

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

INCOME TAX REFERENCE NO.192 OF 1999

Bajaj Auto Ltd. Bombay

.. Applicant

v/s.

The Commissioner of Income Tax-II,
Bombay

.. Respondent

Mr. P.J. Pardiwala, Senior Counsel a/w Ms. Vasanti Patel for the
applicant
None for the respondent

**CORAM : M.S. SANKLECHA &
S.C. GUPTE, J.J.**

DATED : 8th SEPTEMBER, 2016.

ORAL JUDGMENT : (Per S.C. Gupta, J.)

1. By this Reference under Section 256(1) of the Income Tax Act, 1961 (“the Act”), the Income Tax Appellate Tribunal (“the Tribunal”) has referred the following questions of law for our opinion :-

(a) Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the change in the method of valuation of closing stock of stores, spares, tools, raw-materials, auto spare parts and work-in-progress, by adopting the weighted average cost basis instead of adopting the cost on the basis of “lowest purchase price during the year”, was not justified and accordingly upholding the addition of Rs.12,03,509/- made by the Income-Tax Officer on the said

issue?

(b) *Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in rejecting the change in the method of valuation of closing stock?*

(c) *Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that packing expenses did not qualify for export market development allowance under Section 35B?*

2. The Assessment Years involved in the present Reference are 1976-77 and 1977-78.

Regarding Questions (a) and (b) :-

3. Up to the end of the accounting year relevant to Assessment Year 1975-76, the assessee, who is a manufacturer of scooters, three wheelers and their parts, had been valuing its closing stock of stores, spares, tools and materials and work-in-progress on the basis of cost or market value whichever was lower. For determining the cost for the purposes of such valuation, the assessee had adopted the basis of “lowest purchase price during the year”. Whilst determining the closing stock as on 30th June, 1976, though the stock was valued on the basis of

“cost or market value whichever is lower”, the cost itself was considered on “weighted average cost” basis. This was on the footing that after coming into effect of the Manufacturing and Other Companies (Auditor's Report) Order, 1975, the assessee, in consultation with its auditors, decided to change the method of ascertaining the cost for the purpose of stock valuation so as to adopt a more scientific method of determining the cost. This change in the method of determining the cost took into account both opening quantities (their value being already declared in the earlier assessment year as value of the closing stock) as well as quantities purchased at different rates during the year and the cost of stock was arrived at by dividing the value of opening stock plus the value of purchases by the quantity of opening stock plus purchases during the year. This method of determining the cost, known as weighted average cost, according to the assessee, was one of the normally accepted methods of determining the cost for the purpose of stock valuation. This change resulted in the inventory and profits being shown in the accounting year relevant for A.Y. 1977-78 less by Rs.12,03,509/-. The Assessing Officer did not accept the change and made an addition of Rs.12,03,509/-.

4. On appeal, the Commissioner of Income Tax (Appeals)

["CIT(A)"] set aside the order of the Assessing Officer, deleting the addition, holding that the change in the method of valuation of closing stock was bonafide and proper. On further appeal, the Tribunal set aside the order of CIT(A) and restored the order of the Assessing Officer.

5. The issue that arises for our determination is whether or not the assessee was entitled to employ the method of valuation proposed by the assessee insofar as the closing stock was concerned. The proviso to sub-Section (1) of Section 145 of the Act (then in force), which deals with 'method of accounting', empowers the Assessing Officer to change the basis or manner of accounting in the event the accounts are correct and complete to the satisfaction of the Income Tax Officer but the method employed is such that, in the opinion of the Assessing Officer, the income cannot be properly deduced therefrom. So also, under sub-section (2) of Section 145 of the Act, which was applicable at the relevant date, if the Income Tax Officer was 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 Officer was empowered to make an assessment in the manner provided under Section 144 of the Act. The assessee's case is that the

Assessing Officer could not have rejected the method of accounting employed by the assessee without having found under the proviso to Sub-section (1) of Section 145 that income cannot be properly deduced from the method employed or without being satisfied under Sub-section (2) that no method of accounting has been regularly employed by the assessee. It is submitted that it is for the assessee to employ any particular method of accounting and the Assessing Officer is not empowered to reject the method employed except in cases covered by the proviso to sub-section (1) or sub-section (2) of Section 145 of the Act.

