
(1998) 09 AP CK 0053
In the Andhra Pradesh High Court
Case No : R.C. No. 139 of 1990

Commissioner of Income Tax, A.P.-I

APPELLANT

Vs

Agarwal Enterprises

RESPONDENT

Date of Decision : 14-09-1998

Acts Referred:

Income Tax Act, 1961 — Section 263

Citation : (1998) 6 ALD 488 : (1999) 236 ITR 412

Hon'ble Judges : T. Ranga Rao, J;S.V. Maruthi, J

Bench : Division Bench

Advocate : Mr. S.R. Ashok, SC for IT Case, for the Appellant; Mr. A. Satyanarayana, for the Respondent

Judgement

S.V. MARUTHI, J

1. The Tribunal referred the following question at the instance of the Revenue for opinion of this Court:

Whether on the facts and in the circumstances of the case and the valuation of the stock-in-trade i.e., land at Rs.6-1/2 lakhs on the opening date of accounting year, the Tribunal was justified in holding that the valuation has no relevance and the land could be valued at Rs.27 lakhs and further holding that there was no escapement of income?

The facts in brief are as follows:

The assessee is a firm consisting of three partners i.e., two individuals and one Limited Company by name Agarwal Vanaspati Private Limited. The firm was constituted on 24-11-1980. The business has dealings in real estate, buildings, properties, etc. The two partners Smt. Shantabai and Smt. Kantabai, brought in as their contribution towards capital their interest in an immovable property situated at Edenbagh, the property was valued at Rs.6.5 lakhs and half share was credited to the account of each individual partner. The third partner i.e., the Limited Company contributed cash of Rs.3.25 lakhs. On 21-1-1981 the firm was

dissolved and the entire assets and liabilities were taken over by the Limited Company at book value. The assessee filed return showing a loss of Rs.600/- which was accepted by the by the Income Tax Officer. The Commissioner initiated proceedings u/s 263 of the Income Tax Act on the ground that the order passed by the Income Tax Officer was erroneous and prejudicial to the Revenue. According to him, immovable property was the stock-in-trade of the assessee firm, and since the firm was dissolved, the stock-in-trade should have been valued at market rate and . the profits so ascertained. Therefore, he set aside the assessment with a direction to re-do the same in accordance with law. He also directed the Income Tax Officer to find out the correct market values of the properties on the date of dissolution.

2. Against the order of the Commissioner, Income Tax (Appeals), the assessee filed appeal before the Tribunal. The Tribunal held that the Commissioner committed an error in exercising the power u/s 263 of the Income Tax Act as an ad hoc valuation was given by the firm in the books of account and it has no relevance at all. If the ad hoc valuation given by the firm in the books of accounts has no relevance, then there is no escapement of the Income and consequently there is no prejudice caused to the Revenue, in that view of the matter, the Tribunal allowed the appeal.

3. At the instance of the revenue, the question set out in the earlier paragraph was referred to this Court for opinion.

4. The undisputed facts are that the two partners Smt. Shantabai and Smt. Kantabai, brought in as their contribution towards capital their interest in an immovable property valuing at Rs.6.5 lakhs and half share was credited to the account of each individual partner. The firm was constituted on 24-11-1980 and it was dissolved on 21-1-1981 i.e., within two months from the date of its constitution. The Assessing Officer accepted the valuation mentioned in the books of accounts on the date of constitution of the firm. He also taken the same value on the date on which the firm was dissolved. While the Commissioner Income Tax stated that the value of the opening stock should be the same as stated by the assessee while the value of the closing stock should be the market value. If the Principle applied by the Commissioner is correct, then there will be an escapement of income. Therefore, the question is what should be the value of the stock-in-trade on the date of constitution of the firm and on the date of the dissolution of the firm, if the immovable property brought in by the two partners is treated as stock-in-trade.

5. According to the Tribunal, the value mentioned by the partners need not be accepted as it is a notional value and the real value should be the market value. If so, the market value as on the date of the closing stock/on the date of dissolution and also on the date of opening stock/ constitution of the firm is one and the same, there is no escapement of income.

6. The learned Counsel appearing for the Revenue contended that the Supreme

Court in A.L.A. Firm Vs. Commissioner of Income Tax, Madras, held as under:

"For example, the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or 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..."

Therefore, the closing stock has to be valued at the market price. As regards valuation of the opening stock is concerned, it is left to the discretion of the assessee and therefore, the value mentioned in the books of accounts should be taken into account. If so, there is escapement of income. The Counsel submitted that the Tribunal committed an error in holding that the opening stock should also be valued at the market price.

7. The learned Counsel for the assessee relying on the decision in Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat, contended that the credit entry made in the partner's capital account in the books of the partnership firm does not represent the true value of consideration. Therefore, the value mentioned in the books of accounts by the partners at the time of constitution of the firm does not represent the real value of the stock-in-trade. If it does not represent the real value of the stock-in-trade, the true principle of accountancy is that the correct value has to be ascertained which should be either the market price or the cost price.

8. The question therefore, is when the book value of the opening stock does not represent the correct value on the date of constitution of the firm i.e., gives only a notional value, is the authority bound to take into account that value or is it necessary to ascertain the true value of the opening stock. In this context the observations made by the Supreme Court in ALA Firm's case (supra) are very much relevant:

"...the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or manufacturer's business the value 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 lower."

In other words, according to the Commercial Accounting stock in trade both at the beginning and at the end should be entered at cost price or market rate whichever is lower.

9. To the same effect is the other observation of the Supreme Court in the same judgment, which reads as follows:

"...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 men, 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 Edition) 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."

From the above, it is clear that it is not always necessary that the book value should be accepted. The true test is what is the fair value. The authority has to ascertain the fair value of the stock-in-trade. When once the authority is not bound to accept the book value, if it does not represent fair value, but only a notional or ad hoc value, then it open to the authority to ascertain the correct value. The correct value is either market price or the cost price. Further the authority has to ascertain the real value of the property, real value of opening stock and the closing stock as he has to ascertain the real income for the purpose of assessment. He cannot take ad hoc figures or notional figures for ascertaining the real income. Real income can be ascertained on the basis of real value of the opening stock and the closing stock. If the assessment is made on the basis of notional value of the opening stock and the market value of the closing stock the assessee would be subject to tax on income which does not exist.

10. If the authority has to ascertain the real value of the property, both on the date of opening stock and also on the date of closing stock and if there is difference between the value of the opening stock and closing stock, then the difference is liable for income tax. Since the partnership firm was dissolved within two months of its constitution, there is not much difference between the value of opening stock and closing stock. Therefore, the question of escapement of income and consequent prejudice caused to the revenue does not arise.

11. In view of the above, we answer the question referred by the Tribunal in the affirmative and in favour of the assessee.

12. The reference is answered accordingly.