

Asstt. Cit Vs. Adlabs

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Jan-05-2007

Judge : K Singhal, K Boliya

Appellant : Asstt. Cit

Respondent : Adlabs

Judgement :

1. These appeals were heard together and are being disposed of by the common order for the sake of convenience. The main issue arising in these appeals, relates to rejection of books of account by invoking the provisions of the proviso to Section 145(1) of the Income Tax Act, 1961 (Act) and the estimate of net profit.

2. Briefly stated the facts, as stated in the assessment order, are these : The assessee-company is engaged in the business of processing negative films exposed by various feature film producers. The assessee is having its processing laboratory at Andheri (East), Mumbai. After such negatives films are processed and the final negative print of the film is taken, the producer place huge orders on the assessee for positive prints and thereafter, the assessee produces the positive prints as per the requirement of producers. The assessee has been following mercantile system of accounting. The expenditure incurred are debited as and when incurred but the income is credited when bills are raised on the producers at the time of delivery of positive prints.

Further, in the process of preparing negative prints, a by-product namely "Hypo" containing silver contents is generated which is shown as income as and when it is sold. Such system is being followed since inception of business.

3. A survey under Section 133(A) of the Act was carried out at the premises of the assessee on 4-12-1992 and the same converted into search action under Section 132 of the Act. In the course of the search, certain cash was seized and at the end of search, the assessee estimated the income for the assessment year 1993-94 at Rs. 19 lakhs including the sale of "Hypo". Another search took place at the premises of the assessee on 30-6-1994 in the course of which excess stock worth Rs. 4 lakhs was found.

4. For the assessment year 1993-94, the assessee declared total income of Rs. 22,67,410. In the course of assessment proceedings, it was noticed by the assessing officer that though the assessee was following mercantile system of accounting yet it neither billed the various producers for processing of negative films while under production nor valued the work-in-progress in respect of the negative films processed but not billed. The assessing officer was, therefore, of the view that the expenditure debited by the assessee on account of processing of negative films were not be allowable unless the corresponding receipts are shown. Accordingly, the assessee was asked to explain in this regard. The explanation of the assessee was that, hundreds of films were processed at various stages of completion and amongst these various films, many films were abandoned by the producers and, therefore, no billing was done. It was also explained that it was not possible to value the work-in-progress. The assessing officer was not satisfied with such explanation of the assessee. The assessing officer also noticed that assessee was in the practice of receiving advances against the contracts from the producers and such advances remained unadjusted for a long time till the delivery of the films when the billing was done. This, according to him, amounted to postponement of profits to future years. It was also noticed by him that advances against contract went on increasing year after year while the entire production A expenditure continued to be debited in the Profit & Loss A/c. The method of accounting adopted by the assessee was, therefore, not acceptable to the assessing officer since correct profits could not be determined. It was also noted

by the assessing officer that in the course of processing of negative films, a by-product called "Hypo" is generated over which there was no control and, therefore, yield of "Hypo" could not be ascertained properly. In view of the same, the assessing officer invoked the first proviso to Section 145(1) of the Act. Consequently, he determined the net profit by applying rate of 15% of the processing charges which amounted to Rs. 16,92,600 for assessment year 1993-94. In addition, the sale of "Hypo" amounting to Rs. 7,20,227 was considered as income of the assessee and the same was added to the estimated income. Against the aforesaid income, the assessing officer allowed depreciation and deduction under Section 43B. The net income for assessment year 1993-94 was thus determined at Rs. 25,77,556. However, he applied net profit rate of 25% for assessment years 1994-95 and 1995-96 and thus determined income for assessment year 1994-95 at Rs. 53,53,570 and for the assessment year 1995-96 at Rs. 84,39,938 which also included addition of Rs. 4 lakhs on account of excess stock. On appeal, the learned Commissioner (Appeals) confirmed the rejection of books of account under the first proviso to Section 145(1) but reduced the net profit rate to 15%. He further upheld the assessment of sale of "Hypo" as income separately. In addition, it was further held that assessing officer failed to assess income by way of lease rent, interest D which were assessable separately in addition to business profit assessed under Section 145(1). However, he allowed deduction for expenses on pro rata basis against lease rent and interest. Thus income for assessment year 1993-94 was enhanced by Rs. 24,14,023. However, no such enhancement was made for other years.

Aggrieved by the same, the assessee has preferred these appeals before the Tribunal.

