

inspecting Assistant Vs. Bareilly Corpn. Bank

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Sep-23-1987

Reported in : (1988)27ITD1a(Delhi)

Judge : A Prakash, S Kapur

Appellant : inspecting Assistant

Respondent : Bareilly Corpn. Bank

Judgement :

1. This is a departmental appeal on the short ground as to whether the learned CIT (Appeals) was justified in giving relief of Rs. 2,88,200 to the assessee-bank on account of valuation of the closing stock of the Government securities, held by the assessee-bank as its stock-in-trade.

2. The relevant facts are very brief and may be noted. The asses-see is a banking concern and as part of its stock-in-trade it holds, inter alia, Government securities. Its accounting period is calendar year. Up to the calendar year 1981, corresponding to assessment year 1982-83.

the assessee-bank has been valuing the Government securities in its stock at market price. In the accounting period under consideration, however, the assessee switched on to valuation of the closing stock at cost or market price, whichever was lower. As a result of this change in the method of valuation of the closing stock, the value of the closing stock got reduced by Rs. 9,03,819.34p. The IAC

(Asst.) recorded the aforesaid change in the method of valuation as bona fide, and, therefore, accepted the closing figure as per declaration of the assessee. The IAC (Asst.), however, felt that in order to arrive at the correct figure of total income of the assessee, the figure of the opening stock of the securities should also be adjusted on the principle of cost or market value whichever is lower. He, accordingly, worked out the valuation of the opening stock on the basis of cost or market price whichever was lower and found that on that principle the figure of the opening stock should go down by Rs. 2,88,500. The above sum of Rs. 2,88,500 was, therefore, reduced by the ITO from the reduction in the closing stock figure of Rs. 9,03,819.34p. It naturally resulted in the corresponding increase in the total income of the assessee.

3. In support of the above action the IAC (Asst.) relied on the following judgments: (i) CIT v. Ahmedabad New Cotton Mills Co. Ltd. [1930] 4 ITC 245 (PC); (ii) K.G. Khosla. & Co. (P.) Ltd. v. CIT [1975] 99 ITR 574 (Delhi).

4. The assessee challenged the above order of the IAC (Asst.) before the CIT (Appeals) and it was pointed out to him by the assessee that the Hon'ble Allahabad High Court had not approved the approach of the IAC (Asst.) in the case of Ram Luxman Sugar Mills v. CIT [1967] 63 ITR 51 (All.) and Ramswarup Bengalimal v. CIT [1954J 25 ITR 17 (All.).

Their Lordships of the Hon'ble Allahabad High Court had based their judgment on the decision of the Hon'ble Supreme Court in the case of Chainrup Sampatram v. CIT [1953] 24 ITR 481 and as such according to the learned counsel for the assessee the order of the IAC (Asst.) deserved to be reversed on this issue and the disallowance made by him ought to be negated.

5. The learned CIT (Appeals) after going through the judgments relied upon by the learned counsel for the assessee accepted the assessee's plea and accordingly deleted the disallowance made by the IAC (Asst.).

6. The revenue is in appeal against the aforesaid order of the CIT (Appeals). It is the contention of the learned D.R. that the matter is squarely covered by the Privy Council judgment in the case of Ahmedabad New Cotton Mills Co. Ltd. (supra). In

that case their Lordships of the Hon'ble Privy Council had pointed out that the real profits of the assessee could not be ascertained by merely raising the valuation of the closing stock, the value of the opening stock should also be correspondingly increased. According to the learned D.R., therefore, the valuation of the closing stock alone could not have been done and that it was necessary to value the opening balance also on the same principle in order to arrive at the real profit of the assessee for the year under consideration. According to the learned D.R. the aforesaid judgment of the Hon'ble Privy Council was not taken note of by the Hon'ble Allahabad High Court. It was further pointed out by the learned D.R. that, in the present case, we are concerned with the change in the system of accounting, whereas the case of Ram Luxman Sugar Mills (supra), the question referred for the opinion of their Lordships was not as above. The question there was: Whether, in the circumstances of the case, the opening stocks have been, in law, rightly taken at cost resulting in an addition of Rs. 1,09,595 on account of the revaluation of the opening stock. Their Lordships, therefore, did not have to go into the question, as to what should be done when the assessee was adopting a change in the system of accounting with regard to the valuation of the closing stock.

