P. Narayanappa Vs. the State of Mysore

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Court : Karnataka

Decided On : Mar-23-1962

Reported in : [1962]13STC993(Kar)

Judge : A.R. Somnath Iyer and ;M. Sadasivayya, JJ.

Acts : Mysore Sales Tax Act, 1948 - Sections 12, 12(2); Mysore Sales Tax (Amendment) Act, 1957 - Sections 23; Mysore Sales Tax Rules - Rules 12, 13, 15, 15(3) and 19; Income-tax Act

Appeal No. : Civil Revision Petition No. 1268 of 1960

Appellant : P. Narayanappa

Respondent : The State of Mysore

Advocate for Def. : D.M. Chandrasekhar, Government Pleader

Advocate for Pet/Ap. : V.P. Anantha Krishnan, Adv.

Judgement :

Somnath Iyer, J.

1. In this revision petition, the petitioner who is a hotelier complains against the assessments made in his case under section 12(2)(b) of the Mysore Sales Tax Act, 1948.

2. The material facts are these :-

The petitioner keeps a hotel called the Durga Lodge at Davanagere and a restaurant called Sri Krishna Vilas Restaurant at the Chitradurga. For the assessment year 1956-57, the turnover declared by him for each of these eating houses was not accepted by the assessing authority who assessed him to the best of his judgment. The declared turnover of the Durga Lodge was Rs. 14,699 and of Sri Krishna Vilas Restaurant Rs. 79,470. The assessing authority determined the taxable turnover of the Durga Lodge to be Rs. 20,000 and of the other to be Rs. 1,00,000. In the appeal to the Deputy Commissioner, the estimated turnover of the Durga Lodge was maintained but that of the Krishna Vilas Restaurant was reduced to Rs. 90,000 and the Sales Tax Appellate Tribunal affirmed these estimates.

3. Although the impugned assessments were made under section 12(2)(b) of the Sales Tax Act, 1948, since that Act was no longer in force when the Sales Tax Appellate Tribunal made its order, this revision petition is presented under section 23 of the Mysore Sales Tax Act, 1957.

4. To support his declared turnover, the petitioner produced before the assessing authority his accounts of the two eating houses, but these accounts were rejected. But although the Deputy Commissioner thought that the accounts of the Durga Lodge were above reproach, he regarded himself bound by a formula evolved by the Sales Tax Appellate Tribunal in some case before it and estimated the turnover of the Durga Lodge at five times its working expenses and concluded that the estimate made by the assessing authority although by a different process but which did not exceed his own, did not require to be disturbed.

5. But the Deputy Commissioner thought that the accounts of the Krishna Vilas Restaurant were not dependable and proceeded similarly to estimate the turnover of that business on the basis of the same formula which he applied to the Durga Lodge and made a slight modification in the estimate of the assessing authority.

6. The Tribunal entirely overlooked the finding of the Deputy Commissioner that the accounts of the Durga Lodge were not open to criticism, and proceeded to

consider whether his estimate was not proper and concluded that it was. The estimate of the restaurant turnover was similarly affirmed.

7. Before us, three submissions were made for the petitioner. The first is that the Deputy Commissioner who accepted the correctness of the accounts of the Durga Lodge should have held that neither he nor the assessing authority had the competence to estimate the turnover of that business. The second is that the assessing authority having found that the accounts of the restaurant were properly maintained could not decline to accept its declared turnover. The third is that the application of a formula for estimating the turnover was not permissible.

8. I first proceed to consider the third submission.

9. Section 12 of the Sales Tax Act, 1948, under which the impugned assessments were made reads :-

'12. Procedure to be followed by assessing authority. - (1) Every dealer whose turnover is seven thousand five hundred rupees or more in a year shall submit such return or returns relating to his turnover in such manner, and within such periods as may be prescribed.

(2)(a) If the assessing authority is satisfied that any return submitted under sub-section (1) is correct and complete, he shall assess the dealer on the basis thereof.

(b) If no return is submitted by the dealer under sub-section (1) before the date prescribed or specified in that behalf or if the return submitted by him appears to the assessing authority to be incorrect or incomplete, the assessing authority shall assess the dealer to the best of his judgment : Provided that before taking action under this clause the dealer shall be given a reasonable opportunity of proving the correctness and completeness of the return submitted by him.'

10. Clause (b) of sub-section (2) makes it clear that the power to substitute his own turnover for that declared by the dealer becomes available to the assessing authority only if he is of opinion that the return submitted by the dealer is incorrect or incomplete. It is equally plain that the turnover which the assessing authority

may substitute for the declared turnover should be determined by the assessing authority to the best of his judgment.

11. Under section 25 of the Act, Government made rules prescribing the procedure for estimating the turnover in cases in which an unsatisfactory return was furnished. They are rules 12, 13 and 15. The 12th rule directed the assessing authority to make an enquiry before he made an estimate and the 13th rule required him before making an estimate to afford an opportunity to the dealer to produce his accounts and prove the correctness and completeness of his return.

12. These two rules authorised the assessing authority to make a provisional estimate of the dealer's turnover for the purpose of a provisional assessment and these two rules to the extent they empowered the assessing authority to make such provisional assessment have, as pointed out by this Court, no validity.

13. But, although rules 12 and 13 can no longer be used for a provisional best judgment assessment, it is clear that the procedure referred to in those two rules has nevertheless to be adopted before a turnover can be estimated under section 12(2)(b), and that is the requirement of rule 15(3). What that sub-rule says is that before an estimate is made under section 12(2)(b) that estimate must be preceded by the steps prescribed by rules 12 and 13. These steps are the holding of an enquiry and the affording of an opportunity which is also enjoined by the proviso to section 12(2)(b) of the Act. Rule 15(3) reads :-

'15. Annual return and final assessment. -

* * * * * (3) If no return is submitted or if the return submitted appears to the assessing authority to be incorrect or incomplete, the assessing authority may, after following the procedure prescribed in rules 12 and 13, finally assess the tax according to the best of his judgment.