5. The learned Counsel for the assessee has assailed the orders of the lower authorities by submitting that the method of accounting adopted by the assessee is being consistently followed since inception i.e., the year 1978 and the same was also accepted in the past. According to him, the choice is with the assessee to adopt any method of accounting including hybrid system and the department cannot reject the same unless there are materials to form an opinion that the true profits cannot be ascertained from the method adopted by the assessee. Reliance

was placed on the Supreme Court judgment in the case of Investment Ltd. v. CIT , and the judgment of the Hon'ble Bombay High Court in the case of CIT v. Tata Iron & Steel Co. Ltd. . It was further submitted by him that the assessee is in the business of processing of films, negative as well as positive on the basis of films shot by the producers. From the footage given by the producers, the assessee prepares the negative prints which remain with the assessee and on the basis of the negative print, the producers place orders with the assessee for producing the negative prints. It is on the basis of these positive prints, the film is released and exhibited at the theatres. Proceedings further, it was submitted that billing is done at the time of delivery of the positive prints and the income is booked at that stage. It was further pointed out by him that no defect has been pointed out by the assessing officer with reference to the expenditure incurred and the remuneration received in respect of the positive prints and the only objection of the assessing officer was that, expenditure in respect of negative print are claimed as deduction without showing the corresponding receipt. According to him, this, by itself, is not sufficient to invoke the provisions of the first proviso to Section 145(1). He also pointed out that no defect has been pointed out with reference to the recovery of "Hypo" i.e., the silver content.

As and when such "Hypo" is sold, the same is accounted for in the books of account and even the assessing officer has assessed the same under the head "Misc. income" on the basis of sale shown by the assessee.

Regarding the disclosure made by the assessee under Section 132(4), it was pointed out by him that the return of income filed by the assessee is in consonance with the disclosure in as much as the return has been filed after claiming the deduction on account of bad debt. It was further pointed out that even in the course of search no specific incriminating material was found against the assessee. Accordingly, it was pleaded that book result shown by the assessee be accepted.

6. On the other hand, the learned D.R has vehemently relied upon the reasoning given by the assessing officer. He pointed out that in the course of search, the assessee agreed that the profit margin was in the range of 32% to 35% and the

assessing officer was justified in applying the average profit rate of 33.5%. Proceeding further, it was submitted that the method of accounting adopted by the assessee was such that true profit could not be ascertained inasmuch as the assessee was claiming deduction in respect of the expenditure incurred for preparing the negative prints without showing the corresponding receipts for the year under consideration. The expenditure can be allowed only against the receipt. According to him, the assessee was postponing the profits in respect of the negative prints to subsequent years. He relied on the decision of the Hon'ble Supreme Court in the case of CIT v. British Paints India Ltd. , for the proposition that if the method of accounting adopted by the assessee shows a distorted picture, then the same cannot be accepted merely because it was being accepted in the past. In view of the same, it was pleaded by him that the appeal of the assessee be dismissed.

7. Rival submissions of the parties have been considered carefully.

There is no dispute that the assessee had been following the aforesaid method of accounting since inception of its business and the same was being accepted by the revenue in the past. According to Section 145, as was in force for the years under consideration, the Legislature gave choice to the assessee to adopt any method of accounting for computing his business income. However, the first proviso to Section 145(1) provided that in any case, where the method employed by the assessee is such that the income cannot properly be deduced therefrom, then the income shall be computed on such basis and in such manner as the assessing officer may determine. This legal position is fortified by the judgment of the Apex court in the case of Investment Ltd. (supra), wherein it was observed as under: A taxpayer is free to employ, for the purpose of his trade, his own method of keeping accounts and for that purpose of value his stock-in-trade either at cost or at market price. A method of accounting adopted by the trader consistently and regularly cannot be discarded by the departmental authorities on the view that he should have adopted a different method of keeping account or of valuation. The method of accounting regularly employed may be discarded only if in the opinion of the taxing authorities income of the trade cannot be properly deduced therefrom. Valuation of the stock at cost is one of the recognised methods.

8. In view of the above legal position, the question for our consideration is whether it can be said that the facts of the case justify the action of assessing officer invoking the first proviso to Section 145(1). There is no dispute that assessee is required to first process the film footages given by the producers to the assessee and when the negative print is produced, then the producers place orders for preparation of the positive prints so that the film may be exhibited at various theatres across the country. According to the method of accounting followed by the assessee, the expenditure is booked in the books of account as and when incurred while the revenue incomes are credited-(z) in respect of negative prints and positive prints, when billing is made at the time of delivery of positive prints and (it) when by-product "Hypo" is sold. Considering the method of accounting, we are of the view that it cannot be said that the method of accounting is such that entire true profits cannot be deduced therefrom. g Our reasons are as follows: (i) No defect has been pointed out by the assessing officer in respect of the income derived by the assessee from the preparation of positive prints which is the major source of the business income.

