IT: Where assessee-bank valued its stock of shares and securities on cost basis in books of account, in view of fact that price of those shares fell sharply during relevant year, in such a case, in order to arrive at real income/loss, correctly, assessee could value closing stock of shares on market price or cost, whichever was lower basis in its return of income

[2018] 96 taxmann.com 235 (Calcutta)

HIGH COURT OF CALCUTTA

United Bank of India

v.

Commissioner of Income Tax, W.B.-IV, Calcutta*[*]*

I.P MUKERJI AND AMRITA SINHA, JJ.
ITR NOS. 19 OF 1999 & 7 OF 2000†
JUNE 27, 2018

Section 145 of the Income-tax Act, 1961 - Method of accounting - Valuation of stock (Shares) - Assessment year 1990-91 - During relevant year, assessee-bank invested certain amount in shares and securities of public limited companies - In books of account, assessee valued stock of shares and securities on cost basis - Since price of those shares fell during relevant year, assessee suffered huge loss - Thus, in return of income, assessee valued closing stock on market value or cost, whichever was lower basis - Authorities below opined that assessee could not adopt different method of valuation of shares in its return of income - Whether in view of fact that changed method of valuation of closing stock i.e. cost or market price whichever was lower would determine income/loss correctly, impugned order passed by authorities below was to be set aside - Held, yes [Para 9] [In favour of assessee]

CASE REVIEW

United Bank of India v. *Dy. CIT* [1999] 68 ITD 332 (Cal.) (para 9) *Partly reversed.*

CASES REFERRED TO

United Bank of India v. *Dy. CIT* [1999] 68 ITD 332 (Cal.) (para 2), *CIT* v. *UCO Bank* [1993] 200 ITR 68 (Cal.) (para 7) and *United Commercial Bank* v. *CIT* [1999] 106 Taxman 601 (SC) (para 8).

Abhratosh Majumdar, Sr. Adv., **Avra Majumdar**, and **Amiya Kanti Bandyopadhyay**, Advs. *for the Petitioner*. **Md. Nizamuuddin**, **R.N. Bandyopadhyay**, and **Aniket Mitra**, Advs. *for the Respondent.*

JUDGMENT

ITR No. 7 of 2000

I.P. Mukerji, J. - This is a reference application under Section 256(1) of the Income-tax Act, 1951.

2. The applicant/assessee wanted the following questions arising out of the order of the Income-tax

Appellate Tribunal (hereinafter 'the tribunal') dated 27th March, 1998 in *United Bank of India* v. *Dy. CIT* [1999] 68 ITD 332 (Cal.) in the assessment year 1990-91 to be answered by this Court.

"1. Whether on the facts and in the circumstances of the case the Tribunal was justified in law in holding that the assessee is not entitled to value the shares and securities which were held to be its stock in trade on the basis of the cost or market price whichever is lower as claimed in the return and the valuation of the closing stock was to be made on the cost basis as disclosed in the Balance Sheet and the profit or loss, if any, is to be determined on such basis?

2. Whether on the facts and in the circumstances of the case and in view of the directions of the C.I.T. (Appeals) that in regard to the purchase and sale of shares and securities made during the year and which are not out of the opening stock of shares and securities as on 1.1.84, the said shares and securities included in closing balance constituted the stock-in-trade of the banking business and the assessee will be entitled to change over to the present method of valuation of the closing stock at cost or market price whichever in lower and in view of the fact that there is no appeal preferred by the department against the said finding and direction, the Tribunal was justified in law in holding that the assessee cannot for the purpose of the Income-tax Return claim the valuation of the closing stock on the basis of cost or market price whichever is lower and the profit or loss cannot be computed on such method?

3. Whether on the facts and in the circumstances of the case and in view of the finding of the Tribunal that all the assessee during the relevant accounting period constituted its stock-in-hand, the Tribunal was justified in law in holding that the assessee claim in the Income Tax Return the valuation of its closing stock of shares & securities on the basis of the cost or market price whichever is lower and the profit & loss, if any, is to be computed on the basis of cost and not on the basis of valuation of the closing stock the cost of market price whichever is lower?"