Referring to the judgment of the Hon'ble Supreme Court in the case of Chainrup Sampatram (supra), the learned D.R. again pointed out that the question before their Lordships in that case was also not as to what should be done when change in the system of account is permitted and closing stock is allowed to be valued on a certain principle, whether in such a case, opening stock should or should also be revalued on the basis of the valuation of the closing stock, was not for the consideration of their Lordships and, therefore, it cannot be said that their Lordships of the Supreme Court had disapproved the proposition laid down by their Lordships of Privy Council in the case of Ahmedabad New Cotton Mills Co. Ltd. (supra). In support of the proposition that the same principle should govern the valuation of the opening stock and closing stock in a given year, in order to find out the real profit of the assessee, the learned D.R. relied upon the following orders of the Tribunal: Goodlass Nerolac Paints Ltd. v. IAC [1985] 13 ITD 270 (Bom.), Sandvik Asia Ltd. v. ITO [1985] 14 ITD 35 (Bom.), ITO v. Hindustan Petroleum Corpn. Ltd. [1986] 16 ITD 574 (Bom.).

It was stressed by the learned D.R. that for the purpose of assessment of business income under Section 28, it had to be real income and if a method of accounting produces a figure which was not the real income, that should not be accepted by the Courts and that if the accounts of the assessee did not bring out real income, it was open to the ITO to make such adjustments in the account, as will bring out the real business income of the assessee.

7. The above submissions of the revenue were opposed by the learned counsel for the assessee who stressed the facts that the assessee came from the State of U.P. and, therefore, the judgments of the Hon'ble Allahabad High Court were binding on us with regard to the question in issue before us and that the judgment of their Lordships was categorical in this regard and clearly stipulated that it was not open for the Income-tax Department to revalue the opening stock, merely because the closing stock was valued on a different principle.

Referring to the judgment of the Hon'ble Delhi High Court in the case of K.G. Khosla & Co. (P.) Ltd. v. CIT [1975] 99 ITR 574, the learned counsel pointed out that in that case also the question involved was not regarding the change in the system of accounting and as to how should it be given effect to for the purpose of valuation of the stock and to arrive at the real income of the assessee. The question was as to whether the valuation of the closing stock was done by the assessee in that case on the same principle on which the opening stock was valued. It was nobody's case in that case that the method of valuation of the closing stock was being changed from one recognised manner to another one. There, while valuing the opening stock of goods, the assessee had gone by interest plus customs duty and charges, but while valuing the closing stock, the customs duty and charges were excluded.

The method of valuation in that case was thus the same namely, cost price but while working out the cost price, whereas certain components of cost were taken into consideration while valuing the opening stock, the same were ignored while valuing the closing stock. In that setting of facts, their Lordships of the Delhi High Court had pointed out that this could not be done. 99 ITR 574 could not, therefore, be the authority for the proposition that even when there was a bona fide change

in the method of accounting of the valuation of the closing stock, the opening stock must also be valued on the same principle as the closing stock.

