



**IN THE INCOME TAX APPELLATE TRIBUNAL
ALLAHABAD BENCH, ALLAHABAD**

**BEFORE SHRI. A. D. JAIN, VICE PRESIDENT
AND SHRI T. S. KAPOOR, ACCOUNTANT MEMBER**

ITA No.328/ALLD/2014
Assessment Year: 2009-10

M/s ARM Rice Mills 23/41, B-1, Allahpur Allahabad	v.	CIT Allahabad
TAN/PAN:AAFJA0268M		
(Appellant)		(Respondent)

Appellant by:	Shri Praveen Godbole, C.A.		
Respondent by:	Shri S. K. Madhuk, CIT (DR)		
Date of hearing:	19	11	2019
Date of pronouncement:	20	11	2019

ORDER

PER A. D. JAIN, V.P.:

This is assessee's appeal against the order of the Id. CIT, dated 36/3/2014, passed under section 263 of the Income Tax Act, 1961, taking the following grounds:

1. That in any view of the matter, order passed u/s 263 of the income tax Act by the Commissioner of Income Tax is bad both on the facts and in law and the reasons narrated in the order are incorrect and contrary to the actual facts, therefore such order is liable to be cancelled.
2. That in any view of the matter, order passed u/s 143(3) of the income tax Act dated 30.12.2011 is well reasoned order passed by the Assessing Officer after considering the books, audit reports, various explanations, then there is no justification to cancel valid and reasoned order in vague manner.
3. That in any view of the matter, when during the assessment proceedings, the Assessing Officer considered all issues in respect of trading result or in respect of profit

and loss account, then there is no justification to draw a different view by invoking the provision of section 263 of the income tax act.

4. That in any view of the matter, the Commissioner of Income Tax while passing the order u/s 263 of the income tax act wrongly interpreting the facts/expenditure issue, hence the order u/s 263 of the income tax act is liable to be cancelled.

2. The assessee has also filed before us the statement of facts in this case, which, for the sake of reference, is reproduced hereunder:

*“The appellant is a firm engaged in the business of rice mill and the year under consideration was not the first year of business but the appellant engaged in such business for last number of years. In respect of such business regular books of accounts have been maintained which are audited and audit report duly filed along with the return. In compliance to notice u/s 143(2) of the income tax act books of account were produced from time to time which were thoroughly scrutinized which will appeal from order sheet. The method of valuation adopted by the assessee year after year is duly accepted and no defect was found in books. The assessing officer has determined the income at Rs.24,39,910.00 and in computing the income additions on account of extra profit and disallowances were made. Against the addition, appeal was filed before the Commissioner of Income Tax (Appeals) who by his order dated 15.11.2012 confirmed the action of assessing officer by passing exparte decision. Against the order of the Commissioner of Income Tax (Appeals) the second appeal was filed in the ITAT which was heard and decided by order dated 01.05.2013 and in appeal appellant got the full relief. **In this way the original order merged in the order of the Commissioner of Income Tax (Appeals) and Tribunal and therefore the proceedings initiated u/s 263 of the income tax act as initiated and simultaneously an order was passed the Commissioner of Income Tax is invalid, illegal and bad in law. In this way the order u/s 263 of the income tax act is totally illegal and liable to be cancelled. Under these circumstances the appellant is***

filing appeal on the following grounds for adjudication before the Hon'ble Court.”

3. The brief facts of the case are that the assessee is a firm engaged in the business of rice and other byproducts; that the assessee maintains the books of accounts, which are audited and the audit report are also filed along with the return. For the year under consideration, the Assessing Officer determined the total income of the assessee at Rs.29,39,910/-, by making addition on account of extra profit and disallowances were also made. Against the addition/disallowances, the assessee filed an appeal before the Id. CIT(A), who, by his order dated 15.11.2012, confirmed the action of Assessing Officer by passing an ex-parte order. Against the order of the Id. CIT(A), the assessee preferred an appeal before the Tribunal, which vide order dated 1/5/2013 in ITA No.62/A/2013 allowed the appeal, granting full relief to the assessee. Thereafter, the Id. CIT, vide order dated 26/3/2014, exercising his power under section 263 of the Act set aside the order of the Assessing Officer, dated 30/12/2011 passed under section 143(3) of the Act to the limited extent of proper valuation of the closing stock and directed the Assessing Officer to include all the relevant costs to such valuation of closing stock.

