

(1974) 08 CAL CK 0033

In the Calcutta High Court

Case No : Income-tax Reference No. 9 of 1970

British Paints India Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 22-08-1974

Acts Referred:

Income Tax Act, 1922 — Section 13

Income Tax Act, 1961 — Section 145(1), 256(1)

Citation : (1978) 111 ITR 53

Hon'ble Judges : Sabyasachi Mukharji, J;Janah, J

Bench : Division Bench

Advocate : D. Pal, P.K. Pal and A.K. Roy Chowdhury, for the Appellant;S.C. Sen and Ajit Sen Gupta, for the Respondent

Judgement

Sabyasachi Mukharji, J.—In order to appreciate the question involved in this reference it would be necessary to narrate briefly the facts leading up to the making of this reference. The assessee is a company engaged in the business of manufacture and sale of paints. This reference arises out of assessment orders for the years 1963-64 and 1964-65, for which the relevant accounting years were the calendar years 1962 and 1963, respectively. The assessee had valued raw materials at cost in the closing stock inventory. However, the goods in process and the finished products had been valued at the cost of raw materials only, which, according to the assessee, formed 84.49% representing overheads. The assessee had contended that it had been the practice to uniformly value the goods-in-process and the finished products at the cost of raw materials only. It was submitted that the paints had a limited storage life and if these were not sold within a certain period these lost their market value. The Income Tax Officer did not accept the said reasoning and contention. He was of the opinion that the basis of valuation of stocks, according to the well-known principles of accountancy, should have been, either cost or market price, whichever was less. The Income Tax Officer, therefore, valued such stock of goods-in-process and finished products at 100% of cost including the overheads as against 84.49% as

shown in the books of account of the assessee. On the aforesaid basis the Income Tax Officer revalued the closing stock and also the opening stock and made an addition of Rs. 1,04,417 in the assessment year 1963-64, and allowed a deduction of Rs. 3,338 in the assessment year 1964-65, by adjustment of valuation of stocks. There was an appeal before the Appellate Assistant Commissioner. The Appellate Assistant Commissioner, for the reasons mentioned in his order, upheld the Income Tax Officer's order.

2. There was a further appeal before the Tribunal. It was urged before the Tribunal that the basis of valuation adopted by the assessee was in accordance with the recognised, system of accounting. It was urged that the practice of valuing the closing stocks at only the value of raw material had been followed consistently over the years and, therefore, the same should not be disturbed by the departmental authority. Reliance was placed on certain books of accountancy in support of the method followed by the assessee. It, was reiterated that depending upon the life of a particular kind of paint which was described as "shelf-life ", that is to say, the period during which the paint could reasonably be stored without losing its quality, experience had shown that, irrespective of the actual cost, the writing down of it in the manner it was done was necessary for the purpose of balancing the profits on sale of such products. The Tribunal was of the opinion that the goods-in-process as well as the finished products had been arbitrarily taken below the cost, that is, the cost of raw materials and other overheads. The Tribunal was of the opinion that in this case there was no evidence that the stocks had either become obsolete or slow-moving. In the premises there was, according to the Tribunal, no justification for writing down the value of the stocks. It was noted by the Tribunal that in none of these years the assessee had claimed deduction for depreciation of stocks remaining unsold over a stated period. The Tribunal, therefore, came to the conclusion that, apart from a mere possibility of the paint losing its quality, there was nothing to show that the goods-in-stock had actually deteriorated in value. The Tribunal noted that in this case it was not merely the cost of raw material that was debited in the account but the cost of overheads had also been debited in the account. The Tribunal thought that if the entire revenue expenditure was to be claimed as deduction, then, it could only be on the basis that either the sales were accounted for or the closing stock accounted for the full value, that is, the cost and overheads. The Tribunal, therefore, was of the opinion that the assessee's method of accounting was such from which true profits could not be deduced. In the premises, the Tribunal upheld the order of the Income Tax Officer. The Tribunal in the aforesaid facts and circumstances of the case has referred to this court the following question u/s 256(1) of the Income Tax Act, 1961 :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in rejecting the method of valuation of the goods-in-process and the finished products on the basis of cost of raw material adopted by the assessee, and taking their valuation on the basis of cost of the finished goods ? "

3. It is, therefore, necessary in order to determine the question before us, to examine the purpose of valuation of stocks in computing the tax liability of an assessee. In the case of Chainrup Sampatram Vs. Commissioner of Income Tax, West Bengal, , the Supreme Court observed that it was a misconception to think that any profit arose out of the valuation of the closing stock ; valuation of unsold stock at the close of an accounting period was a necessary part of the process of determining the trading result of that period, and could in no sense be regarded as the source of such profit. At page 485 of the report the Supreme Court observed as follows:

"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."

