

Cit Vs. Sanjeev Woollen Mills

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Court : Mumbai

Decided On : Dec-11-2002

Reported in : [2003]127TAXMAN209(Bom)

Appeal No. : IT Appeal Nos. 9 & 10 of 2001 11 December 2002

Appellant : Cit

Respondent : Sanjeev Woollen Mills

Advocate for Pet/Ap. : R.V. Desai, P.S. Jetly and R. Asokan, *for the Revenue*
Ms. Shobha Jagatiani and Ms. Bina Pillai, *for the Assessee.*

Judgement :

S.H. Kapadia, J.

Both the above appeals under section 260A of the Income Tax Act, 1961 are taken up together as they deal with common questions of law and facts. Appeal No. 9 of 2001 concerns assessment year 1992-93 whereas, Appeal No. 10 of 2001 concerns assessment year 1993-94. For the assessment year 1992-93, the assessee valued the opening stock at the market rate of Rs. 90 per kg. and they valued the closing stock at a higher market rate of Rs. 130 per kg. and, accordingly, for the assessment year 1993-94, the assessee valued the opening stock at Rs. 130 per kg. There was no closing stock for the assessment year 1993-94. Therefore, the main point which arises for determination is whether

valuing the closing stock at higher market price was done by the assessee to avail excess deduction under section 80HHC for assessment year 1992-93 and to suppress the profits of the subsequent assessment year 1993-94.

2. Accordingly, the following questions of law arise for determination :

'1. Whether, on the facts and in the circumstances of the case and in law, the Honourable Income Tax Appellate Tribunal was justified in holding that the higher market rate method of valuation of closing stock adopted by the assessee is correct, without appreciating that acceptance of the said method has resulted in a doctored abnormal gross profit ratio of 2054.60 per cent which, by no yard stick of the basic principles of accountancy can be held as proper reflection of income

2. Whether, on the facts and in the circumstances of the case and in law, the Honourable Income Tax Appellate Tribunal was justified in holding that the assessee has followed the market rate method for valuation of closing stock for several years, therefore, the same cannot be disturbed by the assessing officer, without appreciating that section 145 of the Income Tax Act fully empowers (sic) the assessing officer to alter the method of accounting adopted by the assessee if he has reason to conclude that the correct income cannot be deduced from the said method ?

3. Whether, on the facts and in the circumstances of the case and in law, the Honourable Income Tax Appellate Tribunal was justified in holding that the decision of Supreme Court in the case of *Mc. Dowels & Co. Ltd. v. CTO* : [1985]154ITR148(SC) is not applicable and in missing to appreciate that the Honourable Supreme Court has clearly laid down that any colourable device cannot be the part of tax planning and it is wrong to entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods.'

Facts for the assessment year 1992-93

3. The respondent-assessee is a firm engaged in the manufacture and export of blankets. For the assessment year 1992-93, the gross sale including exports were shown in the returns filed by the assessee at Rs. 34,70,405.90. The closing stock

