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*IN THE HIGH COURT OF DELHI AT NEW DELHI

+ ITA 244/2009, 547/2011, 548/2011 & 615/2011

COMMISSIONER OF INCOME TAX ..... Appellant
Through Ms. Suruchi Aggarwal, Sr. Standing Counsel.

versus

SUPERIOR CRAFTS ..... Respondent
Through Mr. Sastish Khosla & Mr. Manu K. Giri, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V.EASWAR

O R D E R

% 06.03.2012

Revenue has preferred these four appeals under Section 260A of the Income Tax Act, 1961 (Act, for short) in the case of a partnership firm, Superior Crafts. ITA No. 244/2009 pertains to assessment year 2002-03 and is directed against the order dated 28th March, 2008 passed by the Income Tax Appellate Tribunal (tribunal, for short). As this appeal was treated as a lead case by the counsel for the parties, we will first refer to and decide this appeal.

2. In the assessment year 2002-03, the Assessing Officer had directed special audit under Section 142(2A) of the Act. After receiving a special audit report, the Assessing Officer

rejected the closing stock as declared by the responde assessee and held that there was under-valuation of closing stock to the extent of Rs.1,49,28,900/-.

3. The CIT (Appeals) confirmed the said addition, but by the impugned order the tribunal has deleted the said addition.

4. The contention raised by the appellant Revenue is that the decision of the tribunal is perverse. Learned counsel for the appellant has placed reliance on three facets. Firstly, stock register was not maintained or at least not produced before the Assessing Officer. She submits that the Assessing Officer has recorded that the stock register was possibly maintained by the assessee but deliberately not produced. Secondly, in the special audit report, adverse remarks have been recorded, but not given due credence by the tribunal. Lastly, it is submitted that there was a change in method of valuation of closing stock. In this connection, she has drawn our attention to the table noted by the Assessing Officer, who has held that the closing stock was bifurcated into three categories; finished goods, semi finished goods and goods under process. The Assessing Officer has stated that the opening stock of finished goods was valued @ 90% of the sales recorded/made for first 20 days of the beginning of the year i.e., 1st April, 2001 to 20th April, 2001 but

the closing stock was valued @ 90% of the sales made in tl period of 15 days after end of the financial year from 1st April, 2002 to 15th April, 2002. Similarly, 'Semi finished Goods' and 'Goods under Process' were valued @ 74% and 64% of the sale value, respectively but the period of days was 20 days and 35 days for the purpose of opening stock but 15 days and 20 days for the purpose of closing stock. She has drawn inspiration from the findings recorded by the CIT (Appeals), who has held that there was change in the method of valuation of closing stock as the assessee had computed the closing stock by applying different periods in which the sales were made viz. the opening stock. Thus, an anomaly has resulted and the consequence was understatement of closing stock.

5. To examine the contention of the learned counsel for the Revenue, we have gone through the papers and material placed before us. The stand of the appellant Revenue that there was a change in the method in the valuation of closing stock is false and wrong. Findings to this effect recorded by the CIT (Appeals) and the Assessing Officer are incorrect. The assessee's case, which has been accepted by the tribunal, is that the assessee was not maintaining stock register on a daily basis. This fact is also mentioned in the audit report and stated in the report

submitted by the special auditor. The allegation that stock register was maintained but not produced is an assumption or surmise without any foundation. The assessee undertakes physical stock inventory at the end of the financial year. The physical inventory is divided and consists of four categories; finished goods; semi finished goods; work under process; and raw material. The finished goods are valued at 90% of the sale value i.e. the sale price received on sale made in the next year. Semi finished goods and goods under process are valued at 74% and 60% of the sale value. The raw material is valued at costs. The Assessing Officer has not disturbed or disputed the closing stock of raw material. The closing stock of finished, semi finished or work in process, it is not disputed was sold in the next assessment year and sale value was received when the export was made. The contention of the Revenue is that opening stock and closing stock of finished, semi finished or work in process must be sold/exported within the same time period. For example, opening stock of finished goods was sold within 20 days and therefore closing stock of finished goods should have sold/exported within 20 days. Accordingly, entire exports made in 20 days should be treated as closing stock of finished goods. The time period during which the finished goods,

unfinished goods and goods under process etc. were sold ar exported depends upon various factors, like, availability of container, inspection by the importer's agent, need and requirement of the importer, time of shipment etc. The closing stock, whether finished, semi finished etc. need not be sold/exported within a fixed/specified period each year. There cannot be any such assumption and it is not logical to accept this proposition. The contention of the Revenue is that opening stock and closing stock must be sold/exported within the same period cannot be accepted. The respondent assessee has, before us, filed a chart giving year-wise details of the closing stock from the assessment year 1997-98 to 2005-06 in respect of finished goods, semi finished goods, goods under process and raw material. The said chart indicates that the closing stock was exported or was sold in different time spans in each year. This chart was filed before the tribunal. There is no consistency or certainty in this regard and indeed there cannot be any consistency and certainty as to the period when the finished, semi finished or goods under process would be sold by way of export. The charge/allegation of change of method of valuation of closing stock is baseless, factually incorrect and has to be rejected.

