

**SUPREME COURT OF INDIA**

United Commercial Bank, Calcutta

Vs.

Commissioner of Income Tax, West

(D Wadhwa and M Shah JJ.)

29.09.1999

**ORDER**

**M.B. SHAH, J.**

1. This appeal is filed by UCO Bank, Calcutta against the judgment and order dated 25th July, 1991 passed by the High Court of Calcutta in Income Tax Reference No. 73 of 1989. At the instance of revenue, the Income Tax Appellate Tribunal referred the following two questions for the opinion of the High Court under Section 256(1) of the Income Tax Act, 1961 for the assessment year 1982-83:

1. Whether on the facts and in the circumstances of the case, the Tribunal is justified in law in cancelling the CIT's order under Section 263 of the Income-tax Act holding that the case of State Bank of Travancore v. CIT, Kerala (158 ITR 102) is not applicable to the facts of the present case?

2. Whether on the fact and in the circumstances of the case, the Tribunal is correct in law in holding that the notional loss in the investment trading (India) to the extent of Rs. 7,45,35,029 by working out a difference between the book value of shares as shown in the final account and their market price as on the last due of the accounts, is admissible to be deducted from the book profits of the assessee bank?

2. The High Court answered both the questions in the negative and in favour of the revenue and arrived at the conclusion that stock valuation of shares shown in Bank's final accounts could not be permitted to be revalued at market value for income tax purposes only.

3. The aforesaid questions arise in the context of the fact that appellant-assessee Bank submitted return for the assessment year 1982-83 contending that there was notional loss of Rs. 7,45,35,029 on

account of closing stock of securities at the market value. The Inspecting Assistant Commissioner of Income Tax, Assistant Range-III, Calcutta by the assessment order dated 19th March, 1985 accepted the same. The Commissioner of Income Tax, West Bengal by order dated 9th March, 1987 under Section 263 of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') set aside the said assessment order by holding that the Bank had no right to calculate profit or loss arising out of investment trading account as it has excluded it from the preparation of its own final accounts. Unless a Bank itself accepts the position by incorporating such loss or profit in the final accounts, it would have no right to put across such hypothetical loss for the purpose of income tax assessment. The practice followed by the Bank is entirely contrary to the decision rendered by this Court in *State of Travancore v. CIT Kerala*. The assessee was following mercantile system of according and loss claimed by the assessee had not been debited in the books of accounts.

4. Against that order, Bank preferred an appeal before the Income Tax Appellate Tribunal. The Tribunal by order dated 14th October, 1988 arrived at the conclusion that it is established on facts that assessee had claimed the loss by following the same method which it was following for the last 30 years and the principle laid down by this Court in *State Bank of Travancore v. C.I.T. Kerala* was not applicable to the facts of the present case. Hence, the order passed by the CIT under Section 263 was set aside. Against the said judgment and order at the instance of the revenue, the aforesaid two questions were referred for the opinion of the High Court.

5. Answering the said questions, the High Court observed that the assessee has not valued the stock of shares and securities in its books of accounts in accordance with the method "cost or market price whichever is lower"; if this method is not followed in writing and preparing accounts consistently, the assessee cannot claim a notional method of stock valuation only for computation of income by the tax authorities and the submission made by the assessee clearly goes against Section 145(1) of the Act. The Court further observed that the book results can be rejected by the tax authorities only if the method adopted by the assessee is either defective or if the system adopted does not disclose a proper and true income. The Court further held that mere fact that the system followed by the assessee had not been questioned in the past, is no ground, to say that it should be accepted all along as there is no estoppel in these matters.

6. We may mention at this stage that the learned Counsel, Mr. Debiprosad Pal sought an intervention to appear in this matter on behalf of the United Bank of India. It was contended by him that the same question is involved in matters pertaining to other banks which are governed by the Banking Regulation Act, 1949 and we have permitted him to make his submission on the question of law involved.

7. It has been pointed out by the learned Counsel for the appellant that preparation of balance sheet by the assessee bank is governed by the provisions of the Banking Regulation Act, 1949. Section 29, inter alia, provides that at the expiration of each calendar year, every banking company incorporated in India in respect of all business transacted by it, shall prepare a balance sheet and profit and loss account with reference to that year in the Forms set out in the Third Schedule or as near thereto as circumstances admit. In the prescribed form in the column of Property and Assets, Item 4 provides for mentioning the investments thus:

Investments (stating mode of valuation e.g. cost or market value (f).

