

(1957) 04 PAT CK 0006

In the Patna High Court

Case No : Misc. Judicial Case No. 498 of 1955

M.A. Rauf

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 24-04-1957

Acts Referred:

Income Tax Act, 1922 — Section 66(1), 66(2)

Citation : AIR 1957 Patna 467 : (1957) 5 BLJR 487 : (1958) 33 ITR 843

Hon'ble Judges : Ramaswami, C.J;Raj Kishore Prasad, J

Bench : Division Bench

Advocate : S.N. Dutt, Syed Hasan, Narayan Prasad and B.P. Rajagarhia, for the Appellant; R.J. Bahadur, for the Respondent

Judgement

Raj Kishore Prasad, J.—This is a reference u/s 66 (2) of the Indian Income Tax Act, 1922. The Income Tax Appellate Tribunal, on being required by the High Court, has stated a case and referred it to the High Court and submitted for its opinion the following question of law :

"Whether there is material to support the assessment of Rs. 39,114/- as taxable profits of the country liquor shops for the assessment year 1946-47?"

2. The assessee has also Excise business in respect of country spirit and out-still liquor. In the present case, we are concerned with the income of the assessee from his country spirit shops only. The Assessee is a licensed vendor in country spirit, which is purchased from the Government at fixed rates and sold by the assessee at controlled rates. The assessee purchases country liquor from Government on payment of charges called ""Duty and Cost" and licence fees. The annual licence fee is paid on the total consumption of liquor after deducting the Duty and Cost paid to Government.

3. In the year under assessment, which is 1946-47, corresponding to the accounting period from 1st of April, 1945 to 31st of March, 1946, the assessee returned a net income of Rs. 5,351/- from his Excise business. The Income Tax

Officer did not accept the account-books produced by the assessee in respect of his Excise business, and, therefore, on the basis of the last year's assessment in 1945-46 made a best judgment assessment.

On appeal, the order of the Income Tax Officer was set aside by the Appellate Assistant Commissioner, who asked him to make a fresh assessment. After remand, the Income Tax Officer held that the accounts produced by the assessee were not maintained during the regular course of business, and, therefore, refused to accept the same, and, made an estimate of the assessee's income from the Excise business. With reference to the sale of country liquor, with which we are concerned in the present reference, the Income Tax Officer estimated the net profit at Rs. 39,114/- in the following manner :

"5. Country spirit shops : Sales" Rs. 7,05,383 @ 30 per cent, profit as adopted by the Tribunal in the immediately preceding assessment year.

Rs. 2,11,614

Less License fee Rs. 1,72,500

39,114".

4. The Income Tax Officer, therefore, adopted the 30 per cent, profit basis as adopted by the Tribunal in the immediately preceding assessment year 1945-46. Against this order of the Income Tax Officer after remand, which is dated 3rd March, 1953, an appeal was taken by the assessee to the Appellate Assistant Commissioner, who set aside the estimate of the Income Tax Officer in respect of the country liquor business, against this order, the assessee as well as the Department both filed separate appeals before the Appellate Income Tax Tribunal. The Tribunal disposed of the two appeals by a consolidated order dated 9th August, 1954, by which it allowed both the appeals and restored the estimate of the Income Tax Officer with respect to the country spirit shops.

5. The assessee, thereafter, made two applications u/s 66 (1) before the Tribunal for a reference to the High Court, but these applications were rejected by the Tribunal on 23rd February, 1955. The assessee then moved this Court u/s 66 (2) of the Act on which the High Court, on 17th October, 1955, required the Tribunal to state a case and refer it to the High Court on the question of law stated before.

6. Mr. S. N. Dutt, who appeared for the assessee, submitted, that there was no material before the Tribunal, and, none has been mentioned on which it could restore the Income Tax Officer's estimate of profit of Rs. 39,114/- as taxable profits of the country liquor shops of the assessee in the assessment year. He further urged that the decision of the Tribunal in the preceding year 1945-46 could not be a legal basis for making an assessment in the year under assessment. He also submitted that there was no justification for the Income Tax Officer to reject the accounts maintained and produced by the assessee.

