of these cases has any application to the facts of the present case . There is no authority directly in point dealing with this question, where a partnership concern dissolves its business in the course of the accounting year, what is the basis on which the stock-in-trade has to be valued as on the date of dissolution. We have accordingly to deal with the matter on first principles.
>
> The case of a firm which goes into liquidation forms a close parallel to the present case. In such a case all the stock-in-trade and other assets of the business will have to be sold and their value realised. It cannot be controverted that it is only by doing so that the true state of the profits or losses of the business can be arrived at. The position is not very different when the partnership ceases to exist in the course of the accounting year. The fact that Ramachari, one of the ex-partners, took over the entire

> stock and continued to run the business on his own, is not relevant at all, when we consider the profits or losses of the partnership' which has come to an end. It should, therefore, follow that in order to arrive at the correct picture of the trading results of the partnership on the date when it ceases to function, the valuation of the stock in hand should be made on the basis of the prevailing market price."

We are not quite sure that the first of the considerations that prevailed with the High Court is relevant in the present case. Even in a continuing business, the valuation at market value is permissible only when it is less than cost; it is not quite certain whether the rules permit an assessee if he so desires to value closing stock at market value where it is higher than cost. But, in either event, it is allowed to be done because its effect can be offset over a period of time. But here, where the business comes to a close, no future adjustment of an over or under valuation is possible, In this context, it is difficult to see how valuation, at other than cost, can be justified on the principle of Ahmedabad Advance Mills case (supra).

We, however, find substance in the second consideration that prevailed with the High Court. The decision in Muhammad Hussain Sahib v. Abdul Gaffor Sahib, [1950] 1 M.L.J.81 correctly sets out the mode of taking accounts regarding the assets of a firm. While the valuation of assets during the subsistence of the partnership would be immaterial and could even be notional, the position at the point of dissolution is totally different:

> "But the situation is totally different when the firm is dissolved or when a partner retires. The settlement of his account must be not on a notional basis but on a real basis, that is every asset of the partnership should be converted into money and the account of each partner settled on that basis.........The assets have to be valued, of course, on the basis of the market value on the date of the dissolution ......"

This applies equally well to assets which constitute stock-in-trade. There can be no manner of doubt that, in taking accounts for purposes of dissolution, the firm and the partners, being commercial man, would value the assets only on a real basis and not at cost or at their other value appearing in the books. A short passage from Pickles on Accountancy (Third Edn), p. 650 will make this clear:

> "In the event of the accounts being drawn up to the date of death or retirement, no departure from the normal procedure arises, but it will be necessary to see that every revaluation required by the terms of the partnership agreement is made. It has been laid down judicially that, in the absence of contrary agreement, all assets and liabilities must be taken at a "fair value," not merely a "book value" basis, thus involving recording entries for both appreciation and depreciation of assets and liabilities. This rule is applicable, notwithstanding the omission of a particular item from the books, e.g. investments, goodwill (Cruikshank v. Sutherland). Obviously, the net effect of the revaluation will be a profit or loss divisible in the agreed profit-or loss-sharing ratios."

The real rights of the partners cannot be mutually adjusted on any other basis. This is what happened in Ramachari. Indeed, this is exactly what the partners in this case have done and, having done so, it is untenable for them to contend that the valuation should be on some other basis. Once this principle is applied and the stock-in- trade is valued at market price, the surplus, if any, has to get reflected as the profits of the firm and has to be charged to tax. The view taken by the High Court has held the field for about thirty years now and we see no reason to disagree even if a different view were possible. For these reasons, we agree with the answer given by the High Court to the second question as well.

The appeal fails and is dismissed. But we would make no order regarding costs.

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R.N.J.                                                   Appeal
dismissed.
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