

(1973) 02 MAD CK 0038

In the Madras High Court

Case No : Tax Case No. 135 of 1967 (Reference No. 48 of 1967)

V. Rajan

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 15-02-1973

Acts Referred:

Income Tax Act, 1961 — Section 66(2)
Tamil Nadu General Sales Tax Act, 1959 — Section 16

Citation : (1974) 96 ITR 64

Hon'ble Judges : V. Ramaswami, J;G. Ramanujam, J

Bench : Division Bench

Advocate : S. Padmanabhan, for the Appellant; V. Balasubrahmanyam and J. Jayaraman, for the Respondent

Judgement

Ramanujam, J.—The assessee is a Hindu undivided family carrying on business in ginning and sale of cotton. It owned a ginning factory. For the assessment year 1960-61, it returned a net loss of Rs. 5,391. On a scrutiny of the assessee's accounts, the Income Tax Officer found the following discrepancies between the stock account and the stock declaration given by the assessee to the bank as on December 31, 1959 :

Quantity pledged with the bank Stock as per book

Cotton 80 candies 20 candies

Cotton seeds 3,500 bags. 2, 100 bags

Kappas 900 pothis nil

2. The assessee was called upon to explain the above discrepancy. The assessee's explanation was as follows :

So far as cotton was concerned, there was a sale of 112 candies on December 31, 1959, and if the stock of cotton is taken into account, the actual stock as per the assessee's books of account would be 132 candies. As regards the cotton

seeds, the assessee stated that there was a sale of 104 bags on December 31, 1959, and if this was taken into account, there would be a stock of 2,204 bags. The declaration to the bank was made only on a rough estimate of the stock without any physical verification. It was also stated that the assessee inflated the stock of cotton seeds for the purpose of obtaining a higher loan from the bank and this is a normal practice resorted to by the ginning factories to cover the loan desired by them. As regards the stocks of kappas, the assessee stated that it had in its possession 153 pothis belonging to the customers who brought the same for ginning and this stock was inflated and shown as 900 pothis in the declaration given to the bank with a view to get a higher loan.

3. The Income Tax Officer accepted the explanation of the assessee only as regards the discrepancy in the cotton stock, but he did not accept the assessee's explanation with regard to the discrepancies in the stocks of cotton seeds and kappas. He took the view that there must have been large transactions in cotton seeds and kappas outside the books and the income from these transactions had not been accounted for in the books of account. He, therefore, estimated the income from these transactions at Rs. 1,23,000 and added to the income returned by the assessee.

4. For the assessment year 1961-62, the assessee had filed a return admitting an income of Rs. 41,237. Taking the addition made to the income for the assessment year 1960-61, the Income Tax Officer estimated the profit from the transactions outside the accounts in the assessment year 1961-62 at Rs. 6,150 and added that amount to the income declared by the assessee.

5. The assessee preferred appeals to the Appellate Assistant Commissioner against the said additions made by the Income Tax Officer in the assessment years 1960-61 and 1961-62. The Appellate Assistant Commissioner, however, felt that the discrepancies in respect of cotton seeds and kappas were due to the fact that the assessee has resorted to the inflation of the stocks as on December 31, 1959, for the purpose of raising a higher loan from the bank, and that the Income Tax Officer is not justified in rejecting the explanation of the assessee. In that view, the Appellate Assistant Commissioner set aside the additions made in both the years.

6. The revenue filed appeals before the Tribunal contending that the Appellate Assistant Commissioner was not justified in accepting the assessee's explanation with regard to the discrepancies between the stock shown as pledged to the bank and the stock as per the assessee's books as on December 31, 1959. As the Income Tax Officer has accepted the explanation given by the assessee as regards the discrepancy in the stocks of cotton as on December 31, 1959, the Tribunal considered only the discrepancies in the stocks of cotton seeds and kappas. As regards the discrepancy in the stock of cotton seeds, the Tribunal took note of the fact that the loan from the bank was an open loan, that the stock of cotton seeds actually continued to be in the physical possession of the assessee, that in view of the nature of the loan it is possible that the stocks

should have been inspected by the bank in a cursory manner and that the discrepancy might be due to a rough estimate made of the total stock. In that view, the Tribunal chose to accept the assessee's explanation as regards the discrepancy in the stock of cotton seeds. With regard to the discrepancy in the stocks of kappas, however, the Tribunal was not inclined to accept the assessee's explanation that the stocks were inflated for the purpose of getting a higher loan from the bank. Therefore, the Tribunal set aside the order of the Appellate Assistant Commissioner and restored the additions made by the Income Tax Officer to the extent of Rs. 70,000 for the year 1960-61 and Rs. 3,500 for the year 1961-62.

