K and Co. Vs. Deputy Commissioner of

K and Co. Vs. Deputy Commissioner of

SooperKanoon Citation : sooperkanoon.com/67851

Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Sep-29-1995

Reported in : (1996)56ITD448(Delhi)

Judge : R Mehta, B Saluja

Appellant : K and Co.

Respondent : Deputy Commissioner of

Judgement :

1. This appeal is directed against the order passed by the Commissioner of Income-tax (Appeals) raising for the consideration of the Tribunal three separate and specific issues which are disposed of as under.

2. In order to appreciate relevant facts of the case as also the issues involved it would be necessary on our part to mention that the appellant is registered firm engaged in the business of organising lotteries on behalf of the Government of Sikkim. The first ground pertains to the disallowance of a sum of Rs. 1,01,057 under the head "Opening ceremony expenses." The Assessing Officer made the aforesaid disallowance on the ground that the expenditure was inadmissible in nature.

3. On further appeal before the Commissioner of Income-tax (Appeals), it was contended that a substantial part of the expenditure pertained to the stay of the firm's stockists in hotels and presents given to them. It was claimed that such type

of expenditure was normal business expense and not covered by Explanation 2 to Section 37(2A) of the Income-tax Act.

4. The aforesaid submissions did not find favour with the Commissioner of Income-tax (Appeals), who at the outset, set out the details of the expenditure in question as follows :-Date Ch. No. To whom paid Particulars Amount Rs.12-9-1987 607789 Chicken Inn Dinner for 500 42,800.00 persons on14-9-1987 607793 Hotel Sofital Stay charges of Surya.

stockists 39,942.751-9-1987 194140 M/s. Bhagwan 30 Safari Suit 18,315.00 Das & Sons.

case.

---------- 1,01,057.75 5. By referring to Explanation 2 to Section 37(2A) the Commissioner of Income-tax (Appeals) opined that entertainment expenditure included the amount spent on provision of hospitality of every kind by the assessee to any person whether by way of food or beverages or in any other manner. According to him it was immaterial whether such provision was made by reason of any express or implied contract or custom or usage of trade. He, therefore, concluded that the entire amount of Rs. 1,01,057 was covered by Explanation 2 to Section 37(2A) and liable for disallowance/deduction in accordance therewith. A direction was, however, given to the Assessing Officer to allow the relief to which the assessee would be entitled in accordance with the appropriate section, viz., 37(2A).

6. We have heard both the parties and have also perused the material on record, to which our attention was invited during the course of hearing. The learned counsel for the assessee advanced the following main arguments:- l (i) That the expenditure of Rs. 18,315 on the Safari suits given to the stockists was not covered by Section 37(2A); (ii) The expenditure of Rs. 42,800 on the dinner for 500 persons in connection with the opening ceremony of the new office at Pamposh Enclave did not partake the character of entertainment and was primarily a business expense. The alternative submission was, however, to the effect that an appropriate percentage be allowed as a deduction vis-a-vis the staff

participation ; (iii) That the sum of Rs. 39,942 at the most could fall under the category of entertainment expenditure vis-a-vis Explanation 2 although the main submission to the effect that it be allowed in full being business expenditure.

7. In support of the aforesaid arguments, reliance was placed on the judgment of the Hon'ble Delhi High Court in the case of CIT v. Indian Aluminium Cables Ltd. No. 2 [1990] 183 ITR 611 and that of the Jaipur Bench of the Tribunal in the case of Mangalam Cement Ltd. v. Dy. CIT [1992] 43 ITD 292.

8. The learned Departmental Representative, on the other hand, strongly supported the orders passed by the tax authorities and the subsequent arguments advanced by him were a reiteration of the reasons recorded by the Commissioner of Income-tax (Appeals) in rejecting the view point canvassed on behalf of the assessee.

9. After considering the rival submissions, we are of the view that the entire expenditure aggregating Rs. 1,01,057 falls under the category of entertainment expenses within the meaning of Explanation 2 to Section 3 7(2A). The expenditure on the Safari suits to the stockists cannot be considered independent of the expenditure of Rs. 39,942 spent on the stay charges of the said stockists in the hotel. Similarly, the expenditure of Rs. 42,800 on the dinner for 500 persons is also hit by the same Explanation. We would however, accept the alternative submission of the learned counsel and direct that 25 per cent of the said expenditure, viz; Rs. 10,700 be excluded from the purview of the disallowance being allocated to the employees of the assessee on an estimated basis. The Assessing Officer is now directed to recompute the disallowance in accordance with the aforesaid directions.