(i) Securities of the Central and State Governments and other Trustee securities, including Treasury

Bills of the Central and Provincial Governments.

(ii) Shares (classifying into preference, ordinary, deferred and other classes of shares and showing separately shares fully paid up and partly paid up) ...

(iii) Debentures or Bonds

(iv) Other investments (to be classified under proper heads) (v) Gold" Note (f) reads as under:

Where the value of the investments shown in the outer column of the balance sheet is higher than the market value the market value shall be shown separately in brackets.

8. Further, in exercise of the powers conferred by Section 53 of the Banking Regulation Act, 1949, the Central Government, on the recommendation of the Reserve Bank of India had issued a notification for the assessee Bank for the assessment that provisions of Note (f) appended to Form 'A' in the Third Schedule to the said Act shall not apply to the United Commercial Bank in respect of its balance sheet as on the 31st December, 1981 which, when the value shown in the inner column against any of the sub-heads (ii), (iii), (iv) and (v) of item 4 of the Property and Assets side of the said Form, exceeds the market value of the investments under that sub-head, shows separately within brackets the market value of the investments under the sub-head.

9. On the basis of the said notification, the assessee Bank did not mentioned market value of the investments under the sub-heads separately within the brackets, in the balance sheet.

10. Learned Counsel for the appellant-assessee further pointed out that the requirement of disclosing the value of closing stocks of shares and securities at cost and mentioning the market price, if lower within the brackets has now been dispensed with by Circular dated 20th June, 1992 issued by the Reserve Bank of India. By this Circular, standard investment in securities other than approved securities are to be classified under 'Current' category and valued at market price or at cost whichever is less and depreciation is to be provided for the shortfall, if any.

11. From the aforesaid form of the prescribed balance sheet, it is evident that Scheduled Nationalised Banks were directed to put the value of shares and securities at cost and if the market value is lower, it was to be shown separately in brackets. Now, the question would be when such a Bank is submitting its statutory return of income, whether it can disclose in its return its real profit and/or loss on the basis of market value of securities and shares? It has been pointed out that the balance sheet or the audited accounts maintained on the basis of the investment in shares at cost would not disclose the real profit or loss of the Bank in view of the fact that depreciation in the value of the shares or fall in the market value of the shares and securities is not provided in the audited accounts. Learned Counsel for the appellant submitted that even though in the balance sheet maintained by the assessee, market price of the shares and securities is not mentioned, yet for determining the real income of the assessee Bank, the said price is required to be taken into account. And, for that purpose since years, the assessee Bank was submitting income tax returns after taking into account the market price of such shares and securities which has been accepted by the Department without any objection. He also submitted that not making of proper entries in the balance sheet could hardly be a ground for not assessing the real income.

12. For the reasons, the Central Government had issued Notification dated 12th May, 1982

permitting the assessee bank not to disclose in brackets the market value of the investment under the sub-heads in inner column against any of the sub-heads (ii), (iii), (iv) and (v) of Item 4 of the assets side of the prescribed form. It is also undisputed that:

(a) the appellant is a Nationalised Bank and therefore is governed by the Banking Regulation Act, 1949.

(b) The appellant follows mercantile systems of accounting both for Book keeping purpose as well as for tax purposes.

(c) The appellant consistently and for over 30 years prior to the assessment year in dispute (1982-83) has been valuing its stock- in-trade (investments) 'at cost' in the balance sheet whereas for the same period of time the appellant has been valuing the very same investment 'at cost or market value whichever is lower' for income tax purposes.

13. In the background of the aforesaid facts, we would state that it is an established rule of commercial practice and accountancy that closing stock can be valued at cost or market price whichever is lower. In *Chainrup Sampatram v. Commissioner of Income Tax, West Bengal*, this Court explained the underlying reasons for the said practice thus:

'It is wrong to assume that the valuation of the closing stock at market rate has, for its object, the bringing into charge any appreciation in the value of such stock. The true purpose of crediting the value of unsold stock is to balance the cost of those goods entered on the other side of the account at the time of their purchase, so that the cancelling out of the entries relating to the same stock from both sides of the account would leave only the transactions on which there have been actual sales in the course of the year showing the profit or loss actually realised on the year's trading. As pointed out in paragraph 8 of the Report of the Committee on Financial Risks attaching to the holding of Trading Stocks, 1919,

As the entry for stock which appears in a trading account is merely intended to cancel the charge for the goods purchased which have not been sold, it should necessarily represent the cost of the goods. If it is more or less than the cost, then the effect is to state the profit on the goods which actually have been sold at the incorrect figure.... From this rigid doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, viz., the adoption of market value at the date of making up accounts, if that value is less than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of attributing to the following year's results a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question." (extracted in paragraph 281 of the Report of the Committee on the Taxation of Trading Profits presented to British Parliament in April, 1951).