7. Having failed to get a reference from the Tribunal, the assessee moved this court for a reference u/s 66(2) of the Income Tax Act and the following questions have been referred by the Tribunal on the directions of this court:

"(i) Whether the Tribunal had any material to hold that 500 pothis of kappas were held by the assessee as stock of kappas ? and

(ii) Whether the finding of the Tribunal that the assessee possessed stock of 500 pothis outside the books, is legally justified ?"

8. Before us, the learned counsel for the assessee contends that there was no material before the Tribunal to hold that there was, in fact, any excess stock of kappas over and above the stocks disclosed in its books of account and that the declaration given to the bank cannot at all be taken as the basis for making any addition, for it is an usual practice for the ginning factories to inflate their stocks for the purpose of raising higher loans from the banks, especially when the loan is an open loan, and that an estimate cannot be based merely on the basis of such declaration without any material to infer that the assessee should have indulged in purchase and sales of kappas outside the books of account. According to the learned counsel, there is no finding by any of the authorities including the Tribunal that the books of account of the assessee were either defective or incomplete and if the account books have not been rejected, the book results should themselves have been accepted. The learned counsel also explained as to why the book results should be accepted in this case, notwithstanding the above discrepancy in the stocks of kappas as on December 31, 1959.

9. It is stated that 1960-61 is the first year of assessment after the joint family had started the business and that it could not have acquired such huge stocks of kappas as shown in the stock declaration given to the bank.

10. Next, it is stated that the assessee is not selling kappas as such, but it deals only in ginned cotton and, therefore, the stocks of cotton shown in the statements of the bank could have been sold as kappas without ginning. It is then stated that the electricity consumption in the ginning factory during the relevant period, will clearly show that no extra stock of kappas could have been ginned in that factory.

11. We find that the Tribunal has considered the above three circumstances pointed out by the learned counsel for the assessee, and it has held that though 1960-61 is the first assessment year after the assessee has started the business, it is not possible to assume that the stocks of kappas could not have been purchased by the firm. The Tribunal took note of the fact that though the Hindu joint family had just started to run the business as a separate concern, earlier the eldest member of the family had carried on the same business with his brother as a partnership concern. The Tribunal also considered the assessee's case that it was not selling kappas at any time, but actually found that the books of the assessee did disclose sales of kappas as such, and that, therefore, it is possible for the assessee to have sold the excess stocks of kappas. The Tribunal, therefore, felt that the consumption of electricity would not be quite relevant for the purpose of deciding whether the assessee was in possession of the stocks of kappas in excess of the stocks shown in its books of account. As regards the assessee's explanation that the stocks had actually been inflated for the purpose of raising a loan from the bank, the Tribunal felt that even if there is such a practice prevailing in the trade, inflation to such an extent could not have been possible in the case of the stocks of kappas as the stocks had been verified by the bank authorities.

12. The Tribunal took note of the following circumstances : The bank had informed the Income Tax Officer by its letter dated August 2, 1962, to the effect that the officers of the bank had inspected the assessee's stocks on December 30, 1959, and had actually found it to agree with the stocks declared by the assessee as on that date. This, according to the Tribunal, showed that the stocks should have actually been inspected by the officers at the assessee's ginning factory. Another letter had been sent by the bank to the Appellate Assistant Commissioner on October 4, 1962, to the effect that there was no actual weighing of stocks at the stage of verification, but only a rough estimate was made as to the quantity of the stocks. From this letter, the Tribunal felt that the inspection of the stocks on December 30, 1959, referred to by the bank in its earlier letter could have been only of a cursory nature. With this background, the Tribunal considered the explanation given by the assessee as regards the discrepancy in the stocks of kappas. The Tribunal was inclined to accept the assessee's case that 153 pothis of kappas belonging to its customers had been hypothecated to the bank and shown in the declaration. Even then, the discrepancy was 747 pothis of kappas. Having regard to the fact that the bank had stated that there was inspection and verification of the stocks as on December 30, 1959, the Tribunal was not inclined to accept the position that a stock of 153 pothis would have been inflated to 900 pothis and that the bank had accepted the stock of 153 pothis as stock of 900 pothis. If there was such a large inflation, it could have been easily found out by the bank officials. The assessee put forward a plea that the stocks of kappas could not be properly estimated for the reasons that the stocks are normally kept loose and it is possible to over-estimate the stocks even by the bank officials. This the Tribunal was not inclined

to accept in view of the large variation between the declared stock and the actual stock. The Tribunal also took note of the varying explanations given by the assessee at different stages. Before the Income Tax Officer, its explanation was that there was inflation of stock for the purpose of getting the loan from the bank. In the appeal before the Appellate Assistant Commissioner in addition to this explanation, it also said that the discrepancy was due to anticipated arrivals of fresh stocks of kappas. But, the actual explanation given by the assessee at the time of hearing before the Appellate Assistant Commissioner was that it had made only a rough estimate of the stocks available and that there was a tendency to over-estimate the stocks for getting a larger loan. These varying explanations were taken by the Tribunal, as showing that they had been offered according to its own convenience and that they cannot be true.