10. The second ground in the appeal pertains to the disallowance of a sum of Rs. 18,67,822 in respect of the depreciation on vehicles which were leased out by the assessee. The Assessing Officer in the course of the assessment proceedings noted that the following vehicles had been purchased and leased out on the last day of the accounting period :-Date Description of Vehicle Amount Rs.30-3-1989 D.C.M. Toyota 23,75,92031-3-1989 Truck TATA 1,60,00030-3-1989 Maruti 1,39,41231-3-1989 Premier Padmani 65,00030-3-1989 Maruti Car 94,50031-3-

1989 Ambassador 1,16,000 ---------- 11. Vide order-sheet entry the Assessing Officer asked the assessee to show cause as to why depreciation not be disallowed on the aforesaid vehicles as they were purchased and leased out on the last day of the accounting period. A perusal of the order of the Assessing Officer shows that in response to the query raised, the assessee withdrew the claim for depreciation to the tune of Rs. 7,26,121. The Assessing Officer further noted that in the field of evidence temporary registration certificates had been produced and which, according to her, were not sufficient to prove that the vehicles had been put to use in the accounting period under consideration. The non-production of a commercial permit, licence, permanent registration, etc., was duly noted by the Assessing Officer. On the further ground that it Was an important factor for claiming depreciation that the vehicles /assets be put to use for business purposes and in the instant case there being no evidence to prove such a fact she, in the final analysis, disallowed depreciation to the tune of Rs. 18,67,822.

12. Before the Commissioner of Income-tax (Appeals) detailed arguments were advanced on behalf of the assessee, but for purposes of disposing of the present appeal it would suffice if we summarise these as under :- (i) That the vehicles were owned by the assessee and leased out before the end of the accounting year ; (ii) That the vehicles were used for purposes of the leasing business of the assessee; (iii) All relevant conditions stipulated by Section 32 stood fulfilled to entitle the assessee to claim the depreciation; (iv) That the assessee had received rentals from the lessees of the said vehicles and the transaction between the parties was complete as soon as the assets viz., the vehicles had been given on lease ; (v) It was not the concern of the assessee as to what use the vehicles were put to by the lessees after the same had been given on lease ; and (vi) That the vehicles had been insured and temporary registration certificates duly obtained.

On the basis of the aforesaid facts and submissions, it was urged that depreciation be allowed.

13. The aforesaid submissions, however, did not find favour with the Commissioner of Income-tax (Appeals) who proceeded to confirm the

disallowance more so on the following grounds :- (i) The temporary registration certificates and the insurance on the vehicles were not sufficient since surrounding facts and circumstances and "reality of the situation" had to be duly considered; (ii) Section 42 of the Motor Vehicles Act, 1988 made it obligatory on the part of the owner of a transport vehicle to obtain a permit from the Transport Authority concerned authorising thereby the use of the vehicle for the purposes specified therein. That Section 123 of the same Act made it an offence to use the vehicle without a permit and the obtaining of a temporary permit was not sufficient enough; and (iii) Without obtaining a permanent and regular permit it was not possible to put the vehicle to commercial use.

14. We have considered the submissions of both the parties in support of their respective stands. The learned counsel in addition to reiterating the arguments advanced before the lower' authorities raised for our consideration the following:- (i) That proper lease agreements had been entered into between the assessee and the lessees before the end of the accounting period ; (ii) That the lessees had confirmed in writing that these vehicles had been put to commercial use before 31-3-1989 ; (iii) That the vehicles leased out had been duly insured and registration certificates although temporary had been duly obtained ; (iv) The assessee was entitled to depreciation as soon as the lease agreement had been concluded and the vehicle physically taken possession of by the lessee and it was immaterial whether the said lessee put it to use or not; (v) That no cross verification had been made by the tax authorities from the various lessees to whom the vehicles had been leased ; (vi) That in the succeeding assessment year, the Assessing Officer had allowed depreciation on the vehicles in question on their written down value and not the full amount; (vii) That provisions of Section 42 of the Motor Vehicle Act were not applicable as these pertained to the registration of a motor-vehicle belonging to a diplomaj. Similarly Section 123 was not relevant as it referred to the carrying or travel of a person on the running board, on the top or on the bonnet of a motor vehicle ; (viii) That Section 43 of the said Act provided for the grant of a temporary registration by the Authorities concerned and in the present case such temporary registration had been duly obtained and this being a fact not disputed by the tax authorities ; and (ix) That the lease rentals from the various lessees amounting to Rs. 75,306 had been duly received and accounted for as the

assessee's income for the assessment year under consideration.

