SooperKanoon - India's Premier Online Legal Search - sooperkanoon.com

Singh Construction and Co. Vs. Assistant Commissioner of

Singh Construction and Co. Vs. Assistant Commissioner of

SooperKanoon Citation : sooperkanoon.com/69181

Court : Income Tax Appellate Tribunal ITAT Patna

Decided On : Sep-26-1997

Reported in : (1998)64ITD153(Pat.)

Appellant : Singh Construction and Co.

Respondent : Assistant Commissioner of

Judgement :
23. As we differ in our views in the above case, we request the hon'ble President to kindly refer the matter to the Third Member on the following point : "Whether in the facts and circumstances of the case and in law, net profit on contract should be estimated after disallowing partly specific items of expenses or should be estimated by applying a flat rate of net profit ?" 24. Under sub-section (4) of section 255 of the Income-tax Act, 1961 (hereinafter referred to as the "Act" for brief), I have been nominated by the hon'ble President of the "Appellate Tribunal" to act as a Third Member for giving my opinion on a dissent on the following identical points of difference between the learned Members, who heard this appeal : "Whether in the facts and circumstances of the case and in law, net profit on contract should be estimated after disallowing partly specific items of expenses or should be estimated by applying a flat rate of net profit ?" 25. On the facts, as are relevant for the purposes of my opinion, it may be stated that the assessee is a registered firm and derived income from contract work. It filed its return of income in respect of the assessment year 1991-92 at a figure of Rs. 7,65,110. The assessment was completed on an income of Rs. 9,57,254. The assessee's stand

has been that, as in the past, profit from the contract business undertaken by them should be arrived at by applying a profit rate of 10 per cent.

against self-executed works and 7 per cent. on works executed through sub-contractors, depreciation to be allowed further as per rules. This stand did not find favour with the Assessing Officer who determined the assessee's income at a figure of Rs. 9,57,250 by scrutinising and disallowing various expenses individually.

26. Aggrieved, the assessee filed an appeal which was disposed of by the learned Commissioner of Income-tax (Appeals) vide his order dated September 30, 1992. The learned Commissioner of Income-tax (Appeals), as it appears from his order also took into consideration the various disallowances, examined them and disposed of the objections raised in respect thereof and allowed the appeal partly.

27. Still feeling aggrieved, the assessee came up before the Tribunal.

Although not related to the dissent part of the orders rendered by the two learned Members but only with a view to complete the records, it may be stated that the Appellate Tribunal noted that some of the points taken by the assessee before the learned Commissioner of Income-tax (Appeals) had not been disposed of which were directed to be re-heard and decided.

28. Coming to the controversy before the Third Member, it may be stated that the learned Judicial Member who has authored the order took the view that it was not possible to agree with the stand of the assessee that income from contract business should have been computed in the manner as done in respect of the assessment years 1989-90 and 1990-91.

The principal reason at the back of this view is that in respect of these two and the assessment year 1992-93, the account books maintained by the assessee were rejected by the Assessing Officer by applying the provisions of section 145(1) of the Act. As against this, the learned Judicial Member held that in respect of the year under consideration, the books of account of the assessee were not rejected by the Assessing Officer nor were the provisions of section 145(1) of the Act

invoked.

The Assessing Officer instead examined the account books and the relevant materials after which different additions were made under different heads. He, therefore, proceeded to adjudicate these additions individually on their merits.

