
(1992) 12 GAU CK 0010

In the Gauhati High Court

Case No : Income-tax Reference No. 25 of 1987

Commissioner of Income Tax

APPELLANT

Vs

Doom Dooma India Ltd.

RESPONDENT

Date of Decision : 04-12-1992

Acts Referred:

Income Tax Act, 1961 — Section 145

Citation : (1993) 200 ITR 496

Hon'ble Judges : U.L. Bhat, C.J.;N.G. Das, J

Bench : Division Bench

Advocate : D.K. Talukdar and B.J. Talukdar, for the Appellant; J.P. Bhattacharjee, G.K. Joshi, Y. Dolai and R.K. Joshi, for the Respondent

Judgement

U.L. Bhat, C.J.—The Income Tax Appellate Tribunal has, at the instance of the Revenue, referred the following question u/s 256(1) of the Income Tax Act, 1961 (for short, "the Act") :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessee had properly opted to value the closing stock at cost or market price, whichever was lower, in the first year of its business ?"

2. We have heard learned counsel for the Revenue and learned counsel for the respondent.

3. M/s. Doom Dooma Tea Company Ltd., incorporated in the United Kingdom, was a foreign company. On account of restrictions imposed by the Reserve Bank of India, foreign participation in the company had to be brought below 75 per cent. under the provisions of the Foreign Exchange Regulation Act, 1973. Therefore, a device was adopted for incorporating a new company which has less than the maximum prescribed foreign participation. The new company, M/s. Doom Dooma Tea Company Ltd., was incorporated on December 26, 1977. The new company took over the assets and liabilities of the foreign company on

January 1, 1978, and obtained the certificate of entitlement to commence business on March 9, 1978. The stock in hand of the foreign company became the stock of the new company in the year 1978-79, which is the previous year relevant to the assessment year 1979-80. The assessee, in its accounts, showed the value of the stock taken over from the foreign company at the price agreed upon less sale charges. That stock was sold out during the year. More quantity of tea was manufactured and sold, leaving a closing stock out of the tea so manufactured. In the accounts, the assessee valued the closing stock at the manufacturing cost. The order of the Income Tax Officer shows that stock of 22,94,897 kgs. of tea was taken over by the assessee as on January 1, 1978, at Rs. 3,61,11,394. This worked out to Rs. 15.30 per kg. This was the price paid less the sale charges. The stock which remained at the end of the year, namely, as on December 31, 1978, was 23,63,544 kgs. valued at Rs. 1,63,97,073, which worked out to Rs. 6.94 per kg.

4. The original statutory authority, the Inspecting Assistant Commissioner, took the view that the stock taken over from the foreign company was the opening stock for the year and was valued at the price paid, namely, the market price and, therefore, the closing stock should have been valued at the market price but the same was valued at the manufacturing cost so as to bring down the income of the year and this cannot be permitted under the provisions of Section 145 of the Act. The Appellate Assistant Commissioner took a contrary view and sustained the accounts of the assessee and this has been affirmed by the Tribunal.

5. Section 145 of the Act deals with the method of accounting. The part of the section relevant for the purpose of this case is quoted below :

"145. Method of accounting.--(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with the method of accounting regularly employed by the assessee :

Provided that in any case where the accounts are correct and complete to the satisfaction of the Income Tax Officer but the method employed is such that, in the opinion of the Income Tax Officer, the income cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Income Tax Officer may determine."

6. It is for the assessee to adopt any recognised method of accounting for his business. The income shall be computed in accordance with the method of accounting regularly employed by the assessee. In other words, it is open to the assessee to opt for such method of accounting as he deems reasonable and appropriate. He may opt to adopt the manufacturing cost price method or the market price method provided the method is followed in regard to both the opening stock and the closing stock. It is not open to him to adopt one method for valuing the opening stock and a different method for valuing the closing stock

so as to intentionally suppress the income derived or derivable in the particular previous year. Even where an assessee has adopted a particular method for a period of years, there is no provision of law which prevents him from changing to any other method, provided the change-over is not made in the same assessment year.

7. The proviso to Sub-section (1) empowers the Assessing Officer to compute the income on such basis and in such manner as he determines if the accounts are correct and complete but the method adopted is such that, in his opinion, the income cannot properly be deduced therefrom. The jurisdiction can be invoked where he is of the opinion that the income cannot properly be deduced therefrom. He cannot exercise the jurisdiction merely on the ground that the method adopted, which is otherwise regular or fair, is detrimental to the Revenue or advantageous to the assessee. If the Assessing Officer is not satisfied about the correctness or the completeness of the accounts of the assessee, or where no method of accounting has been regularly employed by the assessee, the Assessing Officer may make an assessment in the manner provided in Section 144.

