Commissioner of Income Tax Vs Jagatjit Industries Limited

Court: Delhi High Court

Date of Decision: Sept. 6, 2010

Acts Referred: Income Tax Act, 1961 â€" Section 11, 143(2), 145, 260A, 263

Citation: (2011) 339 ITR 382 : (2010) 194 TAXMAN 158

Hon'ble Judges: Dipak Misra, C.J; Manmohan, J

Bench: Division Bench

Advocate: Prem Lata Bansal, for the Appellant; Satyen Sethi, for the Respondent

Judgement

Dipak Misra, C.J.
The present appeal preferred u/s 260A of the Income Tax Act, 1961 (for brevity "the Act") was admitted on the

following substantial question of law:

Whether ITAT was correct in law in deleting the addition applying Rule of consistency holding that such a practice was adopted by the assessee

and accepted by the Department in past?

2. The facts that have been depicted are that the respondent-assessee is engaged in the business of manufacturing and sale of Indian made foreign

liquor, country liquor, malted milk food, SMP, Ghee, Glass and Plastic Containers, etc. It also manufactures malted milk food products for M/s

SmithKline Beechem Consumer Health Care Ltd. and Ghee for M/s Milk Food Ltd. In the course of assessment proceedings, the assessing officer

noticed that the assessee was maintaining mercantile system of accounting and had claimed expenses amounting to Rs. 14,55,720/- under the head

"prior period expenses" pertaining to earlier years. The auditor, in column 22(b) of the Tax Audit Report, stated that prior period expenses

amounting to Rs. 14,55,720/- had been debited to the Profit & Loss Account. The assessee in pursuance of notice u/s 143(2) appeared before

the Assessing Officer and was required to explain the nature of the expenses covered under the said head. He was asked to further explain why

the said amount should not be disallowed. The assessee by letter dated 11.12.2006 submitted the details of the expenses clubbed in prior period

expenses in the Tax Audit Report. The Assessing Officer noticed that a loss on the sale of fixed assets amounting to Rs. 23,813/- had already been

added back by the assessee while computing his total income. He also filed a copy of the notice from the Chief Administrative Officer, New Okhla

Industrial Development Authority, wherein the lease rent of industrial plot 35-C, Sector-57, Noida had been increased with retrospective effect.

The total demand raised was for Rs. 1,02,982/- out of which an amount of Rs. 17,373.78/- pertained to the financial year 2003-04 and the rest,

that is, Rs. 85,608/- related to the prior period. As the assessee had received notice for the said payment pertaining to the earlier year during the

current year, the same was allowed as an expenditure crystallized during that year. The Assessing Officer scrutinized the letter of explanation dated

11.12.2006 which pertains to various expenses like security expenses, LTA, rent, payments to staff members, managerial remuneration, legal and

professional expenses, sales promotion expenses, miscellaneous expenses and repair and maintenance expenses under the head ''prior period

expenses''. The nature of expenditure as was observed by the Assessing Officer could easily be classified as provisions made for the said

expenditure in the year in which the expenditure was incurred.

3. Considering the submissions of the assessee, the Assessing Officer held that the nature of the expenses was such that they had occurred and

crystallized during the earlier years. It was further held that as the same had been crystallized during the relevant year, the same could not be

allowed in the later years. Being of this view, the Assessing Officer came to hold that the assessee had claimed Rs. 13,46,299/- as expenditure of

prior period allowable in the current year and, accordingly, disallowed the same. After disallowing the same, he initiated a proceeding u/s 271(1)

(c) of the Act on the ground that the assessee had furnished inaccurate particulars of income.

4. Being dissatisfied with the aforesaid order, the assessee preferred an appeal before the CIT(A) forming the subject matter of appeal No.

523/06-07 wherein the first appellate authority came to hold that the assessee-appellant was maintaining the mercantile system of accounting and it

had different offices spread throughout the country and hence, at the end of the financial year, it was not possible to account for all the expenditure

incurred by the various branches. The CIT(A) further observed that there may be certain increase in the rate and, hence, the difference was paid in

the subsequent years. Vouchers have been received from the employees after 31st March of the financial year for the expenses incurred in the

previous year. It was held by it that looking into the turnover of several hundred crores, such an expenditure which had spilled over other financial

years could not be debited. It was also held that regard being had to the business practice of the assessee and keeping in view the accounting

system, the addition of Rs. 13,46,299/- deserved to be deleted and, accordingly, it was so directed.

