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

*Decided on: 1<sup>st</sup> February, 2019.*

+ ITA 66/2018

PRINCIPAL COMMISSIONER OF  
INCOME TAX, DELHI-17,

..... Petitioner

Through: Mr. Ruchir Bhatia, Sr. Std. Counsel.

versus

M/S WADHAWAN DESIGNS

..... Respondent

Through: Mr. Lalit Valecha & Ms. Divya  
Vishvapriya, Advs.

**CORAM:**

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

**HON'BLE MR. JUSTICE PRATEEK JALAN**

**S. RAVINDRA BHAT, J. (OPEN COURT)**

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**CM Appl. 2633/2018 (exemption)**

Exemption allowed, subject to all just exceptions.

The application is disposed of.

**ITA 66/2018**

1. The question of law framed in this case is as follows:-

*“Did the ITAT fall into error in setting aside the concurrent finding with respect to the disallowance of purchases worked out at ₹6,77,21,540/-, claimed by the assessee in the facts and circumstances of the case?”*

2. The relevant facts are that the assessee reported income for A.Y. 2010-11; during the course of scrutiny the AO noticed that the sum of ₹6,77,21,540/- were shown in the assessee's books, as amounts spent towards purchases made on account of raw materials sought to have



procured to manufacture garments. The assessee claimed that the readymade garments were exported and claimed drawback amounts from the concerned authorities. After enquiry, the AO was of the opinion that the amounts claimed towards purchase of the raw materials were bogus. In para 3.3 of the AO's orders, the AO detailed the nature of the particulars provided by the assessee with respect to the entities/firms from whom purchases were made.

3. The assessee's claim was disallowed and the entire sum of ₹ 6.77 crores was brought to tax under Section 68. The assessee appealed to the Commissioner, and the Appellate Commissioner considered its submissions as well as the relevant case laws. The CIT(A) also noted that the assessee's partner one Mr. Inderpal Singh Wadhawan when confronted with a similar situation, had approached the Settlement Commission resulting in a favourable order. The CIT(A), accordingly, enquired further into the matter as is evident from the discussion in the appellate order. The CIT(A) thereafter noted as follows:-

*“5.5 I have carefully considered the facts of the case and submission of the appellant. I have perused the material available on the record. Further, on specific query raised by me, for producing the parties from whom purchases shown to have been done and giving their current address, the appellant showed its inability to do so. However, in the submission filed before the AO on 15.03.2015, the appellant stated that these parties did not receive notices due to various reasons. If appellant's submission filed before the AO on 15.03.2015 is accepted; then it is surprising to note that when the appellant knew the reasons of non-service of the notices at that point of time then why the appellant did not produce these parties before the AO even when specifically asked by the AO to do so. It means that the appellant's reasoning of not getting the notices served on stated suppliers are not at all genuine. Since the parties from whom purchases shown to have been done*



*were not demonstrated by the appellant to be in existence at given address or at any address even in the appellate proceedings; therefore, such conduct of the appellant buttresses the AO's inference that the purchases are not verifiable. Here, in such facts & circumstances, the AO; placing reliance on the decision of the Hon'ble Delhi High Court in case of La Medica (2001) 250 ITR 575, concluded 30% of the purchases of Rs.22,57,38,469/- as unverifiable/bogus/inflated and consequentially, made disallowance of Rs.6,77,21,540/- on this score.*

*5.6 On similar facts, the appellant's group concerns who filed the above mentioned Applications before the ITSC had admitted that they were not able to establish the genuineness of such purchases to the satisfaction of the AO. Some of the suppliers of the appellant are also suppliers in those two cases who filed the above mentioned Applications before the ITSC. Thus in view of above mentioned facts & circumstances, it is inferred that the appellant's purchases are not verifiable at all. The payments made through banking channel do not substantiate the fact that the purchases made by the appellant from the parties under reference are genuine. In view of facts mentioned in the impugned order and the appellant's failure to demonstrate the genuineness of purchases before me, I concur with the finding of the AO. ”*

4. Furthermore the CIT[A] noted that another amount of ₹6,18,35,598/- stood on account of debt owned by sundry creditors in the assessee's books which were also without any explanation. Using the concurrent powers, CIT[A] was not satisfied with the assessee's explanation and proceeded to treat them as unexplained credits under Section 68. The CIT[A] however held that since the larger sum of ₹6.77 crores was brought to tax, this amount i.e. ₹6,18,35,598/- could be subsumed.

