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

\+ **ITA 141/2017**

PR. COMMISSIONER OF INCOME TAX-12, NEW DELHI
..... Appellant

Through Mr. Asheesh Jain, Sr. Standing Counsel

versus

HARPREET KAUR L/H OF VIRENDER SINGH KOCHAR
..... Respondent

Through Mr. Gautam Jain, Advocate

\+ **ITA 142/2017**

PR. COMMISSIONER OF INCOME TAX-12, NEW DELHI ..... Appellant

Through: Mr. Asheesh Jain, Sr. Standing Counsel

Versus

HARPREET KAUR L/H OF VIRENDER SINGH KOCHAR
..... Respondent

Through: Mr. Gautam Jain, Advocate

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE PRATHIBA M. SINGH

O R D E R

% 24.07.2017

Dr. S. Muralidhar, J:

1. These are two appeals by the Revenue against the common order dated 29th June 2016 passed by the Income Tax Appellate Tribunal ('ITAT') in

ITA No. 844/Del/2011 and ITA No. 2081/Del/2011 for the Assessment Years ('AY') 2006-07 and 2007-08, respectively.

2. While admitting these appeals on 21st February 2017 this Court framed the following questions of law for consideration:

> "(i) Did the ITAT fall into error in holding that invocation of Section 145 of the Income Tax Act, 1961 ('the Act') in the facts of this case was not justified?
> (ii) Is the impugned order erroneous inasmuch as it interprets Section 80IA (8) and (10) of the Act."

3. The facts in brief leading to the filing of these appeals are that the Respondent-Assessee was the Proprietor of M/s Vi-John International, Delhi and M/s Maja Personal Care, Baddi, Himachal Pradesh (H.P.) which are engaged in the manufacturing of cosmetic goods.

4. In relation to AY 2006-07, the Assessee filed a return income on 31st October 2006 declaring an income of Rs.2,02,760/-. During the course of the assessment, a questionnaire was issued by the Assessing Officer ('AO') following which the AO framed the assessment by order dated 26th December 2008 assessing the total income of the Assessee at Rs. 1,47,00,040/-. The AO came to the conclusion that the gross profit (GP) of the units of the Assessee located at Baddi was abnormally high when compared to the GP of the units located in Delhi; these units were selling the products through another related concern of the family, viz., M/s Suchet Agencies on consignment basis; "all of them have been in the same line of business for years, and all the relevant variables related to the business of

manufacturing of cosmetics are exactly similar in all of the above named concerns". According to the AO, even after accounting for the advantages that accrued to the units at Baddi, at the highest an average GP to the extent of 23% may be allowed. Consequently, the GP of M/s Maja Personal Care was taken at a maximum of 23% instead of 38.05% as declared by the Assessee. Consequently, the net profit (NP) ratio for the deduction under Section 80 IC of the Income Tax Act, 1961 ('the Act') was computed at 21% and a difference was added back to the income of the assessee.

5. Likewise for AY 2007-08 the AO on similar basis, by the assessment order dated 31st December 2009, the AO added back the difference in the GP by taking it at a maximum of 25% instead of 43.07%.

6. Aggrieved by the above assessment orders, appeals were filed by the Assessee before the Commissioner of Income Tax (Appeals) [CIT(A)]. By orders dated 26th December 2008 (for AY 2006-07) and 10th November 2010 for AY 2007-08 the CIT (A) allowed the appeals of the Assessee. The CIT(A) held that "the AO was not justified in rejecting the trading results shown by the Assessee summarily without pointing out either any mistake/deficiency in the accounts or disturbing the figures of sales or purchase as declared by the Assessee". According to the CIT(A) there were considerable differences in the business environment of the Assessee's concerns in Delhi and at Baddi in H.P. Consequently, the CIT(A) was of the view that the AO was not correct in slashing the GP rates in both the areas and substituting it by that determined by the AO.