15. On the basis of the aforesaid submissions, the learned counsel urged that depreciation as claimed be allowed. In support the following decisions were relied upon :- 3. Indian Management Advisers & Leasing (P.) Ltd. v. Dy. CIT [1994] 51 ITD 566 (Delhi).

16. The learned Departmental Representative, on the other hand, strongly supported the orders passed by the tax authorities and in addition to the reasons recorded in the said orders it was canvassed that the transactions of lease had not to be considered in substance, but in form. It was, however, submitted that there was no dispute between the Revenue and the assessee to the effect that the vehicles had been given on lease during the previous year relevant to the assessment year under consideration.

17. Alter considering the rival submissions, we are of the view that there is substantial merit in the arguments advanced by the learned counsel for the assessee. It is not disputed before us by the Revenue that the lease agreements have been entered into and concluded prior to the end of the accounting period. Further there is no dispute on the score that the vehicles have been physically taken possession of by the lessees and the lease rentals duly paid over to the assessee and accounted for as income. The further fact which requires repetition on our part is that whereas the lessees furnished certificates to the effect that they had taken possession of the vehicles and put them to commercial use before the end of the accounting period there was no attempt on the part of the Revenue authorities to make enquiries or confront the lessees. The orders of the tax authorities have proceeded entirely on suspicion and without any reasonable or cogent basis. As rightly contended by the learned counsel, the transaction on its part stood completed as soon as the lease agreement was concluded and physical possession of the vehicles handed over. As the business to which the aforesaid transactions pertained was that of leasing the assessee became entitled to claim depreciation irrespective of what the lessees did.

18. The further aspect of the matter is that the vehicles were duly insured as would be apparent fromthe sample placed on the paper-book by the learned counsel and

as already stated earlier temporary registration permits were duly obtained from the Transport Authorities and as rightly contended by the learned counsel provisions of Sections 42 and 3 23 of the Motors Vehicle Act did not apply. Further Section 43 of the same Act did provide for a situation where a temporary registration permit could be obtained and no other provision of the Act has been brought to our notice on behalf of the Revenue which could prevent the vehicles to be used for commercial purposes on the basis of a temporary permit pending the receipt of a permanent one. Then against it is not disputed before us on the part of the Revenue that in the subsequent assessment year depreciation although allowed to the assessee on the said vehicles was on the WD V and not the gross amount.

In our opinion, some consistency was required to be maintained on the part of the Revenue authorities in processing the claim on account of depreciation. In the final analysis, we accept the arguments advanced by the learned counsel on behalf of the assessee as these find apt support from the decisions cited and more so the one of the Delhi Benches of the Tribunal in the case of Indian Management Advisers & Leasing (P.) Ltd. (supra). The Assessing Officer is accordingly directed to allow necessary relief on account of the depreciation claimed.

19. We now come to the last ground in the appeal, which by far was the most contested. As per the memorandum filed before the Tribunal, the said ground reads as under:- 3. (i) The CIT (Appeals) erred in rejecting the method of accounting followed by the assessee and thereby upholding an addition of Rs. 97,22,280.

(ii) The CIT (Appeals) erred in holding that under the new method of accounting the assessee had not accounted for the lottery tickets despatched before the end of the accounting year in the closing stock when it was clearly shown to the CIT (Appeals) and the Assessing Officer and is borne out by the record that the corresponding adjustment for the closing stock of such tickets had been made in the accounts under the new method of accounting.

20. During the course of the assessment proceedings the Assessing Officer noted a change in the method of accounting earlier followed by the assessee inasmuch

as no closing stock of tickets in respect of draws not held had been reflected and earlier system of reflecting as sales the value of the tickets despatched irrespective of the dates of draw had been departed from. On being asked to work out the effect of the aforesaid changed method the assessee filed a comparative statement and which reflected a difference of Rs. 97,22,290 which was termed by the Assessing Officer as a reduction in the profits.