* * * * * This sub-rule refers to the procedure specified in rules 12 and 13 and directs that the same procedure should be adopted when making the estimate under section 12(2)(b). The rule-making authority instead of writing once again in rule 15(3) the procedure to be so adopted by the assessing authority directs him to

look into rules 12 and 13 and to adopt the same procedure even when he makes an estimate under section 12(2)(b).

14. Then, there is rule 19 which reads :-

'19. Reasons to be given if turnover is determined at a figure other than that given in the return. - If in any case the assessing authority determines the turnover at a figure different from that shown in a return submitted under the provisions of these rules, he shall record his reasons briefly in writing and shall furnish the assessee with a copy of such record. Nothing contained in this rule shall affect the validity of any assessment duly made.'

15. The meaning of this rule is clear. It requires the assessing authority to assign reasons even in cases in which he discards the return furnished by the dealer and estimates the turnover under section 12(2)(b).

16. The effect of these four rules is that the assessing authority should before he estimates the turnover under section 12(2)(b) make an enquiry and afford an opportunity to the dealer to support his return by his accounts, and if he discards the return and determines the turnover by the estimator method, he should assign reasons for the substitution of his estimate.

17. Although there is a striking similarity between the provisions of section 23(4) of the Income-tax Act and section 12(2)(b) of the Mysore Sales Tax Act, 1948, it is clear that although both the statutory provisions provide for an estimate, the estimate under the Sales Tax Act must as provided by rule 15(3) be preceded by an enquiry which, as observed by their Lordships of the Privy Council in Lakshminarain's case is unnecessary under the Income-tax Act.

18. But, it is, I think, manifest that the advice given by their Lordships of the Privy Council in that case as to how an estimate should be made under the Income-tax Act has equal apposition to an estimate under the Sales Tax Act. This is what their Lordships said at page 138 :-

'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 and assessments 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 guesswork. In that sense, too, the assessment must be to some extent arbitrary.'

19. In further elucidation, their Lordships of the Supreme Court on two occasions drew attention to the other well established rule that the estimate of an Income-tax Officer should have some basis and should be preceded by a disclosure to the assessee of the materials constituting such basis. In Dhakeswari Cotton Mills Ltd. v. Commissioner of Income-tax, West Bengal ([1954] 26 I.T.R. 775; A.I.R. 1955 S.C. 65), at page 70 of the report, their Lordships said :-

'In this case we are of the opinion that the Tribunal violated certain fundamental rules of justice in reaching its conclusions. Firstly, it did not disclose to the assessee what information had been supplied to it by the departmental representative. Next, it did not give any opportunity to the company to rebut the material furnished to it by him, and lastly, it declined to take all the material that the assessee wanted to produce in support of its case. The result is that the assessee had not had a fair hearing. The estimate of the gross rate of profit on sales, both by the Income-tax Officer and the Tribunal, seems to be based on surmises, suspicions and conjectures.'

20. Again, in Raghubar Mandal Harihar Mandal v. State of Bihar : [1958]1SCR37 , their Lordships referred with approval to the following passage of Din Mohammad, J., in Ganga Ram Balmokand v. Commissioner of Income-tax :-

'It cannot be denied that there must be some material before the Income-tax Officer on which to base his estimate, but no hard and fast rule can be laid down by the Court to define what sort of material is required on which his estimate can be founded,' and proceeded to observe at page 814 of the report :- 'If, in this case,

the Sales Tax Authorities has based their estimate on some material before them, no objection could have been taken; but the question which was referred to the High Court and which arose out of the orders of assessment was whether it was open to the said authorities to make an assessment on a figure of gross turnover, without referring to any materials to justify the adoption of that figure. In answering that question in the affirmative, the High Court has given a carte blanche to the Sales Tax Authorities and has, in our opinion, misdirected itself as to the true scope and effect of clause (b) of sub-section (2) of section 10 of the Act.'

21. If the rule therefore is that an Income-tax Officer who gathers materials for his estimate from any one of the sources referred to by their Lordships of the Privy Council should to the extent permissible disclose those materials to the assessee before he makes the estimate, it is reasonable to think that an estimate under the Sales Tax Act should also be preceded by a similar disclosure to the dealer. The insistence on such disclosure is to my mind plainly implicit in rule 12 which enjoins an enquiry before the estimate. That rule which empowers the assessing authority to make only such enquiry as he considers necessary does not, it is clear authorise him to dispense with it.

22. The principles applicable to the estimation of a turnover under section 12(2)(b) are thus substantially the same as those applicable to an assessment under section 23(4) of the Income-tax Act, although while in one case an enquiry is imperative, in the other it is not.

23. This discussion demonstrates that under the Sales Tax Act, 1948, the estimate of the turnover of a dealer who has submitted an unsatisfactory return has to be made in the following way :-

(1) The dealer must be afforded an opportunity to prove the correctness of his return;

(2) If the correctness of the return is not established, an enquiry must precede the estimate;

(3) The estimate must rest upon some material;

(4) The material on which the estimate is founded should be disclosed to the extent permissible to the dealer;

(5) The estimate must be a just and honest estimate.

If this is the process by which an estimate should be made, the question is whether the estimate made by the Deputy Commissioner which rested on a formula evolved by the Tribunal in another case is an estimate properly made under section 12(2)(b). Now, that clause requires the estimate to be made to the best of the judgment of the assessing authority, which means that the assessing authority must by the employment of his own intellectual faculties made an estimate which he considers to be a fair and proper estimate of the taxable turnover. It may be that such estimate is possible by the adoption of a flat rate or by a rule of averages or by the application of some other general working rule. There are many methods by which a person's income or turnover may be estimated, although no inerrancy can be claimed for any one of them. An estimate being by its very nature not scientifically unassailable every method by which such estimate is possible is bound to be scientifically imperfect. So, although it is the duty of the assessing authority to ascertain the taxable turnover as accurately as can be done, no assessing authority can claim the capacity to discover by the employment of any estimator method the real and true turnover of a dealer. A dealer who produces an unsatisfactory return and therefore commits default in supplying information takes the risk of the estimate exceeding the real turnover although it is equally possible that a fortunate dealer discovers the estimate to be to his advantage. But, however that may be, the non-disclosure of the true turnover clothes the assessing authority with the power to estimate it, and how and by what process the estimate is to be made is for the assessing authority to choose. It is for him to select out of the manifold methods which may be available that which best suits the case before him having regard to its facts and circumstances.