5. Grieved by the aforesaid order, the revenue preferred an appeal before the tribunal. The tribunal has held thus:

From the facts sated above it is clear that the assessee has been claiming prior period expenses on the ground that the vouchers of such expenses

from employees/branch offices were received after 31st March. The assessee had its branch offices throughout the country. As per past business

practice, the expenditure spilled over to next year had been debited in the subsequent year and the same were claimed and allowed by the

Assessing Officer. This accounting practice has been consistently followed by the assessee and accepted by the department. Therefore, the rule of

consistency has to be followed. In our considered view, Ld. CIT(A) has rightly deleted the addition following the business practice adopted by

assessee and accepted by the department for past so many years. Accordingly, we do not find any infirmity in the order passed by Ld.CIT(A) in

deleting the addition of Rs. 13,46,299/-.

6. We have heard Mrs. Prem Lata Bansal, learned Counsel for the appellant, and Mr. Satyen Sethi, learned Counsel for the respondent.

7. It is contended by Mrs.Prem Lata Bansal that the tribunal has fallen into grave error by affirming the order of the CIT(A) solely on the ground

that the assessee has been following the mercantile system of accounting consistently and the said business practice deserved to be accepted

though there was a Tax Audit Report which clearly pointed out that the said sum had been debited by the assessee to the Profit & Loss Account.

The learned Counsel has commended us to the decision in CIT v. British Paints India Ltd. (1991) 188 ITR 45 (SC).

8. At the very outset, we may note with profit that there is no dispute that the assessee was following the mercantile system of accounting. There is

also material on record that as per the past business practice the expenditure spilled over to the next year and was debited in the second year

which was allowed by the assessing officer. The tribunal, as is evincible, has followed the principle of consistency.

9. The submission of Mrs. Prem Lata Bansal, learned Counsel for the revenue, is that the assessing officer had dealt with the issues by ascribing

cogent and germane reasons but the CIT(A) as well as the tribunal, without appreciating the same from proper perspective and without dwelling

upon the relevant aspects, have adopted a laconic approach which immensely exposits the perversity of approach. It is canvassed by her that had

the approach been different and had there been a detailed discussion by way of proper and apposite advertence to the facts by the tribunal, the

conclusion would have been different. Mr. Sethi, learned Counsel for the assessee/respondents sounding a contra note, has contended that both

the first appellate authority as well as the tribunal have kept themselves abreast with the factual situation in entirety and taken note of the business

practice prevalent in the previous years and, therefore, it would be totally incorrect to say that there is perversity of approach. It is urged by him

that the colossal complaint made by the revenue that the order of the tribunal or, for that matter, the order of the CIT(A) is a cryptic one or a

laconic one, has no legs to stand upon as there has been appropriate ratiocination of the factual matrix which is the heart and soul of the order. It is

contended by him that consistency has to be maintained and when a particular method of accountancy, a recognized one, has been accepted by

the tribunal, the same cannot be given a go-by as that would tantamount to paving the path of deviancy without any seemly justification.

10. In this context, we may refer to the decision in Director of Income Tax (Exemption) and Another Vs. Apparel Export Promotion Council (No.

1), wherein it has been held that when there was no material change in the activities of the assessee as compared to the earlier years, the question

of exemption u/s 11 of the Act which had been examined in earlier years cannot be raised again though the doctrine of res judicata would not

strictly apply to income tax proceedings, yet in order to maintain consistency, the revenue could not be permitted to take up stale issues merely

because the scope of appeal is wider than a reference.

