
(1971) 03 KL CK 0016

In the High Court Of Kerala

Case No : Income-tax Reference Case No. 72 of 1968

M. Durai Raj

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 06-03-1971

Acts Referred:

Income Tax Act, 1961 — Section 10, 12, 144, 145, 256

Citation : (1972) 83 ITR 484

Hon'ble Judges : P. Govindan Nair, J;M.U. Isaac, J

Bench : Division Bench

Advocate : S.A. Nagendran, P.A. Mohamed, C.P.S. Prasad and N.N.D. Pillai, for the Appellant; P.K. Krishnan Kutty Menon, for the Respondent

Judgement

Isaac, J.—This is a reference by the Income Tax Appellate Tribunal, Cochin Bench, u/s 256(2) of the Income Tax Act, 1961, as directed by this court at the instance of the assessee. The questions referred are :

" 1. Whether, on the facts and in the circumstances of the case the Tribunal was right in rejecting the trading results of the applicant without it being established that there was any suppressed turnover ?

2. Whether the Tribunal was right in holding that the mahimai collections which were utilised for the purpose of charity represented the trading profit of the applicant?"

2. The assessee is a dealer in rice on wholesale and on commission basis. In the previous year ending on August 16, 1962, relating to the assessment year 1963-64, his books of account showed a turnover of Rs. 11,56,138. The gross profit was Rs. 4,365, and thus works out to a rate of 0.4%. In the opinion of the Income Tax Officer, this was a very low rate when compared to the profits disclosed by other similar dealers. The assessee has maintained regular books of account, and also a stock book on the basis of number of bags. The Income Tax Officer held that the stock book should have been maintained in terms of weight

for a proper verification of the stock. He also found that the addresses of parties given in the duplicate copies of the sale bills were not sufficient for a cross verification. The assessee explained the low rate of profits as being due to the fact that he had to sell the rice on certain occasions at a loss due to fall in the market; and he attempted to substantiate it by sale bills. But the Income Tax Officer did not accept that explanation, since the sale bills could not be related to any particular purchases. The assessee expressed his inability to tally the stock in terms of weight on the basis of the entries in the stock book. The Income Tax Officer held, for the above reasons, that the accounts did not reflect the real state of affairs. He estimated the turnover as Rs. 11,70,000 and the gross profit at 2%. This resulted in an addition of Rs. 10,035 to the income returned by the assessee.

3. The assessee had collected some amounts from purchasers, which he had credited in a separate account styled " mahimai account ". The gross collections less disbursements during the accounting year under this head amounted to Rs. 4,497.60, He transferred this amount to another head called "God"s account". The assessee claimed that this amount was not includible in his total income as it was set apart for charitable purposes. The claim was rejected on the ground that the said amount had not been applied for charitable purposes.

4. The assessee filed an appeal from the order of assessment to the Appellate Assistant Commissioner. In the course of the hearing of the appeal, the assessee prepared certain statements in an attempt to tally the stock in terms of weight. That was unsuccessful, and the Appellate Assistant Commissioner rejected those statements. He concurred with the finding of the Income Tax Officer and dismissed the appeal.

5. The assessee then filed an appeal before the Income Tax Appellate Tribunal, before whom the assessee made another unsuccessful attempt to tally the stock by weight by filing some statements prepared on the basis of the stock book. The Appellate Tribunal also concurred with the finding of the Income Tax Officer and dismissed the appeal.

6. Counsel for the assessee did not rightly press the second question in the reference. The Appellate Tribunal found that what was being credited in mahimai account and subsequently transferred, to God"s account were actually collections towards incidental expenses in his trade, and that there was no legal obligation to spend any part thereof for charitable purposes. The second question in the reference is, therefore, answered in the affirmative and against the assessee.

7. On the first question, counsel for the assessee contended that the grounds stated by the Appellate Tribunal and the subordinate authorities for not computing the profits and gains of the assessee"s business in accordance with the method of accounting employed by him are irrelevant, and that the same should have been determined on the basis of the books of account, so long as there was no finding of any suppression of turnover. On the other hand, counsel

for the revenue contended that the grounds stated by them are adequate to reject the book results and make a best judgment assessment of the income. The arguments were mainly centered on the true interpretation of Section 145 of the Income Tax Act, 1961, and its application to the facts of the case. This section corresponds to Section 13 of the Indian Income Tax Act, 1922. Section 145 of the 1961 Act reads:

"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.

(2) Where the Income Tax 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 income tax Officer may make an assessment in the manner provided in Section 144."

