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\* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ ITA 478/2011

+ ITA 479/2011

CIT

..... Appellant

Through Mr. Sanjeev Sabharwal, sr. standing counsel

versus

LOKESH GARMENTS PVT LTD

..... Respondent

Through

**CORAM:**

**HON'BLE MR. JUSTICE S. RAVINDRA BHAT**

**HON'BLE MR. JUSTICE R.V.EASWAR**

**ORDER**

% **05.07.2012**

On 15.3.2012 following substantial question of law was formulated :

“Whether the Income Tax Appellate Tribunal was right in dismissing the appeal of the Revenue by holding that appropriate and required enquiries had been conducted by the Commissioner of Income Tax (Appeals) to accept the return of income at loss?”

2. Brief facts of the case are that the assessee claimed a loss to the tune of Rs.30,07,45,129/- in the return filed on 2.12.2003 for the assessment year 2003-04. The return was processed under Section 143(1)(a) of the Income Tax Act, 1961 and thereafter was selected for scrutiny. Apparently the Assessing Officer sent various notices to parties. During the course of proceedings the Assessing Officer noticed that the assessee had entered into transactions with related persons falling within the Section 40A(2)(b) of the Act. This covered trading transactions as well as the advance received from the parties. The order of the Assessing Officer records that though summons were served under Section 131, the said parties did not join the proceedings and participate in it; the Assessing Officer in his order noted that the summons were returned with the remark “left/no such firm”. Based on the materials available on record the Assessing Officer disallowed the loss claimed and completed the assessment. The assessee appealed right



up to the Income Tax Appellate Tribunal ('ITAT', for short), which restored the matter to the file of the Assessing Officer, who in the second round completed the proceedings holding that the loss claimed could not be admitted.

3. The assessee appealed to the CIT(A). At this stage, appellate authority was furnished with books of accounts giving ledgers containing particulars of sale, purchase account, cash book etc. The CIT(A) appears to have, on an examination of the books in a first instance, as it were, accepted the submissions of the assessee. The material reasoning of the CIT(A) is as follows :

“5.1 I have carefully considered the written submission on behalf of the appellant, the findings of the Assessing Officer in the assessment order and the facts on record. During the appellate proceedings, the books of account including the ledger indicating purchase/ sale account, cash book, purchase invoices, export sale invoices, bank statement, declaration forms for import under Sales-Tax Department, details of sundry creditors and debtors and shipping bills were produced which were test-checked by the undersigned. It is observed that the (sic) while rejecting the books of accounts maintained by the assessee, the assessing officer was solely guided by the comments/ remarks of the Auditors in the Tax Audit report under section 44AB of the Act. It is also observed that the books of accounts including records of purchase, sale stock and cash book etc. were seized by the Directorate.

Revenue intelligence on 15.10.2003 and that was main reason due to which it was not before the Auditors while they prepared and signed the Tax Audit Report on 18.11.2003.

As per the directions of the Hon'ble ITAT the books of accounts and the supporting documents which were seized by the Directorate of Revenue Intelligence were produced before the undersigned which were duly test checked. The issue of referring the matter in terms of section 142(2A) of the Act for the purpose of special audit was also examined and it was found that the accounts are not complex enough to direct the assessee to get the accounts audited in terms of section 142(2A) of the Act. In my opinion the Assessing Officer was quite justified to reject the trading loss declared by the assessee in its return of income on the ground that the books of accounts and the supporting documents were not produced by the assessee during the assessment proceedings. However, this also cannot be denied that the justification regarding incorrectness or incompleteness of the account maintained by the assessee is to be arrived at by the assessing officer on the basis of positive findings and (sic) not merely on conjectures and surmises. The appellant has proved beyond doubt that the balance sheet and the profit & loss account forming part of the Tax Audit Report are correct and no adverse inference can be drawn.



The material on record to which my attention has been drawn in the course of the hearing clearly shows that the assessee had valid reasons for suffering gross loss during the year under assessment. It is observed that the appellant suffered losses because of non-receipt of payments by the foreign bankers from whom export bills were purchased.