7. Aggrieved by the orders passed by the CIT(A) for each of the AYs, the Revenue went in appeal before the ITAT which by the impugned common order dismissed the appeals. The ITAT concluded that the AO had arbitrarily made the addition by rejecting the books of accounts and the additions made by the AO were rightly deleted by the CIT(A). The ITAT summarized and affirmed the reasons given by the CIT(A) for reversing the AO. In addition, the ITAT observed as under:

> "20. However, there is not an iota of material on the file to prove the inter-unit transfers between the related units of the assessee, one situated at Baddi, Himachal Pradesh, and another situated at Delhi. Moreover, when correctness and completeness of the audited books of account has not been disputed, merely disputing the trading result on the basis of higher gross profit ratio is not permissible under law. When AO has also not returned any specific findings that there was some arrangement between the assessee unit, an 80-IC unit and his non 80-IC unit situated at Delhi to carry out such, transfer of goods, the question of invoking provisions contained u/s 80-IA (8) & (10) does not arise."

8. The ITAT was of the view that the AO had invoked Section 80 IC read with Section 80-IA (8) and (10) of the Act "on the basis of conjectures and surmises only without having an iota of material on record and as such, the question is answered in favour of the assessee".

9. Having heard Mr. Asheesh Jain, learned the Senior Standing counsel for the Revenue and Mr. Gautam Jain, learned counsel for the Assessee, the Court is of the view that the orders of the CIT(A) and the ITAT suffer from no legal infirmity. The reasons for this conclusion follow.

10. Under Section 80-IA(8) of the Act, one of the pre-requisites for the AO to not grant the deduction as claimed by the Assessee in his return is where the AO finds that the consideration at which transfers were made of goods and services of the eligible business as recorded in its accounts "does not correspond to the market values of such goods." The Proviso to Section 80-IA (8) further states:

> "that where, in the opinion of the Assessing Officer, the computation of the profits and gains of the eligible business in the manner hereinbefore specified presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such **reasonable basis** as he may deem fit." (emphasis supplied)

11. The expression "such reasonable basis" pre-supposes that the AO has to explain with sufficient clarity why the AO is rejecting the profit figures as put forth by the Assessee which emerges from the audited accounts of the Assessee. In the present case, for instance, the AO had to explain why he was rejecting for AY 2006-07 the GP ratio of 38.05% and substituting it with a rate of 23%. What the AO appears to have done in the present case is to reject an explanation given by an Assessee as to the difference in the selling price of the products manufactured by it at its Baddi unit compared to that at Delhi unit. The AO proceeded on the basis that the sales were to related parties thus giving an unfair advantage to the Assessee.

12. The above approach of the AO was rightly found by the CIT(A) to be not justified. Without pointing out the error, if any, in the accounts or disturbing the figures of sales or purchases, to compare the trading results of business of two units and simply reject was clearly not a "reasonable basis", as contemplated by the proviso to Section 80-IA (8) of the Act. The AO's

order does not explain the basis for determining the GP ratio of 23% instead of 38.05% for AY 2006-07 and 25% instead of 43.07% for AY 2007-08.
In the circumstances, the ITAT's conclusion that the AO's order was passed on conjectures and surmises cannot be said to be erroneous.

13. When there are audited accounts of an entity and the calculation of the GP ratios hinges upon their analysis, the AO should not lightly undertake an exercise that would amount to negating those accounts.

14. The questions framed by this Court are answered thus:
Question (i) is answered in the negative by holding that the ITAT did not err in holding that invocation of Section 145 of the Act in the facts of this case was not justified.

Question no. (ii) is answered in the negative by holding that the impugned order of the ITAT in its interpretation of Section 80-IA (8) and (10) of the Act is not erroneous. Consequently, the questions are answered in favour of the Assessee and against the Revenue.

15. The appeals are dismissed.

S.MURALIDHAR, J

PRATHIBA M. SINGH, J

JULY 24, 2017
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