5. The ITAT to whom the assessee appealed, allowed and accepted the assessee's plea while affirming the finding with respect to rejection of the books of accounts of the assessee. However, it adopted the strange



reasoning that the amounts were taxed on gross profit basis and applied a rate of 6.05%, having regard to the past year's income and profit reported.

The findings of the ITAT are as follows:-

*20. In view of the above we are inclined to hold that the addition of 30% of total purchases made by the AO which also includes alleged sundry creditors pertaining to same purchase cannot be held as sustainable specially in the event of rejection of books of account u/s 145(3) of the Act. On the basis of above discussion we reach to a logical conclusion that when the books and trading results of the assessee have been rejected by the AO then no addition on account of bogus purchases or unexplained sundry trade creditors, who are related to the impugned purchases, can be made in the hands of assessee.*

*21. However, in the event of rejection of books of accounts the AO is eligible to proceed to estimate gross profit and net profit rate of the assessee for arriving to taxable business income of the assessee. But this power of estimation is not arbitrary power as when the books of account and trading results are rejected u/s 145(3) of the Act, then the AO gets right to assess the business income u/s 144 of the Act by using his logical and judicial wisdom under 'best judgment assessment'. For the best judgment assessment the Assessing Officer after taking into account all relevant material which the assessing officer has gathered shall after giving the assessee and opportunity of being heard made the assessment of the total income or loss to the basis of its judgment and determine the same table by the assessee on the basis of such assessment in the present case no such exercise has been carried out by the AO as per mandate and requirement of the provisions of the Act.*

*22. Be that as it may, in the present case, the rejection of books of accounts by the AO u/s 145(3) of the Act has been accepted by the assessee as there is no challenge to this conclusion recorded by the authorities below. In this situation, the AO is eligible to estimate the gross profit and net profit rate of the assessee comparing the earlier year results or comparing for the gross profit and net profit rate of the another entity which is engaged in the similar kind of business. In the present case, since on being asked by the Bench the Ld. DR could not*



*controvert this fact that the gross profit and net profit rate of the assessee in the present A.Y. 2010-11 was 6.05% and 2.01% respectively, which was higher in comparison to gross profit and net profit rate of immediately preceding A.Y.2009-10 then no further addition in this regard can validly be made and sustained. Thus, on the basis of foregoing discussion we hold that the addition made by the AO 30% of total purchases is not a valid and sustainable addition on all four corner of the factual matrix of the present case as noted above and mandate of the Act, therefore, we dismiss the same. Accordingly, the ground no.1 of the assessee is allowed.”*

6. The Revenue urges that since the assessee's books of accounts were rejected and at the same time sum of ₹6.77 crores was brought to tax concurrently, under Section 68, ITAT could not have apply GP Ratio as in this case. Learned counsel for the assessee, on the other hand, submits that during the course of the assessment proceedings the materials which it possessed by way of names and identity of the suppliers had been duly furnished. It was further stated that the assessee had regular transactions with those suppliers and in these circumstances the entire amounts would not have been disallowed.

7. The AO as well as CIT[A] had relied upon the decision of this Court in *Commissioner of Income Tax, Delhi-III, New Delhi vs. La Medica, Delhi (2001) 250 ITR 575*. In that judgment the Court had dealt with a somewhat similar situation where the claim of expenditure was suspected. The relevant discussion is as follows:-

*“Though essentially the conclusion of the Tribunal have the colour of factual findings, still we find that the Tribunal has not taken into consideration relevant materials and has also acted on irrelevant materials. The fact that the alleged sellers have been found to be persons with no means to effect purchases or to carry on business is a factor which does not appear to have been considered by the Tribunal in its proper perspective.*