5.2 In the case on hand, the undisputed fact is that the assessee has been consistently following a particular method of accounting and the accounts are regularly maintained and are complete in the sense that there are not significant omissions therein. It is well settled that the assessing authority has to look into the substance of the situation and decide the matter in such a manner that neither the Revenue is put to unreasonable liability nor the assessee is subjected to unreasonable hardship. No doubt it is not only the right but also the duty of the Assessing Officer to consider whether or not the books disclosed the true state of accounts and the correct income can be deduced there from. But these rights and duty have to be exercised in such a manner and have to be based on cogent reasons and sufficient material. Rejection of books of account should not be done light heartedly as held by the Kerala High Court in the case of St. Teresa's Oil Mills, v. State of Kerala [1970] 76 ITR 365 and by the Assam High Court in the case of Tolaram Daga v. CIT [1966] 59 ITR 632. Accounts regularly maintained in the course of business have to be taken as correct unless there are strong and sufficient reasons to indicate that they are unreliable and incorrect. The AO has to prove satisfactorily that the books of accounts are unreliable or incorrect or incomplete before he can reject the accounts and this can be done by showing that important transactions are omitted or if proper particulars and vouchers are not forthcoming or the accounts do not include entries relating to a particular class of business. When a return is finished and accounts are put in support of that return, the accounts should be taken as the basis for assessment. They should not be rejected because they are complicated. The procedure of the Assessing Officer is of judicial nature and in making the assessment he should proceed on judicial principles, if evidence is produced by the assessee in support of its return if (sic) should be accepted unless it is rebutted by admissible evidence and not by mere hearsay (sic). As the assessee has produced sufficient material justifying its claim and as it has repelled the contentions advanced by the Assessing Officer with cogent material and evidence, I am of the considered view that on the facts and in the circumstances of the case. (sic) The assessing officer was not correct in disallowing the claim of loss declared in the return of income furnished by the assessee. Thus for all these reasons and as the assessee has produced sufficient material justifying its claim it is held that the entire exercise done by the AO is based on surmises and conjectures and without any evidence. The claim of loss as per the return of income is therefore directed to be allowed.



5.3 It has been submitted on behalf of the appellant during the appellate proceedings that the returned loss has and shall not be carried forward for adjustment in future income as the appellant is not carrying on any business activity. Even otherwise, though the original return was filed within the time allowed under section 139(3) read with section 80 of the Act but the same could be declared as defective and invalid under section 139(9) of the Act by sheer dint of the fact that the audited profit and loss account and balance sheet and the auditor's report backed by supporting books of accounts and other relevant documents were neither filed along with return nor produced during the assessment proceedings. Thus by implication it can be concluded that the assessee failed to furnish the return in time as per the provisions of section 139(3) of the Act. Therefore, it is held that the assessee was not entitled to carry forward the loss to the subsequent year(s). It may also be relevant to mention here that by its own admission, the assessee has not filed its return of income from A.Y. 2004-05 onwards as it is not carrying on any business activity since then and it has become pauper and insolvent. Therefore, the issue regarding carrying forward the loss to the subsequent year(s) becomes of academic significance only. Subject to the above remarks, ground Nos.2 & 3 are partly allowed."

The revenue's appeal met with the same fate before the ITAT. Consequent to the assessment, the Assessing Officer had also imposed penalty u/s 271(1)(c) which was cancelled by the CIT(A) consequent to his decision allowing the loss. The Tribunal, on appeal by the revenue, affirmed the decision of the CIT(A) as it had confirmed the view taken by the CIT(A) in the quantum appeal.

4. We have considered the materials on record. The findings of the Assessing Officer with regard to the transactions by the assessee, in respect of the related parties covered by Section 40A(2)(b) of the Act have not been dealt with at all by either the CIT(Appeals) or the ITAT. This was a material circumstance of which the CIT(Appeals) had to take into account, in view of the positive findings that the said parties did not respond and the assessee had no explanation to furnish, during the course of proceedings. Furthermore, this Court in its judgment reported *Director of Income Tax Vs. Modern Charitable Foundation* (2011) 335 ITR 105 emphasized that if fresh material filed by way of additional evidence, is taken into consideration, it should be necessary that the appellate body adopts some system of verification. In the facts of the above case the CIT(Appeal) had called for remand report and decided the appeal but the Court was of the opinion that the matter had to be remitted to the Assessing Officer, who had to go into



the veracity of documents produced. In the light of the above observations, we are o  
opinion that the Tribunal committed a serious error of law in not setting aside the order of  
the CIT(Appeals), who appears to have accepted the documents and books of account  
furnished in the first instance before him without any form of verification. The matter is  
accordingly, remitted to the Assessing Officer who shall take into account the documents  
and books of account, which were furnished by the assessee to the CIT(Appeals) and  
after giving proper opportunity and hearing to the assessee pass an order in accordance  
with law. The impugned orders are accordingly set aside.

A handwritten signature in black ink, appearing to read 'S. Ravindra Bhat'.

S. RAVINDRA BHAT, J

A handwritten signature in black ink, appearing to read 'R.V. Easwar'.

R.V.EASWAR, J

**JULY 05, 2012**

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