4. Aggrieved, the assessee is in appeal before us with the submission that the initiation of proceedings under section 263 of the Act is totally unjustified, incorrect, illegal and against the judicial norms, insofar as the Assessing Officer in his order dated 30/12/2011, had made various additions/disallowances; that the Id. CIT(A) confirmed the order of the Assessing Officer by passing an ex-parte order dated 15/11/2012; that the Tribunal vide its order dated 1/5/2013 in ITA No.62/A/2013 allowed the appeal, granting full relief to the assessee; and that thus, the

Assessing Officer's order and the ld. CIT(A)'s order have merged in the order of the Tribunal dated 1/5/2013. The ld. Counsel for the assessee has also placed reliance on various judicial pronouncements.

5. The ld. D.R., on the other hand, placing reliance on the order of the ld. CIT, has submitted that the Assessing Officer had not made necessary enquiry which was required to be done by him; and that therefore, the assessment order is erroneous and prejudicial to the interest of the Revenue, as correctly held by the ld. CIT.

6. Heard. It is an undisputed fact that in the case of the assessee, the assessment order, dated 30/12/2011 has been passed under section 143(3) of the Act, by making various additions/disallowances. Against this order, the assessee preferred an appeal before the ld. CIT(A), who confirmed the order of the Assessing Officer. Against the order of the ld. CIT(A), dated 15/11/2012, the assessee preferred an appeal before the Tribunal and the Tribunal, vide its order dated 1/5/2013 in ITA No.62/A/2013 deleted the entire additions/disallowances, allowing the appeal of the assessee, by observing as under:

"2. The assessee has raised as many as 8 grounds of appeal. However, at the time of hearing the ld. Authorized Representative submitted that effectively there are two grounds of appeal, one is against the addition of Rs.18,85,630/- made on account of extra profit, Rs.9,32,038/- and Rs.82,240/- on account of disallowance of interest under section 36(1)(iii) of the Income Tax Act, 1961 ('the Act' hereinafter).

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11. We have heard the Id. Representatives of the parties and records perused. To examine this issue, first we would like to refer section 145 which reads as under:

"145. (1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assesseees or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144]"

12. It is to note that under section 145(1), the income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" has to be computed in accordance with the method of accounting regularly employed by the assessee, unless in the opinion of the Income-tax Officer, the income, profits and gains cannot properly be deduced therefrom or the Income-tax Officer is not satisfied about the correctness or completeness of the accounts of the assessee. Under the sub-section (3) of section 145 in any case where 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 Income-tax Officer, the income cannot properly be deduced therefrom, then the computation has to be made upon such basis and in such manner as the Income-tax Officer may determine. However, if the Income-tax 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 Income-tax Officer may make the assessment in the manner, provided in section 144. Section 145 is mandatory and the Revenue is bound by the assessee's choice of a method regularly employed unless by that method the true income, profits and gains cannot be arrived at. In other words, section 145

enacts that for the purpose of section 28 (profits and gains of business, profession or vocation) and section 56 (income from other sources), income, profit and gains must be computed in accordance with the method of accounting regularly employed by the assessee. Therefore, if the assessee regularly employs a particular method of accounting and if no defects are found in the method or maintenance of accounts, the taxing authority is bound to compute the profits and gains of business or profession or vocation in accordance with the method employed by the assessee. Therefore, in case where the Income-tax Officer or the taxing authority finds that in maintaining accounts, the assessee has regularly employed a particular method and does not make any investigation to find or does not find any defect in the accounts and accept the accounts as they are, he is bound *to compute* the income in accordance with the accounts maintained by the assessee. Therefore, when the assessee represents to the taxing authority that its accounts are maintained by a method of accounting regularly employed, he expects the Income-tax Officer to act upon such method and compute the income accordingly.

