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Hela Holdings Pvt. Ltd. Vs Commissioner of Income Tax and Another

Court: Calcutta High Court

Date of Decision: Sept. 27, 2002

Acts Referred: Income Tax Act, 1961 â€" Section 145

Citation: (2003) 185 CTR 245 : (2003) 263 ITR 129 : (2003) 133 TAXMAN 16

Hon'ble Judges: Indira Banerjee, J; Ajoy Nath Ray, J

Bench: Division Bench

Advocate: N.K. Poddar and R.K. Jaiswal, for the Appellant;P.K. Ghosh, for the Respondent

Final Decision: Allowed

Judgement

Ajoy Nath Ray, J.
This is an appeal u/s 260A of the Income Tax Act, 1961, from an order of the Tribunal dated April 5, 2002, passed in

respect of the assessment year 1995-96.

2. The brief facts leading to the controversy in this case are as follows :

Although the assessee was in business for quite some years past, yet it entered into the business of dealing in stocks and shares for the first time in

the assessment year 1994-95 in respect of which the previous year ended on March 31, 1994.

3. For the assessment year 1994-95, the assessee had adopted the method of taking the cost of acquiring of stocks for the purpose of valuing the

closing stock-in-trade of shares held by the assessee at the end of the year.

4. For the assessment year 1994-95 return had been made on this basis of stock valuation, i.e., valuing the stock at the cost of acquiring and

returning the profits, if any, made during the year on account of stock dealings by taking into account the actual profits or losses if any made,

computing the difference between the actual sale price and the cost price of stock for the accounting year 1993-94.

5. It is an admitted fact before us, that the auditors of the assessee raised certain objections with regard to this type of stock valuation, and it was

suggested that instead of taking the cost of stocks as the way of valuation, the assessee should adopt instead, the yardstick of cost of acquiring or

market value, whichever is lower.

6. In the month of October, 1994, the board of directors of the assessee passed a resolution adopting this changed method of valuation and such

change was adopted by the assessee for the accounting year 1994-95, relevant to the assessment year 1995-96 with which we are concerned.

7. It also so happens that the accounting standards (marked AS) issued from time to time by the Institute of Chartered Accountants of India issued

their standard AS 13 and made it compulsory for accounting purposes, for accountants to adopt as from April 1, 1995, the method of stock

valuation which was cost or market value, whichever is lower.

8. Mr. Poddar has given us materials which show that from September, 1993, the institute had made the cost or market value, whichever is lower,

the preferable mode of valuation but they enforced it as amongst the accountants, as stated above.

9. The result of the change in valuation method adopted by the assessee for the assessment year 1995-96 was this, that the closing stock got

valued at a figure of some Rs. 50 lakhs less than the figure at which it would have been valued, had the assessee adopted its earlier method of

stock valuation at the flat rate of cost of acquiring only.

10. Out of this sum of Rs. 50 lakhs nearly Rs. 47 lakhs is attributable to five items of share purchases made during the financial year 1994-95 itself

which corresponded to the relevant assessment year. There was a fall in the market, to quite an appreciable extent, in this year, and we were told

that this had relation to Harshad Mehta"s share scandal, but we are not so much concerned with the cause of the fall in market, as with the actuality

of the fall itself, and the legal result of such a fall.

11. Directly as a result of this changed method of stock valuation the otherwise profit of the assessee for the assessment year, which would have

been Rs. 71 lakhs approximately got reduced to a little under Rs. 20 lakhs.

12. The assessee has not suppressed any materials. The accounts of the assessee are not challengeable in any manner. That the cause of the lower

profits returned by the assessee is the change in the accounting method of stock valuation, and the change only, has been pointed out repeatedly by

the assessee in the return, in the remarks by its auditors and accountants, and in representations before the Department also, at every stage.

13. Suppression, misrepresentation and dishonesty these are not to be found anywhere in the papers or facts of this case.

14. The problem, however, arises whether in law the assessee was entitled to change its valuation method, in the above facts and circumstances,

knowing fully well that it would drastically reduce its tax liability.

15. One other remark we also make in this respect, and that is that the assessee must be assumed to have been fully aware that the change in the

valuation method would benefit it greatly in the matter of tax incidence. Just as honesty, in the previously explained sense, we have to assume on

the part of the assessee in this case, so also, we have to assume sufficient ordinary prudent businessman like understanding, on the part of the

assessee, which was, that the adopted change of valuation method was going to benefit it in the matter of its tax return substantially.

16. In these circumstances, the Assessing Officer held that the method of changed valuation was detrimental to the Revenue and the Assessing

Officer disallowed the loss of Rs. 50 lakhs (approx.) claimed by the assessee on the changed method.