While anticipated loss is thus taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into account, as no prudent trader would care to show increased profit before its actual realisation. This is the theory underlying the rule that the closing stock is to be valued at cost or market price whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy. As profits for income tax purposes are to be computed in conformity with the ordinary principles of commercial accounting, unless, of course, such principles have been superseded or modified by legislative enactments, unrealised

profits in the shape of appreciated value of goods remaining unsold at the end of an accounting year and carried over to the following year's in a business that is continuing are not brought into the charge as a matter of practice, though as already stated, loss due to a fall in price below cost is allowed even if such loss has not been actually realised. As truly observed by one of the learned Judges in *Whimster & Co. v. Commissioner of Inland Revenue* 12 Tax Cas. 813, 827,

Under this law (Revenue Law) the profits are the profits realised in the course of the year. What seems an exception is recognised where a trader purchased and still holds goods or stocks which have fallen in value. No loss has been realised. Loss may not occur. Nevertheless, at the close of the year he is permitted to treat these goods or stocks as of their market value.

(Emphasis supplied)

14. With regard to maintenance of accounts this Court in *Investment Ltd. v. The C.I.T., Calcutta* 77 ITR 533 observed as under:

In the balance-sheet, it is true, the securities and shares are valued at cost, but no firm conclusion can be drawn from the method of keeping accounts. A tax-payer is free to employ, for the purpose of his trade, his own method of keeping accounts; and for that purpose to value his stock-in-trade either at cost or 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 stock at cost is one of the recognised methods. No inference may therefore arise from the employment by the company of the method of valuing stock at cost, that the stock valued was not stock-in-trade.

(Emphasis added)

15. The learned Counsel for the Revenue submitted that once the asses-see has finalised his accounts as per the statutory provisions, then it is not permissible for him to adopt for the income tax purposes a method different from the one on the basis of which his final accounts were prepared. For this purpose, he relied upon the decisions rendered by this Court in *State Bank of Travancore v. CIT* and *Commissioner of Income Tax v. British Paints India Ltd.* . In our view, the submission made by the learned Counsel has no substance. In the case of the *State Bank of Travancore* (supra), this Court considered the question whether interest on 'sticky' advances debited to the customers account but taken to 'Interest Suspense Account' can be termed as accrual income. In that context, majority view was where the interest has accrued and the assessee has debited the accounts of the debtor, the difficulty of recovery would not make its accrual non-accrual. Before discussing the question involved, the Court after considering provisions of the Income Tax Act observed thus:

It is settled that the income of the assessee will have to be determined according to the provisions of the Act in consonance with the method of accountancy regularly employed by the assessee. The method of accounting regularly employed by the assessee helps the computation of income profits and gains under Section 28 of the Act and the taxability of that income under the Act will then have to be determined. The question is, whether the income which has been computed according to the method of accounting followed regularly by an assessee can be diminished or diminished by any

notion of real income. This has to be judged in the light of the well-settled principles.

16. After considering various decisions, the Court has laid down inter-alia, the following propositions:

(1) It is the income which has really accrued or arisen to the assessee that is taxable. Whether the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation. (2) The concept of real income would apply where there has been a surrender of income which in theory may have accrued but in the reality of the situation, no income had resulted because the income did not really accrue. (3) Where a debt has become bad, deduction in compliance with the provisions of the Act should be claimed and allowed. (4) Where the Act applies, the concept of real income should not be so read as to defeat the provisions of the Act, (5) If there is any diversion of income at source under any statute or by overriding title, then there is no income to the assessee. (6) The conduct of the parties in treating the income in a particular manner is material evidence of the fact whether income has accrued or not. (7) Mere improbability of recovery, where the conduct of the assessee is unequivocal, cannot be treated as evidence of the fact that income has not resulted or accrued to the assessee. After debiting the debtor's account and not reversing that entry-but taking the interest merely in suspense account cannot be such evidence to show that no real income has accrued to the assessee or been treated as such by the assessee. (8) The concept of real income is certainly applicable in judging whether there has been income or not but, in every case, it must be applied with care and within well-recognised limits.