13. The basic question for consideration is, whether the assessee has been following an acceptable method of accounting for declaring its income and whether the method employed by the assessee is such that correct profits cannot be deduced from the accounts of the assessee, so that the provisions of s. 145 of the *I.T. Act could apply. In the case under consideration, the assessee has followed a consistent system of accounting and regularly employing the same system of accounting for computing its income from year to year. It is also not in dispute that this system of accounting was not found to be defective by the ITO. It must be said at the outset that the choice to account for income on an acceptable basis is that of the assessee, and not of the Department. This is, however, not an unlimited choice, because the ITO has always the liberty to examine the system of accounting regularly employed by the assessee, to determine whether the system of accounting is defective, and whether by following such system of accounting, correct profits cannot be deduced from the account books maintained by the assessee. If, on such scrutiny, the ITO comes to the conclusion that with*

reference to the method of accounting followed by the assessee, correct profits cannot be deduced, it is open to him to apply the provisions of s. 145 of the I.T. Act and make the assessment in an appropriate manner. In the present case, there is no material to indicate why the ITO considers the system of accounting regularly, followed by the assessee to be defective, or the system of accounting followed to be such that correct profits cannot be deduced there from. The ITO's power to substitute a system of accounting for the one followed by the assessee, flows from the provisions of s. 145 of the I.T. Act. It is, therefore, imperative that before rejecting the system of accounting followed by the assessee, the ITO must refer to the inherent defect in the system and record a clear finding that the system of accounting followed by the assessee is such that correct profits cannot be deduced from the books of account maintained by the assessee. As already observed above, there is no finding to that effect in this case. The ITO's view that there could be a better system of accounting is no reason to the application of the provisions of s. 145 of the I.T. Act, especially in view of the fact that this system of accounting is followed by the assessee uniformly and regularly for the past several years, and was accepted by the Department without quarrel. It is not open to the ITO to intervene and substitute a system of accounting different from the one which is followed by the assessee, on the ground that the system which commends to the ITO is better. There are any number of Court pronouncements where it has been held that provisions of section 145 are mandatory and the proper method of accounting regularly followed by an assessee is binding on the assessing authorities. As early as in the case of CIT v. Sarangpur Cotton Mfg. Co. Ltd. [1938] 6 ITR 36 (PC), the Judicial Committee of the Privy Council noted that even if the profit brought out in the accounts is not the true figure for income-tax purpose, the same would be compulsory basis of computation of income if the true figure can be accurately deduced there from. Incidentally, this judgment of the Privy Council has been cited and relied upon in a number of judgments delivered thereafter by the Hon'ble Supreme Court and various High Courts in India.

14. In *Keshav Mills Ltd. v. CIT* [1953] 23 ITR 230, the Hon'ble Supreme Court held that the provisions of section 13 of 1922 Act (corresponding to section 145 of 1961 Act) was compulsory on the income-tax authorities and imposed upon them an obligation to accept the mode of accounting regularly adopted by the assessee except in cases when the proviso to that section came into operation. The profits earned and credited in the books of account were to be taken as the basis for computation of income.

15. In *CIT v. A. Krishnaswamy Mudaliar* [1964] 53 ITR 122, the Supreme Court reiterated that the Income-tax Officer is bound to compute the profits by appropriate adjustments from the accounts maintained by an assessee where a system of account is regularly employed. The Court held:

"The only departure made by section 13 of the Indian Income-tax Act from the legislation in England is that whereas under the English legislation, the Commissioner is not obliged to determine the profits of a business venture, according to the method of accounting adopted by the assessee, under the Indian Income-tax Act, prima facie, the Income-tax Officer has for the purpose of sections 10 and 12 to compute the income, profits and gains in accordance with the method of accounting regularly employed by the assessee. If, therefore, there is a system of accounting regularly employed and by appropriate adjustments from the accounts maintained taxable profit may properly be deduced, the Income-tax Officer is bound to compute the profits, in accordance with the method of accounting. But where in the opinion of the Income-tax Officer, the profits cannot properly be deduced from the system of accounting adopted by the assessee it is open to him to adopt a more suitable basis for computation of the true profits."