17. The assessee won before the Commissioner of Income Tax (Appeals) but lost before the Tribunal.

18. From the Tribunal''s order, we have found that according to it, the assessee could not claim the tax benefit on the changed valuation method

because, according to the Tribunal, the conditions necessary for such change were not satisfied.

19. We have felt very dissatisfied with this type of vague reasoning by the Tribunal. It is not enough merely to state generally that some condition

has not been fulfilled and that condition is necessary ; a specific mention of the condition is needed and also a specific finding as to why the

assessee cannot be held to have satisfied that condition, before a verdict of disallowance is entered.

20. However, a remand in this matter is not just or proper. The case has been argued threadbare before us. The facts are not in dispute. We are

unfortunately saddled with the task of having to do practically for the first time what the Tribunal should have attempted to do itself as part of a fair

disposal of the case.

21. The questions which we have framed for our own consideration in this appeal are as follows :

(i) Whether, on the facts and in the circumstances of the case, the assessee was barred by any provision of the law from changing its stock-in-

trade valuation method from the cost basis, which was followed for the assessment year 1994-95, being the year of commencement of business, to

the method of cost or market value, whichever is lower ?

(ii) Whether, in the circumstances of this case, and in general in any event, an assessee is permitted in law to change its method of stock valuation

to benefit itself in the matter of incidence of tax, provided such change is made honestly, and a sufficient degree of consistency is disclosed in the

matter of change, so as to satisfy the requirements of Section 145 of the Income Tax Act, 1961 ?

(iii) Whether, on the facts and in the circumstances of this case, the Tribunal erred in law in finding that the assessee had not satisfied the conditions

stipulated in law which permit an assessee to change the stock valuation method in one particular assessment year, the relevant assessment year in

this case being 1995-96 ?

22. The sole section which is material for our consideration from the Income Tax Act is Section 145 thereof which, as it stood at the material time,

is set out below :

145. Method of accounting.--(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources"

shall be computed in accordance with the method of accounting regularly employed by the assessee :

Provided that in any case where the accounts are correct and complete to the satisfaction of the Assessing Officer but the method employed is

such that, in the opinion of the Assessing Officer, the income cannot properly be deduced therefrom, then the computation shall be made upon

such basis and in such manner as the Assessing Officer may determine :

Provided further that where no method of accounting is regularly employed by the assessee, any income by way of interest on securities shall be

chargeable to tax as the income of the previous year in which such interest is due to the assessee :

Provided also that nothing contained in this sub-section shall preclude an assessee from being charged to Income Tax in respect of any interest on

securities received by him in a previous year if such interest had not been charged to Income Tax for any earlier previous year.

(2) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where no method of

accounting has been regularly employed by the assessee, the Assessing Officer may make an assessment in the manner provided in Section 144.

23. Mr. Poddar, appearing for the appellant-assessee, submitted that as far as the method of stock valuation itself is concerned, i.e., the principle

of valuing it at cost or market value, whichever is less, the same is beyond the region of any dispute now.

24. The Institute of Indian Accountants have enforced it and to value the shares by any other method would be challengeable today.

25. Indeed as on date, because of the amendments incorporated in the Companies Act in the year 1998, as per Section 211, Sub-sections (3A)

and (3C), the Central Government having itself not issued any notifications itself in that regard, the directives of the Institute of Accountants would

statutorily have to be followed as on date. Although such statutory compulsion was not present in the assessment year 1995-96, yet following the

cost or market whichever is lower, was no type of error or illegality committed by the assessee.

26. A large number of cases were also cited before us to vindicate the perfect pedigree of this type of stock valuation. It would suffice to mention

that the root case in India in this regard is the case of Chainrup Sampatram Vs. Commissioner of Income Tax, West Bengal, where this type of

valuation was accepted as a long standing permitted commercial practice by the Supreme Court, even though it should have the effect of reducing

tax. In the case of CIT v. British Paints India Ltd. : [1991]188ITR44(SC) , heavily relied on by the departmental authorities, mention is made of an

English case of the 1920"s, being the case of Whimster and Co. v. IRC [1925] 12 TC 813, where also this principle of valuation is ruled as

acceptable. Just as the method of valuation is acceptable, according to Mr. Poddar, the entitlement of an assessee to make a change in the

accounting method is also, in law, equally settled and accepted. Mr. Poddar submitted that it is not the law that once an assessee adopts one

method of accounting, then and in that event, he must follow that method every year inflexibly until he winds up business. The proposition could

hardly be disputed by Mr. Ghosh, who appeared for the Revenue. We refer in this regard to a Division Bench decision of our court, given in the

case of Commissioner of Income Tax Vs. National and Grindlays Bank Limited, , and since the point is so well settled, we need not dilate upon it

any further. Both the Assessing Officer and the Tribunal have opined, on the supposed authority of the British Paints case : [1991]188ITR44(SC) ,