21. The Assessing Officer thereafter allowed the assessee an opportunity to justify the changed method and in response to which detailed submissions were made, but the sum and gist being that the changed method was a bona fide one and permissible under the law and that the same had been adopted with a view to correct the wrong presentation of accounts on the basis of the earlier method and further there was no attempt to postpone the tax liability from one year to the other. These submissions on the part of the assessee were rejected by the Assessing Officer on the following main grounds:- (i) It was strange that the assessee took out from 'its sales the despatches already made against regular sale bills especially when all the conditions for a sale were fulfilled within the meaning of the Sale of Goods Act and the Indian Contract Act, the moment the tickets were despatched ; (ii) That the sale was complete as sobri as the purchasing parties had offered to purchase the tickets and the assessee had accepted the offer and despatched the tickets as per bills to the respective destinations ; (iii) It was entirely a matter of convenience that the assessee took out the despatches from the sales on the ground that they pertained to the draws which were not held in the accounting year under consideration; (iv) That confirmed sales of Rs. 8.36 crores duly reflected in the books of account "were kept in abeyance to suit assessee's convenience"; and (v) That the assessee's disclosed figures reflected a distorted picture since the G.P. rate which was-18.84 per cent in assessment year 1986-87 carne down to 10.71 per cent in the assessment year under appeal. However, the difference of 5.43 per cent was explained to be on account of the higher prize money paid and this was accepted by the Assessing Officer, but the balance of 1.60 (correct figure should be 2.61%) per cent was attributed to the change in the method of accounting.

22. On the basis of the above, the Assessing Officer, in the ultimate analysis, concluded that the changed method had been adopted by the assessee "to reduce its profit and tax incidence." The difference between the old method and the changed method, viz., Rs. 97,22,290 was added to the returned income. In making the impugned addition the Assessing Officer referred to various reported judgments and these are duly discussed at page 4 of the assessment order and also find due mention in para 9.4 of the order of the CIT (Appeals).

23. Being aggrieved with the rejection of its "changed method" by the Assessing Officer and the consequent addition the assessee took up the matter before the CIT (Appeals) and at which stage arguments more or less identical to those tendered before the Assessing Officer were advanced. These may be summarised as under:- (i) That the changed method adopted by the assessee in the assessment year under appeal had been followed regularly by a number of other assessees in the same line of business. The changed method stipulated that tickets despatched before the end of the year in respect of lotteries ; the draws of which had not taken place before the close of the year were riot treated as sales, but shown as closing stock. As soon as the draws took place, these were reflected in the sales ; (ii) That the changed method was a recognised one as the same had been followed by other assessees in the lottery business and once the said method stood accepted in other cases it was not open to the Assessing Officer to take the view that the true profit could not be worked out and assessed in the assessee's case ; (iii) That the assessee's taxable income in the succeeding assessment year on the basis of the changed method was higher by Rs. 28 lakhs and odd and since the method was a recognised one it could not be rejected on the ground that it reduced the tax liability ; and (iv) That the assessee was entitled to adopt a different method as compared to preceding assessment years even though the interest of the Revenue was adversely effected by such a change.

24. In support of the view-point canvassed, reliance was placed on the judgments reported in Forest Industries Travancore Ltd. v. CIT [1964] 51 ITR 329 (Ker.), Snow White Food Products Co. Ltd. v. CIT [1983] 141 ITR 861 (Cal.) and Triveni Engg. Works Ltd. v. CIT [1987] 167 ITR 742 (All.), all for the proposition that the changed method be accepted and the income taxed by the Assessing Officer be

accordingly reduced.

25. The Commissioner of Income-tax (Appeals) considered the aforesaid arguments with reference to the material on record as also the decisions cited before him to ultimately come to the conclusion that the action of the Assessing Officer was valid and required to be confirmed. We need only highlight the main reasons recorded by the CIT (Appeals) in doing so as under:- (i) That the system followed by other assessees in the same line of business was relevant to their assessments as that was the consistent system followed by them all along in the past whereas in the case of the assessee it was the system consistently followed by him, which was required to be taken into account; (ii) That in the case of the assessee the system had been abruptly changed whereby the lottery tickets despatched towards the end of the accounting period and in respect of which the draw had not been held had neither been accounted for in the sales and nor in the closing stock ; and (iii) The assessee had accounted for the opening stock according to the new method whereas it did net account for the tickets despatched on the last dates of the accounting period either in sales or in the closing stock and this gave a distorted picture of assessee's taxable profits.

