

(1967) 05 CAL CK 0033

In the Calcutta High Court

Case No : Income-tax Reference No. 81 of 1962

BAJRANGBALI ENGINEERING CO. PVT. LTD.

APPELLANT

Vs

COMMISSIONER OF Income Tax, WEST BENGAL.

RESPONDENT

Date of Decision : 02-05-1967

Acts Referred:

Income Tax Act, 1961 — Section 13, 66(2)

Citation : (1967) 66 ITR 82

Hon'ble Judges : Masud, J; Banerjee, J

Bench : Full Bench

Judgement

BANERJEE J. - In compliance with an order by this court, u/s 66(2) of the Indian Income Tax Act, a statement of case on the following question of law has been made by the Tribunal :

"Whether, on the facts and in the circumstances of the case, there was any material before the Tribunal to estimate an addition of Rs. 65,000 on sales of disposal goods ?"

The circumstances under which the above question comes up for consideration are hereinafter stated in brief. The assessee is a private limited company and carries on business as a dealer in scrap iron and in other commodities and articles as may be purchased from the Disposal Directorate, e.g., lorries, cranes, motors, water pumps, machine pumps, etc. Some of the goods purchased from the Disposal Directorate were sold in lots but others were sold in pieces. For the accounting year ending with March 31, 1953, there was an overall turnover of Rs. 69,06,153. The account books of the assessee disclosed a gross profit of Rs. 4,40,499 on the above turnover. On calculation, the gross profit rate came up to 6.3% as against the overall gross profit rate of 8.5% appearing from the books of the assessee for the immediately preceding year. Called upon by the Income Tax Officer to explain the reason for the lower rate of gross profit for the assessment year, the assessee submitted a written statement therein explaining the reason in the following language :

"During the year of account sale of scrap comes to Rs. 42,17,130-9-6 out of the total gross sales of Rs. 69,06,153-9-6. In the scrap dealing the rate of gross profit is generally very low. If the scrap sales are deducted from the trading account, rate of gross profit earned in disposal goods comes to 13.1%. On account of heavy sales in scrap there is a fall in the overall rate of gross profit."

This explanation was not considered to be satisfactory by the Income Tax Officer. The Income Tax Officer found fault with the manner in which stock books and accounts were maintained and observed that it was not possible to verify the purchases and the corresponding sales therefrom. According to the Income Tax Officer, there was no proper record maintained in respect of stock and that the stocks were not checked by the auditors but were merely certified by the management. In his opinion, in the absence of proper records, the veracity of the trading account could not be satisfactorily checked. He accordingly rejected the book version of the profits and made an addition of Rs. 2,00,000 to the disclosed profits, which had the effect of raising the overall gross profit rate, on the total turnover, to a little over 9%.

Dissatisfied with the assessment, the assessee appealed before the Appellate Assistant Commissioner. The Appellate Assistant Commissioner found that the purchases and sales were all vouched and that there was no material on record to show that the assessee had received anything over and above the prices recorded in the books. He, therefore, came to the conclusion that there was no evidence from which it could be established that purchases have not been accounted for in the books of the assessee. The assessee filed before the Appellate Assistant Commissioner quantitative details in respect of scrap iron. The Appellate Assistant Commissioner examined the statement and came to the conclusion that the statement showed only a negligible shortage, which was likely to occur in business of the magnitude as carried on by the assessee. The Appellate Assistant Commissioner further came to the conclusion that the gross profit rate of 2% in respect of scrap iron on a turnover of Rs. 39,69,502 could not be characterised as unreasonable. He, therefore, did not consider that any addition was necessary in respect of scrap iron sale. As regards sale of disposal good, however, the Appellate Assistant Commissioner estimated the gross profit at 16%, on a proportionate enhanced turnover of Rs. 30,60,000, as against a little over 12% gross profit shown by the assessee on sale of Rs. 29,39,651 (Rs. 29,29,651 in the statement of case). This resulted in an addition of Rs. 1,28,825 (Rs. 1,26,825 in the statement of case), in place of the overall addition of Rs. 2,00,000 made by the Income Tax Officer. A relevant extract from the judgment of the Appellate Assistant Commissioner is set out herein below :