that an assessee is compelled to follow the same method of accounting, which is adopted, and regularly followed by it, and such method cannot be

departed from unless there is good reason for the same. The case of British Paints : [1991]188ITR44(SC) lays down no proposition of this sort. It

was a case where the Supreme Court rejected the assessee"s method of stock valuation, where it included in such valuation, the costs only, and

ignored totally the overheads. We are not concerned with that issue here. Similarly, the Supreme Court was not concerned with the changing of the

method of valuation in the case of British Paints : [1991]188ITR44(SC) . The case of Snow White Food Products Co. Ltd. v. CIT (No. 1) was

also referred to us by Mr. Poddar, and it is a case decided by a Division Bench of our High Court. There are passages in that case, reported at

Snow White Food Products Co. Ltd. Vs. Commissioner of Income Tax (No. 1), , which positively indicate that the assessee is entitled to change

his regular method of accounting by another regular method and that such a change did not need any prior approval of the Income Tax authorities.

It is also positively stated in the said case, that once the assessee-company does change its accounting method, it would be open to it to produce

records and show, that it had followed such changed accounting method in subsequent years ; the proof of such subsequent records had not been

made in the Snow White Food Products Co. Ltd. Vs. Commissioner of Income Tax (No. 1), , and the court pointed that out also.

27. In the present case before us the assessee showed to the Tribunal that for the two subsequent assessment years following the assessment year

1995-96, viz., assessment years 1996-97 and 1997-98, the assessee continued with the method of valuing at cost or market value whichever is

lower. Indeed, AS 13 having come into operation the assessee had no option but to follow the very same method of valuation, to which, it changed

over, by the resolution of the board of directors taken in October, 1994.

28. The Tribunal''s decision that the conditions for change in valuation method were not satisfied is, therefore, wrong in law. The existence of the

assessee''s right to change its method of accounting, in general, is legally accepted. The assessee had adopted the cost method of valuation for

stocks and shares for one year only. If by adopting a method for one year the method becomes so entrenched with the assessee that he cannot

change it thereafter, then it would mean a denial of the entitlement to change altogether. That is not the law. Moreover, the regularity needed to be

proved by sticking to the change in subsequent years, is also shown sufficiently in this case.

29. Accordingly, it is impossible to opine in law, that the method of accounting for stock valuation employed by the assessee for the assessment

year 1995-96 was not regularly employed by it.

30. We might mention in this regard that whether an accounting method has been regularly employed by the assessee or not will depend on the

facts and circumstances of each different case. On such facts, the court has to decide the questions which are mixed question of facts and law. In

case the assessee''s accounts and dealings disclose an irregularity, which tends to distort the true view of accounts, or profits, or the commercial

transactions, then and in that event, the assessee cannot take the benefit of such distortion. The change in the accounting method must not be too

frequent, and the assessee must not lend itself liable to this criticism, that it is changing its accounting method every now and then, with a view to

reduction of tax liability, and with that view only in its mind. Such extreme cases might no doubt occur, but the present case is not one such.

31. Before we step on to the second question framed by us and before we leave questions Nos. (i) and (iii), which really go in hand, we also have

to point out that in this case, the acceptability of the method of accounting adopted by the assessee was not in dispute. The method was

acceptable. The method is the correct method, accepted by all the accountants. That the method gives rise to a picture of true accountings, and a

reflection of the true profits, is also not disputed. In such a situation it would be a distraction to consider such cases as the case of B.S.C Footwear

Ltd. v. Ridgway [1972] 83 ITR 269 , equivalent to [1971] 2 WLR 1313, where the House of Lords rejected a method of stock valuation by a

retailer footwear dealer, who had adopted the method of slashing down the valuation of its unsold stock, on the basis of its own principles, not

recognised in any standard general accounts procedures. The House of Lords observed that such slashing down of prices, deferred continuously

the payment of tax, and such method of accounting was not acceptable. In the above case of British Paints : [1991]188ITR44(SC) also the point

was as to the acceptability of the method of accounting itself. That is not the case here. Our case concerns the permissibility of changing one

acceptable method and adopting another acceptable method which, in a manner of speaking, is even more acceptable than the former one.

32. In these circumstances, questions Nos. (i) and (iii) must be answered in favour of the assessee with this added remark, even at the cost of

repetition, that the Tribunal should not have generally disallowed the assessee"s claim, by a mere vague reference to non-satisfaction of conditions,

without mentioning those conditions specifically and without mentioning the breaches of the assessee, if any, equally specifically.