8. The learned counsel for the assessee drew support for his case from the following authorities of the Hon'ble Madras High Court in *Indo Commercial Bank Ltd. v. GIT* [1962] 44 ITR 22 and *CIT v. Carborandum Universal Ltd.* [1984] 149 ITR 759. It was pointed out to us that at page 765 the Hon'ble Madras High Court had taken note of the judgment of the Privy Council in the aforementioned case reported in 4 ITC 245 and had yet held that it would not be correct for the ITO to value the opening stock also on the same principle at which the closing stock was valued, when the assessee was seeking to change the method of valuation. In that case our attention was invited to the following observation of their Lordships at page 765: The main contention of the revenue in this case is that the change in the method of valuation of the stock should be applied both to the opening stock as well as closing stock, which alone will indicate the true or real profits as has been held in *CIT v. Ahmedabad New Cotton Mills Co. Ltd.* [1930] 4 ITC 245 (PC), and that it is not open to the assessee to apply the new method to the closing stock alone without reference to the opening stock. Thus, according to the learned counsel for the revenue whatever be the method of valuation adopted by the assessee, it should be applied to both the opening and closing stock, as otherwise it will give a distorted picture of the assessee's income. The Tribunal's reasoning for rejecting this contention of the revenue is that so far as first year when the charge is introduced is concerned, there is bound to be a light distortion in the profits but that will get adjusted in course of time as the new method of valuation of stock is going to be applied on a permanent basis year after year.

On a due consideration of the matter, we are inclined to agree with the view of the Tribunal. If the assessee is called upon to apply the new method of valuation to the opening stock of the accounting year as well, then, in consequence, the value of the closing stock of the year previous to the accounting year will also get altered and that will result in the modification of the assessment for the previous year. It is for this reason the Tribunal has stated that though by adoption of the new method of valuation for the closing stock alone the assessee may appear to get some unintended benefit, in course of time it will get adjusted and the revenue will not be

a loser. Even apart from this reason, if the revenue's contention that the new method should be adopted both to opening stock and closing stock even in the first year of the introduction of the new method is accepted, then it will lead to the position that the assessee cannot at all change the method or the assessee has to revalue the closing stock of the previous year which will be the opening stock of this year, and such a revaluation on the new basis as per the assessee is not ordinarily possible. That when a new method of valuation of stock is adopted in any particular year, the assessee can on that basis leave intact the valuation of the opening stock on the old method has been laid down in a series of cases.

For the above stand their Lordships of the Hon'ble Madras High Court again relied upon the observation of the Hon'ble Supreme Court reported as *Chainrup Sampatram's case* (supra) and on the earlier judgment in the case of *Indo-Commercial Bank Ltd.* (supra).

9. We have given our careful consideration to the facts of the case and rival submissions. There is merit in the submission of the assessee's learned counsel that the issue before us is directly and squarely covered by the ratio of the judgment of the Hon'ble Allahabad High Court in the case of *Ram Luxman Sugar Mills* (supra). There too the dispute was, whether the opening stock could be revalued on the same principle at which the closing stock had been valued. The accounting period of the assessee in that case ended on 30th September, 1949. For the earlier assessment year, i.e., for assessment year 1948-49, for which the relevant previous year closed on the 30th September, 1947, the closing stock of sugar was valued by the assessee at market rate at a figure of Rs. 5,39,874. The same amount was shown as value of the opening stock in the relevant previous year, beginning from 1-10-1947 and ending on 30th September, 1948. For the purpose of computing the profits for the assessment year 1949-50, the assessee chose to value his closing stock at the end of the previous year on 30th September, 1948 at cost instead of market rate. In the assessment proceedings the ITO held that the assessee was not entitled to value the closing stock of the previous year at cost, since in the earlier year the closing stock had been valued at market rate as also the opening stock of this previous year. That decision of the ITO was, however, set aside in appeal by the AAC, who held that the assessee

was entitled to value his closing stock at the end of the previous year on 30th September, 1948 at cost price. Thereupon the ITO in making the reassessment, after remand, decided to revalue the opening stock on the 1st October, 1947 and held that it should also be valued at cost and not at market value.

He, therefore, worked out the value of opening stock at Rs. 4,20,279.