8. Section 13 of the 1922 Act reads :

"13. Method of accounting.--Income, profits and gains shall be computed, for the purposes of Sections 10 and 12, in accordance with the method of accounting regularly employed by the assessee:

Provided that, if no method of accounting has been regularly employed, or if the method employed is such that, in the opinion of the Income Tax Officer, the income, profits and gains 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."

9. Both sections are not in the same language. But it does not appear that the change in the language has made any substantial difference in the law. The main purpose of couching Section 145 in a different language seems to be to clarify the true legal position. A careful reading of Section 145 shows that Sub-section (1) applies to a case where the assessee has employed a regular method of accounting, his accounts are correct and complete, and the method employed is such that the income can be properly deduced therefrom. Then the Income Tax Officer is bound to compute the income" according to the method employed by the assessee. The proviso comes into operation when the accounts are correct and complete, but the method of accounting is such that the income cannot be properly deduced therefrom. In that case, the Income Tax Officer is entitled to compute it on such basis and in such manner as he may determine. Subsection (2) applies to a case where the accounts are neither correct nor complete, or

where the assessee has not employed any regular method of accounting. Then the Income Tax Officer would determine the income to the best of his judgment after taking into account all relevant materials which he has gathered. The question whether, in so determining the income, the assessee should be given notice of the said materials and given an opportunity to meet them does not arise in this case. The controversy is only whether it is Sub-section (1) or Sub-section (2) that applies. According to the assessee, he has employed a regular method of accounting, the accounts are correct and complete, and the method employed is such that the income can be deduced therefrom; and the income should, therefore, be computed accordingly. Admittedly, the assessee has employed a regular method of accounting and the income can be deduced therefrom. But, according to the revenue, the accounts are neither correct nor complete ; and Sub-section (2) of Section 145 applies. Therefore, the question for consideration is whether there are any materials for holding that the accounts are not correct or complete.

10. The Income Tax Officer stated three grounds for rejecting the assessee's books of account; and they have been affirmed by the Appellate Assistant Commissioner and the Appellate Tribunal. Those grounds are: (i) a low rate of profit when compared to other similar dealers; (ii) non-maintenance of a stock book on the basis of weight, without which the stock cannot be verified in terms of weight;

(iii) absence of particulars of the addresses of the customers, without which verification of the sales is not possible.

11. According to the assessee, these are not valid grounds for rejecting the accounts, and the book results should be accepted, so long as it is not established that there is any suppression in the turnover, or that any transaction has not come into the accounts. Both parties cited a number of decisions in support of their respective contentions.

12. Counsel for the assessee relied on the decision of the Madras High Court in *R. M. P. Periantha Pillai and Co. Vs. Commissioner of Income Tax, Madras*, in support of his contention that the accounts of the assessee cannot be rejected on the only ground that the gross profits disclosed by his books were low and compared unfavourably with those of others in the same line of business. In that case, the court said :

" It is true that the gross profits disclosed by the assessee's accounts were low. That by itself was not enough to reject the system of accounts maintained by the assessee. Low gross profits should certainly put the department on enquiry to verify if the entries in the account books were spurious or to verify if the system of accounts itself was defective which made it impossible to accept the book results as disclosing the true profits of the assessee. In other words, on the only ground that the gross profits were low and compared unfavourably with those of others, the system of accounting adopted by an assessee cannot be rejected."

13. Counsel for the assessee also relied on the decision of the Punjab High Court in *Pandit Bros. Vs. Commr. of Income Tax*, In that case, the question referred for decision was "whether any addition may be made to the book version of the business profits where no stock account is maintained, on the sole ground that the net profits disclosed appear to be insufficient in relation to the total turnover". Dealing with the above question the court said :

" There is no finding that there was material before the Income Tax Officer to lead him to the conclusion that a proper statement of income, profits and gains could not be deduced from the material placed before him. All he said was that the profits appeared to be somewhat low and there was no stock register. In my view the fact that the profits are low is merely a warning to him to look into the accounts more carefully and see whether there is material to lead him to the conclusion that there is something false in the account books. The mere fact that the profits are low is not material upon which a finding u/s 13 can be based, because the assessee may be incompetent or his methods of business may be uneconomic. Again, the fact that there is no stock register only cautions him against the falsity of the returns made by the assessee. He cannot say that merely because there is no stock register the account books must be false."