was calculated at Rs. 130 per kg. amounting to Rs. 8,69,13,158. On the other hand, the opening stock was shown at Rs. 90 per kg. amounting to Rs. 1,13,36,831 and, consequently, the gross profit was shown as Rs. 7,13,03,219.99. (See page 11 of the paper book in Income Tax Appeal No. 9 of 2001). The next profit was shown by the assessee accordingly, at Rs. 6,40,11,915 (See page 21 of the paper book in Income Tax Appeal No. 9 of 2001). The assessing officer found, on the basis of the above calculations, that the assessee had valued the opening stock at Rs. 90 per kg. and the closing stock at Rs. 130 per kg. whereas, in fact, the goods were sold at Rs. 136 per kg. The assessing officer further found, on the above calculation, the gross profit ratio of 2054.60 per cent. Under the circumstances, the assessing officer concluded that the method followed by the assessee in valuing the closing stock at market rate gave a distorted picture in the sense that the assessee had artificially inflated the profits in order to get the benefit of deduction under section 80HHC. He further found that in the subsequent assessment year 1993-94, the assessee had valued the opening stock at Rs. 130 per kg. and consequently, the assessee has filed a return of loss of Rs. 54,420. Therefore, the assessing officer concluded that the entire exercise was a device to avail excess deduction in the first year and to suppress the profits in the Second Year. In the circumstances, the assessing officer computed the total income by applying the principle of 'Lower of cost or market value'. Consequently, the assessing officer reduced the gross profits from Rs. 7,13,03,219.99 to Rs. 4,45,64,939 by valuing the opening stock at Rs. 90 per kg. for assessment year 1992-93 and by valuing the closing stock also at Rs. 90 per kg. Accordingly, the value of the closing stock was reduced by the assessing officer from Rs. 8,69,13,158 to Rs. 6,01,71,130 and, consequently, the net profit was reduced by the assessing officer from Rs. 6,40,11,915 to Rs. 3,72,73,634 and profits from business at Rs. 3,78,01,032. For the sake of brevity we hereinafter refer the assessment year 1992-93 as the 'first Year' and assessment year 1993-94 as the 'second year'. Consequently, the assessing officer restricted the deduction under section 80HHC to Rs. 3,78,01,032 instead of Rs. 6,45,39,313 which the assessee would have got if the gross profits was taken at Rs. 7,13,03,219.99. Being aggrieved, the assessee carried the matter in appeal to the Commissioner (Appeals). The appeal was dismissed. Being aggrieved, the assessee carried the

matter in appeal to the Tribunal which took the view that as per the usual practice followed by the assessee for the last several years the closing stock was valued at market price. The Tribunal further found that the assessing officer was wrong in applying the principle of 'Lower of cost or market value' particularly when there was no change in the method followed by the assessee. That, there was no need to interfere with the system of accounting followed by the assessee for last several years. That, in fact, the assessee had shown more than the cost. That if the assessee had consistently adopted a recognized method of accounting which results into higher income and consequently into higher deduction, the assessing officer cannot accuse the assessee of defrauding the revenue because the assessee has been valuing the finished goods at market price since 1986-87 which has been accepted by the department throughout. Therefore, the Tribunal allowed the appeals by holding that the assessing officer was not justified in changing the valuation adopted by the assessee.

Facts for the assessment year 1993-94

4. For the assessment year 1993-94, the assessee returned a loss of Rs. 54,420. For the assessment year 1993-94, the opening stock was calculated by the assessee at Rs. 130 per kg. amounting to Rs. 8,60,13,158.

For the assessment year 1993-94, there is no closing stock. According to the assessing officer, the opening stock should have been valued at Rs. 90 per kg., i.e., at cost amounting to Rs. 6,01,74,878 instead of Rs. 8,60,13,158. According to the assessing officer, the entire exercise was undertaken at the market rate in order to suppress the income by Rs. 2,67,38,280. In the circumstances, the assessing officer added an amount of Rs. 2,67,38,280 to the total income of the assessee. Being aggrieved, the assessee carried the matter in appeal to Commissioner. The appeal was dismissed. Being aggrieved, the assessee preferred an appeal to the Tribunal. By the impugned order, the Tribunal allowed the appeal of the assessee for the reasons given in its order for the earlier assessment year. Being aggrieved, the department has come in appeal under section 260A of the Income Tax Act.

Arguments

5. Mr. R.V. Desai, learned senior counsel appearing for the department, contended that under the proviso to section 145(1), if the assessing officer in a given case finds distortion in income to be deduced, the assessing officer can certainly discard the system of accounting adopted by the assessee. He contended that the opening stock for the first assessment year was computed at the rate of Rs. 90 per kg. and the closing stock was computed at the rate of Rs. 130 per kg. That, in the first year this was done because, there were export sales whereas in the Second Year, there were no exports. Therefore, the entire device was to claim maximum deduction under section 80HHC in the First Year and in the second year the attempt was to suppress the profits. He, therefore, contended that the assessing officer was right in valuing the closing stock of the First Year at Rs. 90 per kg. as the opening stock was also valued at Rs. 90 per kg. Therefore, the assessing officer was right in valuing the opening stock in the second year also at Rs. 90 per kg. He contended that each assessment year is a unit by itself. That, merely because in the past the department accepted valuation of closing stock at a higher market rate vis-a-vis value of the opening stock will not debar the assessing officer from invoking the proviso under section 145(1) as it stood at the relevant time.