The value of the opening stock having thus been reduced, the difference of Rs. 1,09,595 in computation worked out as additional profit earned by the assessee during this previous year, and this amount was thus added to his taxable profits. The assessee appealed to the Appellate Assistant Commissioner and the Tribunal, but unsuccessfully. Thereupon on reference to the Hon'ble High Court of Allahabad, the assessee's viewpoint was upheld.¹⁰ Similarity of the facts stated as above with the facts of the present case, is in our opinion striking. Identical situation, as was considered by their Lordships of the Allahabad High Court in the above case, obtains in the present case. There too the assessee had been following market price as the basis for valuing the closing stock up to the end of the immediately preceding year. The opening stock this year is thus also based on the market rate. For the year under consideration the assessee switched on to the method of valuing the closing stock of Government securities on cost or market value whichever is lower. The IAC (Assessment) accepted the change in the method of valuation as it was bona fide, but he adjusted the opening stock also on the principle of cost or market value whichever was lower, and thereby reduced the value of the opening stock by Rs. 2,82,200. The submission of the learned D.R. that the facts in this case were different and that the ratio of the said judgment will not therefore apply to the facts of the present case, does not appear to us to be correct. The facts are identical and so the ratio of the aforesaid judgment will, in our opinion, squarely cover the facts of the case. For, it is not material in this case, as to in what form the question referred to the Hon'ble High Court in *Ram Luxman Sugar Mills'* case (*supra*) was framed. The crux of the problem in either situation is the same, namely, whether when the method of valuation of closing stock is changed in a bona fide manner, the same principle of valuation as adopted for the closing stock, should also simultaneously be applied to the valuation of the opening stock. To this question, their Lordships gave a

categorical reply that it could not be done. The reasoning of their Lordships was as follows: The answer to the question referred to us is very plain from the principles recognised by a Bench of this Court in the case of *Ram Swarup Bengalimal v. CIT*. In that case also, the question that came up for consideration related to the method of valuation of opening and closing stocks. This Court held: Two principles have now become well settled: (1) that the assessee is entitled to value the closing stock either at cost price or market value, whichever is lower, and (2) that the value of closing stock must be the value of opening stock in the succeeding year, that is, an assessee cannot close his accounts and value his stock at a particular figure and the next morning on the first day of the next year he cannot value it at a different figure.

Their Lordships further pointed out that the Hon'ble Allahabad High Court had already recognised the principle that: an assessee has a right to value his stock at market price or cost price whichever is lower if he desires to do so. This principle was also recognised by the Supreme Court in *Chainrup Sampatram v. CIT*.¹¹ The decision of the Hon'ble Allahabad High Court is binding on us and therefore, we have no option in the matter, but to follow the aforesaid judgment, even if some other High Court had taken a different view in the matter. But as it turns out, no judgment of any High Court has been brought to our attention which might have taken a different view. The Hon'ble Madras High Court has not only followed the principle enunciated by their Lordships of the Allahabad High Court in the abovementioned case, but has also elaborated this in their judgment in the case of *Carborandum Universal Ltd.* (supra), quoted by us in extenso above in para 8, supra. Their Lordships have also placed reliance on the judgment of the Supreme Court in *Chainrup Sampatram's* case (supra), for the proposition they enunciated in the above judgment.

12. *Chainrup Sampatram's* case (supra) is the leading authority on the question of valuation of the stock, the rationale behind it and the principle underlying it. At page 485, it is what their Lordships observed: It is wrong to assume that the valuation of the closing stock at market rate has, for its object, the bringing into charge any appreciation in the value of such stock. The true purpose of crediting the value of unsold stock is to balance the cost of those goods entered on the other side of the

account at the time of their purchase, so that the cancelling out of the entries relating to the same stock from both sides of the account would leave only the transactions on which there have been actual sales in the course of the year showing the profit or loss actually realised on the year's trading.

Having explained the principle of valuing the stock and bringing it into the trading account as above, their Lordships proceeded to observe as follows: From this rigid doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, *vi z.*, the adoption of market value at the date of making up accounts, if that value is less than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect if prices rise again, of attributing to the following year's result a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question.