24. It is, I think, implicit in this power given to the assessing authority to estimate a turnover to the best of his judgment, that no formula incorporating any rigid or inflexible rule can be substituted for his judgment. For the purpose of making the

estimate, the assessing authority must make his own mind think about it. He should after considering the facts and circumstances of each case and the materials by him estimate the turnover as nearly as it can be done. If that is what he has to do, an estimate on the basis of a formula evolved by someone else would not be his estimate or one to the best of his judgment, although a formula such as the one which has been adopted by the Deputy Commissioner in this case, namely, that the turnover of a hotel-keeper is nearly always five times the working expenses, may be a good working rule generally. It would be for the assessing authority to consider whether that rule if applied to the case before him is likely to yield a just and proper result and to refuse to apply it if he thinks it does not. It would be equally open to the dealer to demonstrate that that working rule which might normally be considered to be a satisfactory basis causes hardships to him and should therefore be discarded. No rule, not even a rule which experience has proved to be a good general working rule, can have universal application so as to exclude an estimate except by its application.

25. I now turn to the cases under the income-tax law which have considered the question whether an assessing authority empowered to make an estimate can in a case like the one before us regard himself to be bound by any particular estimator method.

26. In The Imperial Fire Insurance Company v. Wilson ((1876) 1 Tax Cas. 71), in estimating its annual profits, a fire insurance company deducted from its profits 33 per cent. of the premiums paid to it on account of unearned premiums. The Court of Exchequer taking the view that it was for the insurance company to prove what the proper deduction was and that it had failed to prove it, reached the conclusion that no deductions could be made from the premiums paid which in its view had to he regarded as profits.

27. This decision was understood as laying down a rule that the premiums received by a fire insurance company during the whole of the current year formed part of the company's taxable income of that year.

28. A similar question arose in Scottish Union and National Insurance Company v. Smiles ((1889) 2 Tax Cas. 551). The Lord President in that case referred to a

general rule which he said was a useful guide to the Revenue Officers and the General Commissioners of Income Tax in dealing with such cases, and observed at page 577 :-

'(3) Seeing that fire insurance policies are contracts for one year only, premiums received for the year of assessment, or on an average of three years deducting losses by fire during the same period, and ordinary expenses may be fairly taken as profits and gains of the company without taking into account or making any allowance for the balance of annual risks unexpired at the end of the financial year of the company : (See The Imperial Fire Insurance Company v. Wilson ((1876) 1 Tax Cas. 71)).'

29. Then, in the year 1907, the question came before the House of Lords in The General Accident, Fire and Life Assurance Corporation Ltd. v. M'Gowan ((1907-8) 5 Tax Cas. 307). The Commissioners in that case assessed the receipts from premiums as taxable income whereas the company claimed that an allowance of 33 1/3 per cent. of the total premiums should be deducted for unexpired risks. Repelling the claim made by the company, the Lord Chancellor observed at page 323 of the report :-

'During 32 years, since the decision of Wilson's case ((1876) 1 Tax Cas. 71), the method of assessing fire and accident companies has been that adopted by the Commissioners in the present case. It is not scientifically unassailable, for it obviously proceeds upon the supposition that the unexpired risks at the beginning and at the end of each year are in substance the same, or that, if an average of three years is taken, they are upon an average the same. But no method is scientifically unassailable that does not enter into an analysis of the contracts made and contracts current in each year so minute that it is in a business sense impracticable. I think the particular correction sought by the appellants in this case is quite indefensible upon the materials before us, and further that the method adopted by the Commissioners is a good working rule in the present instance and generally. If in any particular case an insurance company can show it works hardship, no doubt the rule ought to be modified, so that the real gains and profits may be ascertained as near as may be. I am for dismissing this appeal with costs.'

30. But Lord Macnaghten said this :-

'My Lords, I think your Lordships would probably agree with Mr. Danckwerts in thinking that the present mode of assessing the profits of a fire insurance company for the purpose of the income tax is neither accurate nor scientific. But it has been established for a very long time. It is very simple, and it does not appear that in the long run it is productive of injustice. The alternative mode first proposed by the learned counsel for the appellants is certainly not more accurate. The enquiry afterwards suggested would, I think, be interminable. It is impossible to obtain anything approaching complete accuracy by any conceiving method.'

31. A similar question arose in the year 1910 in The Sun Insurance Office v. Clark ((1910-12) 6 Tax Cas. 59). A company carrying on the business of fire insurance had made the practice of carrying forward annually, as a reserve, 40 per cent. of the yearly premium receipts representing estimated losses on unexpired risks and claimed to be assessed on this basis. This Commissioners found that the allowance claimed for unexpired risks was reasonable and proper and admitted that claim. In the appeal on behalf of the Crown, it was contended that it was a well settled rule that in the case of all fire insurance companies, all the premiums received by the company are its profits and that no portion of it could be carried forward the estimated losses on unexpired risks. The rule enunciated to that effect in Wilson's case ((1876) 1 Tax Cas. 71) and M'Gowan's case ((1907-8) 5 Tax Cas. 307) formed the foundation of this argument.

32. Bray, J., delivering the judgment of the King's Bench Division, overruled that contention pointing out that as in all other cases, the profits of an insurance company must also be ascertained as nearly as can be done on the facts and circumstances of each case and that no rule and not even a good working rule could be adopted for that purpose in every case and pointed out that the conclusion reached in each of the three earlier cases rested upon its own facts and circumstances. At page 65 of the report, referring to the observations of Lord Chancellor in M'Gowan's case ((1907-8) 5 Tax Cas. 307), he observed :-

'Then Lord Loreburn says : 'I think the particular correction sought by the appellants in this case is indefensible upon the materials before us, and, further,

that the method adopted by the Commissioners is a good working rule in the present instance and generally.' That must be taken. It is : 'A good working rule generally.' That does not mean that it is to be adopted in every case. If there be a case where you, really can arrive at the fair value instead of a rule of thumb value, there is no law, as I understand it, which prevents you taking the real value instead of a rule of thumb value.'