26. In support of the aforesaid proposition and findings, the Commissioner of Income-tax (Appeals) placed reliance on the judgment of the Hon'ble Supreme Court in the, case of CIT v. British Paints India Ltd. [1991] 188 ITR 44. The aforesaid judgment in fact has been discussed at length in paras 9.10 and 9.11 of the order of the first appellate authority and the ultimate conclusion being reached to reject the changed method.

27. We have heard both the parties at substantial length in respect of the aforesaid issue and have also perused the material on record, to which our attention was invited during the course of the hearing. The learned counsel for the assessee reiterated most of the arguments advanced before the lower authorities, but highlighted for our consideration the following:- (1) The changed method adopted by the assessee was a recognised one and followed by other assessees in the same line of business; (2) That material on record clearly revealed the closing stock of lottery tickets had been duly shown although by way of an adjustment in

the prepaid expense account. That written submissions to the CIT (Appeals) in this respect had been completely ignored to record an erroneous finding that closing stock had not been shown ; (3) In effect there was no change in the method of accounting and what the assessee had done was to show in the closing stock the tickets which had been sent to the stockists on "consignment basis" and in respect of which the draws had not taken place ; (4) The change was bona fide and followed consistently in the subsequent assessment years. Further in the succeeding assessment year the returned income was more by a figure of Rs. 28,00,000 and odd as a result of the changed method ; (5) That in the course of the appellate proceedings before the CIT (Appeals) for the assessment year 1990-91 the Assessing Officer had accepted that closing stock of tickets had been duly reflected in the various assessment years including assessment year 1989-90 at a figure of Rs. 57,87,163 and which was presently in appeal. That in assessment years 1990-91 and 1991-92 the CIT(A) had set aside the assessments vis-a-vis the addition resulting from the changed method by specifically referring to the remand report and the categorical statement of the Assessing Officer to the effect that closing stock had been reflected in assessment year 1989-90 ; (6) That the assessee in fact had filed a misc. application against the order of the CIT (Appeals) for the assessment year 1989-90 seeking thereby to point out certain mistakes apparent from the record in as mush as findings had been recorded to the effect that closing stock had not been reflected although the material on record disclosed otherwise (the fate of this misc. application, however, was not indicated to us) ; (7) That as per the terms of the agreement with the stockists (sample agreement appended at pages 72 to 75 of the paper-book) the despatch of the tickets did not tantamount to a sale within the meaning of the Sale of Goods Act. A reading of the various clauses would indicate that the tickets continued to be the property of the assessee; (8) That although the assessee had been following a different method all along in the past it was on the expert advice of the auditors that it was obliged to change the method, but the latter also being a recognised method followed by others in the same line of business and accepted by the Department. That in fact it was not a change in the method, but only the removal of certain "anomalies" in the earlier method; (9) That the change on the facts and circumstances of the. case was bona fide and this had also been accepted by the

Assessing Officer in the remand report sent to the Commissioner of Income-tax (Appeals) in assessment year 1990-91 ; and (10) No finding had been recorded by the tax authorities to the effect that the despatch of lottery tickets tantamounted to a sale.

28. In support of the viewpoint canvassed, the learned counsel placed reliance on various reported decisions and sought to distinguish the judgment of the Hon'ble Supreme Court in the case of British Paints (India) Ltd. (supra). According to him a decision of a Court had to be read in the relevant context and with specific reference to the question raised. For the aforesaid proposition, he placed reliance on the judgment of CIT v. Sun Engg. Works (P.) Ltd [1992] 198 ITR 297 (SC). The following decisions were, relied upon :- (vii) CIT v. Bharat General Reinsurance Co. Ltd. [1971] 81 ITR 303 (Delhi); (ix) Reform Flour Mills (P.) Ltd. v. CIT [1978] 114 ITR 227 (Cal.); and (x) CITv. Guranditta Mal Shanli Parkash Zira [1987] 164 ITR 774 (Punj. & Har.).

29. The learned Departmental Representative, on the other hand, vehemently supported the order passed by the Commissioner of Income-tax (Appeals) placing reliance on the judgment of the Hon'ble Supreme Court in the case of British Paints (India) Ltd. (supra). The subsequent arguments advanced by him were a reiteration of the reasons recorded by the tax authorities in rejecting the viewpoint canvassed on behalf of the assessee. He, however, did not dispute before us that closing stock in respect of the tickets had been shown by the assessee by adjustment in the prepaid expenses account. To add to this, he did not dispute the contents of the remand report forwarded by the Assessing Officer to the Commissioner of Income-tax (Appeals) in respect of appellate proceedings for assessment year 1990-91. It was, however, vehemently argued that the despatch of tickets to the stockists constituted a sale and in that view of the matter, the assessee was obliged to reflect all such despatches as sales as it had done in the past and the changed method was required to be rejected.

