
(1971) 03 AHC CK 0036

In the Allahabad High Court

Case No : Income-tax Reference No. 337 of 1966

Raza Textiles Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 23-03-1971

Acts Referred:

Income Tax Act, 1922 — Section 13

Citation : (1972) 86 ITR 673

Hon'ble Judges : R.S. Pathak, J;H.N. Seth, J

Bench : Division Bench

Advocate : B.L. Gupta and Ashok Gupta, for the Appellant; R.R. Misra, for the Respondent

Final Decision : Dismissed

Judgement

Pathak, J.—The Income Tax Appellate Tribunal has referred the following question u/s 66(2), Indian Income Tax. Act, 1922 :

"Whether there was any material on the record for not accepting the shortage in the production of yarn and in the production of cloth as disclosed by the assessee and what was the basis of the estimate of shortage made by the Income Tax Tribunal ?"

2. The case relates to the assessment year 1950-51, for which the relevant previous year is the year ending December 31, 1949. The assessee is a public limited company incorporated in 1948, under the Rampur Companies Act and having its registered office at Rampur. It operates a textile unit at Rampur in which both spinning and weaving are carried on. The State of Rampur merged into the Dominion of India in 1949.

3. For the assessment year 1950-51, which was the first assessment year under the Indian Income Tax Act, 1922, in respect of the assessee, the assessee filed a return showing a net loss of about Rs. 4,93,191. The Income Tax Officer, however, applied the proviso to Section 13 of the Act and estimated the total

income of the assessee at Rs. 82,437. By his assessment order dated December 13, 1945, he added back a sum of Rs. 2,58,541 on account of unexplained shortage in the production of yarn and cloth. On appeal by the assessee, the Appellate Assistant Commissioner reduced the addition to Rs. 36,711. Both the assessee and the Income Tax Officer then appealed to the Income Tax Appellate Tribunal, but the Tribunal confirmed the decision of the Appellate Assistant Commissioner.

4. Learned counsel for the assessee contends that there is no justification for applying the proviso to Section 13, especially having regard to the detailed records maintained by the assessee. We shall now proceed to examine this contention.

5. The account books maintained by the assessee disclose that 51,23,346 lbs. of cotton were issued to the mill. Out of this, 50,60,550 lbs. of cotton were put into the machinery for the manufacture of yarn, the balance of 72,796 lbs. being claimed as shortage on account of the drying up of moisture. The total quantity of yarn manufactured was 40,42,517 lbs. The manufacturing wastage was thus shown as 10,08,033 lbs. The waste product obtained was 7,56,257 lbs. On this basis the overall refraction worked out at 19.96%, The dust matter and fine cotton particles amounted to 2,51,776 lbs., which worked out to 5% over and above the shortage of 1.5% for moisture. The return filed by the assessee proceeded on that basis. The Income Tax Officer considered the shortage disclosed in the production of yarn as excessive. He took the normal refraction at 18% and valuing the yarn shortage at Rs. 1-8-0 per lb. he added Rs. 1,48,407. This was in respect of yarn. In regard to the production of cloth, the Income Tax Officer found that on the assessee's claim the percentage increase in the weight of yarn after treating with sizing material worked out to 3.5%. The percentage of the sizing material applied worked out to 11%, and the Income Tax Officer holding that after making an allowance of 3% for the dropping of sizing material and a further 3% for hard waste considered that the increase should have been 5% and not 3.5% shown by the assessee. He valued the excess shortage of 1.5% at Rs. 1-4-0 per lb. and, therefore, added Rs. 1,10,134.

6. The Appellate Assistant Commissioner allowed the shortage in yarn at 4.5% and thus reduced the addition in respect of yarn to Rs. 1,20,000, As regards cloth he held that the net increase after the addition of sizing material should have been 4% and not 5%, and on this account also reduced the addition to Rs. 36,711.

7. When the case came on before the Tribunal, it was urged on behalf of the assessee that there was no ground for applying the proviso to Section 13 inasmuch as the records maintained by the assessee were complete and free from defect, and there was no justification for making any addition either for shortage of yarn or for shortage of cloth. It was pointed out that the records maintained by the assessee showed the amount of the ginned cotton purchased, the amount of cotton sent to the blow room, the weight of soft waste found in