4. In this connection the Supreme Court referred to the extract from the report of the Committee on Taxation and Trading Profits presented to the British Parliament in 1951. At page 281 of the said report, the Committee observed as follows :

"As the entry for stock which appears in a trading account is merely intended to cancel the charge for the goods purchased which had 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 as the incorrect figure.....From this rigid doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, that is to say, the adoption of market value at the date of making up of accounts if that value is less than the 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 the prices rise again, of attributing to the following year's result a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question."

5. In the case of Indo-Commercial Bank Ltd. Vs. Commissioner of Income Tax, Madras, of the report, the Madras High Court has dealt with certain examples which might demonstrate that if a method of accounting recognised by accounting principles is regularly adopted over a course of years then true profits and true loss for Income Tax purposes could always be determined though in a particular year it might not be the reflection of the actual trading profits. It is for this purpose that in the case of The Commissioner of Income Tax, Madras Vs. A. Krishnaswami Mudaliar and Others, , the Supreme Court observed that the Income Tax Officer was entitled to apply the proviso to Section 13 of the Indian Income Tax Act, 1922, which is similar to Section 145(1) of the Income Tax Act,

1961, with which we are concerned in this case, not arbitrarily but only within the limitations enjoined by the statute, i.e., after examination of the method of accounting employed by the assessee, to come to the conclusion that either the method had not been regularly employed or that the income, profits and gains of the assessee under the Income Tax Act could not be properly deduced therefrom. In the case of India Motor Parts and Accessories Ltd. (P), Madras Vs. The Commissioner of Income Tax, Madras, , the Madras High Court held that if the method of valuation adopted by the assessee was a recognised method and had normally been regularly followed by the assessee, then the fact that occasionally solitary items might be sold for higher prices than the cost price would not detract from the nature of the system followed ; to be rejected it must be shown that the method was improper or the same did not lead to the determination of the true profits for Income Tax purposes or was patently irregular and unless these conditions were fulfilled the revenue authorities were not entitled to resort to the provisions of the proviso to Section 13 of the Indian Income Tax Act, 1922. The same principles were reiterated by the Supreme Court in the case of P.M. Mohammed Meerakhan Vs. Commissioner of Income Tax, Kerala, . In this connection reference is necessary to a decision of the Judicial Committee in the case of (1938) 6 ITR 36 (Privy Council) . There the Judicial Committee observed, in the facts of that case, that the view that an Income Tax Officer was prima facie entitled to accept the profit shown by the assessee's account where there was a method of accounting regularly employed by the assessee was not a correct view. It was the duty of the Income Tax Officer where there was such a method of accounting, to consider whether the income, profits and gains could be properly deduced therefrom and to proceed according to his judgment on the question. In that case, the assessee had employed a regular method of accounting but had for some years past adopted a method of valuation of stock by taking some price under both cost and market price with the object of creating a secret reserve which involved the retention of "secret profit" as not to be included in the profit shown to the shareholders. For the accounting year 1930, the assessee had submitted their profit, and loss account showing a profit of Rs. 2,64,086 and return of the total income of the company showing an income of Rs. 1,99,086 which was arrived at by taking into account the result of wider-valuation of stock which the company had adopted in the previous years. The Income Tax Officer, without considering whether the true income could be arrived at from the method of accounting employed by the assessee, held that the assessee was bound by the profits shown in the balance-sheet. It was held by the Judicial Committee that the Income Tax Officer was not entitled to take the profit shown in the balance-sheet as the real income of the assessee but was bound to consider whether the true income could be determined from the account of the assessee and to proceed according to his judgment on this question. In the case of Sun Insurance Office v. Clark [1912] AC 443 Viscount Haldane observed in his speech :

"It is plain that the question of what is or is not profit or gain must primarily be

one of fact, and of fact to be ascertained by the tests applied in ordinary business."