17. In the light of the aforesaid proposition by majority view, it was held that the additions of the sums representing interest on sticky advances as income was justified.

18. Even applying the aforesaid tests laid down by this Court, what is taxable under the Act is the really accrued or arisen income. On the basis of the method of accountancy regularly employed by the assessee, the real income is pointed out in the income-tax return submitted by the assessee. This cannot be ignored by holding that in a balance sheet which is required to be statutorily maintained in a particular form, market value of the shares and securities is not mentioned or is mentioned in brackets. The decision in the case of State Bank of Travancore does not lay down any rule that whatever is not mentioned in the prescribed statutory balance sheet is not to be taken into account for deciding real taxable income.

19. At this stage, we would mention that the aforesaid case of State Bank of Travancore was considered (in the case of assessee bank) by this Court in UCO Bank v. CIT . After referring to the decision in State Bank of Travancore case (supra) the Court observed:

Under Section 145 of the Income-tax Act, 1961, income chargeable under the head "Profit 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 a case where the accounts are correct and complete but the method employed is such that in the opinion of the Income-tax Officer, the income cannot properly be deducted therefrom, the computation shall be made in such manner and on such basis as the Income-Tax Officer may determine. In the present case, the method employed is entirely for a proper determination of income.

Thereafter, the Court further observed:

The very fact that the assessee, although generally using a mercantile system of accounting, keeps such interest amounts in a suspense account and does not bring these amounts to the profit and loss account, goes to show that the assessee is following a mixed system of accounting by which such interest is included in its income only when it is actually received. Looking to the method of accounting so adopted by the assessee in such cases, the circulars which have been issued are consistent with the provisions of Section 145 and are meant to ensure that assessees of the kind specified who have to account for all such amounts of interest on doubtful loans are uniformly given the benefit under the circular and such interest amounts are not included in the income of the assessee until actually received if the conditions of the circular are satisfied.

20. Thereafter, the Court explained the decision in case of State Bank of Travancore by observing that relevant circular of the Board was not pointed out to the Court and that majority decision in the said case cannot be looked upon as laying down that a circular which is properly issued under Section 119 of the Income-tax Act for proper administration of the Act and for relieving the rigour of too literal a construction of the law for the benefit of the assessee in certain situations would not be binding on the departmental authorities. The Court held that this would be contrary to the ratio laid down by the Bench of five judges in *Navnit Lal (C) Javeri v. K.K. Sen*. The Court further held that in fact *State Bank of Travancore v. CIT*, has already been distinguished in *Keshavji Ravji and Co. v. CIT*, by a Bench of three judges in a similar fashion and "it is held only as laying down that a circular cannot alter the provisions of the Act."

21. The learned Counsel for the Revenue further relied upon the decision in *Commissioner of Income-Tax v. British Paints India Ltd.*. In our view, the said decision would not in a way advance the contention raised by the respondent. The Court while dealing with the contention of the assessee for valuation of the raw material without taking into account any portion of the cost of manufacture, held that the question of fact which the Assessing Officer must necessarily decide is whether or not the method of accounting followed by the assessee discloses true income and observed thus:

It is a well recognised principle of commercial accounting to enter in the profit and loss account the value of the stock-in-trade at the beginning and at the end of the accounting year at cost or market price, whichever is the lower.

22. The Court further considered Section 145 of the Act and observed that what is to be determined by the officer in exercise of the power is a question of fact, that is, whether or not income chargeable under the Act can be properly deduced from the books of accounts and the question must be decided with reference to the relevant material and in accordance with the correct principles. The Court also observed:

Where the market value has fallen before the date of valuation and, on that date, the market value of the article is less than its actual cost, the assessee is entitled to value the articles at market value and thus anticipate the loss which he will probably incur at the time of the sale of the goods. Valuation of the stock-in-trade at cost or market value, whichever is the lower, is a matter entirely within the discretion of the assessee. But whichever method he adopts, it should disclose a true picture of his profits and gains. If, on the other hand he adopts a system which does not disclose the true state of affairs for the determination of tax, even if it is ideally suited for other purposes of his business, such as the creation of a reserve, declaration of dividends, planning and the like, it is the duty of the Assessing Officer to adopt any such computation as he deems appropriate for the proper determination of the true income of the assessee. This is not only a right but a duty that is placed on

the officer, in terms of the first proviso to Section 145, which concerns a correct and complete account but which in the opinion of the officer, does not disclose the true and proper income.

