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Court : Income Tax Appellate Tribunal ITAT Patna

Decided On : Sep-26-1997

Appellant : Singh Construction and Co.

Respondent : Assistant Commissioner of Income

Judgement :

1. The assessee has taken 11 grounds in this appeal. Ground Nos. 2, 3 and 11 are general and do not require any decision thereon. In ground Nos. 9 and 10, the assessee has a grievance that the CIT(A) has not given any finding or decision in respect of disputes raised in ground Nos. 12 and 13 in the first appeal before him. We have examined the impugned order as well as the grounds of appeal taken in the first appeal before the CIT(A) and we are convinced that the grievance of the assessee in this appeal in ground Nos. 9 and 10 is well taken. We, therefore, restore the matter to the file of the CIT(A), with the direction to rehear the assessee and give his finding and decision in respect of disputes raised before him in ground Nos. 12 and 13. We order and direct accordingly.

2. In ground No. 1, the assessee states that the CIT(A), while passing the appellate order, has not given any comment in respect of the ground Nos. 1, 9 and 10. In this regard, we have read the ground Nos. 1, 9 and 10 taken in first appeal and we find that the same are of general nature and do not require any comments or decision from the CIT(A). The first ground taken in this appeal is, therefore, rejected as of no consequence. The effective grounds are, therefore, ground Nos. 4 to 8 which we shall decide accordingly.

3. In ground No. 4, the grievance is that the CIT(A) erred in confirming the disallowance of Rs. 41,850 made by the AO towards lack of evidence and supporting vouchers towards material consumed in contract work.

4. In the fifth ground, the grievance is that the CIT(A) erred in confirming the addition of Rs. 61,083 being 10 per cent. estimated disallowance in labour expenses claimed of Rs. 6,10,838 in Singrauli account.

5. In the sixth ground, the grievance is that the CIT(A) erred in confirming the addition of Rs. 2,348 being medical expenses disallowed and added as not being for business purposes.

6. In the seventh ground, the assessee disputes the computation of capital gain in a sum of Rs. 3,944 on sale of jeep which has been erroneously confirmed by the CIT(A).

7. In the eighth ground, the grievance is that the CIT(A) erred in confirming the addition of Rs. 15,750 being accrued interest on National Savings Certificates of Rs. 90,000 appearing in the balance sheet.

8. Heard both sides and perused the material brought on record. We are unable to agree with the submissions of the assessee's counsel that the income from contract business should have been computed in the manner done for the asst. yrs. 1989-90 and 1990-91, copies of which assessment orders have been placed in the paper book. We have also seen the pro forma format placed at pages 1,2 and 3 of the paper book. The reason is that in the asst. yrs. 1989-90, 1990-91 and 1992-93, the account books maintained by the assessee were rejected by applying the provisions of s. 145(1) of the Act. For the year under appeal, which is asst. yr.

1991-92, the AO has not rejected the account books nor invoked the provisions of s. 145(1) of the Act. The AO examined the account books and other related material produced before him and after examining the same, different additions have been made under different heads. We will, therefore, examine and give our decision in respect of each of the additions made by the AO which have been

disputed in ground Nos. 4 to 8 before us in the second appeal which we have extracted above. In our view, the addition of Rs. 41,850 has been rightly confirmed by the CIT(A) as the assessee, in spite of the opportunity, failed to substantiate by cogent evidence purchase of raw material for the purpose of execution of contract work. Even before us, no satisfactory evidence has been laid so as to rebut the conclusion of the CIT(A). We therefore, agree with him. Addition rightly confirmed.

9. Regarding the addition of Rs. 61,083, we find substantial force in the argument of the assessee's counsel that the addition has been made for the sake of making addition in an ad hoc and arbitrary manner and not on any valid basis or sound reasoning. The AO has merely stated that the wages debited to P&L a/c in Singrauli branch to the tune of Rs. 6,10,838 is highly disproportionate to the contract receipt and, hence, 10 per cent. of the expenses is being disallowed and added back.

It is very apparent from the observations of the AO that the addition has been made in an arbitrary and ad hoc manner and, as such, this type of addition cannot be made or sustained in law. The CIT(A), therefore, erroneously confirmed the addition of Rs. 61,083 in Singrauli branch a/c. We direct deletion of the same.

10. Regarding the confirmation of addition of Rs. 2,348, we do not agree with the CIT(A) that medical expenses were not incurred for business purposes. The assessee is a contractor and in the course of executing contract work, medical attention is required to be given to labourers as well as other field officers and employees and it cannot be said that medical expenses are not incurred for business purposes.

In our view, they are very much related to business and are allowable.

The CIT(A) committed an error in confirming the addition. We direct the AO to delete the addition of Rs. 2,348 made by him.