6. On behalf of the assessee, Smt. Jagatiani, learned counsel for the assessee submitted that for the last several years prior to the assessment years in question, the assessee has been following a system of accounting under which the assessee was valuing the closing stock at the market rate and, accordingly, they have valued the closing stock for the assessment year 1992-93 at Rs. 130 per kg. and they have valued the opening stock for the assessment year 1993-94 at Rs. 130 per kg. She relied upon numerous judgments of the Supreme Court in support of her contention that valuation of closing stock at market rate was a well settled principle of accounting. That, the assessee had followed that system for last several years and in the circumstances, the assessing officer was not justified in changing the valuation done by the assessee. She contended that the assessee was free to adopt a given system of accounting. She contended that in this case, the assessee has not changed its method of accounting. She contended that this case cannot be equated with cases where the assessee changes its accounting. She further contended that the proviso under section 145(1) was not applicable to

this case as in this matter, no higher tax was payable. She contended that the proviso to section 145(1) was applicable only to cases where there was loss of revenue. She contended that in this case, if one looks at the computation of income done by the assessing officer, it is clear that even with reduced net profits of Rs. 3,78,01,032, the assessee was not required to pay any tax in the assessment year 1992-93 and, therefore, there was no loss of revenue. She contended that the order of the assessing officer on page 22 indicates the computation. She submits that the assessing officer has taken the profits from business at Rs. 3,78,01,032 from which there is a deduction under section 80HHC of the same amount. Therefore, even according to the assessing officer, the taxable income was nil. Therefore, the assessing officer could not have insisted on valuing the closing stock at Rs. 90 per kg. and if the assessing officer was not so justified in valuing the stocks at Rs. 90 in the first year, he was also not justified in valuing the opening stock in the second year at Rs. 90. She further contended that in this case we are concerned only with finished goods and not raw materials.

Findings

7. The basic point which we are required to consider is whether the method followed by the assessee has resulted in escapement of tax and whether the assessing officer was justified in insisting on the assessee valuing its closing stock at 'Lower of cost or market value'. As stated above, for assessment year 1992-93, the assessee valued the opening stock of finished goods at Rs. 90 per kg. However, they valued the closing stock for the same assessment year at Rs. 130 per kg. The reason was obvious. In the assessment year 1992-93, the assessee had earned export profits amounting to Rs. 7,07,88,773. Therefore, as per the computation of income filed by the assessee, the amount of profit under the head 'Profits and gains of business' is shown at Rs. 6,40,11,915 in its returns. Office is directed to take the returns for the two assessment years on record and mark as X-(Colly). In the same computation, they have claimed deduction under section 80HHC also at Rs. 6,40,15,212. The petitioners export turnover and the total turnover was the same at Rs. 34,70,406. The formula applicable was 'Business profit multiplied by export turnover divided by total turnover'. Therefore, if one cancels out export turnover against total turnover, the quantum of deduction will be