14. Another decision relied on by counsel for the assessee is that of the Bombay High Court in *R.B. Jessaram Fetechand (Sugar Dept.) Vs. Commissioner of Income Tax, Bombay City-II*, . In that case, the books of account of the assessee were rejected by the Income Tax Officer on the ground that the assessee was unable to supply the addresses of the customers and the gross profit was low when compared to other traders. The court held that these were not sufficient grounds for rejecting the accounts. In doing so, it stated:

" The Income Tax Officer had scrutinised closely the account books of the assessee and had found no fault with them excepting that the addresses of the customers for the cash sales of sugar had not been entered. It was not found by him that there were any other reasons for not accepting the said cash sales, such as, for instance, the sales being at lower rates than what were prevailing in the market or that they were not comparable with the other verified sales, which the assessee had made during the material time. In these circumstances, the reason given by the Income Tax Officer for rejecting the book results shown by the assessee's accounts or for not accepting the cash transactions as genuine cannot be accepted as good and sufficient unless there was an obligation on the part of the assessee to keep a record of the addresses of the cash customers. It could not, therefore, be said that the failure on his part to maintain the addresses was a suspicious circumstance giving rise to a doubt about the genuineness of the transactions entered into by the assessee.

In the case of a cash transaction where delivery of goods is taken against cash payment, it is hardly necessary for the seller to bother about the name and address of the purchaser."

15. Counsel for the assessee also referred to the decisions of this court in B.F. Varghese (No. 2) Vs. State of Kerala, and C.M. Francis and Co. (P.) Ltd. Vs. Commissioner of Income Tax, .. In the former case, there is an observation that, in the absence of any omission, irregularity or other defect in the method of maintaining the accounts or positive evidence to show that the accounts do not disclose the whole income of the assessee, his books of accounts cannot be rejected. In the latter case, the books of accounts of the assessee were rejected by the Appellate Tribunal on the sole ground that the purchases of arecanuts from agriculturists from market overt were not supported by sale bills, which in the ordinary course of business was found not possible; and the court held that it was not, in the particular circumstances of the case, a proper ground for rejecting the accounts. Reliance was also placed on the following passage appearing in another decision of this court in S. Veeraiah Reddiar Vs. Commissioner of Income Tax, Travancore-Cochin, Bangalore, .:

" No assessment under the proviso to Section 13 can be sustained if the Income Tax Officer (or the appellate authority, in cases of appeal) has not considered and recorded a finding against the assessee as to whether he has been regularly employing a method of accounting or whether his income, profits and gains can properly be deduced from his method of accounting if he has been regularly employing a method of accounting and that the Income Tax Officer's decision on these matters is not to be a subjective or arbitrary decision but a judicial decision and cannot be accepted if there is no material to support his finding."

16. As against the above authorities, counsel for the revenue first cited the decision of the Supreme Court in S.N. Namasivayam Chettiar Vs. The Commissioner of Income Tax, Madras, . Counsel relies on the following passage in the above decision:

" In cases such as the instant case, the keeping of a stock register is of great importance because that is a means of verifying the assessee's accounts by having a " quantitative tally ". If after taking into account all the materials including the want of a stock register, it is found that from the method of accounting the correct profits of the business are not deducible, the operation of the proviso, to Section 13 of the Income Tax Act would be attracted."

17. Reference has been made in the above case to the decision of the Punjab High Court in Pandit Bros v. Commissioner of Income Tax and after quoting from the said decision a part of the passage which has been herein quoted already, the Supreme Court said :

" The want of a stock register was, in that particular case, not a very serious defect because the account books had been found and accepted as correct and disclosed a true state of affairs. It cannot, therefore, be said that that case laid down as a proposition of law that the want of a stock register by which a proper check could be made was not such a serious defect as to make the proviso to

Section 13 inapplicable."

18. The above decisions show that the question whether the want of a stock register is a relevant ground for not computing the profits and gains of the business of an assessee would depend on the facts and circumstances of the case, and that by itself is not a sufficient ground for making a best judgment assessment.

19. Counsel for the revenue next cited the decision of the Supreme Court in *Chhabildas Tribhuvandas Shah and Others Vs. Commissioner of Income Tax, West Bengal*, . In that case, the Supreme Court held that the absence of a tally of quantities at least in respect of the major items of the trading account, and want of satisfactory explanation for the fall in the margin of profits, particularly in the light of the fact that the assessee had a large amount of import quota which would have given him a handsome margin of profit was sufficient ground for the Income Tax Officer not to accept the assessee's accounts and compute the profits and gains of the business to the best of judgment. This decision also shows that absence of a stock register is not by itself a sufficient ground for not accepting the book profits of an assessee; but it is only a corroborative circumstance in the light of other facts which establish that the profits disclosed by his books of account cannot be accepted as true.