7. In the present case, it will appear from the order of the Tribunal dated 29th

March, 1947, passed for the year 1945-46 that, as admitted by the assessee's lawyer in that case, the Income Tax Officer visited three of the 21 shops of the assessee, and, at none of these places any books of account were found, except the books prescribed by the Excise Department. The explanation offered by the assessee was that as the time of the visit was mid-day, the managers or agents of the assessee were away from the shop.

This explanation failed to dispel the suspicion entertained by the Income Tax Officer that the accounts produced before him were written up at leisure to suit the assessee's fancy and his views about Income Tax liability. The Tribunal accepted this reasoning of the Income Tax Officer for not accepting the accounts produced by the assessee, and, it further mentioned that the suspicion of the Income Tax Officer became a conviction when at one shop the agent admitted that no accounts of the type produced before the Income Tax Officer were written day to day at that shop.

In these circumstances, the Tribunal held that the Income Tax Officer had successfully demolished the assessee's position based on his account and proved the unreliability of the assessee's declarations. The Tribunal, therefore, held, that the Income Tax Officer was justified in invoking the aid of the proviso to Section 13 of the Act, which had been rightly resorted to. For ascertaining the profit with regard to the assessee's income from country liquor business, the Tribunal found that in the year 1945-46 the assessee had earned no profit, even after calculating the profit from the sales of liquor in the country liquor shops of the Assessee at 30 per cent., as will appear from the following figure given by it :

Sales in C. S. Shops 443365

Profit 30 per-cent. 133009

Less Licence fees 156000

Net losses Rs. 22,991

Rs. 69,565.

8. In the year under assessment 1946-47, the Income Tax Officer gave reasons in his order dated 3rd March, 1953, for not accepting the account books produced by the assessee in respect of his Excise business. Five account books were produced by the assessee in respect of the country spirit during the year of account. No ledger, or any other account-book was admitted to have been kept from which the capital account and the balance-sheet could be furnished.

The assessee filed extracts of receipts and expenses in respect of each of the shops, but scrutiny of the details of the sales, however, showed that the sales were noted in lump sum account, and that there were no cash memos or bills for the sales. Even for purchase of raw materials and other expenses including salaries etc., no vouchers were said to be maintained. The Income Tax Officer further observed that a perusal of the last Year's assessment would show that

the then Income Tax Officer visited three excise shops of the assessee at Bararee, and Aralgoria, but found that no account books were being maintained at those shops.

This visit was made during the previous year under assessment, that is, in March, 1946. The Income Tax Officer, therefore, concluded that as no accounts were found by the then Income Tax Officer at these shops, the inevitable conclusion was that the accounts now being produced by him had been written up later. He further observed that the assessee, in spite of huge losses that he has been declaring since several years past, has been bidding for excise contracts year after year, which fact rather went to show that as a matter of fact the assessee has been making good profit, as otherwise no sane man would continue the losing concerns.

In these circumstances, the Income Tax Officer held that the accounts produced before him had not been maintained during regular course of business, and, as such, they could not be accepted for the purpose of assessment. He, accordingly, adopted the basis of profit at 30 per cent on the sales as was done by the Tribunal in the previous year and calculating on that basis and after deducting the licence fee, he found the profit of Rs. 39,114/-, and, accordingly, he assessed the assessee on that amount.

9. On appeal to the Appellate Assistant Commissioner, he accepted the finding of the Income Tax Officer, and found that the so-called account books which had been produced before the Income Tax Officer had no probative value, because the profits could not be deducted therefrom, and, therefore, the Income Tax Officer was justified in applying the proviso to Section 13 for computing the profits by estimate.