13. It is true, as pointed out by the assessee's learned counsel that the books of account produced by the assessee had not been commended upon adversely by any of the authorities and they have only proceeded on the basis of the stocks declaration made by the assessee to the bank showing a large discrepancy between the stocks held by the assessee and the stocks declared to the bank. In view of the said discrepancy in the stocks, though there was no specific rejection of the books of accounts of the assessee, it can be inferred that the Income Tax Officer was not inclined to accept the book results and chose to make an estimate on the basis of the declaration given by the assessee to the bank. One of the circumstances as to why the book results had not been accepted is the large variation between the stocks disclosed in the books and the stocks shown in the declarations given to the bank. The assessee's explanation for such variation in the stocks had not been accepted by the Income Tax Officer as well as by the Tribunal so far as the kappas are concerned, for the reasons set out above. If the assessee's explanation for the large discrepancy in the stocks is not accepted then the stock declaration given by the assessee to the bank will be a material to reject the assessee's books of account and for making an estimate.

14. The learned counsel for the assessee refers to the decision in *India Motor Parts and Accessories Ltd. (P), Madras Vs. The Commissioner of Income Tax, Madras*, in support of his submission that the statement of stocks given to the bank for purposes of securing a loan cannot be taken as the basis for making an addition to the income returned. In that case, the assessee dealt with spare parts of motor cars, the import of which was banned. The articles were valued at higher prices for purposes of obtaining overdrafts from banks but the assessee had valued them notionally which was less than their cost price. The question was whether the method of accounting adopted by the assessee could be rejected and the value of the closing stock given in the books of account should be enhanced. This court held that the figures furnished by the assessee to the banks for obtaining overdrafts were not concerned with the actual stock valuation for determining the trade results for purposes of maintaining the profits derived from the business, and that the method adopted by the assessee of valuing closing stocks at a notional figure not having been shown as improper or patently

false, that method could not be rejected merely on the basis of, the stocks given to the bank. The decision in that case proceeded on the basis that the valuation of stocks for obtaining loan from the bank will not detract from the regular method adopted by the assessee of valuing the closing stock at a notional figure having regard to the market conditions.

15. In our view the said decision cannot apply to the facts of this case where there has been a large discrepancy in the stocks disclosed by the books and the stocks declared to the bank, giving room for doubt as to the correctness of the entries made in the assessee's accounts.

16. Reference is also made to a decision of this court in *State of Tamil Nadu v. Indian Crafts and Industries*, [1970] 25 S.T.C. 466, to which one of us was a party. In that case the assessee, in order to obtain a quota to import a higher quantum of raw material, inflated production figures in his application to the Director of Industries and Commerce. But he was always granted by the Director of Industries only less than 1/4th of the quantum applied for. The actual quantity allotted has been properly accounted for in the books of the assessee. But the assessing officer, relying on the figures furnished in the application for import licence, reopened the assessment of the assessee u/s 16 of the Tamil Nadu General Sales Tax Act on the ground that the account books did not reflect properly the actual production. The Sales Tax Tribunal held that there was no suppression. This court, on a revision by the State, held that merely because the assessee conducted himself in a manner which was not conducive to ethics, the taxing officer could not invoke the provisions of reassessment and penalise him, and that the finding of the Tribunal that the assessee utilised in his business only the actual quantum of raw material granted by the Director of Industries and that had been duly accounted for in the books of account was essentially a finding of fact which could not be interfered merely on the basis of suspicion. In that case, the Sales Tax Appellate Tribunal, which is the final fact-finding authority, has held that the assessee had received only less than 1/4th of the quantity applied for and that has been duly accounted for by the assessee and this has been accepted by this court. On these findings, it was held that the statement made by the assessee in his application to the Director of Industries asking for higher quantity cannot be a ground for reopening the assessment completed earlier. The decision in that case clearly proceeded on the basis of the finding given by the Tribunal that though the assessee applied for a larger quantity he got only a lesser quantity which has been duly accounted for by the assessee. Therefore, this decision cannot be of assistance in this case where there is no finding that there was actual inflation of stocks.