30. We have examined the rival submissions with reference to the material on record and the decisions cited at the bar. Judicial opinion is heavily weighed in favour of an assessee who wants to change the method of accounting regularly

followed by him provided the said change is bona fide and not an attempt to hoodwink the Department and the changed method is followed in the subsequent years. In other words, one regularly followed method is substituted by another method to be followed regularly. The third condition is that the new method should be an acceptable one in law and also approved by the profession of accountancy.

31. Further a change of any type is likely to affect adversely one party and which in tax proceedings would be the revenue and though at the first instance the assessee would "gain" the effect would be neutralised both ways over a period of time. For instance in the present case the admitted fact is that the assessee has not booked as sales the tickets despatched to the stockists for which the draws have not been held prior to 31 -3-1989, but it is an accepted fact on the part of the revenue before us that the closing stock thereof valued at Rs. 57,87,163 is included in the accounts although not separately, but by an adjustment in the prepaid expenses account by debit and the corresponding credit being to the "paper consumed account" which is shown less by the said figure in the profit and loss account under the head "Cost of sales". This fact is also accepted by the Assessing Officer in the remand report sent to the Commissioner of Income-tax (Appeals) in the appellate proceedings for assessment year 1990-91 and thereafter echoed by the CIT (Appeals) in his orders for said assessment year as also assessment year 1991-92. If such be the situation then incomes in the subsequent years are likely to be more as per the new method. The assessment order for assessment year 1990-91 takes due note of this.

32. We further find that in the said remand report the Assessing Officer has categorically stated that some other assessees doing "similar business" "are following almost the same method of accounting". In the present assessment year, however, the assessee's case has been rejected on the ground that whatever is the "regularly followed method" adopted by other assessees and accepted by the Department in their cases cannot be implanted into the assessee's case as it is following a different method which has been accepted by the Department as its consistent method. In our opinion, this is not a valid reason for rejecting the "new method" without a further finding to the effect that the changed method is faulty and erroneous in law, outside the principles of accountancy and an attempt to

evade the legitimate revenues of the Government. We find no such finding on the part of either the Assessing Officer or the CIT (Appeals). An assessee is entitled in law to improve upon an existing system within the parameters of law and accountancy and as long as the change allows the Assessing Officer to compute the legitimate taxable income there should be no grievance on the part of the revenue. The Assessing Officer in fact in his remand report for assessment year 1990-91 states that the accounting method of the assessee remains the same, as mercantile....

33. At this stage we find it necessary to refer to some of the decisions cited by the learned counsel and extract relevant observations of Their Lordships of various Hon'ble High Courts as follows :- An assessee is entitled to change his regular method of accounting by another regular method and such a change can be effected in respect of a part of the assessee's income.

Section 145 of the Income-tax Act, 1961 lays down that if an assessee regularly employs a method of accounting, his income should be computed in accordance therewith. The section, in its terms, does not require any enquiry into the bona fides of the assessee in following a regular method.

A recognised method of accounting followed regularly would necessarily result in a proper computation of the assessee's real income. Even if one regular method of accounting is substituted by another regular method, the same result will follow. Only in a case where the assessee changes his regular method of accounting by another method and does not follow the change regularly thereafter, it might be possible for the assessee by introducing successive changes in his methods of accounting to exclude items of his income in the computation of his total income. Therefore, when an assessee changes his regular method of accounting by another regular method the question of his bona fides have little relevance.

Only in the year where a change in the method of accounting is introduced for the first time, it is to be examined by the Revenue authorities whether the change introduced is meant to be regularly followed or not. Where it is found that an assessee has changed his regular method of accounting by another recognised method and has followed the latter method regularly, it is not open to the Revenue

authorities to go into the question of bona fides of the introduction and continuance of the change.

Held that in view of the Tribunal that the adoption of the direct cost method was bona fide and was a permanent arrangement with the intention to follow the same method year after year, the change would have to be accepted notwithstanding the fact that during the assessment year in question; which was the first year when the change of method was brought about, a prejudice or detriment might be caused to be Revenue.