6. The Special Auditor in his report in respect of the stock trade had observed as under:-

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S. No.	Particulars	Reference	Amount	Remarks
1	Stock in trade	Enclosure "B"	1,49,28,900/-	The observations are summarized as under: • No paper stock records kept. • Change in method of valuation of stock. • Certain elements and cost are ignored while valuing the stock. • The stock in earlier years valued as percentage of requirements of number of days. The requirement as number of days in current years is substantially less than in earlier years. • The method of valuation of closing stock is neither reorganizer nor recommended by the

				Accounting Standard 2 issued by the Institute of Chartered Accountants of India. • Suppression in Closing Stock Rs.1,49,28,900/-.

7. As noticed above, the tribunal has clearly and rightly held that there was no change in method of accounting for closing stock in the earlier years. The tribunal has further held that the special auditor had rightly held that the stock in the earlier year and the subsequent year was valued at a particular percentage of sale price. With regard to the elements and cost element included while valuing the stock, it will be appropriate to note that in spite of the observations of the special auditor, the Assessing Officer did not interfere/reject the valuation of the closing stock made by the assessee @ 90%, 74% and 60% of the sale value for finished, semi finished and goods under process. There is a good reason why the Assessing Officer did not disturb the said valuation. The gross profit rate, as declared by the assessee, was 28.92% and after the additions made by the Assessing Officer, it had gone up/increased substantially. In

case, the closing stock is calculated by excluding the gross prc rate, the value of the closing stock would have come down substantially. The observation of the special auditor that expenses/costs have been left out while computing closing stock is factual incorrect and has no basis. No document/material has been filed by the Revenue before us to justify their contention.

8. We may reproduce the findings recorded by the tribunal on the question of closing stock in the impugned order:-

> "4.8 We have perused the records and considered the rival contentions carefully. The dispute raised in this ground is regarding method of valuation of semi finished, finished and goods in progress appearing in the closing stock. The assessee admittedly is not maintaining day-to-day account of the stock due to practical difficulties because of nature of business. The assessee had been taking periodical inventory of stock. The items of finished goods, semi finished goods and goods in process appearing in the closing stock at the tiend of the eyar have been valued on the basis of sales made of finished goods relating to the items appering in the closing stock in the immediate following accounting year. From the sales made in the next year, the first sales made up-to the quantity of finished stock were being allocated towards finished stock; the second sales up to the quantity of semi finished stock were appropriated towards the semi finished stock and the rest towards the goods under process. The assessee was adopting a particular percentage of these sales as per details given in para 4 of this order earlier for

determining the value of closing stock. The A.O. did not accept the plea of the assessee that it was not possible to maintain proper accounts of stock records. He also noted that the assessee had taken a shipping loan against the stock at the margin of 25%, which meant that stock at the end of the year should be 125% of shipping loan but actually it was only 80%. He, therefore, rejected the method of valuation adopted by the assessee. He adopted the period of sales for the purpose of stock valuation same as in the case of opening stock but accepted the percentage of sales adopted by the assessee in respect of different categories. This resulted into addition of Rs.14928900/- on account of under valuation of closing stock. In appeal, CIT(A) also noted that the assessee had not produced the stock inspection report of the bank in connection with the shipping loan and also did not give any reason for ensuring the premises at D-13, Mundappa, although no stock was stated to be maintained there. Ensured value of stock was also pointed out to be higher. He, therefore, agreed with the decision of the A.O. and confirmed the addition.

4.9 On careful consideration of all the aspects of the matter, we find that the approach adopted and the finding given by the lower authorities in relation to closing stock valuation is not correct. It is an admitted fact that the assessee had not been maintaining day-to-day account of the stock. The assessee has been determining the closing stock items on physical verification at the end of the year. For valuing the inventory appearing in the closing stock, the assessee has to follow a particular method. The assessee has either to compute the cost of each item separately or he can derive the cost after deducting

certain margin from the sale price. Considering the volume of business and numerous items involved, the assessee has been valuing the finished goods, semi finished goods and goods in progress on the basis of sale price of these items sold in the subsequent year after deducing a particular margin, which has been uniformly followed by the assessee in the earlier and the subsequent years. For computing the sale values of items of closing stock in different categories, the assessee has been appropriating the first sales towards the finished goods, the next sales towards the semi finished goods and the balance against the goods under progress. This is a systematic and reasonable basis adopted by the assessee, which has been uniformly followed. As the quantity of items appearing in closing stock will vary from year to year, the period of sales adopted for valuation of closing stock in different year will also differ. This has been demonstrated by the assessee by producing a chart regarding the valuation for different years which show that period of sales adopted for different years is different.