33. But this decision of Bray, J., was reversed by the Court of Appeal which considered itself to be not at liberty to depart from the rule laid down by the House of Lords in M'Gowans's case ((1907-8) 5 Tax Cas. 307). Cozens-Hardy, M.R., referring to the decision of the House of Lords said this at page 69 :-

'I can only say that I read the judgment of the noble lords as meaning and deciding that the view taken by the Court below in the Scotch Court, which was based upon a general principle and not in the least upon any inadequacy of proof that 33 1/3 was proper ..... I take the judgment of the House of Lords as assent to the argument on the part of the Crown and a dissent from the argument on the part of the appellants. Then is it possible now for us to say that we can distinguish the present case because in the M'Gowan's case ((1907-8) 5 Tax Cas. 307) no actual deduction had been made in the accounts of the company of 33 1/3 per cent. or any other particular percentage, whereas here it has been proved that the Sun Office since, I think 1888, have done that which seems to me to be obviously in accordance with good management and good accountancy, namely, deducted a percentage which they estimate at 40 per cent. as an allowance for unexpired risks There is, of course, here a finding that that is a reasonable estimate to be allowed in respect of that. I cannot think that we ought to or should be justified in attempting to distinguish this case from the decision of the House of Lords on such a ground as that. I can only bow to the decision of the House of Lords, and it must be left for the House of Lords, if the respondents are so minded to take the case there, to say whether the distinction raised in the present case is a valid distinction leading to a different conclusion from that which was arrived at in M'Gowan's case ((1907-8) 5 Tax Cas. 307).

For these reasons, obeying to the best of my ability the rule laid down by the House of Lords, and again, as I say, not expressing my own individual view, I think this appeal must be allowed and the judgment of Mr. Justice Bray must be set aside.'

34. Buckley, L.J., at page 73 said :-

'I heartily wish that I felt myself at liberty to give effect in this case to my own conviction. I could give reasons for distinguishing this case from M'Gowan's case ((1907-8) 5 Tax Cas. 307) but I mistrust myself in so doing. A judge who has the misfortune not to agree with a decision which binds him is necessarily suspicious of himself in relying upon reasons for distinguishing the case before him. Further, I think there is great force in the contention that in M'Gowan's case ((1907-8) 5 Tax Cas. 307) the House were not laying down any principle of law; they were, however, seemingly approving a general working rule in income tax cases of this description and it is a sound principle that the law should as far as possible be rendered certain. On the whole I think it better that this case should go before the House of Lords, leaving it to them to say, firstly, whether in M'Gowan's case ((1907-8) 5 Tax Cas. 307) they were determining any principle of law at all; and, secondly, if that is answered in the affirmative, whether under the circumstances in which, as it seems to me, this case differs from that, the working rule which they approve is applicable or not.'

35. The hope expressed by the Court of Appeal that the House of Lords by whose dictum it considered itself bound would explain that the decision in M'Gowan's case ((1907-8) 5 Tax Cas. 307) was not founded on any general rule of universal application, turned out prophetic. The company appealed to the House of Lords and the Lords Chancellor (Lord Loreburn) who also decided the M'Gowan's case ((1907-8) 5 Tax Cas. 307) made it perfectly clear that it did not in M'Gowan's case ((1907-8) 5 Tax Cas. 307) intend to lay down any general rule of universal application that no part of the premiums received by a fire insurance company could be carried forward towards the estimated losses on unexpired risks. The company's appeal was allowed and the decision of Bray, J., was restored and in doing so, Lord Loreburn, L.C., observed at page 75 :

'If that be so, it follows that in assessing such fire insurance companies, you must proceed wholly or in part by estimate.

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 question of fact and of figures whether what is proposed in each case is fair both to the Crown and to the subject.'

36. Again, at page 77, he added :-

'In the hope that it may help to prevent future misunderstanding I will recapitulate my own opinion. 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.

I am equally anxious that your Lordships should not be supposed to have laid down that the method applied by the Commissioners in the present case has any universal application. If the Crown wishes in any future instance to dispute it they can do so by evidence, and it is not to be presumed that it is either right or wrong. A rule of thumb may be very desirable, but cannot be substituted for the only rule of law that I know of, viz. that the true gains are to be ascertained as nearly as it can be done.'

37. At page 83, Lord Atkinson said this :-

'As I understand, Lord Justice Moulton is of opinion that some method might be adopted by which the problem cold be solved with scientific accuracy. Unfortunately, he does not describe in detail what that method is. It may, for all

that appears, involve such complicated calculations in reference to each particular policy as to be practically unworkable, and certainly it does not appear to me that it is possible to adopt any method which does not involve recourse, at some stage of its processes, to estimates, averages, or such like things. If these matters be borne in mind, it does seem strange that it should have been supposed that it could ever have been laid down as a matter of law that one method, and one method alone, could legally be employed to solve the problem.'

38. That what the House of Lord said about the estimate of the profits of an insurance company is not confined to the estimation of the profits of an insurance business but should be the guiding principle to be adopted in all cases in which an estimate of either the profits or the turnover or the like is authorised by the statute is, in my opinion, irrefutable. Indeed, that was what the House of Lords said in the year 1956, in the Southern Railway of Peru Ltd. v. Owen ([1957] A.C. 334; 32 I.T.R. 737), in which at page 347, Lord MacDermott referring to the earlier decision of the House in the Sun Insurance Office case ((1910-12) 6 Tax Cas. 59; [1912] A.C. 443) remarked :-

'It was said that that decision related only to insurance business and had no application to the facts of this appeal. I see no reason for confining the scope of the decision in this way. Its ratio is much wider than that, and is, in my view, applicable to cases producing the same sort of problem, whether they relate to contracts of insurance or not.'