While anticipated loss is thus taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account, as no prudent trader would care to show increased profit before its actual realisation. This is the theory underlying the rule that the closing stock is to be valued at cost or market price whichever is lower, and it is now generally accepted as an established rule of commercial practice and accountancy. As profits for income-tax purposes are to be computed in conformity with the ordinary principles of commercial accounting, unless of course, such principles have been superseded or modified by legislative enactments unrealised profits in the shape of appreciated value of goods remaining unsold at the end of an accounting year and carried over to the following year's account in a business that is continuing are not brought into the charge as a matter of practice, though, as already stated, loss due to a fall in price below cost is allowed even if such loss has not been actually realised.

13. The above principle was illustrated by their Lordships in its practical working with reference to the facts of the case of *CIT v. Chengalvaraya Chetti* 1925 ILR 48 Mad. 836. In that case the assessee had purchased a large stock of piece goods at Rs. 13-8-0 a piece. At the end of the year the market value fell to Rs. 6 a piece,

and he made out a loss by valuing the whole stock at the market rate including the unsold pieces in hand at the end of the year. The loss was allowed in his assessment of income-tax. In the following year (1922), however, he entered the same unsold goods as opening stock at the cost price of Rs. 13-8-0. Some of those pieces remained unsold at the end of 1922 also and he credited their value at Rs. 8-8-0 a piece, the market rate then prevailing, and showed a loss on the year's trading. The income-tax authorities refused to allow the loss thus calculated, and assessed him as having made a profit on the footing that the opening stock of 1922 should have been valued at Rs. 6 a piece and the unsold pieces at Rs. 8-8-0. The assessment was upheld as properly made, though it will be seen, the transactions of 1922, or even of the two years taken together, ended actually in a loss. Thus, while the valuation of the unsold stock at the end of each year at market rate which was less than cost was accepted, the valuation of the unsold goods carried over as opening stock of 1921 at Rs. 6 a piece consistently with their valuation at the closing stock of 1921 was insisted upon in order to rectify the distorted picture of the trading results of 1921 which were not correctly reflected in the accounts by reasons of the assessee having adopted the lower market rate instead of cost as the value of the closing stock in 1921. Their Lordships pointed out that if the market had risen in 1922, to say, Rs. 15 instead of to Rs. 8-8-0 a piece at the end of 1922, then, on the principles indicated above, it would have been open to the assessee to value the closing stock at cost (Rs. 13-8-0), and the income-tax authorities could not have claimed to bring into the assessment the appreciated value of the unsold goods. It will thus be seen that no question of charging the appreciated value of closing stock as "notional profits" can really arise. Their Lordships also explained that it was a misconception to think that any profit 'arises out of the valuation of the closing stock', that is in fact not the true purpose of bringing the value of the closing stock into the trading account.

13.1 From the aforesaid judgment of the Hon'ble Supreme Court, the following points clearly emerge: (i) That the true purpose of valuing the stock and bringing it in the accounts, both at the beginning of the year and at the end of the year, is not to bring into charge any profits, arising out of the valuation of the closing stock. Its mere purpose is to neutralize in the accounts, the entries regarding the purchases which have earlier been debited, but large part of which remained in hand and

have not been sold at the end of the accounting period. The profit arises from purchases and sale and not from the holding of the stock.

(ii) To this principle, as explained by their Lordships, there is one exception, namely, that anticipated losses can be brought into account even though the real purpose of bringing the value of the stocks into account is to neutralise the earlier debit entries with regard to the goods which remained in hand. When this anticipated loss is brought into account, apparently the true profits of the year are distorted and lesser amount is taken into account, but it is permitted by usage and custom and so on. Their Lordships held that anticipated losses may be allowed provided they are based on the principle of valuing the stock at cost price or market price, whichever is lower.