6. In the first place, it is important to note that what the assessee has changed in the present case is the method of ascertaining the cost for the purpose of stock valuation and not the method of accounting employed by the assessee for the purpose of stock valuation as such. The method, as before, continues to be “cost or market value whichever is lower”. It is only for determining the cost for the purpose of this method that instead of “lowest purchase price” during the year, the basis of “weighted average cost” was adopted. This on the footing that the latter was a more scientific basis for accounting the closing stock. It is doubtful whether this change can be termed as a new method of

accounting. Be that as it may, we need not actually consider that question since we are satisfied that even if one proceeds on the footing that this change amounts to a change in the method of accounting, the assessee was well within its rights to bring about such change. So long as the assessee adopts such change *bona fide* and proposes to employ the new method regularly, no fault can be found with the same, as explained by us below.

7. As held by the Madras High Court in the case of ***Indo-Commercial Bank Ltd. Vs. Commissioner of Income Tax, 44 ITR 22***, it is the assessee and not the Department that has the choice of the method of accounting. The Department is bound by the choice of the assessee except in cases specified in the proviso to Section 13 (Section 145 of the present Act, as it then applied, being in *para materia* with Section 13 in this behalf). The Madras High Court held as follows :-

“.....The method of accounting chosen by an assessee can be rejected by the department if it was not regularly employed. Even if it was established to have been regularly employed by an assessee, the department can reject the accounts as the basis for the computation of the income of the assessee, if the income cannot be properly deducted from the accounts based on the system of the assessee's choice. Section 13, however, does not expressly or impliedly sanction a rejection of the assessee's accounts, if nothing more is established than that the assessee has changed his method of accounting. If an assessee bona fide changed his method of accounting and satisfied the requirement

of regular employment thereafter of that changed method of accounting, the only basis for the rejection of the accounts would be that the income, profits and gains could not be properly deduced from the accounts maintained on the basis of the changed method of accounting.”

8. The Madras High Court proceeded to quote in this behalf the following text from ***Law and Practice of Income-tax by Kanga and Palkhivala, fourth edition, Volume 1*** dealing with the decision of our Court in the case of ***Sarupchand Vs. Commissioner of Income Tax***, :-

“Sarupchand's case (supra) is a clear authority for the proposition that it is open to an assessee to make a clean change of the regular method adopted by him up to that time, provided, he satisfied the department on proper evidence that he has in fact changed the regular basis of accounting and has not merely abandoned or changed it for a casual period to suit his own purposes. A bona fide change of the regular basis of accounting must be accepted by the department and may be given effect to on such terms as may be necessary for preventing escape from taxation or double taxation. But even bona fide changes, if too frequent, would disentitle the assessee to have his yearly income computed in accordance with his own changing methods and would justify an assessment under the proviso; for under this section the assessee's method of accounting prevails only if it has been regularly employed. The intention of the legislature in enacting section 13 was that for income-tax purposes the assessee should be entitled to make use of any method of accounting that he chooses to adopt, but he must follow the selected method 'regularly' and is not to be allowed to change his system of book-keeping from year to year or so frequently as to prevent a fair estimate of his income, profits and gains, de anno in annum from being ascertained.”