39. Lord Radcliffe reiterating the view expounded by Lord Loreburn in the Sun Insurance Office ((1910-12) 6 Tax Cas. 59; [1912] A.C. 443), rejected the submission made on behalf of the Crown that in ascertaining the profits chargeable to income tax there was some rule of law to which adherence was necessary.

40. At page 365 of the report, he observed :-

'But there is no difficulty if we accept the main argument of the Crown. That argument is that, quite simply, there is a rule of law which forbids the introduction of any provision for future payments in or payments out, if the right to receive them

or the liability to make them is in legal terms contingent at the closing of the relevant year. The rule, it seems, is absolute and must be adhered to whatever the current principles or practices of commercial accountancy may require as a method of ascertaining the year's profits. And this is the argument which hitherto has prevailed in the High Court and the Court of Appeal. Now, in my opinion, there is no such rule of law governing the ascertainment of annual profits. Where does not it come from Not from anything to be found in the Income Tax Acts, which, indeed, by the well-known rule limiting the exclusion of debts, show a different and, as I think, a more realistic approach to the problem. Not from any decided authority which is binding on your Lordships. On the contrary, there are two decisions of this House which negative the existence of any such rule of law.'

41. Lord Tucker, expressing agreement with what Lord Radcliffe said, observed at page 361 :

'I agree with him that there is no such absolute rule of law governing the ascertainment of annual profits as was contended for by the Crown in the present case, and that there is no ground for holding that the decision of this House in Sun Insurance Office v. Clark ((1910-12) 6 Tax Cas. 59; [1912] A.C. 443) must be confined exclusively to insurance companies.'

42. It is therefore a firmly established principle that a general working rule although founded on experience or practical knowledge cannot have the status of a rule of law and does not dispense with the duty to consider in each case whether that rule is a suitable expedient or method for ascertaining the turnover in that case. Although recourse to a flat rate or a rule of averages or any other similar general working rule is on principle unexceptionable, what is open to criticism is the mechanical application of any one of those methods without the examination of its suitability to the case in which it is to be employed even if it has been found to be an efficacious expedient in the case of another dealer carrying on a similar business or trade. The true rule is that the ascertainment of the turnover should in each case be made by the adoption of that method which in the opinion of the assessing authority will assist a just and substantially accurate estimate in that case. It is for him to select that method there being no rule of law as to a proper

way of making an estimate.

43. The ratio of this rule is obvious. A working rule yielding a satisfactory result in the case of one dealer might produce injustice and hardship in the case of another and even in the case of the dame dealer when it is applied to him again.

44. An assumption, for example, that the turnover of every hotel keeper is generally five times his working expenses or that there is invariably some ratio between the working expenses of a trader and his profits can lead to imperfect and unjust results where by force of circumstances or otherwise, the working expenses of a person are higher or have increased without a corresponding expansion of his turnover or profits. The application of any ratio or rule should, as Lord Loreburn in Sun Insurance Office case ((1910-12) 6 Tax Cas. 59; [1912] A.C. 443) observed, depend on the facts and figures of each case, and not on any general classification. No ratio between the working expenses and the turnover or profits can be constant or immutable and judged by the rules of economics or accountancy no working rule however evolved can survive the test of infallibility. To replace the duty to make an estimate after reflection, by the mechanical application of a rule of thumb is to mistake domestication for judgment.

45. So, it is for the assessing authority to deliberate and decide in each case whether he should have recourse to a flat rate or a rule of averages or some other working rule which in his opinion is apposite, but he should disclose to the dealer to the extent possible, the materials justifying recourse to that method and consider his objection to its adoption.

46. An example of a case in which a general working rule was properly applied for the solution of a problem similar to the one presented by this case is Gamini Bus Co., Ltd. v. Commissioner of Income Tax, Colombo ([1952] A.C. 571). That was an appeal from a judgment of the Supreme Court of Ceylon on a case stated by the Board of Review under section 74 of the Ceylon Income Tax Ordinance. This Supreme Court confirmed the decision of the Board of Review upholding four assessments made on the appellant, which was a bus company, by the Commissioner of Income Tax. The accounts furnished by the appellant company which were tendered in support of its returns had not been accepted by the

assessor who estimated the amount of taxable income in each of the four years. But, when the appeal was heard by the Commissioner of Income Tax, the assessor produced before the Commissioner a document setting out the expenditure of seven other bus companies on petrol and oil and the net profit upon which those companies were assessed. The tabulation made in that document demonstrated an average ratio of profits to the expenditure. The assessment arrived at by the Commissioner and which was confirmed by the Board of Review rested to some extent upon the view that the profits of a bus company in that particular area bore a fairly constant ratio to the company's expenditure on petrol and oil. Since there was a correct record of the appellant's expenditure, the profits were estimated on the basis of that ratio. Before making this estimate, the figures relating to the other bus companies were extracted from the files relating to those companies by the Income Tax Department and those figures were supplied to the appellant although the names of those bus companies were not furnished.

47. The complaint made on behalf of the appellant was that it was unfair to make any use of the document produced before the Commissioner of Income Tax since the appellant could not be given an opportunity of examining the files from which the figures of the other bus companies were extracted or to ascertain which companies they were. That complaint was rejected as groundless since the taxing authorities had in fact disclosed to the appellant the figures relating to the expenditure and the profits of the other companies, extracting those entries anonymously from the official files. Discarding the argument that the production of the document containing those figures was a breach of section 4(1) of the Ceylon Income Tax Ordinance, Viscount Simon on page 579 observed :-

'But rule 14 does not necessarily make a disclosure of 'the affairs of any person' within the meaning of the section, for it contains no name except that of the appellant company, and the other entries are extracted anonymously from numbered official files. Their Lordships would strongly deprecate the production or use of such a document if it did in effect disclose information about other identified or identifiable taxpayers, but it is obvious that the document was prepared and produced not for this purpose but to help to show that the ratio above referred to between net profits as assessed and the costs of petrol and oil was a fairly

constant ratio in many cases, and that in using the suggested ratio as a test the assessor, and the Commissioner after him, were not acting capriciously or at random.'