(iii) One more thing which is clear from the observations of their Lordships, is that the opening stock's valuation may be on one basis, namely, the market price and the closing stock valuation may be, on the other basis, namely, the cost price and that it is not necessary to have the same principle of valuing the opening stock and closing stock. In an example given by their Lordships the goods were purchased at Rs. 13-8-0 per piece, the market price at the end of the year had gone down to Rs. 6 a piece, thus bringing into account the actual losses in respect of the goods in hand.

13.2 If the above is permissible in the first year of trading, it is not understood as to why in any subsequent year of trading an assessee cannot be allowed to value its closing stock at cost price or market price or whichever is lower. It is a recognised principle of valuation of stock and it cannot be refused to the assessee merely on the ground that by doing these, the profits of the year are transferred to the next year. The distortion in the accounts from the point of view of true profits is embedded in the commercial practice of valuing the stock at cost or market price or whichever is lower. The said distortion was elaborately illustrated by their Lordships in the example given by them at page 486, when they pointed out that even though as a result of trading for the years 1921 and 1922, there would be a net loss, yet on account of the method of valuation adopted by the assessee, namely, the cost price or market price, whichever is lower, the trading results of

the first year were distorted in the sense that actual losses are exaggerated, the next year's profits were also distorted in the sense that even though there was really a loss, some profit arose to the assessee by taking the closing stock of 1921 as the opening stock of 1922. Thus distortion in course of time will cancel each other out and that was the purpose of insisting that the closing stock of one year should be the opening stock of the following year, for, that way alone the distorted picture of 1921 would, according to their Lordships, be rectified. Their Lordships of the Hon'ble Madras High Court have brought into sharp focus the above principle enunciated by their Lordships of the Hon'ble Supreme Court reported as *Carborandum Universal Ltd.'s case* (supra) at page 766. Their Lordships of the Hon'ble Allahabad High Court also emphasised this point when they held that the closing stock of one year should be the opening stock of the following year.

14. With regard to the aforesaid insistence, namely, the closing stock of one year should be the opening stock of next year, the aforesaid judgments do make a departure from the implications (not the principle explicitly stated) of the facts and ratio of the Privy Council judgment in the case of *Ahmedabad New Cotton Mills Co. Ltd.* (supra). In that case their Lordships had directed that the opening stock figure should also be revalued to remove the element of under-valuation, because the under-valuation of the closing stock, similarly made, was sought to be eliminated by the revenue. If the opening stock of the year in question was allowed to be disturbed, as indeed their Lordships directed, the value of the opening stock of the current year would naturally be different from that of the closing stock of the immediately preceding previous year. Thus, their Lordships of the Privy Council were prepared to contemplate a situation, where the closing stock of the earlier year would not be the opening stock of the following year. But their Lordships of the Hon'ble Supreme Court did not countenance such a situation in *Chainrup Sampatram's case* (supra). To this extent, therefore, the Privy Council ratio would stand modified by the judgment of the Hon'ble Supreme Court. It is true that there is no reference to the judgment of the Hon'ble Privy Council in the case of *Ahmedabad New Cotton Mills Co. Ltd.* (supra), in the judgment of *Chainrup Sampatram* (supra), yet the principle had been laid down by their Lordships in no ambiguous terms and, therefore, the principle laid down by the Privy Council can no more be regarded a good law in India.

15. Apart from it we notice that the facts in the case of the Privy Council judgment, referred to above, were different. In that case the question referred to their Lordships of the Privy Council did not concern itself with the problem, of change in the system of accounting with regard to the valuation of closing stock. The method remaining the same and both the opening stock and the closing stock having been under-valued, the question for determination was, as to whether it was correct for the ITO to merely correct the closing stock figure by removing the under-valuation therefrom and to ignore the under-valuation of the opening stock. The method of valuation for opening stock and closing stock was otherwise the same and no change was being sought in the system of valuation. The question was -- whether the ITO was justified in removing the element of under-valuation from the closing stock only, or, whether, he should also remove the element of undervaluation from the opening stock, in order to arrive at the correct and real profits of the business of the assessee. It was in that context that their Lordships of the Privy Council had held that real profits of the assessee could not be ascertained by merely raising the valuation of the closing stock not taking into consideration the similar under-valuation of the opening stock. Derivation of a general principle of uniform applicability will not in the circumstances be justified.