4.10 We find that the A.O. has accepted the basis of valuation of closing stock items adopted by the assessee i.e. as a specified percentage of sales of the closing stock items. He has rejected the inventory of closing stock and has taken the period of sales of the closing stock items as the same period as taken for the sale of closing stock of last year in order to determine the closing stock inventory and its value. One of the reasons given for rejecting the closing stock is that the value of closing stock shown was only 80% of shipping loan whereas as per terms and conditions of loan it should have been 125%. But there is no material

collected by the A.O. to show that the closing stock was actually more than the one declared by the assessee. Violation of terms and conditions of loan or the fact that the assessee did not produce the stock inspection report of the bank, cannot be the ground for rejecting the closing stock declared by the assessee. Similarly, the ensured value of stock being higher or insuring of some premises other than the factory premises for the purpose of stock are also not conclusive factors in determining the stock on the last day of the year. It is an undisputed fact that there was no stock found at the insured premises. Further, the insured value i.e. the sum insured is the maximum value the assessee can get as per insurance rules and it has no relevance to availability of stock on a particular day which may vary from time to time. No efforts have been made to obtain the stock inspection report from the bank or to gather any other material to establish that the closing stock on the last day of the accounting period was higher than the declared value. Even if the A.O. rejects the closing inventory on the ground that no day to day stock register is maintained, he had to determine the gross profit only on estimate either on the basis of assessee's own past record or on the basis of a comparable case. No comparable case has been brought on record and the GP rate declared by the assessee this year at 28.93% is substantially higher than the GP rate 19.16% accepted in the assessee's own case in the immediate preceding year. In view of better results, no addition is possible on account of trading account of which closing stock value is an integral part. The assessee has followed a reasonable basis of valuation of closing stock, which has been regularly followed and accepted by the department in the earlier years and in the

> subsequent year. In view of this position and the GP rate declared being higher this year compared to accepted GP rate in the immediate preceding year, any addition on account of closing stock valuation is not justified. We, therefore, set aside the order of CIT(A) and delete the addition made by the A.O."

9. The aforesaid findings recorded by the tribunal cannot be categorized and regarded as perverse. These are factual findings based on reasoning and referring to the contentions. We may note here that the assessee had total exports turnover of 25.77 crores and the closing stock declared by them was Rs.8.63 crores, which is equal to about three months of the turnover. The Assessing Officer did not go into the question of lead time, i.e., the time for preparation of the finished product from the date of purchase of the raw material. It is interesting to note that for assessment year 2003-04, an assessment order was passed on 31st March, 2006 and in the said assessment order no addition whatsoever was made to the closing stock but the method adopted by the assessee for the said assessment year was same. In these circumstances, no substantial question of law arises out of the finding recorded by the tribunal on the question of valuation of closing stock.

10. The next question relates to disallowance/addition of

Rs.25,80,879/- made by the Assessing Officer on account travelling expenses incurred by Deven Chachra, who is related to the partners of the firm. Learned counsel for the Revenue has submitted that the order of the tribunal is perverse and merits interference in view of the findings recorded by the Assessing Officer, which were confirmed by the CIT(Appeals). The Assessing Officer while making the said addition has observed that Deven Chachra was paid salary of Rs.1,14,000/- per annum but this was not paid pursuant to specific employer-employee relationship. The exact findings recorded by the Assessing Officer read:-

> "…Upon the comments as made in other para's and findings given by the special auditor that the salary to Mr. Deven Chachra was only an entry and not paid in pursuance to the specific employer-employee relationship. At this stage it will not be out of place to reliance on sub-para k below, his salary is only Rs.1,14,000/- per annum and his expenditure on the mobile phone has been considered above of Rs.2,19,430/- and the same has been disallowed. Again no evidence has been placed on record to substantiate the visits of Deven for the purposes of business of the firm. The assessee is only attempting to cover up the personal expenditure as business without substantiation. In view of any evidence the entire expenditure of Tour & Travelling of Deven of Rs.25,80,879/- is disallowed."

11. The tribunal by the impugned order has held that Deven

Chachra was an employee. He is having degree of Bachelor Science and Economics, with specialization in marketing from Pennsylvania University, Wharton School of Business. He was CEO of the firm since 1994. We may note that statement of Deven Chachra was recorded in the assessment year 2003-04 but an ad hoc amount of Rs.5 lacs was disallowed from the overseas travel expenses on his travel, on ground of personal expenses. The Revenue has not challenged and has accepted the finding of the tribunal that Deven Chachra was an employee of the respondent assessee and on the salary paid to him. But, the challenge is to the foreign travel expenses of Rs.25,80,879/-, on the ground that these were not incurred for the purpose of business. The Assessing Officer had disallowed the entire expenditure of Rs. 25,80,879/- The tribunal while partly deleting the disallowance held that the expenses were incurred for purpose of business under Section 37 and observed as under:-

> "8.4 We have perused the records and carefully gone through the submissions made by both the parties. The dispute raised in this ground is regarding disallowance of travelling expenses of Shri Deven Chachra in India and abroad amounting to Rs.2580579/-. The case of the assessee is that Shri Deven Chachra was an employee who had undertaken the travels for negotiation with foreign buyers, negotiation of disputed issues and

settlement of rates and approval of samples etc. The assessee had filed copies of e-mails to substantiate the claim that the expenditure had been incurred for the purpose of business. It has also been submitted that the expenditure under this head had been allowed in the earlier year and in the succeeding year in scrutiny assessments, as was clear from the chart placed at page 1265 of Paper Book-IX. The case of the revenue is that, it was not established that Shri Deven Chachra was an employee and the expenditure had been incurred for the purpose of business. The e-mails produced by the assessee had originated from India, which can be sent from sitting in a room in India and these did not contain details of business activities.