23. Hence, for the purpose of income tax whichever method is adopted by the assessee a true picture of the profits and gains, that is to say, the real income is to be disclosed. For determining the real income, the entries in a balance sheet required to be maintained in the statutory form, may not be decisive or conclusive. In such cases, it is open to the Income Tax Officer as well as the assessee to point out the true and proper income while submitting the income tax return. In *Kedamath Jute Mfg. Co. Ltd. v. Commissioner of Income Tax (Central), Calcutta*, this Court has negated the contention that "if an assessee under misapprehension or mistake fails to make an entry into the books of account and although, under the law, a deduction must be allowed by the Income-Tax Officer, assessee will lose the right of claiming or will be debarred from being allowed that deduction." The Court held that whether the assessee is entitled to the particular deduction or not will depend upon the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter. In the present case, the question is slightly different. For reasons, Central Government, in exercise of the powers conferred by Section 53 of the Banking Regulation Act, and on the recommendation of the Reserve Bank of India, permitted the assessee not to disclose the market value of its investment in the balance sheet required to be maintained as per the statutory form. But as the assessee was maintaining its accounts on mercantile system, he was entitled to show his real income by taking into account market value of such investments in arriving at real taxable income. On that basis, therefore, Assessing Officer has taxed the assessee.

24. From the decisions discussed above, it can be held:

(1) That for valuing the closing stock, it is open to the assessee to value it at the cost or market value, whichever is lower;

(2) In the balance sheet, if the securities and shares are valued at cost but from that no firm conclusion can be drawn. A taxpayer is free to employ for the purpose of his trade, his own method of keeping accounts, and for that purpose, to value stock-in-trade either at cost or market price;

(3) A method of accounting adopted by the tax payer consistently and regularly cannot be discarded by the departmental authorities on the view that he should have adopted a different method of keeping accounts or of valuation;

(4) The concept of real income is certainly applicable in judging whether there has income or not, but in every case, it must be applied with care and within their recognised limits;

(5) Whether the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation; and

(6) Under Section 145 of the Act, in a case where accounts are correct and complete but the method employed is such that in the opinion of the Income Tax Officer, the income cannot be properly deduced therefrom, the computation shall be made in such manner and on such basis as the Income-Tax Officer may determine.

25. In the present case, the High Court has disallowed the claim of the appellant after holding thus:

(a) The entries made by the assessee in its books of account is not determinative of the question whether the assessee has earned any profit or suffered any loss;

(b) The method of accounting namely "at cost or market value whichever is lower" followed by the appellant for valuing its stock-in-trade (Investment) for income tax purpose is the correct and the permissible method in law. If this method is not followed in writing and preparing accounts consistently, the assessee cannot claim a notional method of stock valuation only for computation of income by the Tax authorities without following the same method in writing and preparing accounts.

(c) Since stock valuation is admittedly a method of accounting the assessee Bank can claim the benefit of stock valuation "at cost or market value, whichever is lower" only if such method is actually followed and adopted by him in preparing the final accounts. Without following this method in preparing the accounts, which are required to be prepared and presented under Section 29 of the Banking Regulation Act, 1949 in the form set out in the third Schedule thereto, the assessee Bank cannot be permitted to claim a loss on revaluation by claiming different method of stock valuation notionally for income tax purposes only.

26. In our view, as stated above consistently for 30 years, the assessee was valuing the stock-in-trade at cost for the purpose of statutory balance sheet, and for the income tax return, valuation was at cost or market value whichever was lower. That practice was accepted by the Department and there was no justifiable reason for not accepting the same. Preparation of the balance sheet in accordance with the statutory provision would not disentitle the assessee in submitting income tax return on the real taxable income in accordance with a method of account adopted by the assessee consistently and regularly. That cannot be discarded by the departmental authorities on the ground that assessee was maintaining balance sheet in the statutory form on the basis of the cost of the investments. In such cases, there is no question of following two different methods for valuing its stock-in-trade (investments) because the Bank was required to prepare balance sheet in the prescribed form and it had no option to charge it. For the purpose of income tax as stated earlier, what is to be taxed is the real income which is to be deduced on the basis of the accounting system regularly maintained by the assessee and that was done by the assessee in the present case.

27. In the result, the appeal is allowed. The impugned order passed by the High Court is set aside. The questions referred by the Tribunal are answered in favour of the assessee and against the revenue.

28. Ordered accordingly. There shall be no order as to costs.