10. The reasoning, however, given by the Appellate Assistant Commissioner for excluding the profit of Rs. 39,114/- calculated by the Income Tax Officer on the sales of country spirit was that the Income Tax Officer has not been logical in determining the net profit of nearly 5 per cent of the declared turnover as against the admitted loss of 5 per cent. determined by the Tribunal in respect of the immediately preceding accounting period. He further observed that the Duty and Costs came to Rs. 5,98,246, and, the licence fee which had been accepted by the Income Tax Officer came to Rs. 1,72,500/-, and the total of these three items came to Rs. 7,70,746/- as against the declared turnover of Rs. 7,05,383/-.

The Appellate Assistant Commissioner, however, did not accept the turnover which had been accepted by the Income Tax Officer for the purpose of the calculation of the profit from the country liquor shops on the percentage basis. He found that the turnover was not supported by cash, memoos, or, even by details of sales from day to day, and, as there was no book of original entry produced before the Income Tax Officer, he declined to accept this turnover of Rs. 7,05,383/- because, he observed, that there was after all such a thing as the dilution of liquor.

11. The Tribunal, however, on appeal against this order, did not give any detailed reason, but it contended itself by simply saying:

"With respect to the country spirit shops we do not find any reason to differ from the decision arrived at by the Tribunal in the preceding year. In fact, in the year of account, the licence fee was proportionately less. Having considered all these circumstances, in our opinion, 5 per cent, net is a reasonable profit in the sale of country liquor. We, therefore, direct that the estimate of the Income Tax Officer with respect to the country spirit shops will be restored."

12. Section 13 of the Act deals with the method of accounting. It reads thus:

"13. Mode 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 deducted therefrom, then the computation shall be made upon such basis and in such manner as the Income Tax Officer may determine."

13. On the language of the proviso to Section 13, it is plain 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, income, profits and gains cannot properly be deducted therefrom, then the Income Tax Officer is empowered to make the computation upon such basis, and, in such manner, as he may determine. This question has been examined in detail by a Bench of this Court in *Sukhdeodas Jalan Vs. Commr. of Income Tax*, :

14. The leading judgment of the Court was delivered by my Lord, the Chief Justice, Ramaswami, J., as he then was, and, I respectfully agree with the interpretation he has put on the proviso to Section 13 of the Act. His Lordship at p. 625 (of ITR): (at p. 260 of AIR) observed:

"It is clear from the language of this section that profits from the business should be computed in accordance with the method of accounting regularly employed by the assessee, but if the method of accounting regularly employed by the assessee does not reflect the true profits of the business, then the Income Tax Officer has authority to determine upon what basis the computation of profits should be made. In this context Section 3 of the Act is important.

Section 3 provides that where any Central Act enacts that Income Tax shall be charged for any year at any rate or rates, tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions of, this Act in respect of the total income of the previous year of every individual, Hindu undivided family, company and local authority, and of every firm and other

association of persons or the partners of the firm or members of the, association individually." The section indicates that the charge is created in the first instance by the annual Finance Act to be passed by the Parliament.

The annual Finance Act imposes the levy of tax and determines the rates. The Income Tax Act re-imposes the said charge and proceeds to deal with principle of assessment and machinery of assessment. The scheme and structure of the Income Tax Act, is, therefore, to make the tax an annual tax for the purpose of assessment. Section 3 makes each "previous year" a distinct unit of time for, the purpose of assessment and the profits made before or after that unit of time are entirely immaterial in assessing the profits of that year. If the provisions of Section 3 are read in the context of Section 13, it is clear that the accounts maintained by the assessee must correctly show or reflect the profits of the preceding year. If the method of accounting adopted by the assessee does not reflect the true profits of the preceding year the proviso to Section 13 will apply and the Income Tax Officer would be entitled to compute the profits upon such basis and in such manner as he may determine."

15. It is, therefore, clear from the proviso to Section 13 that if the accounts produced by the assessee, in the opinion of the Income Tax Officer, do not reflect the true profits of the preceding year, the proviso to Section 13 would apply, and, in such a case the Income Tax Officer would be entitled to compute the profits upon such basis, and, in such manner as he may determine.

