
(1963) 07 MAD CK 0054

In the Madras High Court

Case No : Tax Case No's. 223 to 225 of 1962 (Revision No's. 84 to 86)

A.P. Pyarelal

APPELLANT

Vs

The State of Madras

RESPONDENT

Date of Decision : 12-07-1963

Acts Referred:

Citation : (1964) 15 STC 9

Hon'ble Judges : Venkatadri, J;Srinivasan, J

Bench : Division Bench

Advocate : K. Srinivasan and D.S. Meenakshisundaram, for the Appellant; C. Ramanujam, for Government Pleader, for the Respondent

Final Decision : Allowed

Judgement

Venkatadri, J.—These revisions arise out of a common order passed by the Tribunal in the three appeals preferred by the assessee one A. P. Pyarelal against the orders of assessment relating to the assessment years 1956-57, 1957-58 and 1958-59. The assessee is running a hotel styled as Bombay Ananda Bhavan Hotel at Karaikudi. He is also doing a business in coffee powder under the name of Ananda Manufacturing Company with its head office at Karaikudi and branches at Madurai, Dindigul, Tirunelveli, Sivagangai and Madras. The turnover in respect, of the coffee powder business is not in dispute and we are not therefore concerned with the turnover of that business. Originally the assessee submitted his return in respect of his coffee hotel business for 1956-57. The Deputy Commercial Tax Officer, Karaikudi, determined the net taxable turnover to the best of his judgment at Rs. 3,00,359. The assessee preferred appeals to the appellate authorities and finally when the matter came up to this Court in revision (T.C. No. 58 of 1959) this Court observed :

In the case of Pyarelal (assessee) the position was that in the assessment year the Income Tax Department substantially accepted his books as correct but made an addition of Rs. 3,000 to allow for possible leakages from the till. The Income Tax Department did not find that there had been any suppression of sales or

inflation of purchases. From the statement produced before us, it appears that in 1956-57 the gross profit returned was 17.5 whereas in the earlier years it was slightly more. But at no time did it come anywhere near 50 per cent., the basis on which the turnover was estimated in the case of Pyarelal. Whether the accepted turnover of the previous years and the gross profits disclosed therein afforded a better basis for estimating the turnover in the year of assessment 1956-57 will be for the Tribunal to determine.

2. With the above observations the appeal was remanded for fresh disposal by the Tribunal. By the time the above order was made by the High Court, the assessee had to submit returns for the assessment years 1957-58 and 1958-59 in respect of the hotel business. For those two years the authorities determined the net turnover to the best of their judgment as they were not satisfied with the accounts maintained by the assessee. The best of judgment assessment was based on the general rule that it is justifiable and reasonable to add 50 per cent. to the purchase value as per accounts submitted by the assessee. The assessee preferred appeals to the Tribunal in respect of the assessments for the years 1957-58 and 1958-59 and these appeals came up for disposal along with the appeal for the assessment year 1956-57 with regard to which there was a remand order by the High Court and the Tribunal passed a common order confirming the order passed by the taxing authorities and approving the general principle applied there, namely, the addition of 50 per cent. to the purchase value. Now the assessee has preferred the above three revisions disputing the correctness of the principle adopted by the Tribunal of adding 50 per cent. to the purchase value, besides raising various other contentions.

3. It is necessary for us to give some more facts before we dispose of these revision petitions. The assessee not only runs a meals hotel, but he also runs a restaurant and there is also a stall attached to the hotel. He maintains account books styled as stock registers, which show the day to day opening stock, purchases, issues for preparations in the meals section and tiffin section including issues for preparation of sweets and other eatables and closing stock at the close of the day in respect of the several items of provisions. He has also got stock ledgers which contain a separate folio for each item of provision or grocery used for preparation. Then he has got kaichittais or rough cash books in which all the day to day cash transactions of the hotel are recorded then and there every day. The usual day books are also maintained wherein both the cash and credit transactions are recorded every day. Corresponding ledgers are maintained by the assessee showing under separate accounts total purchases, total sales and establishment expenses. The assessee also keeps purchase files, expenses files and sales book for the monthly meals and tiffin ticket books. In addition he maintains tiffin section bill book register, allocation book, milk account books, cash bill books and stall account books. Thus the assessee maintains account books for the meals section, restaurant section and also the stall section. The department has accepted the account books of the assessee in respect of the meals and tiffin sections. But it is only with regard to the account books

maintained for the stall section that the department is not satisfied with the accounts on the ground that the assessee is not in the habit of giving sale chits to the customers when they make purchases at the stall. But, as pointed out already, the assessee maintains a stall account book which is maintained regularly in the ordinary and usual course of business of the assessee. This book records the daily issues of sweetmeats and savouries to the stall, the unsold sweetmeats and savouries returned from the stall at the close of the day, the quantity of sweetmeats and savouries sold on that day, their respective values and the total of the amount of sweat meats and savouries sold and the actual cash collections in the till at the close of the day from the stall. This book was maintained during the years 1957-58 and 1958-59. The total sales from this book are taken to the allocation book from where they are taken to the daybook and posted to the sales account in the ledger. The Tribunal observed that the sales in the stall are not capable of verification as they are not supported by bills or sales chits and in that view disregarded the accounts maintained in respect of the hotel business and approved the general principle adopted by the Income Tax Authorities of estimating the rate of gross profit at 50 per cent, of the purchase value. It is necessary to point out in this connection that at no time the assessee earned a profit of more than 25 per cent., which was in the year 1957-58, and in previous years, that is in 1953 to 1956, the assessee only showed a gross profit of 16 to 23 per cent, and his returns were accepted and there was no dispute with regard to the turnover.