20. Another decision of the Supreme Court cited by counsel for the revenue is *Commissioner of Income Tax, Bangalore Vs. K.Y. Pilliah and Sons*, . That was a case where it was found that the assessee carried on large scale business in the names of third parties, without bringing those transactions into his accounts. His accounts also contained bogus credit entries. The profits disclosed were abnormally low, and there was no explanation for the same. The accounts were rejected by the Appellate Tribunal on the above grounds. The Supreme Court held that there were sufficient materials to reject the assessee's accounts and assess his income to the best of judgment, and that no question of law arose out of the order of the Tribunal.

21. Counsel for the revenue also relied on the decision of the Calcutta High Court in *HOWRAH TRADING CO. (PRIVATE) LTD. Vs. COMMISSIONER OF Income Tax (CENTRAL), CALCUTTA.*, . The assessee in that case was a manufacturer of iron pipes, drain pipes, etc. He maintained a stock register of the raw materials purchased by weight, and of the articles manufactured in length. The Income Tax Officer held that the profits of the assessee could not be properly determined from the method of accounting adopted by the assessee, as the finished goods were not accounted in weight. The High Court upheld the rejection of the accounts, stating:

" If the stocks received be shown in the accounts by one standard and the goods produced from those raw materials be shown by another standard, as has been done in the instant case, it is quite clear that there cannot be any deduction of profits therefrom, and this proposition could not be controverted on behalf of the

assessee."

22. The judgment is very brief; and this is the only reason given for upholding the rejection of the accounts. With great respect, it has to be stated that there is an over-simplification of the real question that arises for consideration. What is relevant to consider in such cases is whether the assessee's accounts are maintained according to the method regularly employed by him, whether they are correct and complete, and whether the income can be properly computed from the accounts. Absence of a stock register is not by itself a ground to reject the accounts. If a producer buys raw materials by weight, and he sells his products by length, the stock register, in respect of the purchases, can only be by weight, and, in respect of the sales, it can only be by length. In the case of the products, the weight may have no relevancy ; and the tallying of the stock may be possible only by weight and length. At any rate, the assessee is not under any obligation to maintain a stock register of such products by weight and the non-maintenance of such a stock register is by itself no ground to reject his accounts.

23. Whether the accounts of the assessee are maintained according to the method regularly employed by him, whether they are correct and complete, and whether the income can be properly computed from the accounts are all pure questions of fact. The Appellate Tribunal's finding on these matters are not liable to attack for want of sufficiency of materials. But if the findings are not supported by any materials or if the materials relied on are irrelevant or they are such that no Tribunal can reasonably come to such findings on the said materials, then a question of law would arise, and the High Court would be justified in holding that the findings cannot be sustained on any materials. In the instant case, the Appellate Tribunal has found that the profits disclosed by the assessee were low when compared to other similar traders. The assessee gave an explanation for the same. The Tribunal has not found that the explanation was not true; and all that it hold was that its correctness could not be verified. Regarding the non-maintenance of stock register, the assessee's case is that he buys rice in terms of the number of bags and also sells it in the same manner, and that the stock register is, therefore, maintained in terms of the number of bags purchased and the number of bags sold. This case has been apparently accepted by the Appellate Tribunal and the subordinate authorities. There is no case that the assessee has for the purpose of sale repacked the bags and increased their number by reducing their contents. In a wholesale business like that of the assessee, who buys and sells in terms of the number of bags, maintenance of a stock register in terms of weight is a very laborious process. As observed in the Bombay High Court in *R. B. Jessaram Fatehchand v. Commissioner of Income Tax*, there is no need to have complete particulars of the names and addresses of customers in the case of cash transactions, and the absence of such particulars in the sale bills would not be a ground for not accepting the books of account of an assessee. As already stated, the assessee has admittedly maintained his accounts according to the method regularly

employed by him, and the profits and gains of the business can be properly computed from his accounts. The only question is whether the accounts are correct and complete. There is no finding that the purchases have been exaggerated or the sales have been suppressed, or that any transaction has not come into the accounts. In these circumstances, the grounds stated by the Appellate Tribunal are neither valid nor relevant in rejecting the accounts of the assessee. Question No. 1 in the reference is, therefore, answered in the negative and in favour of the assessee.

24. In the circumstances of the case, there will be no order as to costs. A copy of this judgment will be forwarded to the Income Tax Appellate Tribunal in the manner required by Section 260(1) of the Income Tax Act, 1961.