16. The judgment of the Hon'ble Delhi High Court, relied upon by the learned departmental representative, K.G. Khosla & Co. (P.) Ltd.'s case (supra), also does not help the department's case, for, there also the question for determination was not as to whether the opening stock should be revalued, if change in the system of valuation of the closing stock was contemplated, but in that case also the method of valuation of the stock was the same both with regard to the opening stock and the closing stock, namely, the cost price. But while the opening stock was worked out with reference to the cost price plus customs duty and charges, the value of the closing stock was worked out only on the basis of cost price, ignoring the customs duty and the charges. This distortion in the valuation (the method of valuation remaining the same for both the opening and closing stock) was removed by the income-tax authorities in that case and it was held to be justified. In the present case, we are not concerned with such a situation. Here the assessee is keeping the opening stock at the figure at which the earlier year's closing stock stood and with reference to the closing stock he is changing the

valuation by adopting the principle of cost price or market price, whichever is lower. Thereby no doubt some anticipated losses are brought into account this year and in this sense the real profits are being distorted, yet this distortion, as pointed out by their Lordships of the Hon'ble Supreme Court in Chainrup Sampatram's case (supra) would get rectified over a number of years and this should not therefore be the basis for rejecting the assessee's accounts and valuing the opening stock in the manner by the IAC (Asst.).

17. The Revenue's reliance on the order of the Tribunal in the case of Goodlass Nerolac Paints Ltd. (supra) does not appear to be advancing the Revenue's case. In the case of Goodlass Nerolac Paints Ltd. (supra), the Department had interfered with the valuation of the closing stock and no attempt was made to interfere with the valuation of the opening stock. In the present case, the facts are just the reverse of what they were in the case of Goodlass Nerolac Paints Ltd. (supra). No doubt there are some stray observations in that order to the effect that, even assuming that the assessing officer was justified in making the additions in the closing stock, still it was incumbent on the assessing officer to evaluate both the opening and closing stock on the same principles. Admittedly that had not been done in the present case.

The aforesaid stray observations, which are made on the basis of an assumption, cannot be regarded as laying down the law on the point, more particularly when the law has already been explicitly explained in the judgment of the Hon'ble Allahabad High Court and Madras High Court, and earlier by the Hon'ble Supreme Court in the cases, referred to above. We do not consider it necessary to change our observations as above in the light of the stray comments made by the Tribunal in the above case.

18. In the case of Sandvik Asia Ltd. (supra), there are certain observations of the Hon'ble Third Member, contained in paragraphs 22, 23, 24 and 25, which go to lend some support to the Revenue's case. The relevance of the said observation should, however, be judged in the context of the said case. In that case the assessee-company was following the practice of valuing inventories at the lower of direct cost and net realisable value from year to year. During the relevant year the

company changed its method of valuing closing stock from the aforesaid method to the last in first out (LIFO) method on the ground that this method produced a more realistic statement of earnings in view of spiralling inflation. The revaluation of the closing stock resulted in a reduction of closing stock of Rs. 58,46,535 compared to the figure of closing stock if the earlier method had been followed.