16. In the instant case, the Income Tax Officer has found that in the assessment year 1945-46, the assessee did not maintain any account books, as none were produced at the time of the visit of the then Income Tax Officer, at least, in respect of three shops which he visited, and, therefore, he was justified in concluding that the, account book now produced for these shops also had been written up at a later stage. He has further given reason, which have been reproduced earlier, for holding that the account books produced by the assessee did not reflect the true profits of the previous year. In such circumstances, the Income Tax Officer was perfectly justified in applying the Proviso to Section 13 to the present case, and, in making his own estimate of the profit upon such basis and in such manner as he thought proper.

17. The Tribunal, no doubt, has not given reasons for restoring the order of the Income Tax Officer with respect to the country spirit shops, but the fact, that it has restored his order, goes to show, because it has mentioned specifically, that it found no reason to differ from the decision arrived at by it in the preceding year 1945-46. This also clearly goes to show that the Tribunal in the year under assessment, also found the account books to be unreliable, as they were found to be so in the previous year by it, for the reasons given by it in the preceding year, and, by the Income Tax Officer in the present year.

18. Now, the question arises, whether there was any material for the estimate of the profit in the year under assessment, and, whether the previous assessment

was a legal evidence which could be relied upon for the purpose of estimating the profits in the year under assessment?

19. Mr. R. J. Bahadur, who appeared for the Department, has submitted, in the first place, that the question, whether the Income Tax Officer, was well warranted in maintaining the same percentage of profit in respect of the year of assessment, was a question one of fact for him to decide, which could not be interfered with on this reference; and, in the second place he has contended that it is not a case where there was no evidence or material before these officers upon which they might make the estimate, because in the previous assessment year 1945-46, the Tribunal had adopted the basis of "30 per cent. profit on the sales of country liquor, and, the same percentage could be maintained also in the year under assessment, in the absence of any material or evidence produced by the assessee himself.

20. In support of his contention, Mr. Bahadur has relied on two Privy Council decisions in AIR 1933 198 (Privy Council) and AIR 1937 133 (Privy Council) and on a decision of the House of Lords in the Sun Insurance Office v. Clark (1912) 6 Tax Cas 59 (D).

21. In the first case, Lord Blanesburg, in considering the contention that the assertion of the Income Tax Officer as to the assessee's account being kept on the mercantile system could not in point of law be supported, observed:

"Their Lordships do not propose to discuss this question, which hardly seems to them to be one of law. Too much emphasis, has, they think, throughout the case been attached to the use by the Income Tax Officer and the Assistant Commissioner of the term "mercantile system". The finding of both in its essential substance, was that the appellant's system of accounting, by whatever name called, required the inclusion in his accounts of 1926-27 of the Rs. 90,618 referred to, and the only question open to judicial determination is whether there was any evidence before these officers upon which they might so find."

22. In the second case, their Lordships were considering the duty of an Income Tax Officer in making an assessment u/s 23(4) of the Act. Lord Russell of Killowen, in delivering the opinion of the Board, at page 180 (of ITR): (at p. 138 of AIR) observed:

"The officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly, or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by an assessment of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be guess-work in the matter, it must be honest guess-work.

In that sense, too, the assessment must be to some extent arbitrary. Their Lordships think that the section places the officer in the position of a person whose decision as to amount is final and subject to no appeal, but whose decision if it can be shown to have been arrived at without an honest exercise of judgment, may be revised or reviewed by, the Commissioner under the powers conferred upon that official by Section 33."

23. Mr. Bahadur relied very strongly on the above two cases in support of his contention that the Tribunal and the Income Tax Officer were well warranted in maintaining the same percentage in respect of the year of assessment, and, the Tribunal was justified in taking into consideration its own knowledge of previous returns by an assessment of the assessee and thereby in relying on the past records of the assessee. Mr. Bahadur, therefore, submitted that this evidence or material was sufficient to justify the Income Tax authorities to make the estimate of the profits of the assessee from country liquor shops, and, as such, it was impossible, to support the contention of Mr. Dutt that any evidence or material was wanting, and, therefore, the Tribunal had no evidence or material before it upon which it could find that the estimate of 30 per cent. profit made by the Income Tax Officer on the basis of the past assessment was correct.