*Materials on record clearly establish that Chedi Lal was a petty employee of a concern of which Satya Pal Jain was a partner. In fact Satya Pal Jain was a partner of Medipac, one of the sister concerns of the assessee firm. On enquires conducted by the authorities after due notice to the assessee it was found that there was no such concern called Kalpana Enterprises at either 71, Canning Street, Calcutta or 479, Bartan Market, Sadar Bazar, Delhi. Additionally Chedi Lal opened the bank account with the introduction of Satya Pal Jain and the amounts were withdrawn. If the purchases were really affected from Kalpana Enterprises it is not understood as to how some other person namely Inder Sain Jain(HUF) accepted that the materials were supplied by it. The question before the Tribunal was not whether purchases were made from another concern. What was under consideration was whether the purchases were made from Kalpana Enterprises as was claimed by the assessee. Ample material has been brought on record by the Revenue to show that the purchases were in fact not made from Kalpana Enterprises. These are some of the relevant materials which have not been considered by the Tribunal. Tribunal's conclusion that even if it is accepted that Chedi Lal was only an instrument used by Satya Pal Jain, assessee was not involved in it, is a conclusion arrived at without any foundation. On the contrary it has been established by materials on record that assessee knew that the whole thing was a fictitious arrangement. Once it is accepted that the supplies were not made by Kalpana Enterprises to whom payments were alleged to have been made, the question whether the purchases were made from some other source ought not to have weighed with the Tribunal as a factor in favour of the assessee. The conclusion of the Tribunal are, therefore, clearly erroneous contrary to materials on record and have been arrived at without taking into consideration relevant material and placing reliance on irrelevant materials. It is to be noted that assessee's stand was not that it had effected purchases from anybody else. Its stand throughout was that it had effected purchases from Kalpana Enterprises. It was not open to the Tribunal to make out a third case, which was not even the case of the assessee, to hold that the transactions were real and not fictitious as claimed by the Revenue. As observed in Omar Salay Mohamed*



*Sait v. commissioner of Income-tax (1959) 37 ITR 151 (SC), a question of law arises of a finding of fact is arrived at by the Tribunal after improperly rejecting evidence. A question of fact becomes a question of law if the finding is not founded on any evidence or material, or if it is contrary to evidence. Similar is the position if it is perverse or there is no direct nexus or link between conclusion of fact and the primary fact upon which that conclusion is based. Where Tribunal acts on partly relevant and partly irrelevant materials, and it is not possible to say as to what extent latter has influenced its mind, the finding is vitiated because of use of irrelevant material. That given rises to a question of law. This position has been succinctly stated by the Apex Court in Dhirajlal Girdharilal v. Commissioner of Income-tax, (1954) 26 ITR 736(SC), Commissioner of Income-tax v. Daulat Ram Rawatmull, (1973) 87 ITR 349 (SC). Where the Tribunal misdirects itself in law in basing its conclusions on some evidence ignoring other essential materials on record, a question of law arises. (See: Commissioner of Income-Tax v. Radha Kishan Nandlal, (1975) 99 ITR 143 (SC). The answer to the question therefore, is in the negative, in favour of Revenue and against the assessee. ”*

8. In this case, the particulars and materials with respect to the supplier's details furnished by the assessee were unsatisfactory. The AO has in the assessment order discussed this in great detail. It was evident that the suppliers were not forthcoming and even notices sent to them were returned unserved. In these circumstances and given the state of the law – as indicated in *Commissioner of Income Tax vs. Lovely Exports* (2008) 216 CTR 195, affirming the Division Bench judgment of this Court in *Commissioner of Income Tax vs. Divine Leasing & Finance Ltd.* (2008) 299 ITR 268, the burden in the first instance to disclose that the amounts were duly paid, in the course of regular commercial transaction, by establishing the identity of the recipients, genuineness of the transaction and the creditworthiness of the party concerned lay with the assessee. Clearly, it



made some attempt to disclose the identity but was unsuccessful because none of the suppliers could be traced. The genuineness of the transaction too could not be established.

9. In these circumstances, the application of law by the lower revenue authorities [AO and the CIT(A)] was correct. Having accepted that the expenditure claimed was bogus, the ITAT, for strange and unexplained reasons, applied the GP Ratio which was entirely unwarranted and thus, reduced the tax liability of the assessee drastically.

10. In these circumstances the appeal has to succeed. The question of law framed is answered in the affirmative, i.e. against the assessee and in favour of the Revenue.

11. The appeal is accordingly allowed.

**S. RAVINDRA BHAT, J.**

**PRATEEK JALAN, J.**

**FEBRUARY 1, 2019**

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