As the method of valuation adopted by the assessee had obtained recognition from practising accountants and the commercial world for valuation of stock-in-trade, the adoption of that method could not be questioned by the Revenue unless the adoption of that method was found to be not bona fide or restricted to a particular year.

Held, that the assessee was entitled to change his method of valuation of stock in this manner even though the Revenue may be affected adversely by such change. It is a concession given to the assessee based on the well recognised usage of the trade, and the principle underlying that concession is in no way violated when the assessee changes his method of valuation from cost to market value, when the latter is less than the cost price, provided the change in bona fide and the new system is continued in subsequent years. The assessee's claim for deduction of Rs. 1,41,035 was allowable in law.

Held that the assessee had changed its method of valuing its closing stock from market price to cost price or market value, whichever was lower, on bona fide business considerations and to ward off a notional hike in profit and loss on account of fluctuation in decontrolled sugar which was the subject-matter of valuation at the end of each year. There was a further finding that the change had been effected before the relevant previous year and the new method had been regularly followed. The Tribunal was justified in deleting the addition made on revaluation of the closing stock of sugar.

34. As already stated earlier and now reiterated in the light of the reported decisions; there cannot be a blanket rejection whenever an assessee desires to change a method of accounting followed in the past and every case has to be examined on its own facts. On the other hand, the judgment of the Hon'ble Supreme Court in the case of British Paints (India) (P.) Ltd. (supra) would not apply to the facts of the present case as in that case the assessee was following a method of valuation of stocks whereby the overhead expenditure was totally excluded. Their Lordships opined that this method was likely to give a "distorted picture" of the business for purposes of computing the chargeable income. In the case before us, the system which the assessee has switched over to is one which is followed by others in the same line of business and accepted by the Department. Then again it is not against legal and accountancy principles.

35. We would now proceed to examine the arguments of the parties on the agreement between the assessee in its capacity as "organising agent" and the "stockists" to whom the tickets are despatched. As per the Revenue's case the despatch is to be treated as a sale on the part of the assessee whereas the learned counsel referred to various clauses of the agreement to contend that it at the most constituted "an agreement to sell" rather than a "sale agreement". Section 4 of Sale of Goods Act was referred to. A sample agreement was placed by the learned counsel at pages 72 to 75 of his compilation and both parties agreed that this was a part of the record before the Assessing Officer and the Commissioner of Income-tax (Appeals).

36. In order to appreciate the arguments, it would be necessary on our part to set out certain relevant clauses of the agreement as follows :- 2. That the Organising Agent shall despatch tickets for the various Draws so as to reach the stockist at their place of destination mutually agreed upon. In case of loss of tickets in transit, to the place of destination of the tickets, despatched by the Organising Agent then the Organising Agent shall be responsible for such loss.

4. That the Organising Agent shall pay service charges at the rate of 3 per cent on the basis of the total value of the tickets sold. The stockist may deduct the service charges while making the payment.

5. That the Organising Agent may fix quota of lottery tickets to be supplied to the stockist based on his actual demand and sales in the past or as may be agreed. The Organising Agent, however, reserves the right to reduce the quota of tickets for a particular draw or draws without assigning any reason whatsoever. The tickets will be supplied to the stockist on F.O.B. basis on a proper challan form (despatch slip). The stockist would be under an obligation to tally tickets received with the challan forms. Any discrepancy must be immediately intimated to the Organising Agent within 24 hours of the receipt of the tickets.

8. The stockist will ensure that the payment of a particular draw is made to the Organising Agent positively one week in advance of the actual date of draw and the Demand draft will be made in favour of 'K & Co.' New Delhi and shall be payable on the Nationalised bank at New Delhi.

16. That the tickets issued for a draw and anticipated to remain unsold, should so returned that they are physically received by the Organising Agent at least one day before the actual date of the draw. Ticket received thereafter, will not be accepted and treated as sold by the stockist and the stockist shall remain liable for its payment in the same manner as if the tickets have actually been sold. 17. That telegraphic, telephonic or any other information sent to the Organising Agent regarding the unsold tickets would be ignored and in case the stockist want benefit for the return of tickets, the tickets must in that event, reach the Organising Agent at least 24 hours before the draw.

30. That the stockist has deposited interest free but refundable security with the Organising Agent. This security shall be refunded when this agreement is terminated. However, the Organising Agent shall have the right to adjust from the security all dues which are payable by the stockist to the Organising Agent.