29. The learned Accountant Member, however, did not agree with this conclusion. After narrating that in respect of the assessment years 1989-90 and 1990-91 book results were rejected under the proviso appended to sub-section (1) of section 145 of the Act and the manner in which the income was computed, he refers to the observations made by the Assessing Officer in respect of the assessment years 1989-90 and 1990-91 pointing out that the books of the assessee were suffering from the same defects as were found during the earlier years and, therefore, stood rejected under section 145 of the Act. A reference is thereafter made about the adoption of 10 per cent. net profit before depreciation on the works executed by the assessee and 7 per cent. on the works executed through its sub-contractors, a principle followed in the past and based on the findings of the Appellate Tribunal. Reference has then been made to the procedure adopted in respect of the assessment year 1992-93 where the learned Commissioner of Income-tax (Appeals) adopted the net profit rate of 8 per cent. on self-executed works and 5 per cent. on works executed through sub-contractors which was, however, inclusive of depreciation. In view of the aforesaid, the assessee's claim that the same procedure be adopted as per which they were entitled to a relief of Rs. 99,496, the learned Accountant Member further held that during the year under consideration the Assessing Officer departed from the earlier procedure and disallowed certain claims for specific expenditure on raw material, labour, etc. The extent of increase in net profit on contracts on account of these disallowances was not kept in mind. About the applicability of the proviso to sub-section (1) of section 145 of the Act, the learned Accountant Member observed that although no specific mention was made by the Assessing Officer, it was apparent that the disallowances were made by the Assessing Officer only under this provision. According to him, whether disallowances were made individually or overall net profit rate was applied, both would fall within the realm of sub-section (1) of section 145 of the Act, the principle being that income from profits and gains of business

was required to be computed in accordance with the method of accounting regularly employed by the assessee. The learned Accountant Member eventually preferred to apply an overall rate of net profit on the premise that "the disallowance should be made to such an extent that the net profit is made reasonable". He, therefore, directed the Assessing Officer to apply the procedure followed in respect of the assessment years 1989-90 and 1990-91 by rejecting the accounts of the assessee under the proviso to sub-section (1) of section 145 and charging the net profit at 10 per cent. on self-executed works and 7 per cent. on works executed through its sub-contractors, depreciation to be allowed separately.

30. Supporting the view taken by the learned Accountant Member, learned counsel for the assessee contended before me that the directions given by him were in order and if itemwise disallowances were made as affirmed by the learned Judicial Member, it would result in abnormal profits which would be unrealistic. On the other hand, the learned Departmental Representative contended that with the non-application of the proviso to sub-section (1) of section 145 the view taken by the learned Judicial Member about scrutinising individual items was correct and there was no necessity much less any legal compulsion under which profits should have been arrived at only by applying the rate method, although done in the past.

31. I have carefully gone through the view taken by my two learned Brothers and taken into consideration the submissions made on behalf of the assessee and the department. The answer to the question posed before the Third Member in fact depends on the true interpretation of section 145 of the Act and its application to the set of facts of the case.

32. As provided by sub-section (1) of section 145 of the Act, income under the head "Profit and gains of business", etc., shall be computed in accordance with the method of accounting regularly employed by an assessee. However, in a case where the accounts maintained by the assessee are correct and complete to the satisfaction of the Assessing Officer but the method employed is such that in his opinion, the income could not properly be deduced therefrom, the computation shall be made upon such basis and in such manner as the Assessing Officer may determine.

33. The above mandate of law manifestly postulates that in the normal course, income from profits and gains of business should be computed in accordance with the method of accounting regularly employed by an assessee and where the accounts so maintained are found to be correct and complete but the method employed is such that in the opinion of the Assessing Officer, income could not be properly deduced, its computation shall be made upon such basis and in such manner as the Assessing Officer may determine. To support the legal position that where accounts are maintained income has to be computed normally in accordance with the method of accounting regularly employed by the assessee, reference could be made to two decisions of the apex court, namely, CIT v. A. Krishnaswami Mudaliar [1964] 53 ITR 122 and CIT v.McMillan and Co. [1958] 33 ITR 182. There is also no quarrel about the method of accounting whether cash, mercantile or hybrid (lately only cash and mercantile) which option rests with the assessee as held in innumerable judicial decisions. About the Assessing Officer's power not to accept the method of accounting, it may be stated that he cannot impose his own sweet will and thrust a method upon the assessee unless he is of the opinion that income could not properly be deduced. By following the method adopted by the assessee, reaching the requisite determination is a question of fact, namely, as to whether or not income chargeable under the Act could properly be deduced from the books of account and such an opinion must be formed with reference to the relevant material and in accordance with the correct principles. In saying so, the view taken by the apex court in the case of CIT v.British Paints India Ltd. [1991] 188 ITR 44 may be referred to.