16. In the case of *Md. Umer v. CIT* [1997] 101 ITR 525, the Hon'ble Patna High Court have categorically, stated at page 530, "once, therefore, the method of accounting employed by the assessee has been regularly employed and income, profits and gains can properly be deduced from such regularly employed method of accounting, that is the end of the matter for the purpose of proviso to sub-section (1) of section 145".

17. *The profit or loss made by the businessman from that business, as aptly described in the case of Sunil Siddharthbhai v. CIT. [1585] 156 ITR 509/23 Taxman 14W (SC) at page 521 remains in the "Womb of future". The measurement of periodic income is, to that extent, a matter of estimation on the basis of certain acceptable principle of accounting. For this reason, on the same facts and circumstances, the computation of business income may differ depending upon the method of accounting employed. In other words, it is not the legal position that on identical facts, the same amount of income should be assessable in the cases of all the assessees. This position has been clearly recognised by the Hon'ble Supreme Court in the case of CIT v. A. Krishnaswamy Mudaliar [1964] 53 ITR 122, (SC) that the quantum of allowance permitted to be deducted from the profits and gains of business would differ according to the system of accounting, in the case of CIT v. S.M. Chitnavis. [1932] 2 Comp. Cas. 464 (PC), Lord Russel held that if a method of accounting is regularly employed then the assessee ought to get the advantage and suffer disadvantage of that system of accounting, and even though it may happen that in a particular year the revenue may gain in another year the assesses may gain. The Hon'ble Bombay High Court held in the case of CIT v. Tata Iron & Steel Co. Ltd. [1977] 106 ITR 363 that if the method of accounting followed by an assessee cannot be said unreasonable, the same has to be given effect to even if a better method can be visualized. Following judgments may also issue:-*

CIT & EPT v. Chari and Rant [1949] 17 ITR I (Mad) ;

CIT v. Srimati Singari Bai [1945] 13 ITR 224 (All);

CIT v. Doddabasaopa [1964] 54 ITR 221 (Mys);

Juggilal Kamlat, Bankers v. CIT [1975] 101 ITR 40 (All).

(2005) 273 ITR 262 (Mad) CIT V Anandha Metal Corporation Jessaram Fetehchand (R.B.) (Sugar Dept.) v. Commissioner of Income-tax 75 ITR 33 (Bomb)

Calcutta Company Limited vs Commissioner of Income-Tax, West Bengal 37 ITR 1 (SC)

Commissioner of Income-tax v. Margadarsi Chit Funds (P.) Ltd. 155 ITR 442 (AP)

CIT vs. Gotanlime Khamj Udyog, 256 ITR 243 (Raj) CIT vs. Smt. Poonam Rani (Delhi) 326 ITR 223

18. *These are all decisions which lend support to the proposition that the Department is bound by the assessee's choice of accounting regularly employed unless it can be said that the method of accounting followed by the assessee does not reflect the true income.*