the blow room after the moisture was blown off, the weight of cotton actually processed into yarn and the weight of yarn produced. The Tribunal, however, did not accept the contention. The Tribunal, on the other hand, upheld the submission of the revenue that the proviso to Section 13 was attracted because although the assessee could be said to have a complete record of the ginned cotton that was purchased and the cotton that was processed into yarn there was no record of the intangible waste and the dust that was stated to have fallen out in the blow room. It was conceded on behalf of the revenue that although intangible additions could not be made and the dust as a matter of rule was never weighed but, it was said, that did not exonerate the assessee from maintaining the proper records in that regard. It was urged on behalf of the assessee that the percentage of refraction was dependent on the quality of the cotton used and, it was pointed out, that the assessee had used during the accounting year much inferior variety of cotton known as Jarilla and Malvi cotton, and a table was filed showing the percentage of refraction in the case of different qualities of cotton at various stages in the blow room, carding and other departments, from which it appeared that the average percentage of refraction should have been 21.9% during the accounting period. The Tribunal did not accept the data as affording adequate guidance. It reasoned that the actual refraction would depend upon the weight of the particular quality used. It also pointed out that the table was based on an experiment carried out with a ten lbs. sample, and could not reflect conditions obtained in a mill where the manufacturing process was carried out in bulk, in which case the shortage would be, according to the Cotton Committee's Report, much less. The Tribunal examined the data showing the yarn and cotton consumed, the resultant production and the percentage of shortages worked out for the years 1946 to 1950. It also perused an extract from the brochure on the textile industry in India, supplying information on the production of yield in the cotton industry taken into account by the Indian Tariff Commission. On the basis of the data before it, it held that the shortage shown by the assessee in respect of the production of yarn during the accounting period was excessive, and that having regard to the percentages of shortage in the assessee's mill during the other years, the refraction of 18% adopted by the Income Tax Officer and the consequent shortage at 4.5% adopted by the Appellate Assistant Commissioner appeared to be reasonable.

8. As regards the cloth account also, the Tribunal sustained the application of the proviso to Section 13. It was impressed by the point made by the revenue that as no register for the supply of yarn by the spinning department to the weaving department was maintained by the assessee, no co-relation between the supply of yarn and the production of cloth could be established. It observed that while the proportion of sizing material applied during the relevant accounting year was the same as for 1951-52, that is, 11%, the net increase in weight shown by the assessee for 1950-51 was merely 3.5% as compared to 9.6% for 1951-52. It took note of the percentage of increase in subsequent years, it being 5.8% for

1952-53, 5.3% for 1953-54 and as much as 15% for 1954-55. In the circumstances, it observed that the net increase in weight at 3.5% for the relevant year was low. On behalf of the assessee an explanation was put forward that the percentage increase in the weight of cloth depended on the quality of the sizing material used, and that the sizing material used during the relevant accounting period included a large proportion of bajra starch and paraffin wax which fell off from the yarn and reduced the increase in weight. It was said that in 1951-52 and other years the sizing material had included a larger proportion of maize starch and gum by reason of which the weight of yarn showed a comparative increase, the retentive quality of the sizing material being greater. The Tribunal, however, did not accept the explanation, and sustained the increase in weight at 4% taken by the Appellate Assistant Commissioner.

9. In regard to the production of yarn, the Tribunal has applied the proviso to Section 13 for the reason that the assessee did not maintain a record of the intangible waste and dust which had fallen out in the blow room. This is in spite of the admission on behalf of the revenue that such intangible additions could not be made and that the dust was as a matter of rule never weighed. The Tribunal concedes that the proviso to Section 13 becomes applicable in a technical sense only. It is difficult to appreciate what it means by that. When admittedly the dust is not weighed and it is not possible to determine the amount of the intangible waste, it is difficult to see how the absence of such a record can be employed to justify the application of the proviso to Section 13. The question was considered by the Bombay High Court in *R.B. Bansilal Abirchand Spinning and Weaving Mills Vs. Commissioner of Income Tax, Poona*, and the observations contained there fully support the view we are taking. In that view of the matter, the mere circumstance that the shortage worked out for the relevant year varies somewhat from the figures in other years does not by itself justify the rejection of the books of the assessee concerning the production of yarn.

10. In respect of the production of cloth, it does appear that in the absence of a register showing the supply of yarn made from the spinning department to the weaving department it is not possible to determine whether the production of cloth shown in the books can be depended upon. The assessee drew our attention to the statement appended as annexure "J" to the statement of the case, which shows that the yarn issued to the weaving department was 39,95,306 lbs. This, however, does not appear to emerge from the entries contained in any original record. It is the result deduced by deducting the amount of yarn issued to the hosiery department from the amount of total yarn produced. After taking into account the difference on account of the opening balance and the closing balance in process, the net quantity of yarn shown to have been received by the weaving department has been worked out at 39,65,510 lbs. It is this figure which has been shown against the entry, "yarn issued to weaving department", in the statement appended as annexure "G". We are satisfied that the proviso to Section 13 is attracted. Having regard to the percentage of increase in subsequent years, we can see no mistake in law in the

Tribunal sustaining the increase in weight at 4% for the relevant year.