9. In the light of the above statement of law, what one needs to

consider whilst accepting or rejecting a new accounting method proposed by the assessee is, whether the new method is adopted *bona fide* and whether the assessee intends to make this new method his regular method of accounting. As for the *bona fides* of the adoption of this new method by the assessee in the present case, the assessee's case has been that the new method was adopted in the face of the Manufacturing and Other Companies (Auditor's Report) Order, 1975. The Order applies to every company, which is engaged *inter alia* in manufacturing, mining or processing. The order requires that in the case of manufacturing, mining or processing companies, the auditor's report on the accounts must include a statement whether the company is maintaining proper records to show full particulars including quantitative details and situation of fixed assets; whether these fixed assets have been specifically verified by the management; and whether the same have been properly dealt with in the books of accounts. The auditor must further certify his satisfaction that the valuation of the stocks is fair and proper and in accordance with the normally accepted accounting principles. It is the assessee's case that at the relevant time, methods of accounting for measurement of inventories ordinarily adopted by companies were based on accounting standards followed internationally. These required the historical cost of inventories to be

accounted by using the First-in-First-out (FIFO) formula or the “Weighted Average Cost” formula. The weighted average cost formula adopted by the assessee, thus, accorded with the international standards and was a more scientific formula or method than the earlier used “lowest cost of purchase in the year” formula. In fact, both the Assessing Officer as well as the CIT(A) came to an express finding that the formula adopted by the assessee was more scientific than the one which was adopted earlier. The adoption of the new method by the assessee is accordingly clearly *bona fide*.

10. As for the requirement of regular employment of the method of accounting, it is pertinent to note that the Tribunal does not dispute that the new system of accounting was followed by the assessee in the subsequent assessment years as well. This clearly supports the assessee's case that the method was meant to be adopted as a regular method for the future. The Tribunal appears to have been swayed by the fact that by means of this new method of determining the cost, the assessee was having the benefit of taking the cost of items remaining in the closing stock on the basis of the lowest purchase price during the year with further reduction in the cost by following the weighted average cost formula. The method of determining the cost of items

remaining in the closing stock is a part of a system of valuation of closing stock and if this method is changed, it would automatically lead to a change in the valuation of the closing stock. This is inevitable for the first year of change. What we need to consider in every such case is whether the exercise carried by the assessee is *bona fide* and is a permanent arrangement which is to be followed year after year, and not what immediate benefit accrues to the assessee for the particular year in which the change is introduced.

11. A Division Bench of our Court in the case of ***Melmould Corporation Vs. Commissioner of Income Tax, 202 ITR 789*** was concerned with the valuation of closing stock at cost price. Our Court referred to the decision of Karnataka High Court in ***Commissioner of Income Tax Vs. Corporation Bank Ltd. (1988) 174 ITR 616*** and quoted following observations of the Karnataka High Court in that case :-

“The change was a bona fide one and was a permanent arrangement which was to be followed year after year, the change would have to be accepted notwithstanding the fact that during the assessment year in question, which was the first year when the change of method was brought about, a prejudice or detriment might be caused to the revenue, because the opening stock was valued at total cost while closing stock was valued at direct cost.”

12. The foregoing discussion makes it clear that so long as the change made by the assessee in his method of accounting is *bona fide* and amounts to a permanent arrangement to be followed, the Revenue has no cause to complain. The conclusion drawn by the Tribunal that the change in the method of valuation adopted by the assessee, namely, from “lowest price during the year” to the “weighted average cost” formula was not justified, is without any merit. We accordingly, answer questions (a) and (b) in the negative, i.e. in favour of the assessee and against the Revenue.

13. So far as question (c) is concerned, Mr. Pardiwala, learned Senior Counsel appearing for the assessee, fairly states that the issue is covered by the decision of this Court in the case of ***Commissioner of Income Tax Vs. Zenith Steel Pipes and Industries Ltd, 315 ITR 95***. In ***Zenith Steel*** (supra), our Court, relying on the decision of ***Sam Faction Wear Pvt. Ltd. Vs. Commissioner of Income Tax, 209 ITR 214***, held that packing expenses of goods exported did not qualify for an allowance under Section 35B(1)(b) of the Act. The question is, accordingly, answered in the affirmative, in favour of the Revenue and against the assessee.

14. The Reference is disposed of in the above terms. No order as to costs.

(S.C. GUPTE, J.)

(M.S. SANKLECHA, J.)