11. The addition of Rs. 3,944 has been made by the AO by observing as under : "Depreciation - Assessee has claimed depreciation of Rs. 4,157 out of which Rs. 174 only is allowed on Refrigerator. Depreciation on machinery is not allowed as

per calculation.WDV as on 1st April, 1990 Rs. 26,056Addition nilSold during the year Rs. 30,000WDV as on 31st March, 1991 (-) Rs. 3,944 As the consideration so received exceeds the suppressed cost by Rs. 3,944, therefore, the excess is chargeable to tax as short-term capital gain. Accordingly, added back".

The addition has been made on erroneous assumptions and should not have been sustained by the CIT(A). From the above computation, it is clear that the resultant figure of Rs. 3,944 cannot be considered as a short-term capital gain to be added to the returned income. The CIT(A) has not approached this addition in a proper legal perspective. We, therefore, direct the deletion of the said sum of Rs. 3,944.

12. Regarding addition of Rs. 15,750 being interest income on National Savings Certificates on accrual basis, we are of the view that the same requires to be examined with reference to the provisions of s. 10(15) of the Act according to which interest on Savings Certificates are exempt. Moreover, we do not find sufficient facts on record in relation to the Savings Certificates and to which series they pertain. We, therefore, deem it fit and proper to restore the matter to the file of the AO to re-examine the issue in the light of provisions of s. 10(15) of the Act after collecting relevant data in relation to the series from which the saving certificates have been issued and then to arrive at a fresh decision in accordance with law after giving reasonable opportunity of being heard to the assessee. We order and direct accordingly.

1. ave gone through carefully the proposed order of my learned brother but have difficulty in reaching to the same conclusion in respect of net profit on contracts, though not with other conclusions. A separate dissenting order is, therefore, being proposed by me.

2. The assessee is a firm having contract business. The learned counsel for the assessee submitted before us that in earlier years, i.e., asst.

yrs. 1989-90 and 1990-91 the book results were rejected under proviso to s. 145(1) and income from contract was estimated in the following manner :Gross Receipt of contract work Rs. .....Less : Deductions for value of materials supplied by the contractee Rs. .....

---------- income for that year Rs. .....

---------- in the following year Rs. .....

----------Less : Work executed through sub-contractors Rs. .....

---------- Value of self-executed contract Rs. .....

---------- self-executed work subject to depreciation Rs. .....(ii) Net profit adopted @ 7 per cent. for subject to depreciation Rs. .....

---------- Total profit Rs. .....Less : Depreciation allowed Rs. .....

---------- 3. Copies of assessment orders for asst. yrs. 1989-90 and 1990-91 have also been placed in the paper book. It is seen that in asst. yr.

1989-90, the AO observed that the books were suffering from same defects as were found in earlier year and, therefore, the books were rejected under s. 145. It was further stated that "it is a settled principle to take 10 per cent. of net profit before depreciation on the works executed by the assessee itself and 7 per cent. of the works executed through its sub-contractors. This principle has been followed in the past also on the basis of Tribunal and other appellate findings". Thereafter, the profit of contract before depreciation had been calculated. Similar remarks have been given in the assessment order for the asst. yr. 1990-91 and net profit from contract has been worked out in the same manner.

4. The learned counsel for the assessee further submitted that even in the next year, i.e., asst. yr. 1992-93, a similar procedure was followed, but the CIT(A) adopted net profit rate of 8 per cent. on self-executed work and net profit @ 5 per cent. on work executed through its sub-contractors. This was, however, inclusive of depreciation and no further depreciation was allowed.

5. In view of the above, it was submitted that the same procedure may be followed for the year under consideration. Applicability of proviso to s. 145(1) was not disputed and a computation was given for this year (paper book pages 4 & 5) according to which, if the procedure followed is the same as for asst. yr. 1989-90 and 1990-91, a relief of Rs. 99,496 would be available to the assessee on the

income determined after giving effect to the order of the CIT(A). It was submitted that this procedure may be followed and relief allowed accordingly.

6. For the year under consideration, the AO departed from the earlier procedure and disallowed particulars of claims for specific expenditure on raw material, labour, etc. No watch was kept on the extent of increase of net profit on contract on account of these disallowances.

Although there is no specific mention of proviso to s. 145(1), it is apparent that the disallowances were made only under it. Otherwise, under s. 145(1) of the Act, income chargeable under the head 'Profits and gains of business' has to be computed necessarily in accordance with the method of accounting regularly employed by the assessee. In my opinion, whether disallowances are made in the above manner, or overall net profit rate is applied, both are under proviso to s. 145(1).