11. Before we close, we may refer to the cases placed before us on behalf of the assessee. Those cases are C. Arumugaswami Nadar Vs. Commissioner of Income Tax, Madras, , Harakchand Radhakisan Vs. Commissioner of Income Tax, Assam, , K.M. Adam, Madras Vs. Commissioner of Income Tax, Madras, , Chhabildas Tribhuvandas Shah and Others Vs. Commissioner of Income Tax, West Bengal, , B.F. Varghese (No. 2) Vs. State of Kerala, and St. Teresa's Oil Mills Vs. State of Kerala, , With the exception of Chhabildas Tribhuvandas Shah v. Commissioner of Income Tax, the remaining cases are those where the court held that the Tribunal erred in accepting the account books of the assessee. Having perused the judgment in each case, we are of opinion that they are clearly distinguishable. In Arumugaswami Nadar's case, the court expressed the view that in the case of match manufacturing, in view of the difficulties obtaining in manual manufacture, the maintenance of a daily mixture account could not possibly help in the co-relation of the issues of chlorate with the manufacture of matches, and consequently not much weight could be attached to an absence of a daily mixture account. This is a consideration which can hardly be said to arise in the case before us.

12. In Harakchand Radhakisan v. Commissioner of Income Tax, the only consideration upon which the Tribunal had proceeded was that the rate of yield for the relevant year should have been higher when compared to the yield of the preceding year. There can be little doubt that no manufacturing business can expect the same rate of production year after year. Any serious deviation between the figures of the preceding year and the relevant year could, however, legitimately put the revenue authorities on enquiry and if there is no adequate explanation to support the deviation the inference that the books are not reliable can be drawn.

13. In K. M. Adam v. Commissioner of Income Tax, the assessee dealt in snake skins which had a foreign market only and it rejected several skins as being not up to the standard for the foreign market. The revenue authorities held that the rejections shown by the assessee were excessive. The court held that in a case where a trader deals in a particular line of business which commands a foreign market only and he constantly attempts to maintain a certain standard in the goods which he exports in order to retain that market there is no reason why the rejections shown by him should not be accepted, specially in the absence of any material indicating that he had sold the commodity and made income thereby. The decision in this case turned upon its peculiar facts.

14. In B.F. Varghese (No. 2) Vs. State of Kerala, the assessee derived income from pepper. In this case also, the High Court pointed out that, as the yield from pepper vines varied from year to year to a large extent, a comparison with the preceding year's figures could not serve as a legitimate test. Here again, the decision turned on the peculiar nature of the commodity dealt in.

15. In *St. Teresa's Oil Mills Vs. State of Kerala*, the only factor on the basis of which the accounts were rejected was the disparity in the consumption of electricity. The court held that this factor itself without any supporting circumstance could not justify the rejection of the accounts. In our opinion, this consideration is not present in the case before us.

16. In the absence of a register indicating the supply of yarn issued from the spinning department to the weaving department it is plain that there is no possibility of co-relating the supply of yarn and the production of cloth. Therefore, there was no way of checking whether the production of cloth shown in the books represents the true figure of production. The system of records adopted by the assessee is inadequate and does not afford an effective method of determining the true income, profits and gains so far as the production of cloth is concerned. There is also the circumstance that the net increase in weight for the relevant years is far below than in other years and the explanation attempted by the assessee in this behalf has not been accepted by the Tribunal. In *Chhabildas Tribhuvandas Shah and Others Vs. Commissioner of Income Tax, West Bengal*, the Supreme Court laid down that where there was material to support the finding of the Tribunal underlying the rejection of the accounts of the assessee, no question of law arose. In cases involving the applicability of the proviso to Section 13, it observed, the question to be determined by the revenue authorities was a question of fact, namely, whether the income, profits and gains could or could not be properly deduced from the method of accounting regularly adopted by the assessee.

17. Accordingly, we hold that there was no material on the record for concluding that there was an undisclosed shortage in the production of yarn, but in regard to the production of cloth there was material on the record for not accepting the shortage disclosed by the assessee, and we further hold that in estimating the shortage in the production of cloth the Tribunal adopted a reasonable basis. The question referred is answered accordingly.

18. In the circumstances, there is no order as to costs. Counsel's fee is assessed at Rs. 200.