33. In regard to question No. (ii) Mr. Ghosh submitted that the assessee is not permitted according to the modern view of the law to avoid tax

incidence, even if nothing that the assessee does, is either illegal or downright dishonest. Mr. Ghosh strongly relied upon the case of McDowell and

Co. Ltd. Vs. Commercial Tax Officer, , where the modern view has been accepted and adopted in India in no uncertain terms. The Supreme

Court pointed out in that case, that the earlier view taken in England in the case of IRC v. Duke of Westminster [1936] AC 1 was of the most

favourable kind to the assessee. Dicta there indicate that if the assessee has done nothing illegal, then the assessee could so arrange its affairs as to

pay the minimum of tax to the extent to which it could manage to reduce its tax liability. It is also recorded in the Supreme Court case that the

English courts themselves changed their approach and one of the landmark cases in that regard is Ramsay"s case reported at [1982] AC 300.

34. The Supreme Court has stated in clear terms how the changed judicial approach is to be taken as good law in India.

35. Where the Supreme Court has spoken, one has to speak very carefully in the same field. With the greatest of respect, and to the best of our

lights, what we say below in regard to tax avoidance and tax evasion, is not inconsistent with the dicta of the Supreme Court and, in our opinion,

correctly summarises the tax court"s approach in the modern day.

(1) The distinction between tax evasion and tax avoidance is still prevalent.

(2) Generally speaking tax evasion is the result of such things as illegality, suppression, misrepresentation and fraud.

(3) Tax avoidance is the result of actions taken by the assessee, none of which is illegal or forbidden by the law in itself and no combination of

which is similarly forbidden or prohibited.

(4) The permissibility of a tax avoidance, will fall to be decided, when and only when, on the basis of the facts and transactions truly and correctly

disclosed by the assessee, a point of law arises, whether, on a certain reasonable construction of one part of the taxing statute, as applied to the

assessee"s case, tax which would otherwise to be payable by the assessee, becomes not payable in the case in hand.

(5) When the court is faced with a task of construction in the above manner, the court is not bound to make the construction in favour of the

assessee, merely on proof by the assessee, that it has entered into no illegality and made no prohibited transaction.

(6) The court would have to assess, in the facts and circumstances of each case, upon general principles of conscience and justice, whether the

arrangement of affairs by the assessee, so as to cause the possibility of a reduction of tax incidence, can fairly be permitted to the assessee, as a

genuine and legal means of tax reduction, employed by it in a commercially fair sense, or whether, allowing the assessee to earn the reduction, in

the facts and circumstances of the particular case, is opposed to the public policy of not encouraging citizens, to engage themselves in dealings and

transactions, designed primarily for the purpose of non-payment of tax only.

36. Applying these principles formulated by ourselves to our case, we are faced with a situation of assessment. Are we to opine in this case, that

the assessee changed its method of stock valuation, primarily for the purpose of lowering its tax liability ?

37. Or, in the second alternative, do the facts suggest, that the change of valuation adopted by the assessee, was to be adopted for its business

purposes, and future transactions year after year, even though it had the effect of reducing tax liability in the assessment year in question ?

38. Posed in the above manner, the questions themselves show that the only way to answer is to answer the questions in favour of the assessee.

The assessee took the closing stock of shares of the assessment year 1994-95 as the opening stock for the assessment year 1995-96, both of

which had therefore, to be on the cost of acquiring basis. Because the assessee changed the method of valuation in the assessment year 1995-96,

the stock valuation went down and the assessee suffered a loss of about Rs. 50 lakhs. But the carried forward stock accounts for only Rs. 3 lakhs

only. It should be borne in mind that this loss was a real loss. In the mercantile system, one does not go by actual transactions only. If a person"s

stock falls in value in the market, he becomes worth so much less, and then, no doubt he has suffered a real loss in the commercial and the

mercantile sense. Adopting a valuation method to cause this real loss to be reflected in the balance-sheet and the tax return is not something which

can be held in any manner against the assessee.

39. The second question is, therefore, also answered in favour of the assessee. The answer is that an assessee is permitted to change its method of

stock valuation honestly and in accordance with the above principles of permitted tax avoidance set out above ; and that in this case the assessee

changed its stock valuation method correctly and is entitled to the tax benefit arising therefrom. We have already answered the first and the third

questions in favour of the assessee.

40. The appeal is, therefore, allowed. The order of the Commissioner of Income Tax (Appeals) is accordingly restored and the order of the

Tribunal is set aside;

41. The present Section 260A casts a duty upon the court to make an order as to costs (by way of Sub-section (5)). Considering the facts and

circumstances of this case and the good grounds of the assessee and the unsatisfactory manner of disposal of the case by the Tribunal, we award

that the assessee be paid one third the costs to be assessed by the Department, such assessment to be made in this case as if it were a regular

appeal from a decree passed on the original side of this court.

42. Let authenticated copy of the judgment and the order be issued to the parties.

Indira Banerjee, J.

43. I agree.