6. In the case of *Duple Motor Bodies Ltd. v. Inland Revenue Commissioners* [1961] 1 WLR 739 of the report, in his speech, Lord Reid observed:

"It appears to me that we must begin at the other end and simply ask what, in all the circumstances of a particular businesses, a figure which fairly represents the cost of stock-in-trade and work-in-progress. One thing clearly emerges as approved by accountancy profession--whatever method is followed it must be applied consistently. I accept that. So the real question is what method best fits the circumstances of a particular business. And if a method has been applied consistently in the past, then it seems to follow that it should not changed unless there is good reason for the change sufficient to outweigh any difficulties in the transitional year."

7. The purpose and object of valuing the stocks have been aptly described in the speech of Lord Reid in the case of *B.S.C. Footwear Ltd. v. Ridgway* [1972] 83 ITR 269; [1971] 2 WLR 1313 as follows:

"It is a commonplace that a trader's profit for tax purposes must be determined by framing a profit and loss account in which there is set against his gross receipts all relevant expenditure. It has often been said that you set against the receipts all expenditure incurred in earning those receipts. But that is not quite accurate. If you manure the field in year one in order to reap the harvest in year two, no one now doubts that the cost of the manure is a proper charge against the receipts in year one although that cost produces so return until the next year. There are no statutory rules about this, and it is well settled that the ordinary principles of commercial accounting must be used except in so far as any specific statutory provision requires otherwise. The question is what is fair to the taxpayer and fair to the revenue.

8. It has long been recognised that a fair result cannot be achieved without taking into account the trader's stock-in-hand at the beginning and at the end of the year. In the long run it might not much matter how this stock is valued because, if the wrong figure for the stock at the end of year one causes the profit for that year to be too low, the same figure on the other side of the account at the beginning of year two will cause the profit for year two to be to the same extent too high. But for OBVIOUS reasons it is desirable that in each separate year the profit should be determined as accurately as possible.

9. The application of the principles of commercial accounting is, however, subject to one well-established though non-statutory principle. Neither profit nor loss may be anticipated. A trader may have made such a good contract in year one that it is virtually certain to produce a large profit in year two. But he cannot be required to pay tax on that profit until it actually accrues. And conversely he may have made such an improvident contract in year one that he will certainly incur a loss in year two but he cannot use that loss to diminish his liability for tax in year

one.

10. The principle is subject to an exception as regards stock-in-trade. If it were applied logically, stock-in-trade must always be valued at the end of the year at cost, even if it could have been bought at the end of the year much more cheaply. But for half a century at least traders have been allowed to value such stock at the end of the year at its market price or market value at that date if that is lower than the original cost price : on the other hand, the trader is not required to value his stock at market value if that is higher than the original cost. So to this extent he can diminish his profit in year one by setting against it an anticipated loss in year two. It is only an anticipated loss because the market price may move upwards before he sells the stock so that when he does sell it he gets a price equal to or greater than the original cost and so never in fact suffers any loss. If that happens the matter is put right in the year two. The effect of carrying forward the stock at a valuation below cost is that in the account for year two that valuation and not the actual original cost is deemed to be the cost, and so the profit in year two is increased.

11. That exception has been expressed by the phrase " cost or market value, whichever is the lower ". But that is only a shorthand convenient form of expression. It is not contended by the Crown that it is a rule of law to be interpreted as if the words occurred in a statute. It is I think accurate and adequate where there is a market in the ordinary sense." From the aforesaid judicial decisions it appears to us that the following principles emerge for application to the question with which we are concerned in this reference:

(1) The true purpose of valuation of the unsold stock is to balance the costs of these goods entered on the other side of the account at the time of their purchase or production, so that 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 profit or loss actually realised on the year's trading. [See the observations of the Supreme Court in the case of Chainrup Sampatram Vs. Commissioner of Income Tax, West Bengal, and observations of Lord Reid in the case of B.S.C. Footwear Ltd. v. Ridgway [1972] 83 ITR 269.

(2) For the purpose of Income Tax the object of valuation of unsold closing stock is not to bring into charge any depreciation in the value of such stocks. (See the observations of the Supreme Court in the aforesaid decision).