We have considered the matter carefully. Out of total tour and travel expenses on account of Mr. Deven Chachra amounting to Rs.2580879/-, a sum of Rs.2493842/- is on foreign travelling. For claiming any expenditure as deduction, burden is on the assessee to prove that the expenditure has been incurred wholly and exclusively for the purpose of business. From e-mails, it cannot be established that the entire expenditure had been incurred for the purpose of business. The only details given by the assessee at page 43 of paper book-V were the place of visit, purchases of foreign exchange and the money spent. Merely because the person had travelled abroad and the money on foreign travel had been actually spent, cannot establish that the expenditure was incurred wholly and exclusively for the purpose of business. Even if the foreign travel had been made for the purpose of business, the personal expenses or expenses unrelated to the business trip cannot be allowed. No details were given as to how the money was spent

or whether there was any invitation from the buyers for discussing any business matter. However, we can also not overlook the fact that substantial expenditure on tour and travel of Shri Deven Chachra have been incurred and allowed by the revenue in the earlier years as well as in the subsequent year. In the immediate preceding year, expenditure on this account claimed at Rs.2201052/- was allowed in assessment. In the immediate succeeding year, the assessment for which had been completed after the impugned assessment, expenditure on account of tour and travel of Shri Chachra had been claimed at Rs.2615341/- and a sum of Rs.5 lacs on estimate has been disallowed under the head 'tour and travel'. The business requirement of the substantial tour and travel by Shri Chachra has therefore, been accepted by the revenue authorities in the earlier years as well as in the subsequent year. The disallowance of entire expenditure is therefore, not justified. One of the reasons given by the authorities below for making the disallowance of entire expenditure was that he was not an employee. But this aspect, we have already dealt with while dealing with another ground relating to disallowance of salary in the later part of this order and have held in para 12.5 that salary has to be allowed as deduction. However, the full details and evidence are not available to quantify as to how much expenditure had been incurred wholly and exclusively for the purpose of business. Expenditure on travelling may vary substantially from year to year as the business requirement may not be the same. In our view, considering the entirety of facts and circumstances including the past record, it will be appropriate to disallow on estimate 20% of the expenditure claimed as not incurred wholly and exclusively for the

> purpose of business. We order accordingly. The order of CIT(A) will be modified to that extent."

12. Thus, the tribunal has estimated and disallowed 20% of the foreign travel expenditure on the ground that it may not have been incurred wholly and exclusively for the purpose of business. The said amount will be slightly more than Rs.6 lacs. We fail to understand why and on what ground the Revenue can claim and submit that the findings recorded by the tribunal are perverse. No substantial question of law, therefore, arises on the said aspect.

13. The third issue raised in the present appeal relates to deletion of addition of Rs.1,14,60,996/- made by the Assessing Officer under the heading "margin of profit on sale of raw material on cost price to sister concerns."

14. Learned counsel for the Revenue again submits that the findings recorded by the tribunal are perverse and factually incorrect.

15. In the assessment order the Assessing Officer noticed that raw material purchased by the assessee was transferred to two sister concerns, namely, Superior Crafts India and Supreme Exports India. The raw material was transferred on cost basis.

The Assessing Officer held that the respondent assessee ha... shown gross profit rate of 28.92% and, therefore, an addition of Rs.1,14,60,996/- should be made on the ground that the assessee should have earned profit and charged cost price plus profit margin of 28.92% from the sister concerns when they transferred/sold the raw material. The Assessing Officer rejected the contention of the respondent assessee that to secure competitive and lower rates, they had purchased raw material in bulk and sometimes the said raw material was sold to the sister concerns on cost price. It was further submitted by the assessee that quota allocation and export orders, sometimes necessitated and required transfer of raw material to sister concerns. Sale made was viable, reasonable and did not violate law of the land. The aforesaid contentions were rejected on the ground that these averments were general in nature without documentary evidence. The CIT (Appeals) had affirmed this addition.

16. The tribunal has, however, deleted the addition, inter alia, recording as under:

> "14.6 On careful consideration of all the aspects of the issue, we find the stand of the assessee and the arguments advanced by the ld counsel quite convincing. The raw material/semi processed goods had been

transferred to the sister concerns on commercial expediency as quota had been received in their names. Had the assessee not transferred the goods to sister concerns, the goods could not be exported for want of quota and the assessee would have incurred loss and therefore, commercial expediency is involved in the transfer at lower price. As all the concerns belonged to the same group, which are fun by a family, it is quite prudent to make common purchases in bulk to save cost and later transfer the goods. The ld DR has pointed out that the assessee had its own quota which was sold during the year. But the assessee has explained that quota related to some other category of goods and there is nothing to controvert this claim. The only issue is that goods have been transferred at cost price or at a price much below the market price but there is no provision in the Act as rightly pointed out by the ld counsel to make any addition on this ground. There are provisions in Section 40A(2) as per which in case the expenditure incurred on account of connected person is excessive compared to the market value, the A.O. can make disallowance but there is no such provision for making any addition on account of lower sale consideration shown compared to the market value. The only ground for making addition could be tax evasion device but for this burden lies on the revenue to establish that the transfer had been made with a view to evade tax. The ld counsel has pointed out that both the concerns are in the same tax bracket and therefore there is no tax evasion on account of any transfer at lower price. These claims have not been controverted before us. Therefore, we do not see any tax evasion device involved in the transfer. Further the corresponding value of purchase in the case of sister concerns have been accepted by

> the revenue. There is also no material to show that the assessee had received any money over and above the consideration stated in the books. Under the circumstances, any addition on account of lower sale value declared by the assessee is not justified in our opinion. The order of CIT(A) is accordingly set aside and the addition is deleted."