19. *In the light of above background of discussion, if we consider the facts of the case under consideration, we notice that the A.O. has rejected the books of account without pointing out any defect in the books of account regularly maintained by the assessee. The Hon'ble Bombay High Court in the case of R.B. Jessaram Fetechand (Sugar Dept.) vs. CIT, 75 ITR 33 wherein it has been held that the assessee's account books are to be accepted, unless, on verification, they disclosed any faults or defects, which cannot be reasonably and satisfactorily explained by the assessee. Hon'ble Allahabad High Court in the case of CIT vs. Krishna Gopal Kapoor & Sons, 325 ITR 214 (All.) wherein it has been held that the method of accounting followed by the assessee cannot be disturbed. If we consider the facts of the case under consideration, we notice that the assessee has explained the reasons for fall in G.P. that during the year under consideration the business activities of the assessee were different than earlier year. The assessee has demonstrated this fact by facts and figures which are reproduced while recording submission of the Id. Authorized Representative in this order in para Nos.6 to 9. The assessee has explained that production and sale was carried out under the supervision of Government authorities and respective authority did not find any defect in the books of account maintained by the assessee. The assessee has also explained the reason for increase in labour, freight and other expenses with facts and figures which are recorded in this order along with the submission of the Id. Authorized Representative. When the A.O. did not find any defect in the books of account, the A.O. is bound to accept the book result of the assessee. Under the circumstances, we hold that the A.O. is not correct in invoking*

section 145 (3) of the Act. The A.O. did not point out any defect as provided in section 145(3) of the Act. When the books of account is bound to be accepted, the action of the A.O. for estimating G.P. by applying 7% rate is not correct. We, therefore, delete the addition of Rs.18,85,630/- made by the A.O.”

7. The notice, dated 8/8/2013 issued by the ld. CIT under section 263 of the Act relates to the extra profit addition of Rs.18,85,630/- made by the Assessing Officer, and according to the ld. CIT, the order of the Assessing Officer is erroneous and prejudicial to the interest of the Revenue insofar as the manufacturing cost for production of rice were not correctly worked out. As reproduced above, the addition so made by the Assessing Officer and confirmed by the ld. CIT(A) has been deleted by the Tribunal.

8. From the above order of the Tribunal, it is evident that the original assessment order, wherein, the additions/disallowances had been made and also confirmed by the ld. CIT(A), stand merged in the order of the Tribunal dated 1/5/2013. The provisions of section 263 are attracted only if the assessment order is erroneous and prejudicial to the interests of the Revenue. Since the assessment order and the first appellate order stood merged in the order of the Tribunal, there was no assessment order in existence as on the date of issuance of notice under section 263, i.e., on 8/8/2013.

9. In 'Pr. CIT & Anr. Vs. Oil India Ltd.', 175 DTR (Gau) 185, which is a decision directly on this issue, it has been held, as under:

“When the assessee had claimed deduction under section 80-IC claiming to be a mineral based industry and in that background when the claim was disallowed by the

Assessing Officer but allowed by the ld. CIT(A), the issue would stand concluded and there would be no scope for re-examination in the jurisdiction under section 263 as the assessment order has merged in the appellate order. The matter not having been examined in the same manner or to the same extent and depth is immaterial. When the claim for deduction was on that basis, the exception as contained in clause (c) to Explanation 1 to sub-section (1) of section 263 would not apply. The question of considering the wells of the assessee as an undertaking was not accepted by the Assessing Officer through the claim of mineral based industry was not rejected. Whether such acceptance was erroneous and whether the ld. CIT(A) has committed an error in allowing the claim will lose its relevance.”

10. No decision contrary to Pr. CIT & Anr. Vs. Oil India Ltd.’ (supra) has been brought to our notice.

11. In this view of the matter, we are of the view that since the assessment order and the order of the first appellate authority stood merged in the order of the Tribunal, and there was no assessment order in existence as on the date of issuance of notice under section 263, i.e., on 8/8/2013, the revisionary proceedings initiated by the ld. CIT under section 263 are not valid in the eyes of law. Accordingly, we set aside the order.

12. In the result, the appeal of the assessee is allowed.

Order pronounced in the open Court on 20/11/2019.

Sd/-
[T. S. KAPOOR]
ACCOUNTANT MEMBER

Sd/-
[A. D. JAIN]
VICE PRESIDENT

DATED:20/11/2019

JJ:1911

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT(A)
4. CIT
5. DR

By order

Assistant Registrar