(3) For the purpose of the aforesaid valuation it is necessary to determine what in all circumstances represent the costs of stock-in-trade and work-in-progress. What is and what is not profit or gain in those circumstances must necessarily be one of fact, and fact to be ascertained by the tests of ordinary business. (See the observations of Viscount Haldane in Sun Insurance Office v. Clark [1912] AC 443 and of Lord Reid in Duple Motor Bodies Ltd. v. Inland Revenue Commissioners [1961] 1 WLR 739.

(4) There are no statutory rules for making this valuation and the ordinary method of commercial accounting must be followed except in so far as there is any specific statutory provision requiring "otherwise. The method must be fair to the taxpayer and fair to the revenue. Traders are allowed to value their unsold stock and work-in-progress either at "cost or market price, whichever is lower ". This is, however, a shorthand way of expression ; it is not a rule of law. It is a workable method recognised in tax laws. It must be adopted in commercial sense in consonance with accounting practice. Anticipated losses and profits for the aforesaid purpose are permissible, provided, however, there is a market in the ordinary sense and the anticipation is backed by consistency of the method followed and the method followed is supported by recognised accounting principles. [See the decisions of the Supreme Court in the cases of Chainrup Sampatram Vs. Commissioner of Income Tax, West Bengal, , The Commissioner of Income Tax, Madras Vs. A. Krishnaswami Mudaliar and Others, , India Motor Parts and Accessories Ltd. (P), Madras Vs. The Commissioner of Income Tax, Madras, ; observations of Viscount Haldane in Sun Insurance Office v. Clark [1912] AC 443, observations of Lord Reid in Duple Motor Bodies Ltd. v. Inland Revenue Commissioners [1961] 1 WLR 739, in B.S.C. Footwear Ltd. v. Ridgway [1971] 2 WLR 1313; [1972] 83 ITR 269.

(5) Whatever is the method it must be one recognised by accounting practice and sanctioned by commercial practice. The method adopted must be regularly followed over the periods. But the method adopted and regularly followed by the assessee and accepted by the revenue should not be departed from unless there is good reason for the same. If, however, the method adopted and regularly followed by the assessee does not result in the determination of the true profits for tax purposes, even for one particular year, or there is some other good reason, the revenue is entitled to reject the method followed and value the stocks upon basis as will result in the determination of true profits. (See the aforesaid decision of the Judicial Committee, the aforesaid decisions of the Supreme Court and the House of Lords).

12. Bearing the above principles in mind we have to examine the principles of accountancy that were sought to be followed and relied on by the assessee in this case and the facts and circumstances of this case. It has to be borne in mind that we have to deal with the valuation of unsold stocks and products in the process of production, and the item is paints and it is said that the paints have a short duration of life. In Recommendations of accounting principles by the Institute of Chartered Accountants in England and Wales (1961) reprint, it has been said that production expenditure might be divided into various heads, and opinions have differed on the extent to which overhead expenditure should be included in computing the cost of stock. It has been further observed that no one method of dealing with overhead expenditure was suitable for all businesses. The method selected by the management needed to be clearly defined and must have regard to the nature and circumstances of the business so as to ensure that the trend of the trading results would be shown fairly. Once the method had

been, selected it was required to be consistently used from period to period, according to the said recommendations, regardless of the amount of profits available or losses sustained. The recommendations further stated that for selecting a method of dealing with overhead expenditure certain principles were required to be followed. In deciding whether to include a proportion of the overheads as the expenditure of stock and also in deciding which elements of expenses might properly be included for that purpose, it was necessary to have regard to the nature and stage of development of the business, particularly factors such as: the length of the production period, the probability of fluctuations in the level of production or the volume of sales, the risk of selling campaigns by competitors at reduced prices and the extent to which production was undertaken only to- a consumer's order, or "for stock" in expectation, of sale. It was further observed that in businesses which were highly competitive or had a sensitive market for their products, overhead expenditure might properly be omitted in order to avoid carrying forward expenditure which might prove irrecoverable. Raymond P. Marple in his book, *Towards a Basic Accounting Philosophy* (1964), at page 14, observed as follows:

"But let me correct any such impression by emphasizing that the treatment of fixed expenses is, in my opinion, the crux of the inventory valuation problem so far as overhead is concerned. Most of the really difficult problems of overhead application arise because of fixed expenses. Because these expenses do not vary as the volume of production changes, the cost of overhead per unit of product or per machine or direct labour hour tends to vary inversely with the volume of production. This results in low overhead costs per unit of product in periods of more than normal activity when selling prices are likely to be low. Product costs obtained by including overhead on this basis are as unsatisfactory for inventory valuation purposes as they are for the determination of selling prices or the calculation of profits."