However, with reference to this decision of the Supreme Court, it must be said that whatever method the assessee adopts it should disclose a true picture of his profits and gains. Their Lordships of the Supreme Court even went to the extent of saying that in a case where an assessee adopted a system which did not disclose the true state of affairs for the determination of tax, even it was ideally suited for other purposes of his business such as creation of reserve, declaration of dividends, etc., it was the duty of the Assessing Officer to adopt any such method as he deems appropriate for the proper determination of the true income of the assessee. What, therefore, follows is that the method adopted by an assessee should be such which reflects and is liable to depict a true picture of his profits and

gains. It has to be, because it is only the profits and gains which have to be assessed to tax and not any illusory figure. In this connection, it must be stated that the invocation of the first proviso to section 145(1) could be express, as well as implied, since a judgment is a faculty to decide matters with wisdom truly and legally, not depending upon the arbitrary caprice of a judge (in this case, the Assessing Officer who performs a quasi judicial function while completing an assessment). This being so, he may expressly say about the application of the first proviso to sub-section (1) of section 145 or may impliedly invoke such provision by not finding the method employed by the assessee trustworthy to be able to cull out income in a proper manner. In this connection, it may also be stated that although each year is a separate and independent entity, yet the present accounting period which is under consideration should not be seen wholly in isolation, divorced from the past history of an assessee unless the two periods have no connection with each other. In the case in hand, going through the assessment order, it transpires that no substantial change was noticed by the Assessing Officer in the facts of the period under consideration and the assessee's past. Books of account were also produced by the assessee before him and examined on test check basis. No doubt the method employed by the assessee has not been specifically challenged much less rejected by the Assessing Officer, yet, inter alia, considering the fact that the copies of assessment orders in respect of the assessment years 1989-90 and 1990-91, i.e., immediately preceding years were also available before him, as is evident from the paper book on record, copies of these orders available at pages 7-10 and 11-14, it could safely be presumed that the Assessing Officer must have considered them and come to know about the past history of the case. During 1989-90, the Assessing Officer observed in the assessment order that the books of account were suffering from the same defects as during the earlier years. He, thereafter, resorted to an estimate. The same was repeated in respect of the assessment year 1990-91 and interestingly also in respect of the subsequent assessment year, viz., 1992-93. I am unable to appreciate as to what was the occasion under which a different method should have been adopted in respect of the intervening year, i.e., the year under consideration. It is not meant to lay down that in respect of a particular assessment year a different method could not be adopted but there must be some cogent and convincing reason to make a

departure from a procedure/system followed by the Assessing Officer in the past as well the immediate future. Incidentally, going through the assessment order under consideration, it transpires that disallowance of Rs. 41,850 was made in the purchase of raw material to "cover up any possible omission". Similarly an amount of Rs. 61,083 was disallowed out of labour expenses shown by the assessee to the tune of Rs. 6,10,838.83. Medical expenses were disallowed and added back and so were subscription and donation amounts. Several other amounts out of the heads "Machinery and maintenance" and "motor car running", etc., were also disallowed and added back. In such a situation and looking to the immediate past and future, I am of the view that the method adopted by the assessee was not found compatible by the Assessing Officer by which income could properly be deduced. I am, therefore, of the opinion that the first proviso to sub-section (1) of section 145 of the Act stood impliedly invoked by the Assessing Officer.

34. In the result, I am of the view that there was no need to go into the specific items of expenses. The assessment in the present case should have been as in the immediate past and future, completed by applying a net profit rate.

35. I, therefore, agree with the view taken by the learned Accountant Member and answer the point of difference accordingly.

36. The matter will now go back to the regular Bench for disposal of the case in accordance with the provisions of section 255(4) of the Income-tax Act, 1961.

SooperKanoon - India's Premier Online Legal Search - sooperkanoon.com