the same as profits from business because in the formula the ratio of export turnover divided by total turnover has to be applied to business profits. We will demonstrate this point. In the present case, according to computation made by the assessee, the business profit was Rs. 6,40,11,915. If one multiplies Rs. 6,40,11,915 with export turnover upon total turnover, the resultant deduction would be Rs. 6,40,11,915 under section 80HHC because, export turnover and the total turnover is the same at Rs. 34,70,406 and the business profits at Rs. 6,40,11,915 also figures in the formula of deduction, viz., business profits multiplied by export turnover divided by total turnover. In the present case, the assessing officer has calculated business profits at Rs. 3,78,01,032 by valuing the closing stocks at Rs. 90 per kg. This figure also finds place in the above formula of deduction and if export turnover equals total turnover then, the deduction under section 80HHC will be Rs. 3,78,01,032 only. It cannot give any other figure. Therefore, a correct taxable total income can never be computed on the basis of the system of relief provided under section 80HHC. In the present case, the assessing officer was right in coming to the conclusion that the entire device was to inflate deduction under section 80HHC in the first year and to suppress the profits in the second year. In the first year, the assessee-calculated the closing stock at Rs. 130 per kg. and the opening stock at Rs. 90 per kg. By calculating the closing stock at Rs. 130 per kg., the gross profit got inflated to Rs. 7,13,03,219.99 and, consequently, with the inflation of gross profits the resultant deduction under section 80HHC also got inflated. Therefore, the assessing officer rightly adopted Rs. 90 per kg. while valuing the closing stock because, Rs. 90 per kg. was also the rate for calculating the opening stock in the same assessment year. By valuing the closing stock at Rs. 90 per kg., the net profits came down to Rs. 3,78,01,032 from Rs. 6,45,39,313. Therefore, the assessing officer has rightly restricted the deduction under section 80HHC to Rs. 3,78,01,032 and, consequently, the assessing officer has rightly calculated the opening stock for next assessment year 1993-94 at Rs. 90 per kg. In this case, we want to point out that in the second year, what the assessee had done is to inflate the debits by calculating the value of the opening stock at Rs. 130. By that method, the assessee has increased the expenses in the next year. In the next year, there is no closing stock and the assessee had returned a loss of Rs. 54,420 whereas if the value of the opening stock in the second year is

calculated at Rs. 90 as done by the assessing officer then, there is income of Rs. 2,67,38,280, which arises on account of the differences in the rates of Rs. 130 and Rs. 90 per kg. Therefore, the assessing officer was right in adding back Rs. 2,67,38,281 to the income of the assessee for the assessment year 1993-94. Therefore, there is no merit in the argument of the assessee that by the method followed by the assessee, there is no escapement of tax. In the circumstances, the assessing officer was right in applying the principle 'Lower of the cost or market value.'

8. Numerous judgments were cited before us in support of the contention that valuation of the closing stock at market rate is a well accepted system of accounting/valuation. We are not required to go into those judgments as in all those judgments, it has been stated that valuation of closing stock at market rate can be applied provided the assessing officer was in a position to deduce income and in cases where there is no escapement of tax. In the present case, on facts, the assessing officer was justified in invoking the proviso to section 145(1) as it then stood. In this case, we are concerned with the application of the principles laid down by the judgments of the Supreme Court.

9. It was vehemently urged on behalf of the assessee that the company has been following the above method for last several years and, therefore, the assessing officer should not have interfered with the method of accounting. We are concerned in these two appeals with the assessment year 1992-93 and assessment year 1993-94. In these two years, we find that under the method adopted by the assessee, the assessee seeks higher deduction under section 80HHC in the first year and in the Second Year, they are seeking to suppress the profits. In this case, even in the first year, the correct taxable income cannot be deduced on the assessee's method. The assessee is justifying its method by relying on the relief under section 80HHC which is not permissible because it gives a distorted picture. Under the income-tax law, each assessment year constitutes separate units. We are, therefore, concerned with assessment year 1992-93 and assessment year 1993-94. Therefore, we do not find any merit in the argument of assessee that because the assessee was keeping its account under a mixed system of accounting, the assessee can continue to do so even if it results in

income escaping assessment-Dr. Amins Pathology Laboratory v. P.N. Prasad, Tt. CIT : [2001]252ITR673(Bom) .

Conclusion

10. Accordingly, we answer question Nos. 1 and 2 in the negative, i.e., in favour of the department and against the assessee. In view of our answer to question Nos. 1 and 2 in favour of the department, we need not answer question No. 3.

11. We may point out that page 4 of the paper book in Appeal No. 10 of 2001, contains question of law concerning some other matter which by mistake has been incorporated in the paper book. Learned counsel for the department sought leave to amend the said Income Tax Appeal No. 10 of 2001 within one week. Permission granted to carry out the amendments on or before 12-12-2002. Office is directed to place the matter on board if the said amendment is not carried out by the department.

12. Accordingly, both the above appeals are allowed. No order as to costs.

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