17. On the basis of material on record, the tribunal has accepted the stand of the respondent assessee. The aforesaid findings are findings of fact and these cannot be regarded as perverse.

18. At this juncture, we may now deal with the objection of the special auditor that certain elements on costs were ignored while calculating the cost price paid b y the sister concers. It is alleged that the assessee after purchasing stock had transported the raw material. Some other expenses were also incurred. However, while charging the cost price from the sister concerns, no element of charges/expenses on account of transportation etc. were charged. The tribunal examined the said aspect and has held as under:-

> "14.5 …..The assessee has challenged the decision of CIT(A) and it has been argued by the ld counsel that whatever expenses had been incurred in connection with the goods transferred had been duly recovered from the sister concerns, which was clear from

> the pages 904-907 on the paper book-IV. It has been pointed out that the transfer was for commercial expediency as had the goods not been transferred, these were of no value to the assessee in the absence of quota. It was also argued that there was no provision for taxing notional profit and therefore, even if the goods were transferred at cost or lesser value, no addition could be made."
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> (emphasis supplied)

19. Revenue is not able to controvert and contest the said contention.

20. The last addition subject matter of the present appeal was under Section 40A(2)(b) of the Act on the ground that excessive/unreasonable expenditure was incurred on getting garments fabricated from associate concerns, namely, R.A. Exports and Sensational Exports. It is accepted and admitted by the respondent assessee that both of them were associate concerns. The Assessing Officer also made addition in respect of payments made to Prakash Fabrication, which is not an associate concern. The entire payment of Rs.83,48,292 made to R.A. Exports, Sensational Exports and Prakash Fabrication was disallowed as if the assessee had not incurred any expenditure at all on fabrication of garments from the said concerns. The findings recorded by the Assessing Officer for the sake of convenience are reproduced below:-

"Besides above payments a sum of Rs.32,27,883/- as contract payment have also been paid to M/s Prakash Fabrication unit in which transactions of similar nature to related firms have been entered. The above three firms have been shown as contractors of the assessee. The assessee was asked to prove the genuineness of transactions. Payment to the three firms aggregating to Rs.83,48,292/- should be treated as Bogus in view of the fact that above listed two firms being firms in which partners are substantially interested and M/s Prakash Fabrication since all the bills issued by Prakash Fabrication were as cash memos. Moreover at any point either during the course of audit or during the course of assessment proceedings the assessee could not substantiate its claim that the work was actually executed at its business premises or it has actually incurred such expenditure. The assesse did not produce any evidence regarding attendance record of such employees, PF/ESI records of such employees, regular entries in the books of accounts etc. with the help of which we could have relied upon the contention of the assessee. Moreover it was noticed from perusal of page 109 of Part I of Special Auditor's report that ESI & PF contribution of both employer and employee in respect of other similar contractor namely Ram Pravesh Contractor (Babu Finishing) has been borne by the assessee. It is thus not in doubt that assessee is bearing such contributions when the similar contract was bonafide.

Also, as per Page 199-204 of Part-II of the Audit Report, the auditors has mentioned various points which were duly supported with the documentary evidence, which proves that no records were placed on record by the assessee for claiming the

> genuineness of such expenditure. In view of this, the entire amount of Rs.83,48,292/-, being bogus in nature, is added back to the income of the assessee u/s 37(1) of the IT Act.
>
> **ADDITION OF Rs.83,48,292/-**"

21. The said disallowance, it is apparent, is not under Section 40A(2)(b) as stated in the grounds of appeal by the Revenue but the Assessing Officer had treated the said expenses as non genuine or as bogus expenditure. The aforesaid addition was affirmed by CIT (Appeals).

22. The addition has been deleted by the tribunal, inter alia, observing as under:-

> "24.7 We have perused the records and considered the rival contentions raised by both the parties. Dispute is regarding disallowance of fabrication charges paid to M/s.R.A. Exports and M/s. Sensational Exports, which are related to the assessee and to M/s. Prakash Industries, totaling Rs.8348292/-. The special auditor had reported that there were no goods receipt note (GRN) or challans made regarding receipt and dispatch of these goods. The bills in respect of these payments had been issued serially and entered on computer separately. There were also several cases of cash payment. The assessee has explained that payments were for supplying labour to the assessee for doing the stitching job at factory premises as per the conditions imposed by the foreign buyer. The A.O. however, disallowed the entire claim treating the same as bogus on the ground that there was no evidence produced that the job had

actually been done at factory premises as there was neither attendance record nor there was any record for deduction of PF and ESI in respect of employees. The assessee has explained to CIT(A) that there was no record of dispatch of goods as the job had been done at the factory premises. CIT(A) however noted that the payment was not supported by any bills and vouchers and there was no record of labour maintained. There was also no agreement regarding supply of labour. He further observed that the payments had been made for engaging labour but the expenditure was declared under the head 'processing charges'. No evidence had been produced either before the A.O. or at the appellate stage to show that evidence regarding processing charges had been produced before the special auditor. CIT(A) therefore concluded that the assessee did not discharge onus that the payment had been made wholly and exclusively for the purpose of business and accordingly confirmed the disallowance.