11. A Division Bench of the Gauhati High Court in Commissioner of Income Tax Vs. Doom Dooma India Ltd., while dealing the concept of

Section 145 of the Act has held as under:

It is for the assessee to adopt any recognised method of accounting for his business. The income shall be computed in accordance with the method

of accounting regularly employed by the assessee. In other words, it is open to the assessee to opt for such method of accounting as he deems

reasonable and appropriate. He may opt to adopt the manufacturing cost price method or the market price method provided the method is

followed in regard to both the opening stock and the closing stock. It is not open to him to adopt one method for valuing the opening stock and a

different method for valuing the closing stock so as to intentionally suppress the income derived or derivable in the particular previous year. Even

where an assessee has adopted a particular method for a period of years, there is no provision of law which prevents him from changing to any

other method, provided the change-over is not made in the same assessment year.

12. In Commissioner of Income Tax Vs. Guttoffnungashutto Sterkrado, it has been ruled thus:

We have heard learned Counsel for the Department. From the records, we find that a similar dispute, i.e., whether the income has to be assessed

on ""complete contract"" basis, was before the Tribunal for the assessment years 1965-66 and 1966-67. The Tribunal recorded a categorical finding

that no defect in the accounts maintained by the assessee was pointed out by the Assessing Officer and, on the contrary, the profits of the assessee

can be correctly determined from the method of accounting adopted by it. With these conclusions, the orders of the Commissioner of Income Tax

passed u/s 263 of the Act were set aside, and the orders of the Income Tax Officer were restored. It is not in dispute that the Revenue has not

assailed the correctness of the conclusions of the Tribunal. The fact situation being identical, the Tribunal followed its earlier judgment and

observed that the ""complete contract"" basis was the correct mode for determination of the assessee''s income and its income can be correctly

determined from the method of accounting adopted by it. It, therefore, upheld the direction of the Commissioner of Income Tax (Appeals) given to

the Assessing Officer for redoing the assessments on the ""complete contract"" basis. The question that has been referred to this Court is whether the

profits can be properly deduced from the method employed by the assessee by maintaining its accounts on ""complete work"" basis and by the

method of dividing the net profit yearwise in proportion to the yearly gross receipts. The question whether the method employed by the assessee

by maintaining its accounts on a particular basis will be sufficient for determination of profits is essentially one of fact. Whether the income, profits

and gains could or could not be properly deduced from the method of accounting regularly adopted by the assessee is a question of fact. See

Chhabildas Tribhuvandas Shah and Others Vs. Commissioner of Income Tax, West Bengal, Therefore, in our opinion, no question of law arises

out of the order of the Tribunal....

[Emphasis supplied]

13. In Saurashtra Cement and Chemical Industries Ltd. Vs. Commissioner of Income Tax, the Division Bench has expressed thus:

Merely because an expense relates to a transaction of an earlier year it does not become a liability payable in the earlier year unless it can be said

that the liability was determined and crystallized in the year in question on the basis of maintaining accounts on the mercantile basis. In each case

where the accounts are maintained on the mercantile basis it has to be found in respect of any claim, whether such liability was crystallized and

quantified during the previous year so as to be required to be adjusted in the books of account of that previous year. If any liability, though relating

to the earlier year, depends upon making a demand and its acceptance by the assessee and such liability has been actually claimed and paid in the

later previous years it cannot be disallowed as deduction merely on the basis the accounts are maintained on mercantile basis and that it related to

a transaction of the previous year. The true profits and gains of a previous year are required to be computed for the purpose of determining tax

liability. The basis of taxing income is accrual of income as well as actual receipt. If for want of necessary material crystallizing the expenditure is

not in existence in respect of which such income or expenses relate, the mercantile system does not call for adjustment in the books of account on

estimate basis. It is actually known income or expenses, the right to receive or the liability to pay which has come to be crystallized, which is to be

taken into account under the mercantile system of maintaining books of account. An estimated income or liability, which is yet to be crystallized,

can only be adjusted as a contingency item but not as an accrued income or liability of that year. To illustrate, we find from the details of the

expenses that certain expenses related to the fees paid to the experts, out-of-pocket expenses incurred by the consultation firm and discharge of

liability on account of demurrage claimed by the port authorities. Such items without investigation into the facts about the crystallization of such

dues cannot be disallowed merely on the ground that they relate to transactions pertaining to an earlier accounting year....