Rejecting the assessee's grounds for adopting the aforesaid change in the method of valuation the IAC added the sum of Rs. 58,46,535 to the assessee's total income. On second appeal, while the Judicial Member held that the addition of the impugned sum was not justified, the Accountant Member held that the assessee was not entitled to change over to the LIFO method and, therefore, the addition was justified. On reference to the Third Member, it was held that the assessee could change its method of valuation from the earlier one, followed by it to the LIFO method, but the Hon'ble Third Member held that, "If for one year he changes the method of stock valuation, the profit of that year has to be recomputed by either revaluing the closing stock adopting the same method as the opening stock or revaluing the opening stock by following the same method as valuing the closing stock. If this is not done the profit of that year cannot be ascertained. This incongruity cannot be explained away by saying that over the years the total profit would be the same if subsequent to a change the same changed method of closing stock valuation is continued. The profits up to the year prior to the change for each year would be correctly determined. The profit for the years subsequent to the change of the year could also be determined correctly. But the profit of the year where a change in valuation of closing stock is made cannot be determined. Therefore, in applying various principles as above, they have to be properly reconciled with each other for the purpose of arriving at the profit of the current year, and, therefore, according to the Third Member the opening stock should also be revalued on the same principle of LIFO as the closing stock was done.

19. The above observations of the Third Member run contrary to the observations of the Hon'ble Madras High Court, the Hon'ble Allahabad High Court and the Hon'ble Supreme Court in the cases, cited above. It is not that the aforesaid judgments were not brought to the attention of the Third Member, but he somehow felt that the said judgments were not relevant for the determination of the question

before him. His observations with regard to the same are contained in para 26. In his opinion: None of these decisions can be regarded as an authority for the proposition that suddenly the method of stock valuation can be altered even if it involves some amounts of income altogether escaping the tax.

The above observation naturally runs counter to the following observations of their Lordships of the Hon'ble Madras High Court, who noted the above possibility and dealt with it in the following words: Thus, according to the learned counsel for the Revenue, whatever be the method of valuation adopted by the assessee, it should be applied to both the opening and closing stock, as otherwise it will give a distorted picture of the assessee's income. The Tribunal's reasoning for rejecting this contention of the Revenue is that so far as the first year when the change is introduced is concerned, there is bound to be a slight distortion in the profits but that will get adjusted in course of time as the new method of valuation of stock is going to be applied on a permanent basis year after year.

On a due consideration of the matter, we are inclined to agree with the view of the Tribunal.

Even their Lordships of the Hon'ble Supreme Court had, as noted earlier, visualised the above situation and illustrated it by a specific example discussed by us at great length above, while explaining the ratio of *Chengalvaraya Chetti* (supra). Their Lordships observed, inter alia, as below: Thus, while the valuation of the unsold stock at the end of each year at market rate which was less than cost was accepted, the valuation of the unsold goods carried over as opening stock of 1921 at Rs. 6 a piece consistently with their valuation as the closing stock of 1921 was insisted upon in order to rectify the distorted picture of the trading results of 1921, which were not correctly reflected in the accounts by reasons of the assessee having adopted the lower market rate instead of cost as the value of the closing stock in 1921.

The principle of real income being reflected as a result of the valuation of the stock was negated by their Lordships who themselves noted the distortion in real profits and they pointed out that to the principle of neutralization function of the valuation of the stock, there was one exception, namely, that anticipated losses

could be brought into account through the valuation of the closing stock, even though it distorted the true trading result of that year. The argument, therefore, that the trading result should be so ascertained as would be free of distortion on account of change of the system, of valuation of the closing stock do not find favour with the Hon'ble Madras High Court in the case of Carborundum Universal Ltd. (supra), nor with the Allahabad High Court in the case of Ram Luxman Sugar Mills (supra), nor with their Lordships of the Supreme Court in the case of Chainrup Sampatram (supra). When there be conflict between the observations by the Members of the Tribunal and that made by the High Courts and the Supreme Court, it is the latter which would prevail and therefore respectfully following the authority of the Hon'ble Allahabad High Court by which in the present case, in any case we are bound, we uphold the order of CIT (Appeals) and thereby we dismiss the departmental appeal.

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