"The remaining sales represent sales of machines, trucks, tyres, motor parts, etc. These sales amount to Rs. 29,39,651 and disclose a gross profit of Rs. 3,68,775 or a little over 12% on the turnover. In the comparable case cited by the Income Tax Officer a profit of 17% was disclosed. So far as these commodities were concerned, they were also purchased and sold locally by that

party and not exported. In respect of the sale of these goods, therefore, there appears to be little reason for such a low profit. I, however, find one fact in this case, which indicates that the profit of the appellant may be slightly lower than that in the comparable one which has itself purchased these goods from the appellant and then sold it in the market. The margin of profit of the appellant, therefore, in the case of the appellant, must necessarily be lower than the margin of profit of that party. Notes of the Income Tax Officer indicate that in some cases that lower profits were accepted. I will, therefore, estimate the sales of the appellant at Rs. 30,60,000 and estimate the gross profit at 16%. This will raise the gross profit to Rs. 4,89,600 as against Rs. 3,60,775 shown by the appellant. This will result in an addition of Rs. 1,28,825 as against Rs. 2,00,000 added by the Income Tax Officer."

Thereupon, the assessee preferred a second appeal before the Appellate Tribunal. There was no dispute before the Tribunal about the applicability of the proviso to section 13 of the Indian Income Tax Act, authorising the Income Tax Officer to make an estimate of profit on the rejection of the book version of the profits. All that was contended on behalf of the assessee was that the application of the gross profit at 16%, on the sale of disposal goods, was unduly high. It was contended on behalf of the assessee that books results for all the subsequent years, barring the year 1954-55, were all accepted by the revenue department, although there was no separate trading accounts prepared for disposal goods and scrap iron, and there was no reason why the book results should not have been accepted for the year under assessment. The attention of the Tribunal was also drawn to the fact that the sales in lots, amounting to Rs. 2,40,000, were included in the turnover of the disposal goods and that these sales yielded a much smaller margin of profit, which factor would go to reduce the profit of 16%, as estimated by the Appellate Assistant Commissioner. The Tribunal gave partial relief to the assessee with the following observations :

"In the case of disposal goods, the gross profit rates shown by the assessee as per table submitted before us are as follows :

Year 1955-56

...

13.2%

1956-57

....

18.4%

1957-58

....

16.8%

1958-59

....

19.8%

The reason for such widely fluctuating rates of gross profit in the disposal goods is not far to seek. It appears that whenever the proportion of sale in lots is higher, the gross profit rate becomes lower...

It has also to be noted that the articles of disposal goods are of such a varied nature, such as tyres, cranes, motors, water pumps, lorries, etc., that the margin of gross profit will not be consistent in every case. During the accounting period, the sale in lots amounted to Rs. 2,47,688 the gross purchase price being Rs. 2,40,622 and the margin of profit being about 3%. This certainly had the effect of reducing the overall margin of gross profit in disposal goods, the percentage of profit works out to more than 13%. The addition of Rs. 1,28,825 sustained by the Appellate Assistant Commissioner was, therefore, on the high side. Having regard to the fact that the purchases and sales were all vouched, that the sales included a large proportion of sales in lots, that the commodities sold were of such a varied nature that the same margin of profit could not be expected from year to year, we feel that an addition of Rs. 65,000 to the profit shown in the disposal goods in place of Rs. 1,28,825 would cover the leakages that exist."

Aggrieved by the order of the Tribunal, the assessee at first tried for a reference of the question of law, stated above, before the Tribunal. Therein failing, he succeeded in getting an order from this court calling for a statement of the question of law stated above.

Mr. S. K. Achariya, learned counsel for the assessee, argued a very short point for our consideration. He did not contend that the books of the assessee should not have been rejected. He did not also contend that in the facts and circumstances of the case, the proviso to section 13 would not be attracted. The point urged by him was that, in exercising the power under the proviso to section 13, the revenue authorities must not take a leap in the dark, must not proceed arbitrarily but judicially in the light of relevant materials. He submitted that in adding back a sum of Rs. 65,000 to the profits, the Tribunal did not exercise their discretion objectively or judicially on the basis of relevant materials. Now, the point urged by Mr. Achariya, as a proposition of law, is unexceptionable. This is the view also of the Supreme Court expressed in *Commissioner of Income Tax v. K. Y. Pilliah and Sons*. The question is whether the proposition of law is attracted to the instant case.