14. In (2007) 107 ITD 343 while dealing with accounting standards, their Lordships referred to the decisions in Taparia Tools Ltd. Vs. Joint

Commissioner of Income Tax, and J.K. Industries Ltd. and Another Vs. Union of India (UOI) and Others, and thereafter adverted to the

recognition and identification of income under the 1961 Act as is attainable by several methods of accounting. Their Lordships referred to the

completed contract method and the percentage of completion method which were the issues in the said case. After so stating, the Apex Court

expressed the view as follows:

19. In the judgment of the Bombay High Court in Taparia Tools Ltd. Vs. Joint Commissioner of Income Tax, it has been held that in every case of

substitution of one method by another method, the burden is on the Department to prove that the method in vogue is not correct and it distorts the

profits of a particular year. Under the mercantile system of accounting based on the concept of accrual, the method of accounting followed by the

assessees is relevant. In the present case, there is no finding recorded by the Assessing Officer that the completed contract method distorts the

profits of a particular year. Moreover, as held in various judgments, the chit scheme is one integrated scheme spread over a period of time,

sometimes exceeding 12 months. We have examined computation of tax effect in these cases and we find that the entire exercise is revenue neutral,

particularly when the scheme is read as one integrated scheme spread over a period of time.

20. As stated above, we are concerned with assessment years 1991-92 to 1997-98. In the past, the Department had accepted the completed

contract method and because of such acceptance, the assessees, in these cases, have followed the same method of accounting, particularly in the

context of chit discount. Every assessee is entitled to arrange its affairs and follow the method of accounting, which the Department has earlier

accepted. It is only in those cases where the Department records a finding that the method adopted by the assessee results in distortion of profits,

the Department can insist on substitution of the existing method. Further, in the present cases, we find from the various statements produced before

us, that the entire exercise, arising out of change of method from the completed contract method to deferred revenue expenditure, is revenue

neutral. Therefore, we do not wish to interfere with the impugned judgment of the High Court.

[Emphasis added]

15. In Commissioner of Income Tax Vs. Kataria Road Lines, the Division Bench came to hold as under:

9. It is not in dispute that the mercantile accounting system was adopted by the assessee and was permitted by the Revenue for several years. By

virtue of the said accounting system, the assessee was claiming benefit of finance commission in the year of hire purchase agreement itself

irrespective of the fact that the amount of instalments as per the hire-purchase agreement was actually paid in the subsequent years. Answer to the

question whether such an accounting system was permissible or not, is not before us, further the Department itself was permitting the said

accounting system according to which, the assessee was accounting the entire finance commission in the year of hire purchase itself irrespective of

the fact that the instalment pursuant to the hire-purchase agreement was actually paid in the subsequent years. The assessment on the aforesaid

basis was continued for years together and it is only for the assessment years 1980-81 and 1981-82 that the said system was not accepted by the

Department. It is also the fact that the firms have closed their business. Thus, looking to the aforesaid facts and circumstances, and also the

judgment of the hon''ble apex court in the case of (2007) 107 ITD 343 we are of the view that the Department having permitted the assessee to

claim the benefit of finance commission in the year in which hire-purchase agreement was entered, the same system is required to be continued for

the assessment years 1980-81 and 1981-82,...

16. The present factual matrix has to be tested on the touchstone and anvil of the aforesaid enunciation of law. On a scrutiny of the facts that have

been brought on record, it is discernible that the assessee has been claiming prior period of expenses on the ground that the voucher of such

expenses from the employees/branch employees were received after 31st March of the financial year. It has also come as a matter of fact that the

assessee has branch offices throughout the country. The assessee has been debiting the expenditure spill over to the subsequent years and the

assessing officer had been allowing the same. The said accounting practice has been consistently followed by the assessee and accepted by the

department. If a particular accounting system has been followed and accepted and there is no acceptable reason to differ with the same, the

doctrine of consistency would come into play. The said accounting system has been followed for a number of years and there is no proof that there

has been any material change in the activities of the assessee as compared to the earlier years. Nothing has been brought on record to show that

there has been distortion of profit or the books of account did not reflect the correct picture in the absence of any reason whatsoever, there was no

warrant or justification to depart from the previous accounting system which was accepted by the department in respect of the previous years.

17. In view of our preceding analysis, we do not perceive any merit in this appeal and, accordingly, the same stands dismissed without any order

as to costs.