24.8 The ld counsel has reiterated the earlier stand before us that no GRN or challans was required as the goods were fabricated at the factory premises. The attendance of labourers was required to be made by the contractor and not the assessee. It was also pointed out that violation of the provisions of PF and ESI Act, could not be made the basis for disallowance. The ld counsel also submitted that both the special auditor as well as the A.O. had raised query only in relation to section 40A(2)(b) and 40A(3). The assessee had never been asked to prove the genuineness of transaction. No disallowance under the provisions of section 40A(2)(b) could be made as there was no material before the A.O. to show that

payments were excessive compared to the market value. As for the cash transactions, the auditors had not reported the same tin the audit report as the individual payments did not exceed Rs.20,000/-. As the payment for labour had been made in connection with fabrication, the expenditure had been booked under the head 'purchase fabrication account'. The assessee had filed copy of account of the parties as well as confirmation and the parties were assessed to tax separately and the payments had been made by cheques. He also referred to comparative chart placed at page 1290 of paper book-IX to show that no disallowance on this account had been made in the preceding or in the succeeding year.

24.9 We have carefully considered the matter. We find that the disallowance had been made mainly on the basis of some technical defaults noted by the A.O. The assessee has satisfactorily explained the absence of GRN or challans, which were not required as the work was being done at the factory premises of the assessee. Similarly, there was no requirement of any attendance record or deduction of PF & ESI as the work was being on contract and the workers were not employees of the assessee. We find sufficient force in the plea taken by the ld counsel that the A.O. had not doubted the genuineness of expenditure as query letter issued by the A.O. a copy of which is available at page 279-280 of paper book-I, makes it clear that the A.O. had asked the assessee to give justification with respect to section 40A(2) and 40A(3) only. Section 40A(2) relates to reasonableness of payments in case the expenditure had been incurred in relation to connected persona and Section 40A(3) is regarding cash payments. The assessee therefore

> explained the matter only with respect to these provisions vide letter dated 2.11.2005 a copy of which has been placed at page 434 of paper book –II. It has also been claimed that there was no cash payment exceeding Rs.20,000/- and the ld DR has produced no material to controvert this claim. Nor there is any material to show that the payments made to the associate concerns were excessive compared to market value. All these concerns are assessed to tax and the payments had been made by cheques. Similar payments for job work had been made in the earlier years also as well as in the succeeding year when no disallowance had been made. Under these circumstances, any disallowance this year is not justified. We, therefore, set aside the order of CIT(A) on this point and delete the additions made."

23. We fail to understand on what ground and on what basis the Revenue contends and submits the contention that the aforesaid findings are perverse. In fact, it is difficult to appreciate the finding of the Assessing Officer that the entire expense was bogus or should be disallowed by invoking Section 48A(2)(b). The Assessing Officer did not conduct any investigation or verification into the reasonableness of the said expense with reference to payment made to third parties or fair market charges payable for similar nature of work. The Assessing Officer also included the payment made to unrelated concern, namely, Prakash Fabrication while making the said

addition. It is not the case of the Assessing Officer that tl garments were not fabricated or manufactured. Exports of garments have been made. Revenue is unable to show that the findings recorded by the tribunal are not supported by material or evidence. The conclusion reached is after examing a number of facts. It cannot be said that the factual finding are such that "no person acting judicially and properly instructed as to the relevant law" would have reached the same conclusion. Tribunal has not ignored or excluded relevant evidence or taken into consideration inadmissible evidence.

24. In view of the aforesaid discussion, we do not think any substantial question of law arises in the appeal No. 244/2009.

ITA No. 548/2011

25. This appeal by the Revenue pertains to assessment year 2000-01. However, we may notice that the assessment order in this case was passed on 28th December, 2007, whereas the assessment order for the assessment year 2002-03 was passed on 10th November, 2005. The Assessing Officer in this case had rejected the books of accounts. The reasons/findings for rejecting the books of accounts as discernible from the assessment order are:-

(1) Stock register was not produced and, therefore, stock

details could not be verified.

(2) The audit report in form of No. 3CB and 3CD column 28(b) was left blank with the remarks “in view of the large number of items it is not possible to give such details”. The said column pertains to information in respect of qualitative details of raw material, semi finished products etc.

(3) The assessee had not submitted working notes for preparation of inventory of stock and in the absence of the same, comparative qualitative details cannot be verified.

(4) The assessee had insured the stock at a higher value than the figures of the closing stock quoted by the assessee. The assessee was not able to satisfactorily explain the reason for insurance at a higher value.

(5) The assessee had entered into transactions of Rs.1.56 crores (approximately) with its sister concern, namely, Superior Crafts (India). [In this year, no material was transferred/sold to the sister company, namely, Supreme Exports (India)]. As per the Assessing Officer, there is no reason why the transfer was on cost basis only and not for earning profit. No direct or indirect expenses incurred by the assessee were taken into consideration while computing the cost. No evidence was

brought on record to demonstrate that only raw material was transferred and not finished or semi finished products. In absence of stock register, this aspect could not be verified.