48. Again, at page 580, he said :-

'Their Lordships agree with the Supreme Court in thinking that the figures given in rule 14 as going to illustrate and confirm the ratio were not improperly put before the Commissioner or the Board of Review, and that there was no breach of the principles of fair play and natural justice in putting them forward. It is true that the figures of net profit in rule 14 are the figures at which the various bus companies were assessed to taxation, and in most cases are very different from the figures in their own income-tax returns. But this commencement only goes to the weight to be attached to the resulting ratio and does not destroy the whole effect of the contention that the ratio is supported by experience in other instances.'

49. These passages from the judgment of Viscount Simon make it clear that even if in a particular class of business a fairly constant ratio exists between the profits and expenditure, that ratio may be used by the assessing authority either as the estimator method to be adopted in a particular case or for the purpose of testing the estimate otherwise made, provided before doing so, the information demonstrating the existence of that ratio, to the extent permissible, is made available to the person affected by it. What is further clear from these observations is that it is for the assessing authority in each case to decide the weight to be attached to that ratio.

50. The submission of Mr. Government Pleader that a ratio such as the the one which was adopted in the Ceylon case ([1952] A.C. 571), if supported by experience in other instances, has merely to be mechanically adopted by the assessing authority without doing anything more is what was deprecated by Viscount Simon at page 581 of the report. This is what he said :-

'Their Lordships cannot conclude this part of their judgment without emphasizing in the plainest terms that it would be wholly improper to justify the rejection of the appellant's accounts and the substitution of a higher figure of assessment merely

because, in the case of other taxpayers in the same line of business, the conclusion has been reached that their accounts were not accurately kept, and that their returns required to be rejected. Each taxpayer is entitled to have his assessment fixed, if his own return is not accepted, at a figure which the taxing authorities honestly believe to be proper in his individual case, and no argument that in this class of business the figure of return is habitually understated can be used to prove that this happened in his case also.'

51. These observations emphasizing as they do the duty of the taxing authorities in cases in which the taxpayer's return is not accepted, to make an estimate which they honestly believe to be proper in his individual case, demonstrate the unsustainability of the submission that a ratio between the working expenses and the profits which has been discovered to exist in the case of certain persons carrying on a particular class of business can be of universal application.

52. There is, I think, in rule 19 of the rules made under the Mysore Sales Tax Act, 1948, an unmistakable indication that no estimate can be made under section 12(2)(b) of that Act merely on the basis of a general working rule formulated in other proceedings. That rule requires the assessing authority in all cases in which he does not accept a declared turnover but substitutes his own turnover for it, to assign reasons for such substitution. That, in my opinion, is the clear meaning of that rule in so far as it is applicable to the estimation to be made under section 12(2)(b). The requirement that the assessing authority should assign reasons for such substitution by necessary implication excludes the possibility of the substitution of a turnover by the mechanical adoption of a formula or a ratio employed in some other case. It is clear that the application of that formula in some other case is by itself not a reason which will be sufficient for the purpose of rule 19 if a statutory functionary exercising power is enjoined to give reasons for his conclusions. The requirement that he should support his conclusion by reasons would de clearly incompatible with the employment of a set formula prepared by someone else, dispensing with the application of his own mind.

53. When I next turn to the cases on which Mr. Government Pleader depended, I do not find then useful to him.

54. In Feroz Shah v. Commissioner of Income-tax, Punjab and N. W. Frontier Province ([1933] 1 I.T.R. 219; 60 I.A. 325), the assessee's income which the Assistant Commissioner of Income-tax could not deduce from his books, was computed at a flat rate of 32 1/2 per cent. on sales as was done in the two previous years, without objection. The assessee asked for a statement of a case to the High Court, the challenge being confined to the amount of the flat rate. The High Court refused to require a case to be stated and Lord Blanesburgh, expressing agreement with the judgment of the High Court said this at page 334 of the report :-

'With regard to the flat rate of 32 1/2 per cent., their Lordships are in agreement with the judgment of the High Court on that heard. The principle of assessment at a flat rate not being contested, its amount must be for the Income-tax Officer to determine.'

55. The observation of the Judicial Committee that the amount of the flat rate is for the Income-tax Officer to determine far from supporting the contention of Mr. Government Pleader makes it plain that even in cases in which the Income-tax Officer is satisfied that the flat rate method was the proper method for the computation of the income, its amount was still for him to determine in that case.

56. M. A. Rauf v. Commissioner of Income-tax, Bihar and Orissa : [1958]33ITR843(Patna) , was a case in which an Income-tax Officer rejecting the accounts of the assessee and taking into consideration the materials before him estimated the profits of the assessee at a flat rate. That was not therefore a case in which there was any mechanical adoption of a flat rate evolved in some other proceeding.

57. In In re Ganeshi Lal & Sons, Agra : [1938]6ITR390(All) , their Lordships of the High Court of Allahabad upheld an assessment which was made on a similar flat rate basis. The principle of flat rate being incontestable, their Lordships were of the view that the amount of the flat rate determined by the assessing authority was beyond criticism since the amount of the flat rate was based on an uncontested determination during a previous year. This is what they said at page 369 of the report :-

'Under section 13 of the Act, the Income-tax Officer had discretion to accept or reject the assessee's books, and he rejected them. There is nothing apparently unreasonable or arbitrary in applying the rate of 30 per cent. upon sale proceeds, especially when no objection to the application of such rate for the year 1932-33 was made. If we think - as we do - that the Income-tax department was entitled in its discretion to reject the books and if the principle of a flat rate thereby became applicable, the amount of such rate was entirely in the discretion of the Income-tax authorities, as held by their Lordships of the Privy Council in the case above referred to.'

58. Mr. Government Pleader, however, pointed out to us a passage in the judgment which refers with approval to a statement in Sundaram's book on the Law of Income-tax that 'the basis of flat rates is obviously the previous practice and experience of the department in regard to similar trades'. But I do not find in the judgment any recognition of the validity of the postulate that a flat rate once applied in the case of a particular trade becomes as a rule applicable or can be considered to have such application to all cases belonging to such or similar trade.