3. By its referral order dated 23rd March, 1999 the tribunal referred only question No.2 to this Court. It gave the explanation that this question arose in the assessment year 1990-91. They were identical to the questions sought to be raised by the assessee bank in the assessment years 1985-86, 1986-87 and 1987-88. For some reason, the questions raised in this reference for the assessment year 1990-91 could not be included in the statement of case from 1985-86 to 1987-88. Since, for those assessment years only question No.2 was referred to this court on reference, an identical reference *i.e.* of question No.2 was made to this court for the assessment year 1990-91. The Tribunal stated that its statement of case in the referral Order dated 29th January 1999 for the said earlier assessment years be treated as a statement of case for the subject assessment year 1990-91.

4. The issue involved in this case is very technical. It involves accounting principles. It involves employment of those principles to compute profit and loss. But nevertheless it is bound to have far reaching effects. During the period involved, the Reserve Bank of India compelled banks to invest a proportion of the investment that they received in securities and shares in public limited companies. Since it was not the banks' decision and they were acting in accordance with the decision and direction of another body, they treated the investment as stock in trade, treating the closing stock on cost basis, in their books of account. However in their income tax return they valued this closing stock on market value or cost whichever was lower. Since the price of the shares fell the assessees showed huge losses in their return although their books of account did not reflect it.

5. The Board of Directors of the assessee bank in its meeting held on 29th December, 1984 approved that the closing stock of securities as on 31st December, 1984 may be valued on the basis of cost or market value whichever was lower and the loss to be treated as business loss for the sole purpose of the assesse's tax assessment for the assessment year 1985-1986.

6. The present accounting principle being followed by the bank is valuation of the closing stock on cost or market value whichever is lower. They want to apply this principle to the stock in trade acquired in the financial year *i.e*. 1984-85 prior to the assessment year in which the accounting principle was changed so that they could show the change in value of the closing stock and account for the losses accordingly.

7. The tribunal by its order dated 27th August, 1998, relying on the decision of this court in *CIT* v. *UCO Bank* [1993] 200 ITR 68 (Cal) ruled that the assessee was not entitled to claim a different basis of valuation of closing stock of these shares and securities from the one adopted its books of accounts and audited annual accounts.

8. The United Commercial Bank case came to be considered by the Supreme Court in *United Commercial Bank* v. *CIT* [1999] 106 Taxman 601. It held as follows on 29th September, 1999, after the above decision of the tribunal;

> "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.
>
> 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 assessees in the present case."

9. On an appreciation of the above judgement it clearly appears that the court stressed on the determination of real income rather than theoretical principles of accountancy. It says that if the securities and shares were valued at cost and from that no firm conclusion could be drawn a tax payer was free to employ his own method of keeping accounts to value the stock in trade whether at cost or market price. Then it went on to say that the emphasis was on determination of real income. Again it observed that where from the computation, the real income could not be properly deduced, the computation should be made in the manner determined by the Income-tax officer.

We think that the computation made by the assessee for the subject assessment year does not disclose the real income and that changing the method of valuation of closing stock to cost or market price whichever was lower would determine the income correctly.

ITR 19 of 1999

10. The facts and the terms of the reference are similar to ITR 7 of 2000. The questions in both the reference applications are answered in terms of this Judgement and order. It follows that the part of the order of the tribunal dealing with the accounting method for valuation of the closing stock of the assessee is set aside.

11. We direct the Registrar General of this Court to send a copy of this order to the Income-tax Appellate Tribunal 'A' Bench. The said tribunal is directed to revise its order dated 27th March, 1998 on the basis of this judgment and order.

12. The tribunal is requested to pass the necessary order within three months of communication of this order.

Both the reference applications ITR No.7 of 2000 and ITR No.19 of 1999 are disposed of.

13. Certified photocopy of this order, if applied for, be supplied to the parties upon compliance with all requisite formalities.

I agree.

sunil

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*In favour of assessee.

†Arising out of order of Tribunal in *United Bank of India* v. *Dy. CIT* [1999] 68 ITD 332 (Cal.).