37. A reading of the entire agreement and more specifically the aforesaid clauses reveals an arrangement by which the assessee sends the tickets to the stockists who in turn sell these to their "agents".

The freight outwards on tickets despatched is borne by the assessee whereas the freight on unsold tickets returned to the assessee is to the charge of the stockists.

Further, service charges at 3 per cent on the total value of the tickets sold is payable by the assessee to the stockists and which they may deduct even while remitting the sale proceeds to the assessee. The stockists are also obliged to make the payment of a particular draw to the assessee positively one week in advance of the actual date of draw. In other words, the condition of payment is with reference to the date of the draw. Further, any failure to remit the proceeds within the aforesaid period can lead to the curtailment of the quota of tickets of the stockist concerned as also charge of interest at the rate of 18 per cent on the unpaid amount in case the same continues to be withheld beyond 15 days of the "date of draw". There is also a stipulation in the agreement that "tickets issued for a draw and anticipated to remain unsold should be so returned that they are physically received by the organising agent at least one day before the actual date of the draw". Further tickets not received by such time would not be accepted and "treated as sold by the stockist and the stockist shall remain liable for its payment in the same manner as if the tickets have actually been sold". Another clause which requires a mention is the one pertaining to the deposit of interest-free security by the stockists with the assessee and which is refundable in the event of termination of the agreement by any of the parties and the right to do so being made available to both of them.

The balance sheet for the year under appeal discloses the figure of such security deposit at Rs. 2.58 crores.

38. By adverting to the relevant clauses, we note a system of working between the parties whereby the assessee in its capacity as organising agent can curtail the quota of tickets of a stockist under stipulated conditions, ask it to pay interest on unpaid proceeds of the tickets, require deposit of interest-free security and return of unsold tickets in a specified time frame and if necessary terminate the agreement itself. The stockist, on the other hand, is entitled to 3 per cent service charges on tickets sold, send back the unsold tickets of a draw not later than one day before the draw and also to withdraw from the agreement.

39. From the aforesaid discussion, it becomes apparent that tickets sent to the stockists do not become a sale on their despatch, but assume the character of a

sale on the happening of various events including the draw taking place or where these remain unsold and are not sent back to the assessee within a stipulated time frame by the stockist. We were in fact informed by the learned counsel that during the year under appeal the tickets returned to the assessee on one score or the other were of the monetary value of Rs. 7.55 crores. In case the despatch of tickets was to be treated as a sale then there would have been no need to incorporate in the agreement clauses pertaining to return of unsold tickets and reduction in the quota of tickets to be despatched to a stockist on its failure to fulfil certain conditions including the one pertaining to payment of sale proceeds. In a sale the seller is not really bothered what the buyer does with the goods and items purchased and the limited concern is with reference to goods which are defective and these are taken back under stipulated terms and conditions and sales to this extent are reduced.

40. Then again as per clauses 28 and 29 the stockists are required to send "proper accounts" to the organising agent, i.e., the assessee for every draw at least one week before the date of the draw. This also indicates some sort of control by the assessee over the working of the stockists although with a view to safeguard its own interests.

41. Another aspect of the matter which requires mention is that whereas the agreement is between the assessee and the stockist there is another party which finds mention in the said agreement and that is the "agent" to whom the tickets "shall be sold by the stockist". Although the "agent" is not privy to the agreement there are various clauses, viz., 7, 15, 20, 21, etc., which regulate the dealings between the stockists and their agents.

42. In the final analysis, we accept the "changed method" adopted by the 'assessee in the year under appeal not only on the basis of the merits of the said system, but also on an appreciation of the agreement between the assessee and its stockists. We would, however, direct the Assessing Officer to recompute the taxable income strictly in accordance with the method followed by some of the "other assessees in the same line of business" and which has been accepted in their respective cases and these facts having been accepted by the Assessing

Officer himself during the appeal proceedings before the Commissioner of Income-tax (Appeals) for assessment year 1990-91 and echoed by the CIT (Appeals) in his orders for assessment years 1990-91 and 1991 -92.

Further if any change is warranted in the taxable incomes for the subsequent assessment years then this may also be carried out while deciding the issue for such assessment years. As already stated, the point at issue has been set aside to the file of the Assessing Officer by the CIT(A) for assessment years 1990-91 and 1991-92 directing that the same be decided in the light of the IT AT order for assessment year 1989-90.