59. In Commissioner of Income-tax, Madras v. Abdul Aziz Sahib : [1939]7ITR647(Mad) , the Income-tax Officer for estimating the profits of the assessee who was a manufacturer of cigars and beedies depended upon the averages rates of profits made by other manufacturers of cigars and beedies and also on the profits of the previous years of the assessee. In the reference under section 66(2) of the Income-tax Act, the estimate was upheld by the High Court. While it is clear that this estimate also rested on the assessee's own profits of the previous years, it does not appear from the brief judgment whether the average rate of profits of other manufacturers on which the Assistant Commissioner depended, was higher than that on the assessee during the previous years and whether the Assistant Commissioner's information about the profits of the other manufacturers was disclosed to the assessee and his objections to that basis was considered. It is also not clear from the judgment whether any exception was taken on behalf of the assessee to the selection or that basis.

60. In Gadireddi Peda Narasimhalu Naidu and Sons v. Commissioner of Income-tax, Madras : [1952]21ITR70(Mad) , all that was decided in that case was that the estimate of an assessee's income on the basis of comparable cases need not be preceded by a disclosure of detailed information about the business of those other assessees.

61. S. N. Namasivayam Chettiar v. Commissioner of Income-tax, Madras : [1960]38ITR579(SC) , was a case in which the Tribunal after taking into consideration the materials before it for the purpose of deducing the income of the assessee adopted a flat rate of 15 per cent. in regard to one class of transactions and 12 1/2 per cent. in respect of another. It incidentally remarked that in certain other cases which had come to its notice, the rate of profits 'went to 20 per cent.' The argument presented before the Supreme Court was that the Tribunal had violated the rule of natural justice in taking into consideration the rate of profits in other cases which had come to its notice without giving an opportunity to the assessee to explain those cases and relied in support of that contention on Dhakeswari Cotton Mills Ltd. v. Commissioner of Income-tax, West Bengal ([1954] 26 I.T.R. 775; A.I.R. 1955 S.C. 65). That complaint was held by their Lordships to be groundless since the estimate of the profits did not in their opinion rest on that information which the Tribunal had acquired but upon other materials which had been previously disclosed to the assessee. The elucidation by their Lordships that the flat rates adopted in other cases did not in fact form the basis of the Tribunal's estimate was unnecessary if the adoption of that method was unobjectionable.

62. Mr. Government Pleader next asked attention to the following passage in the 14th Chapter of the Income-tax Enquiry Report :-

'Much has been said on the subject of the application of standard rates of profit when estimates are made on a turnover basis. The complaints may be reduced in the main to allegations that the rates are not impartially ascertained, that the highest rate of profits found in any business in a given class of trade is treated as representative of that class, and that the rate applicable to one class of trade is sometimes applied to businesses not strictly within that class or to businesses having special features which make that rate inappropriate ..... It should be

remembered that even when fairly ascertained, the 'standard' rate of gross profit for a given class of trade is merely the average of a number of actual rates with possibility a wide range of variation. It follows that these rates, however carefully computed, should be applied with discretion and with regard to the special circumstances of the individual case. A further point that should be mentioned is, that it is generally more correct to apply a gross rate of profit and to deduct working expenses from the result than to apply a net rate of profit directly to the turnover.'

63. It does not appear from this part of the report that its authors ever intended to suggest tat an estimate could be made by the adoption of the rule of thumb.

64. At one stage, Mr. Government Pleader sought to derive support for his submission from a decision of this Court in C.R.P. No. 1000 of 1961 (Since reported as Rangappa Pandurang Kamath v. State of Mysore [1962] 13 S.T.C. 714). According to him, this Court in that case took the view that the formula that the turnover of a hotel keeper can always be estimated at five times his working expenses was held to be not an arbitrary or capricious formula and that, therefore, in all such cases in which a hotel keeper's declared turnover was rejected, the taxing authority could straight away estimate his turnover at five times the working expenses. In support of this argument, Mr. Government Pleader relied upon the following observations in the order made in that revision petition :-

'The principle of assessment at a flat rate cannot be considered as arbitrary. See In re Ganeshi Lal & Sons : [1938]6ITR390(All) and M. A. Rauf v. Commissioner of Income-tax : [1958]33ITR843(Patna) .

It cannot be said that the working expenses bear no relationship to gross or net turnover. It may or may not be a safe guide. In these matters, we ought to depend upon the experience of the taxing authorities apart from the fact that it is their 'judgment' and not ours. In Anwari Hotel v. State of Mysore (C.R.P. No. 258 of 1959), a Bench of this Court observed :

'If the Commercial Tax Officer, who was proceeding to assess the petitioner according to his best of judgment had proceeded to base his estimation on the

basis that his turnover should have been five times the working expenses of the firm, it would not be open for Mr. Srinivasan to contend that such an order was illegal or it cannot be supported.' We respectfully agree with that view. Hence we cannot agree with Sri T. Krishna Rao, that the formula adopted for arriving at the turnover is an arbitrary or a capricious formula.'

65. I do not understand these observations as laying down a rule that when a hotel keeper's declared turnover is discarded, it would be open to the Commercial Tax Officer by the application of a set formula, to estimate its turnover. Indeed, in the earlier revision petition (C.R.P. No. 258 of 1959), to the observations which this Court referred with approval, this Court also stated as follows :-

'Whatever may be the practice adopted in Madras or adopted by the Tribunal in certain cases to estimate the turnover of a firm or concern, the basis that the turnover should be five times the establishment expenditure incurred by the firm has no legal sanction.'

66. Now, if this Court in another part of the decision in that case stated that it was possible for a Commercial Tax Officer to estimate the turnover at five times the working expenses and also pointed out that that basis adopted by the Tribunal in other cases could not have any 'legal sanction' it becomes manifest that the principle to which this Court was referring was not different from the rule stated by Lord Blanesburgh in Feroz Shah v. Commissioner of Income-tax, Punjab and N. W. Frontier Province ([1933] 1 I.T.R. 219; 60 I.A. 325), that while the principle of a flat rate is incontestable, the amount of the flat rate has to be determined by the assessing authority in each case having regard to its own facts. In other words, this Court while accepting the principle of a working rule, made it clear that no working rule can have universal application.