17. Our attention has been drawn also to a decision of the Gujarat High Court in *Mahendra Mills Ltd. v. P.B. Desai*, Appellate Assistant Commissioner, [1971] 791.T.R. 52 . But we find that the said decision does not touch the question involved in this case. In the statement of facts of that case, except the fact that the Income Tax Appellate Tribunal had accepted a similar explanation given by

the assessee, there is no other discussion on the point in question.

18. The learned counsel also referred to a decision rendered by us in Tax Cases Nos. 45 of 1967 and 122 of 1968, Commissioner of Income Tax, Madras Vs. Ramkrishnan Mills (Coimbatore) Ltd., In that case an addition came to be made to the assessee's income on the ground that there was discrepancy in the stocks as disclosed in the books and the stocks declared to the bank by the assessee. The Tribunal set aside that addition on the ground that the book entries regarding the stocks tallied with the returns submitted by the assessee to the Textile Commissioner at Bombay and that in view of a contemporaneous document showing the book entries to be correct, the declarations made to the bank could only be treated as rough estimates and cannot form the basis for making the addition. This court upheld the decision of the Tribunal holding that the explanation given by the assessee that the stock declarations given to the banks were only rough estimates and not accurate, should be accepted in the face of the returns submitted by the assessee to the Textile Commissioner at Bombay which corroborated the entries in the stock books. This decision cannot be taken to be an authority recognising the so-called commercial practice of inflating the value of stocks for the purpose of getting higher loan from the bank, as urged by the assessee's counsel.

19. We, therefore, find that none of the decisions cited by the assessee's learned counsel establish the proposition that the stock declarations given to the banks for the purpose of raising a loan cannot under any circumstances form the basis for rejection of the assessee's accounts and for making an estimate ignoring the book results.

20. It cannot be disputed" that if there is actual discrepancy in the stocks of kappas the assessee has to explain the same, as otherwise the assessee's accounts showing a lesser stock cannot be accepted in the face of its solemn declaration made by the assessee to the bank showing a larger stock. If there is no proper and acceptable explanation forthcoming from the assessee, the Income Tax Officer is justified in rejecting the accounts on the basis of the said stock declarations. In this case the assessee gave various explanations, the main explanation being that stocks on hand were actually inflated for the purpose of getting a higher loan from the bank. The Tribunal was not inclined to accept this explanation in view of the fact that the variation was so large. The learned counsel for the assessee submits that the Tribunal having accepted such explanation as regards stocks of cotton and cotton seeds, it had no justification in rejecting that explanation so far as kappas are concerned. But the Tribunal has held that, so far as the cotton stocks are concerned, there was in fact no excess and that as regards the stocks of cotton seeds, the assessee and the bank officials might have made a rough estimate of the stocks without physical or actual verification. The Tribunal had in fact not accepted the explanation that the stocks were inflated for the purpose of getting loan, as stated by the learned counsel for the assessee. Even if it is so, it cannot be said that the Tribunal

should have accepted that explanation even as regards stocks of kappas. The Tribunal has not chosen to accept the explanation in view of the large variation in the stocks in kappas between the book entries and the stock declarations given to the bank.

21. The question, therefore, is whether the Tribunal was right in rejecting the explanation given by the assessee. As pointed out by the Supreme Court in *Newton Chikli Collieries Ltd. Vs. Commissioner of Income Tax, Madhya Pradesh and Bhopal*, :

"It was for the Income Tax authorities to consider the correctness or otherwise of these explanations, and if the Income Tax authorities chose not to accept these explanations as correct, that does not mean that the finding.....at which they arrived was a finding based on no material."

22. In that case, the assessee showed under the head "wages and salaries" a sum which was considerably more than the amount shown under that head in the previous year. The Income Tax authorities rejected the explanation given by the assessee for the absence of receipts for payments and held that the wages had been inflated, and added back those amounts to the income. The Supreme Court expressed the view that the finding of the authorities that the wages had been inflated was a finding of fact and that the non-acceptance of the explanation given by the assessee could not convert the question of inflation of wages which was essentially a question of fact into a question of law.

23. Though for deciding the questions referred to us in this case we have to go into the facts, the field of interference is considerably limited, for this court is not exercising the powers of an appellate court. Though the learned counsel may be right in his submission that there is no positive material to establish that 500 pothis of kappas were held by the assessee on December 31, 1959, the Tribunal is justified in proceeding on the basis of the entries made in the declarations given by the assessee to the bank. The Tribunal has chosen to give an estimate after giving due allowance for the probable inflation which the assessee could have made.

24. We are not, therefore, in a position to say that there was no material for the Tribunal to hold that there were unaccounted stocks of kappas on December 31, 1959. In this view, we have to answer both the questions referred to us in the affirmative and against the assessee. The assessee will pay the costs of the revenue. Counsel's fee. Rs. 250.

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