13. The Institute of Cost and Works Accountants, London, in its report on *Marginal Costing* (1961) at page 21 observed :

"The inclusion of overhead cost in the valuation of work-in-progress and finished stock is a subject on which considerably divergent views are held. The extremes vary from the inclusion of total overhead to the inclusion of variable overheads only, or even the exclusion of all overhead cost. Whatever may be the merits of these various cases, they should be consistently applied from year to year or period to period."

14. So far as the facts of this case are concerned it is the case of the assessee, and there was no contrary evidence or nothing to contradict that case of the assessee, that the paints have very short "shelf life". It has further to be borne in mind that the method or the process of valuing the unsold stocks and work-in-progress adopted by the assessee in the manner done in the year in question had been consistently and regularly followed by the assessee and accepted by the revenue for over a large number of years. There was the evidence on behalf

of the assessee that the method followed was a regular method having regard to the nature and type of business carried on by the particular assessee. Next, the assessee has asserted and it was not denied by the revenue that stocks which had remained unsold for a period used to become unsaleable or were not sold by the assessee because of its reputation in the market. It has not been established that the method followed by the assessee was with any ulterior purpose. There was no contrary evidence given by the revenue. Assessee had asserted that experience had shown that the basis of valuing stocks in the manner it was done presented a true picture according to the correct commercial practice. There was no evidence to the contrary by the revenue.

15. The Tribunal has stated, on the other hand, that there was no evidence that stocks had in fact become obsolete or slow moving. There was merely an assertion of a possibility. There was nothing to show that the stocks had actually deteriorated in value and according to the Tribunal the stocks should be valued at cost or an arbitrary method of valuing the stocks. According to the revenue the method followed by the assessee did not disclose true profits. The Tribunal has noted that the assessee had never claimed depreciation of its stock in the previous years. The Tribunal came to the conclusion that although for business purposes stocks might be valued in a particular manner that method would not hold good for Income Tax purposes and the assessee's method of accounting was such from which true profits could not be deduced. Upon the aforesaid basis the Tribunal rejected the assessee's method and upheld the Income Tax Officer's basis of valuing the stocks and goods-in-process at 100% of cost including the overheads. On behalf of the revenue great reliance was placed on the case of *Freeman, Hardy & Willis Ltd. (Now B.S.C. Footwear Ltd.) v. Ridgway* [1969] 1 WLR 1488; [1970] 75 ITR 632, There what happened was that the taxpayer-company carried on business as shoe retailers through its 790 retail shops. In order to effect a large sale it had to keep large stocks and the number of shoes in stock at the end of its trading year which ended in December was generally equal to about one-third of the total annual sales. Some of the remaining stock used to be sold at reduced prices at the January sales, some at even lower prices in subsequent sales and some at less than cost. When making up its accounts the taxpayer-company had followed its practice of 30 years and valued two-thirds of the stock in hand at the end of the year at original cost and the remainder at a lower figure being replacement value, i.e., the price which according to it would be paid for it in the wholesale market. The Crown computed the taxpayer-company's income for Income Tax purposes on the basis that stock was valued at cost or market value, whichever was the less, market value being the price which could be obtained for it on a sale by retail less any expenses referable to the sale, such as seller's commission. Evidence was given, by accountants for the taxpayer-company, that in view of the large stocks maintained "replacement price" produced a fair allocation of profits and losses in the successive accounting years, setting off losses from the stocks brought forward from a previous year against the higher profits resulting from the larger

stocks in that year. Evidence from a dissenting point of view was given by the Crown. Cross J. dismissed an appeal, preferred by the taxpayer from the decision of the Special Commissioners, who had confirmed the decision of the Crown. The learned judge held that the words "market value" in the formula--accepted by law from the practice of accountants for valuation of stock-in-trade--" cost or market value, whichever is the less" prima facie connoted the price obtainable in the market which offered the best price and evidence in that case did not support the existence of an invariable accountancy practice of interpreting "market value" in such a way as to give the trader an option of valuing his stock at the wholesale market price even though that was less than cost (which would have involved giving an unnatural construction to the words in question where the real market value exceeded the cost). The aforesaid decision went up in appeal before the Court of Appeal in England and the decision of the Court of Appeal is reported in B. S. C. FOOTWEAR LTD. Vs. RIDGWAY (INSPECTOR OF TAXES)., . The Court of Appeal held dismissing the appeal preferred by the assessee in that case that in the phrase "cost or market value, whichever is the lower", market value meant the price at which the stock could be expected to be sold in the market in which the trader sold in the case of retail trade the market must be the retail market.