4. We have now to consider whether the general principle of adding 50 per cent, to the purchase value can be justified. Whether this principle can be accepted as reasonable came up for discussion in this Court in T.C. No. 30 of 1958 before a Bench to which one of us was a party, and the Court made the following observations :

The solitary reason that we find given by the Tribunal is that in the business of coffee hotels, the gross profit computed on the purchases is not generally less than 50 per cent, of the purchases. The Tribunal relies upon its experience in coming to this conclusion. It does not appear to us that a statement of this nature is really conclusive of the matter. The view that all coffee hotel businesses should be deemed capable of producing a gross profit of 50 per cent, on purchases seems to us to be unwarranted and to take no note whatsoever of the individual and special circumstances which may affect each business. The gross profit to our minds is dependent upon so many features, most of them of incalculable effect, such as the location, the nature of the clientele, the tastes catered for and the like. An inflexible rule such as laid down by the Tribunal appears to have no validity about it.

5. In another case, T.C. No. 21 of 1958, where the taxing authority added 1 per cent, of the disclosed turnover of purchases and also added a further 40 per cent, of that to estimate the sales turnover, a Bench of this Court observed that the addition was really based upon surmises and conjectures rather than upon

any definite data.

6. The central point for consideration therefore is, given the value of input, how best to determine the value of gross output in the hotel trade. The question is important not only where the assessee keeps incomplete accounts, but also where the correctness of such accounts requires to be checked. As it is, three different methods of determining the value of gross output have been adopted. The estimate of the assessing authority (Deputy Commercial Tax Officer) of the turnover for the assessment year 1956-57 was largely based on his individual judgment and the basis for such estimate was not clearly stated. On appeal the Commercial Tax Officer, Ramanathapuram, arrived at the value of the gross output by adding 50 per cent, to the value of the total input on the basis that 50 per cent, represented the gross profit. The Tribunal adopted a refined version of the method adopted by the Commercial Tax Officer and it appears that a similar estimate adopted by the Tribunal in an earlier case was approved by this Court in the judgment in T.C. Nos. 81 of 1959 and 202 of 1960. Thus these three methods have yielded widely differing results even for one particular year can be seen from the following statement :

7. None of these methods however has any scientific validity. The first method is highly empirical. The second method is but a rule of thumb device and the third method has at best the sanction of the case law, not wholly relevant to changing economic conditions and differing sizes of hotel trade. There is no reason why 50 per cent, formula should for ever hold true, much less why it should be applied only to food materials input. The fuel and packing paper enter as much into the final value of the gross output as the flour, sugar, ghee or oil that goes into the preparation of the food-stuffs.

8. The solution therefore lies in establishing a scientific correlation between the value of input and the value of output in the hotel trade in the State. This cannot be constant. This may vary with the value and dimensions of the initial output and the whole range of correlations will have to be worked out for inputs of different value and dimensions. The task, however, is not as baffling as it seems, thanks to the advances made in recent years in the technics of economic and statistical investigation. The products of the hotel trade have got more or less standardized traditionally throughout the State in size and price. The cooking processes also are more or less uniform. The question, therefore, is only one of costing with reference to the data relating to the value of input and output of a few representative sample hotels. The size and design of the sample are details for the sampling expert to work out. There are a number of co-operative canteens and Annapurna Cafeterias whose correct accounts can serve as controls. We may suggest that the Commercial Taxes Department should either have its own research bureau or should invoke the aid of independent research organizations to undertake such investigations to arrive at the correct relationship between inputs and outputs in various trades subject to the tax levy. "Certainty" is one of the established canons of taxation and it is the duty of the

tax authorities to aim at it.

9. We are not satisfied that the 50 per cent, rule should be uniformly applied to all the hotels merely relying upon the past experience of the Sales Tax Authorities in the matter of assessing the extent of the hotel business in general. The adoption of the 50 per cent, rule is nothing but making a best judgment assessment. What is best judgment assessment is explained in a number of cases arising under the Income Tax Act and Sales Tax Act. The guiding principles for making such assessments were set out thus in the speech of Lord Russell of Killowen in *Commissioner of Income Tax v. Laxminarain Badridas* [1937] 5 ITR 170:

The officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly, or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose, he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by and assessments of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate ; and though there must necessarily be guess-work in the matter, it must be honest guess-work.

10. No doubt the Tribunal took elaborate pains to work out gross profits from the account books maintained by the assessee in respect of certain preparations. We feel that the Tribunal should not have undertaken this upon themselves, but should have asked the department's representative to collect data, and gather necessary materials and arrive at the gross profit of the assessee. We are satisfied that the turnover returned by the assessee was in respect of the entire business including the coffee powder business. The assessee has maintained a number of account books in the regular course of business and it is not likely that he would have suppressed only accounts in respect of the sales in the stall. The accounts in respect of the stall section cannot be rejected on the mere ground that the sales are not capable of verification since the assessee has not issued chits for sales at the stall counter. We hold that the principle of adding 50 per cent, to the purchases should not be uniformly adopted in all the cases. It is a notorious fact that some of the hotels may be earning more than 50 per cent, gross profit and some hotels may be earning a lesser percentage. We think the department would be well advised to carry out immediate investigation by conducting sample surveys of all types of hotels in order to fix the gross output in the absence of correct account books.

11. The petitions are allowed with costs. Counsel's fee Rs. 100 one set.