24. Mr. Bahadur relied also on the decision of the House of Lords in support of his contention that the question of making an estimate was a question of fact. Lord Chancellor Loreburn, in the just mentioned third case, in addressing the House of Lords, at page 77, said:

"There is no rule of law as to the proper way of making an estimate. There is no way of estimating, which is right or wrong in itself. It is a question of fact and figure whether the way of making the estimate in any case is the best way for that case. Experience seems to have satisfied Courts of Law for a considerable time that the method which I have described as the second is a useful working rule. But no one has said in this House that there is any constraint to accept it. It may be that the character or mode of carrying on this insurance business may alter or may have altered, and what was a good method once may become inaccurate or even obsolete....."

25. The noble Lord Chancellor, in the earlier part of his address, said that:

"An estimate being necessary and the arriving at it by in some way using averages being a natural and probably inevitable expedient, the law, as it seems to me, cannot lay down any one way of doing this. It is a question of fact and of figures whether what is proposed in each case is fair both to the Crown and to the subject."

26. The noble Lord then further went on to place before the House the three methods of estimating these gains or profits, to which a reference was made in the General Accident Fire and Life Assurance Corporation Ltd. v. McGowan (1908) 5 Tax Cas 308 (E). In describing the second method which he approved, and, to which a reference is made in McGowan's case (supra) (E), the noble Lord

Chancellor said:

"The second method suggested in that case was that of merely taking for each year the sum total of the premiums received and the sum total of the losses paid subtracting the one from the other, without regard to the fact that the premiums cover risks running on into subsequent years and the losses include losses arising out of contracts made in previous years. This method is of course not precise or scientific. It proceeds upon the view that when this is done for the three consecutive years indicated by the Statute and the figures thus reached are averaged, a fair and reasonable conclusion is attained.

This method was adopted long ago and has more than once been the subject of consideration in Courts of law. I can conceive it being unfair either in the case of rapidly increasing or of a rapidly diminishing fire insurance business. It may prove unfair in other cases. But in McGowan's case (E) it was not proved to be unfair. On the contrary it closely corresponded with the dividends actually, distributed and was upon the facts of that case clearly the most accurate and reasonable of the methods which alone were propounded for our consideration. Accordingly it was adopted.

I think it is in general a good working rule, but no one in this House has said that it ought to supersede the truth if the truth is in conflict with it in any case."

27. From these high authorities, therefore, it is manifestly clear that there is no rule of law as to the proper way of making an estimate. The only rule of law is that the true gains are to be ascertained as nearly as it can be done. There is no way of estimating, which is right or wrong in itself. It is a question of fact and figure whether the way of making the method, in any case, is the best way for that case. In making the estimate, the Income Tax Officer acts u/s 23(4) of the Act, and, he is required under it to make an estimate to the best of his judgment against a person, who is in default as regards supplying information.

He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by, and assessments of, the assessed, and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be guess-work in the matter, it must be, honest guess-work.

It is open to the Income Tax Officer, therefore, to maintain the same percentage in respect of the year of assessment when the assessment at a flat rate of profit at a certain percentage in the preceding year or years has been adopted, and, the objection of the assessee to such an assessment taken by him has been rejected in the preceding years. The Income Tax Officer, therefore, is well warranted in maintaining the same percentage in the year of assessment, and, in taking into consideration the past records of an assessee, provided there is some evidence or material before the Income Tax authorities for making the best

judgment assessment, and, it is not absolutely arbitrary, although in that sense too assessment must be to some extent arbitrary.

28. For these reasons, I would reject the contention of Mr. Dutt and affirm the order of the Tribunal.

29. I, would, therefore, answer the question referred to us in the affirmative against the assessee and in favour of the Department. The assessee must pay the costs of this reference, which is assessed at Rs. 200/-.

Ramaswami, C.J.

30. I agree.