(6) Payments were made to contractors R.A. Exports, Sensational Exports and Prakash Fabrication Unit, but the assessee had failed to prove the genuineness of services rendered by the contractors. These transactions should be treated as bogus as R.A. Exports and Sensational Exports were firms in which partners were substantially interested. The respondent-assessee did not produce attendance records, provident fund/Employees State Insurance records of the employees engaged by R.A. Exports, Sensational Exports and Prakash Fabrication Unit and they did not file inward and outward challans for movement of stock/goods.

26. After rejecting the books of accounts, the Assessing Officer observed that the G.P. rate declared by the assessee in the year under consideration i.e. 2000-01, of 23.87% was low. The G.P. rate for succeeding five assessment years i.e. 2001-02, 2002-03, 2003-04, 2004-05 and 2005-06 were 19.16%, 28.92%, 22.17%, 38.17% and 23.04%, respectively. He held that the G.P rate declared for the assessment year 2002-03 was on the lower side and keeping in view the facts of the present

case, the Assessing Officer applied the G.P. rate of 32% to tl export sales turnover of Rs.41,47,44,473/-. He accordingly computed the gross profit at Rs.13,27,18,231/- as against Rs.9,53,19,,175/-.

27. The CIT (Appeals) deleted the said addition. He substantially relied upon the order passed by the tribunal in the case of the respondent-assessee for the assessment year 2002-03, which is subject matter of ITA No. 244/2009. The findings recorded by him are detailed and extensive. He, in the concluding paragraph, the CIT (A) recorded as under:-

> "3.8 Adverting back to the facts of the case, it is a fact that books of accounts of the assesee are audited and no discrepancy has been pointed out by the AO. The production results have not been found to be acceptable to the AO in absence of day to day stock register. The AO has completely ignored the substantial increase in the gross profit of the assessee which itself indicates that the AO has acted in a very arbitrary and illogical manner by applying g.p. ratio of a proceeding assessment year which is well in absolute terms against normal practice of drawing conclusions on the basis of comparisons and common sense. The AO made other observations also with regard to the reliability of the book results of the assessee which is evident from the text of the assessment order.
>
> The observations of the AO indicate that the AO is inclined to believe that the assessee has indulged in suppression of production, stock and its profit but the AO has not unearthed the suppression. The crucial

> fact of a substantial increase in gross profit ratio as compared to earlier years has been brushed aside.
>
> 3.9 In the light of the judicial authorities cited in preceding paragraphs, and particularly the decision of the Hon'ble ITAT, Delhi in its order in appellant's own case for A.Y. 2002-03 on the similar issue with identical facts and circumstances, as reproduced above; the estimation of gross profit on the basis of a future year in view of absolute facts is liable to be rejected being arbitrary, illogical and not in conformity with a logical practice of drawing conclusions on the basis of precedence of previous trading-results. Therefore, the trading addition of Rs.3,73,99,056/- made by the AO is deleted."

28. Aggrieved, the Revenue preferred an appeal before the tribunal on the aforesaid aspect. The tribunal vide order dated 27th August, 2010, dismissed the said appeal. The tribunal has affirmed and agreed with the findings recorded by the CIT (Appeal). The contention of the learned counsel for the appellant is that the findings of the tribunal are perverse. She further submits that once the stock register was not maintained and there was fall in G.P. rate as held by the Assessing Officer, rejection of books of accounts is justified and proper. In this regard, she relies upon decision of Allahabad High Court in ***Bimal Kumar Anant Kumar Vs. Commissioner of Income-Tax*** *[2007] 288 ITR 278 (All)* and this Court in ***Action***

Electricals Vs. Deputy Commissioner of Income-Tax *(200 , 258 ITR 188 (Del)*.

29. In ***Bimal Kumar Anant Kumar*** *(supra)*, a Division Bench of Allahabad High Court referred to Section 145 of the Act and Court decisions and observed that the Assessing Officer is entitled to compute income in his own way when he is of the opinion that income cannot be properly deduced from the books of accounts. It was noticed that the gross profit declared by the assessee was too low in comparison to other assessees in the same trade. The Assessing Officer had accordingly compared the gross profit rate and made an ad-hoc addition of Rs.15,000/- , which was reduced to Rs.13,000/- by the tribunal. Looking at the factual matrix of the said case, the questions of law were answered in favour of the Revenue and the appeal filed by the assessee was dismissed.

30. In the case of ***Action Electricals*** *(supra)*, the exact observations of the High Court read as follow:-

> "We are unable to persuade ourselves to agree with learned counsel for the assessee. Section 145(2) of the Act empowers the Assessing Officer to make a best judgment assessment when he is not satisfied about the correctness or completeness of the accounts of the assessee. It is not possible to categorise various types of defects which may render rejection of books of account of an

> assessee on the ground that the accounts are not complete or correct. Each case has to be considered on its own peculiar facts, having regard to the nature of business. Though it is true that the absence of stock register, in a given situation, may not per se lead to an inference that the accounts are incomplete or false the absence of such a register, coupled with other factor, like fall in profits, etc., may lead to an inference that the accounts are not correct. As noticed above, in the instant case, non-maintenance of stock register, coupled with the fact that unaccounted sales were detected during the course of search, in our opinion, is a relevant factor to sustain the view of the Assessing Officer. We do not find any legal infirmity in the view taken by the Tribunal that the disclosures/surrender of Rs. 5 lakhs by the assessee at the time of search, as its unaccounted sales, constitutes sufficient material for the Assessing Officer to base his satisfaction that the books of account of the assessee are not correct and complete. In so far as the estimation of the sales/ gross profit rate is concerned, it being a best judgment assessment, based on past years results cannot be said to be arbitrary."