As soon as the positive prints are prepared, the billing is made along with delivery of such prints. Such method is in consonance with the mercantile system of accounting. F (ii) The income from the sale of "Hypo" is also not disputed by the assessing officer. Though casual observation has been made by the assessing officer to the effect that there is no control over the yield of the above by-product, yet he has accepted the sale of "Hypo" as shown by the assessee. Hence, no adverse inference can be drawn against the assessee. No other defect has been pointed out by the assessing officer. The income from sale of by-product can be accounted for on receipt basis since hybrid system is permissible in law in view of the judgment of the Hon'ble Bombay High Court in the case of CIT v. Citibank N.A.

(iii) As far as income from negative prints is concerned, we are of the view that method adopted by the assessee does not depict the true picture. According to the mercantile method of accounting, the income is to be booked on accrual basis. The income by way of processing charges, in our opinion, accrues to the assessee as and when it becomes entitled to receive the same. As and when the negative

print is prepared and the producer is informed, the assessee would become entitled to recover the remuneration since an enforceable debt is created in favour of the assessee. Even the learned Counsel for the assessee could not controvert this legal position in the course of hearing. At this stage, the assessee was required to book the income and adjust against the advance received.

The income once accrued, cannot be postponed to subsequent years merely on the ground that orders for positive prints may not be placed. However, the income from negative print is not significant as compared to income from positive prints.

9. In view of the above reasons, we are of the view that the entire system of accounting followed by the assessee cannot be doubted. The accounting system in respect of negative prints only can be said to be defective since revenue income is not credited when negative print is ready. However, the assessing officer is not correct in observing that expenditure incurred in respect of negative print cannot be allowed since work-in-progress has not been shown by the assessee. The concept of work-in-progress relevant only when the goods are produced as of its own. In the case of jobbers, work-in-progress is never shown in the books as the material always belongs to the customer. In the case of jobbers, the expenditure is allowable in the year in which it is incurred and income is credited when it becomes due from the customer.

The processing charges would become due only when the job done by the assessee is over and not before. Therefore, in the case of assessee, the processing charges would become due from the producer when negative print is ready for delivery. Since the assessee has not shown income from negative print in the relevant years, it can be said that the system followed by the assessee is partly defective.

10. In view of the above discussion, we are of the view that system of accounting followed by the assessee cannot be rejected in toto. The book result shown by the assessee, in our opinion, should be accepted subject to some modification i.e., the processing charges for negative prints should be assessed in the year in which such prints become ready as per the requirement of the customer. We hold accordingly. The orders of the learned Commissioner (Appeals) are, therefore, set

aside and the assessing officer is directed to accept the book result shown by the assessee subject to the A modification mentioned above. However, the assessing officer is further directed to ensure that the assessee is not doubly taxed in respect of processing charges for negative prints.

11. Before parting with this issue, it may be mentioned that the learned Counsel for the assessee has also submitted that in case the action of assessing officer has to be upheld, then the estimate made by him would also cover the profits on account of sale of "Hypo" and consequently no g separate addition should be made on account of sale of "Hypo". Since we have accepted the rrtain contention of the assessee, this aspect of the issue has become academic and consequently no adjudication is required.

12. In respect of assessment year 1995-96, the assessee has also challenged the addition of Rs. 4 lakhs made by assessing officer on account of excess stock. No explanation could be offered for the same at the time of search. In the course of assessment proceedings, it was submitted that excess stock belonged to other parties. The assessee was asked to produce the confirmations for those parties. The assessee neither produced the confirmations nor the names and addresses of the parties. Accordingly, the addition of Rs. 4 lakhs was made which has been confirmed by the learned Commissioner (Appeals). Assessee is in further appeal before the Tribunal. After hearing both the parties we do not find any merit in the ground raised by the assessee in the absence of any evidence. The order of learned Commissioner (Appeals) is therefore upheld on this issue.

13. The learned Counsel for the assessee has also submitted that certain other grounds raised by the assessee would become academic if the main contention of the assessee is accepted. Since we have decided the main issue in favour of the assessee, we need not adjudicate the remaining issues arising from other grounds raised by the assessee in various years.

14. The revenue has also challenged the orders of learned Commissioner (Appeals). The first ground is against reduction of net profit rate for 25% to 15%. The E second ground is against allowance of expenses on pro rata basis against income by way of interest and lease rent. Thirdly, the learned Commissioner

(Appeals) should have made enhancement for assessment year 1994-95 as made by him for assessment year 1993-94. All these grounds do not survive for our consideration since we have already held that books of account of assessee should be accepted, though subject to some modification. Hence, these grounds stand dismissed.

15. In the result, assessee's appeals stand partly allowed while the revenue's appeals stand dismissed.

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