8. In *Chainrup Sampatram Vs. Commissioner of Income Tax, West Bengal*, the Supreme Court observed as follows (at page 485) :

"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... 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 ... As truly observed by one of the learned judges in *Whimster and Co. v. Commissioners of Inland Revenue*, [1926] 12 TC 813(SC), "under this law (Revenue law) the profits are the profits realised in the course of the year. What seems an exception is recognised where a trader purchased and still holds goods or stocks which have fallen in value. No loss has been realised. Loss may not occur. Nevertheless, at the close of the year he is permitted to treat these goods or stocks as of their market value".

9. In *Investment Ltd. Vs. Commissioner of Income Tax, Calcutta*, the Supreme Court observed (at page 537) :

"A taxpayer is free to employ, for the purpose of his trade, his own method of keeping accounts, and for that purpose to value his stock-in trade either at cost or at market price. A method of accounting adopted by the trader consistently

and regularly cannot be discarded by the departmental authorities on the view that he should have adopted a different method of keeping account, or of valuation. The method of accounting regularly employed may be discarded only if, in the opinion of the taxing authorities, income of the trade cannot be properly deduced therefrom. Valuation of stock at cost is one of the recognised methods. No inference may, therefore, arise from the employment by the company of the method of valuing stock at cost, that the stock valued was not stock-in-trade. "

10. In *A.L.A. Firm Vs. Commissioner of Income Tax, Madras*, the Supreme Court dealt with the case of a dissolved firm. The court referred to a number of decisions holding that the principle of valuing the closing stock of a business at cost or market price 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, the profits cannot be ascertained except by taking the closing stock at market value and held that, even if 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. The court observed (at page 302) :

"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 Sampatram Vs. Commissioner of Income Tax, West Bengal*, 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 *The Commissioner of Income Tax, Madras Vs. A. Krishnaswami Mudaliar and Others*, 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."

11. The Supreme Court further pointed out that (at page 302) :

"... 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."

12. The basic fact which has to be borne in mind in deciding the question under reference is that the assessee is a new company which commenced business only in the previous year relevant to the assessment year in question. The assessee did not have any opening stock manufactured by it. The only opening stock, if it can be so called, was the stock manufactured by the foreign company and taken over by the assessee at the commencement of the previous year. The foreign company and the assessee agreed on the price to be paid for such stock. So far

as the foreign company is concerned, the price agreed was not the cost price but the market price or sale price ; the same, so far as the assessee is concerned, was the cost price, if it can be so called, that is because it obtained the stock not by a process of manufacture but by a process of transfer. There is no dispute that the stock so taken over by the assessee from the foreign company was sold during the same year. Therefore, the accounts would automatically reflect the income derived by the assessee by dealing with the stock taken over from the foreign company. The stock which remained at the end of the year, was not part of the stock taken over at the commencement of the year from the foreign company, but what remained out of the stock manufactured by the assessee during the year. The assessee valued the closing stock at the manufacturing cost price. Therefore, it can be said that the assessee adopted the same system of accounting both regarding the opening stock and the closing stock and the valuation was at cost price so far as the assessee is concerned. There is no principle of law by which the taxing authority could insist that the assessee should value the opening stock not at the price it paid to acquire the stock but at the manufacturing cost incurred by the vendor company. The assessee had the option to adopt one or the other method of accounting and the taxing authority can object only if it is of the opinion that the method employed is such that the income cannot be properly deduced therefrom. The Tribunal has taken the view that the assessee adopted the same system of accounting for valuing the opening stock and closing stock and that there is no basis for taking the view that the income cannot be properly deduced from the method employed by the assessee. This view is consistent with law.

13. For the aforesaid reasons, we uphold the view taken by the Appellate Tribunal that the assessee had properly opted to value the closing stock at cost price in the first year of its business. The question referred is answered in the affirmative, i.e., in favour of the assessee and against the Revenue.

14. A copy of this judgment under the signature of the Registrar and seal of the High Court will be transmitted to the Appellate Tribunal. In the circumstances, there will be no order as to costs.

N.G. Das, J.

15. I agree.