67. I do not understand the decision in the later revision petition (C.R.P. No. 1000 of 1961 (Since reported as Rangappa Pandurang Kamath v. State of Mysore [1962] 13 S.T.C. 714)) as stating the principle differently.

68. It should be pointed out that the view expressed by this Court in the earlier revision petition which, in effect, is that a formula adopted by the Sales Tax

Appellate Tribunal for estimating the turnover in the cases decided by it cannot have the status of a rule of a law which a Commercial Tax Officer is bound to employ for his own estimate is fully supported by the high authority of the Supreme Court in Mahadayal v. Commercial Tax Officer, Calcutta : [1959]1SCR551 . The Commercial Tax Officer in that case, instead of exercising his own judgment for making the assessment, solicited the instructions of the Assistant Commissioner in that matter. The Commercial Tax Officer made the assessment on the basis of the Assistant Commissioner's instructions, which were not disclosed to the assessee.

69. Their Lordships of the Supreme Court, who deprecated the procedure adopted by the Commercial Tax Officer which in their opinion was contrary to the principles of natural justice and was calculated to undermine the confidence of the public in the impartial and fair administration of the sales tax department, pointed out that it was the duty of the Commercial Tax Officer to make the assessment supporting it by his own reasons and not to the dictation of the Assistant Commissioner.

70. Now, in the case before us, when the Deputy Commissioner estimated the turnover of the petitioner at five times his working expenses, he merely adopted a ratio which according to the Tribunal existed between the working expenses and the turnover in certain other cases. The figures in those other cases were not disclosed to the petitioner and he was not asked why that ratio should not be applied to his case. The Deputy Commissioner appears to have regarded the decision of the Tribunal in the other cases as a mandate that in the case of all hotel keepers the turnover has to be estimated by the application of that ratio. It is clear that it was not legitimate for the Deputy Commissioner to make the estimate in that way. It was for him consider whether the application of that ratio was the best way of making the assessment in the petitioner's case and before doing so, it was necessary for him to ascertain from the petitioner why that particular method should not be adopted.

71. What the Tribunal did is open to the same criticism, since it thought that the ratio deduce by it in the other cases was conclusive of the matter.

72. The impugned assessment must, therefore, fall to the ground.

73. Normally, after setting aside those assessments, it would have been necessary for us to direct the Deputy Commissioner to make a fresh assessment according to law. But, it would not be necessary in my opinion for us to do so in this case. Although the Commercial Tax Officer discarded the return of the Durga Lodge for the reason that its accounts were unsatisfactory, the Deputy Commissioner thought that the accounts of the Durga Lodge were above reproach and had been correctly maintained. The implication of that fining of the Deputy Commissioner was that those accounts made a record of every transaction of the petitioner in his books and if the turnover returned by the petitioner was based on those accounts, it was clear that that turnover was the real turnover of the petitioner. It was, therefore, impossible for the Deputy Commissioner after pronouncing the accounts of the Durga Lodge to be full and complete to proceed to make an estimate in contradiction of his own finding. The Tribunal on its part entirely missed the finding of the Deputy Commissioner that the accounts of Durga Lodge were all right, and rested its conclusion that there was a case for an estimate on the superseded finding of the Commercial Tax Officer. The taxable turnover of the Durga Lodge was therefore that declared by the petitioner in his return.

74. We must, in my opinion, take the same view about the assessment relating to the Krishna Vilas Restaurant. The Commercial Tax Officer was himself of the view that no criticism could be made of the accounts of the sales in this restaurant. According to him every sale in this restaurant was entered in these accounts. This is what he said :-

'The accounts of this hotel is better than the other boarding hotel, and he has really taken pains to account every transaction caused every day. He has produced duplicate bills for the daily sales.

The bill books are printed in a book form unlike other hotel keepers and just like shop keepers, he has maintained bills in duplicate and these duplicates are very safely kept and produced for my examination. At the end of the day all the sales are totalled and noted in the sales book. Sales and purchases are very well maintained and it is satisfactory with the exception of a few defects in the

purchase accounts.'

75. If he said that, the conclusion was inescapable that the turnover declared by the petitioner which was supported by those accounts was his real turnover. But the Commercial Tax Officer who should have accepted that return discarded it for a strange reason. He thought that the accounts of the restaurant in which, according to him, every item of sale was entered did not contain an accurate record of the purchases made by the petitioner. He reached that conclusion for the reason that the petitioner had not produced vouchers for certain purchases made by him. He was of the view that the account books did not contain a record of all the coffee powder purchased by him. This defect in his opinion justified the rejection of the petitioner's accounts.

76. It should have been obvious to the Commercial Tax Officer that the turnover of the petitioner was the aggregate of the sales by him in the restaurant and that if everyone of those sales was recorded in the accounts, it became immaterial that some purchases by him, no part of which constituted his taxable turnover, had not been accurately recorded in the accounts.

77. Even the Deputy Commissioner and the Tribunal did not consider the matter from that point of view.

78. What follows, therefore, is that the declared turnover of the Krishna Vilas Restaurant was also not liable to be substituted by an estimate.

79. What remains to be considered is the form of the order to be made in this case. Ordinarily, we should have made an order setting aside the impugned assessments since they were made on the basis of illegitimately substituted estimates. But, Mr. Ananthakrishnan for the petitioner has told us that the petitioner has paid the tax demanded of him. That being the position it would be hardly necessary for us to direct a fresh assessment of the declared turnover. In may opinion, it would be enough for us to make the following direction :-

(a) If the petitioner has paid the tax demanded of him, that portion of the tax which is attributable to the turnover in excess of that declared by the petitioner both in

respect of the Durga Lodge and Sri Krishna Vilas Restaurant shall be refunded to him.

(b) If the petitioner has not paid the tax, the demand in each case will be restricted to the tax payable on the declared turnover.

80. I make a direction accordingly.

81. In the circumstances, there should be no order as to costs.

Sadasivayya, J.

82. I agree.

83. Ordered accordingly.