16. The court further held that if the method had been consistently applied in the past it should not be changed unless there were good reasons sufficient to outweigh any difficulty, but there was such a reason in the instant case, namely, that the method consistently applied prior to 1959, however commercially, sensible, did not reproduce the profits and gains for a particular year taken in isolation. Russell L. J. noted that the taxpayer had operated a system in valuing its stock which to some extent was a flexible one which was termed as "an average mark-up". From the decision of the Court of Appeal there was a further appeal to the House of Lords and the said decision is reported in [1971] 2 WLR 1313; [1972] 83 ITR 269 (B.S.C. Footwear Ltd. v. Ridgway), and we have already referred to the said decision. The House of Lords by a majority judgment dismissed the appeal and held that in the phrase "cost or market value, whichever is the lower" market meant the price at which the stock could be expected to be sold in the market in which the trader sold, and in the case of retail trade, that market must be retail market. It was further held that if a method had been consistently applied in the past it should not be changed unless there were good reasons sufficient to outweigh any difficulties, but the House found that there was such a reason in that case, namely, that the method consistently applied prior to 1959, however commercially sensible, did not reproduce the profits and gains of a particular year taken in isolation. Viscount Dilhorne gave a dissenting judgment. Reliance was placed on this decision of the House of Lords by the revenue in support of the conclusion arrived at by the Tribunal in the instant case before us. It has to be borne in mind that the facts of the aforesaid case were very peculiar. Firstly, the assessee was a retailer and had carried on the business of shoe retailer. The mark-up system, a flexible system which had been followed in that case, was not a system of value based on the

expected price to be fetched by the sale of the stock at the retail market. It was a working out method in which the courts found as a fact that the valuation that had been put was not on the basis of the market in which the trader dealt. In other words, the valuation put by the assessee did not represent the market price even according to the assessee. Secondly, there were conflicting evidence, namely, there was evidence on the side of the assessee suggesting that the valuation put was the best practical method of valuing the stock while on behalf of the Crown there was the evidence of the accountant indicating that that was not so. In view of these factors the House of Lords upheld the decision of the Commissioners for the Inland Revenue. That decision in our opinion cannot be availed of by the revenue, in the facts and circumstances of this case. Viscount Dilhorne, of course, did not find sufficient good reason for permitting departure from the accented system. There is, however, one principle enunciated by the House of Lords, namely, that even if the method followed by the assessee was commercially sound and had been consistently applied in the past the same could be departed from if in a particular year taken in isolation it did not reproduce the profits and gains of a particular year, which requires consideration. In our opinion this principle should, however, be applied with caution and upon very cogent evidence in a particular case. The peculiar facts and circumstances of the case with which the House of Lords had to deal in the aforesaid case might have justified the application of that principle in the facts of that case, though we are respectfully inclined to agree with the view of Viscount Dilhorne that sufficient cogent reason was not there for the departure from the practice followed and accepted by the revenue over the periods. It has to be borne in mind that for computation of profits and gains, if any, on this account, as was observed by Lord Reid in the aforesaid decision at page 272 of the report, there are no statutory rules and the ordinary principles of commercial accounting must be used except in so far as any specific statutory provision requires otherwise. In this connection it is necessary also to remember the observations of Viscount Haldane that what is and what is not profit or gain must primarily be one of fact and of fact to be ascertained by test applied in ordinary business. Therefore, the valuation of unsold stock or work-in-progress by a process recognised in the trader's business and sanctioned by accounting practice should be applied and followed unless, as we mentioned before, there are very cogent reasons for departing from it in a particular year.