7. Of the two methods, it is preferable to apply an overall rate of net profit, the reason being that the disallowance should be made to such an extent that the net profit is made reasonable. In the circumstances, the proposal made by the learned counsel for the assessee before us in paras 4 & 5 of the paper book is considered fair and reasonable and the AO is directed to apply the procedure followed in asst. yrs. 1989-90 and 1990-91. The accounts will be rejected under proviso to s. 145(1) and net profit will be estimated @ 10 per cent. on self-executed work and @ 7 per cent. on work executed through sub-contractors.

Depreciation will be allowed separately, as admissible in law.

As we differ in our views in the above case, we request the Hon'ble President to kindly refer the matter to the 3rd 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 ?" 1. Under sub-s. (4) of s. 255 of the IT Act, 1961 (hereinafter referred to as the 'Act' for brief), I have been nominated by the Hon'ble President of the '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 ?" 2. On 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 asst.

yr. 1991-92 at a figure of Rs. 7,65,110. The assessment was completed on an income of Rs. 9,57,254. 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 AO who determined the assessee's income at a figure of Rs. 9,57,250 by scrutinising and disallowing various expenses individually.

3. Aggrieved, the assessee filed an appeal which was disposed of by the learned CIT(A) vide his order dt. 30th of September, 1992. The learned CIT(A), 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.

4. 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 Tribunal noted that some of the points taken by the assessee before the learned CIT(A) had not been disposed of which were directed to be re-heard and decided.

5. 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 asst. yrs. 1989-90 and 1990-91. The principal reason at the back of this view is that in respect of these two and asst. yr. 1992-93 the account books maintained by the assessee were rejected by the AO by applying the provisions of s. 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 AO nor were the provisions of s. 145(1) of the Act invoked. The AO 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.

6. The learned Accountant Member, however, did not agree with this conclusion. After narrating that in respect of the asst. yrs. 1989-90 and 1990-91 book results were rejected under the proviso appended to sub-s. (1) of s. 145 of the Act and the manner in which the income was computed, he refers to the observations made by the AO in respect of the asst. yrs. 1989-90 and 1990-91 pointing out that the books of the assessee were suffering from same defects as were found during earlier years and, therefore, stood rejected under s. 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 Tribunal.

Reference has then been made to the procedure adopted in respect of the asst. yr. 1992-93 where the learned CIT(A) adopted 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 AO departed from the earlier procedure and disallowed certain of 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-s. (1) of s. 145 of the Act, the learned Accountant Member observed that although no specific mention was made by the AO, it was apparent that the disallowances were made by the AO 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-s. (1) of s. 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 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 AO to apply the procedure followed in respect of the asst. yrs. 1989-90 and 1990-91 by rejecting the accounts of the assessee under the proviso to sub-s. (1) of s. 145 and charging the net profit @ 10 per cent. on self-executed works and 7 per cent. on works executed through its sub-contractors, depreciation to be allowed separately.

7. Supporting the view taken by the learned Accountant Member, the learned counsel for the assessee contended before me that the directions given by him were in order and if item-wise disallowances were made as affirmed by the learned Judicial Member, it would result in abnormal profits which would be un-realistic. On the other hand, the learned Departmental Representative contended that with the non-application of the proviso to sub-s. (1) of s. 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 rate method, although done in the past.

8. 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 s. 145 of the Act and its application to the set of facts of the case.

9. As provided by sub-s. (1) of s. 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 AO 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 AO may determine.

10. 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 AO income could not be properly deduced, its computation shall be made upon such basis and in such manner as the AO 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 vs. A. Krishnaswami Mudaliar & Ors., (1964) 53 ITR 122 (SC) and CIT vs. McMillan & Co., (1957) 32 ITR 182 (SC).

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 AO'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 vs. British Paints (India) Ltd. (1991) 188 ITR 44 (SC) may be referred. However, with reference to this decision of the summit 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 if 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 AO 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 figures. In this connection, it must be stated that the invocation of the first proviso to s. 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 AO 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-s. (1) of s. 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 AO in the facts of the period under consideration and the assessee's past books of accounts 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 AO, yet, inter alia, considering the fact that copies of assessment orders in respect of the asst. yrs. 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 and 15-17, it could safely be presumed that the AO must have considered them and come to know about the past history of the case. During 1989-90, the AO observed in the assessment order that the books of accounts 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 asst. yr. 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 AO in the past as well 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 head "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 AO by which income could properly be deduced. I am, therefore, of the opinion that the first proviso to sub-s. (1) of s. 145 of the Act stood impliedly invoked by the AO.11. In the result, I am of the view that there was no need to go into the specific items of expenses. Assessment in the present case should have been as in the immediate past and future, completed by applying a net profit rate.

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

13. The matter will now go back to the regular Bench for disposal of the case in accordance with the provisions of s. 255(4) of the IT Act, 1961.

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