Mr. B. L. Pal, learned counsel for the revenue, however, contended that the books of the assessee being unreliable, it was the duty of the Income Tax Officer to make the computation of profits upon such basis and in such manner as might appear proper to him. He submitted that, according to the case made by the assessee, disposal sales amounted to Rs. 3,68,775 or a little over 12% on the

turnover. This was not acceptable because the books were unreliable. One of the grievances made by the assessee was that sales in lots, amounting to Rs. 2,40,000, were also included in the turnover of the disposal goods and such sales yielded a much smaller margin of profit, which the Income Tax Officer failed to realise. This grievance was quantified by the Appellate Tribunal in the following language :

"This certainly had the effect of reducing the overall margin of gross profit in disposal sales. If the sales in lots were excluded from the turnover of the disposal goods, the percentage of profit works out to more than 13%."

Mr. Pal submitted that the Tribunal proceeded on the basis that, even according to the assessee, 13% would be the appropriate percentage of profit and the addition of about 2% thereon, on estimation under the proviso to section 13, resulting in the add-back of Rs. 65,000, was perfectly justified.

This argument, in our opinion, has been much too easily made. We have tried our best to discover from the judgment of the Tribunal the materials, which included the Tribunal to make an addition of 2% more on 13% profit. The Tribunal no doubt referred to the percentage of profit made by the assessee during the year 1955-56 to 1958-59. The Tribunal, however, did not proceed on the rates of profit for any of those years or on an average thereof. For what purpose the Tribunal referred to the rates of profit, earned by the assessee in subsequent years, namely, the years 1955-56 to 1958-59, does not amply appear. Further, the Tribunal accepted the theory that, whenever the proportion of sales in lots was higher, the gross profit rate was lower. In the instant case, the Tribunal proceeded on the basis that sales in lots amounted to Rs. 2,47,688, the gross purchase price, Rs. 2,40,622, and the margin of profit in respect of such sales amounted to only 3%. The Tribunal was satisfied that the effect of such sales in lots was to reduce the overall margin of profit in sale of disposal goods. Thus the line of reasoning adopted by the Tribunal does not justify the off-hand addition of Rs. 65,000 to the profit in disposal goods on the abrupt theory that such addition would cover leakages that existed. This is particularly so, because the Tribunal came to the conclusion that purchases and sales were all vouched. We are not, therefore, satisfied that the addition of Rs. 65,000 to the gross profit was made by the Tribunal in juridical exercise of discretion under the proviso to section 13.

Mr. Achariya contended that if we were not satisfied with the approach made by the Tribunal in adding back Rs. 65,000 to the profit, the profit must be computed at 12% as claimed by the assessee. We are not prepared to uphold this argument of Mr. Achariya. The view that an Income Tax Officer is, prima facie, entitled to accept the profit shown by the assessee's accounts, where there was a method of accounting regularly employed but the assessee, is not a correct view. In this case, although sales and purchases were all vouched, it was the duty of the revenue authorities to consider whether the income, profits and gain could be properly deduced therefrom and, if not so, to proceed in accordance with the

proviso to section 13. According to the revenue, although sales and purchases were properly vouched, the profits could not be deduced there from correctly. Therefore, it became necessary for the revenue to make a proper computation in judicial exercise of discretion. The view that we take finds support from a judgment of the Privy Council in Commissioner of Income Tax v. Sarangpur Cotton Manufacturing Co Ltd. It was thus within the power of the revenue not to accept 12% profit, as was the case of the assessee. But in order to find out what was the real profit earned by the assessee, by sale of disposal goods, the authorities were not to make a crude guess, not to proceed arbitrarily but judicially in the light of relevant materials. That is what the Tribunal did not do in the instant case. The Income Tax officer went too high. The Appellate Assistant Commissioner reduced the figure arrived at by the Income Tax Officer but was still on the high side. The Tribunal made a further reduction but in so doing did not proceed on any principle but proceeded on crude guess work. That makes the add-back of Rs. 65,000, to the profit of the assessee, unreasonable and opposed to the provisions of the proviso to section 13.

The sure footing on which the Tribunal could proceed was on the basis of their own arithmetical calculation, based on the theory that if sold in lots were excluded from the turnover of the disposal goods the percentage of profit would work out at a little over 13%. The further addition thereto was a mere guess-work on the assumption that certain further leakages existed, which required to be covered up. For this assumption we find no basis.

In the result, we answer the question in the negative, subject to this clarification that the Tribunal was entitled to calculate the profits on the basis of their own arithmetical calculation of percentage as indicated in the preceding paragraph.

In the circumstances of this case, we do not make any order as to costs.

MASUD J. - I agree.

Question answered in the negative.