17. Having regard to the principles that we have discussed above and in view of the facts and circumstances of this case, the question before us is whether the Tribunal was justified in its conclusion ? We have come to the conclusion that the Tribunal was not so justified. The Tribunal was wrong, in our opinion, in taking into consideration the fact that the assessee had not claimed any depreciation in respect of the stock. As the Supreme Court has observed in the case of Chainrup Sampatram Vs. Commissioner of Income Tax, West Bengal, , it is wrong to assume that the purpose of valuation of closing stock was to bring into charge any depreciation in the value of such stock. The Tribunal was wrong in

considering that the principle that the stocks should be valued at cost or market price, whichever is the lower, was a rule of law. The Tribunal should have applied it as a working method suited with modification having regard to the particular business carried on by the assessee. The Tribunal relied on the fact that, apart from a mere possibility of paints losing their quality by lapse of time, there was nothing to show that the goods in stock had actually deteriorated in value. The Tribunal should have appreciated that anticipation of a possibility, is permissible to a certain extent provided such anticipation is made bona fide, in accordance with commercial practice and sanctioned by accounting procedure in respect of a market in which the trader in question dealt, having regard to the nature of the trade and the item comprising the stocks in question. If the Tribunal or the revenue authorities was in any doubt about the actual valuation made, perhaps it would have been more rational for the Tribunal to have examined statement-wise the various items of paints which comprised the stocks of the assessee and also their production period and also the time lag between production and sale. The Tribunal did not do that, perhaps because the Tribunal felt that there was nothing to doubt the accuracy of the figures given by the assessee. For the aforesaid reasons we have come to the conclusion that the Tribunal was not justified in rejecting the method of valuation of the goods in process and the finished products on the basis of the cost of raw material, adopted by the assessee.

18. Counsel for the revenue, however, contended before us that the question referred to this court was a question of fact and there being no question to the effect that there were no materials for the Tribunal to come to the conclusion that it was not possible for this court to question the conclusion arrived at by the Tribunal. In this connection reliance was placed on two decisions. In the case of *Chhabildas Tribhuvandas Shah and Others Vs. Commissioner of Income Tax, West Bengal*, , what happened was that the profits disclosed by the accounts for the relevant year, in comparison with the earlier years, were too low, and that there were no day-to-day stock details for the purpose of verification. The Income Tax Officer rejected the trading accounts of the assessee and added the sum of Rs. 75,000 to the income returned by the assessee. The Tribunal in that case upheld the addition on the ground that the assessee was doing business in the main on wholesale basis and, in the absence of tally of quantities in respect of major items of the trading account, the fall in the margin of profits could not be satisfactorily explained and, further, that the fall in the margin of profits was all the more difficult to explain in view of the fact that the assessee had a quota of imports worth about Rs. 8 lakhs which could have given the assessee a handsome margin of profit. The Supreme Court held that there was material to support the finding of the Appellate Tribunal and no question of law arose out of its order. The Supreme Court further observed that in cases involving the applicability of the proviso to Section 13 of the Indian Income Tax, Act, 1922, the question to be determined by the Income Tax Officer was a question of fact, namely, whether the profits and gains could or could not be properly deduced from the method of accounting regularly adopted by the assessee. There was

nothing special about the question of fact, and generally the only question of law that could possibly arise was whether there was any material for the findings. In the case of India Machinery Stores P. Ltd. Vs. Commissioner of Income Tax, Bihar and Orissa, in the books of accounts of the vendors the stock in question stood at Rs. 1,77,285 whereas in the deed of transfer and in the books of the assessee the stock taken over by it was valued on the same day at Rs. 2,10,285. The Income Tax Officer was of the view that the assessee had inflated the value of the opening stock so as to reduce the ultimate profits and added the difference of Rs. 33,000 to the profits of the assessee. The Tribunal confirmed that order. The High Court also confirmed that order. It was held by the Supreme Court that the reference was incompetent and no question of law arose. As we have noticed, the facts of these two cases were very peculiar. If in any particular case it appears that the actual method followed was defective from the intrinsic defect of the method, then, of course, normally, no question of law would arise, but in the instant case before us the Tribunal had rejected the method of valuation not on any factual dispute but by applying a particular approach to the question of valuation which in our opinion was erroneous. In those circumstances, in view of the amplitude of the question referred to us, we are of the opinion that we are entitled to go into the question whether the Tribunal was justified in its conclusion.

19. In the premises, the question referred to this court is answered in the negative and against the revenue. In the facts and circumstances of the case, however, each party will pay and bear its own costs.

Janah, J.

20. I agree.