31. A careful reading of the aforesaid observations indicates that the same do not support the contention of the Revenue. The High Court has clearly observed that absence of stock register, in a given situation, may not per se lead to an inference that the accounts were incomplete or false but this issue has to be examined keeping view the other factors, which include fall in gross profit rate. All factors

have to be examined and taken into consideration and the alone the Assessing Officer can reject the books of accounts. In the said case there was evidence of unrecorded sales outside the books.

32. Punjab and Haryana High Court in the case of ***Pandit Bros. v. CIT*** *(1954) 26 ITR 159* has elucidated and examined the said question and it was opined as under:-

> "..... Again, the fact that there is no stock register only cautions him against the falsity of the returns made by the assessee. He cannot say that merely because there is no stock register the account books must be false. The account books in this case were accepted as correct and disclosing a true state of affairs. The absence of one register cannot amount to material and there must be material before the Income-tax Officer before he can apply the provisions of the proviso to Section 13. Again, we find that the Income-tax Officer did not adopt any basis for the increase made by him.
>
> XXXXXX
>
> ....In the second place, even if such a finding were to be implied from his order it cannot be said that there was material before him which would enable him to come to this finding. The fact that the profits appeared to him to be insufficient and the fact that there was no stock register maintained by the assessee are not in my view materials upon which such a finding can be given, but these are circumstances which may provoke an inquiry. The Income-tax Officer must discover evidence or material aliunde before he can give such a finding."

33. This decision was referred to by the Supreme Court in tl case of ***S. N. Namasivayam Chettiar v. CIT*** *(1960) 38 ITR 579, 588 (SC)* and it was explained:-

> "....It was rightly argued that the power to compute profits under the proviso to s. 13 arises only where no method of accounting has been regularly employed by the assessee and where the method employed such that the income, profits and gain cannot properly be deduced therefrom. It means that the method adopted by the assessee must prima facie prevail where it is regularly employed, though the Income-tax Officer can resort to the proviso if the method is such that true profits cannot be correctly determined therefrom. In other words, even if the assessee has regularly employed a method of accounting it can be discarded under the proviso if the method does not show correct profits of the year.
>
> XXXXXX
>
> .... Khosla, J. (as he then was) ***[in Pandit Bros.]*** there said 'There is no finding that there was material before the Income-tax Officer to lead him to the conclusion that a proper statement of income, profits and gains could not be deduced from the material placed before him. All he said was that the profits appeared to be somewhat low and there was no stock register'. The want of a stock register was, in that particular case, not a very serious defect because the account books had been found and accepted as correct and disclosed a true state of affairs. It cannot therefore be said that that case laid down as a proposition of law that the want of a stock register by which a proper check could be made was not such a serious defect as to make the proviso to s. 13 inapplicable.

> The importance of such register was pointed out by the Nagpur High Court in ***Ghanshyam Das Permanand v. Commissioner of Income-tax***, C. P. & Berar (1959 (21) ITR 79, 81). In cases such as the instant case, the keeping of a stock register is of great importance because that is a means of verifying the assessee's accounts by having a 'quantitative tally'. If, after taking into account all the materials including the want of a stock register, it is found that from the method of accounting correct profits of the business are not deducible, the operation of proviso to s. 13 of the Income-tax Act would be attracted, ***Bombay Cycle Stores Company Ltd. v. Commissioner of Income-tax*** (1958 (33) ITR 13). It may also be added, as was held by this Court in Commissioner of Income-tax v. MacMillan & Co. (1958 (33) ITR 182, 197), that the Income-tax Officer, even if he accepts the assessee's method of accounting, is not bound by the figure of profits shown in the accounts. It is for the Income-tax Authorities to consider the material which is placed before them and, if, after taking into account in any case the absence of a stock register coupled with other materials they are of the opinion that correct profits and gains cannot be deduced, then they would be justified in applying the proviso to s.13."

34. The Supreme Court had another occasion to examine the said question in the case of ***Chhabildas Tribhuvandas Shah v. CIT*** *(1966) 59 ITR 733 (SC)* and it was held:-

> ".... What we have to see is whether the finding of the Appellate Tribunal that the income, profits and gains cannot properly be deduced from the method of accounting employed by the appellant is based on any

> material. The Appellate Tribunal has given two reasons for its conclusions. The first reason is that the appellant was doing business in the main on wholesaler basis and there should have been no difficulty in tallying quantities in respect of major items of trading account. This certainly is a relevant consideration. In the absence of such a tally, the next reason given is that the fall in the margin is all the more difficult to explain in view of the fact that the appellant also had a quota of imports worth about Rs. 8, 00, 000 which would have given them a handsome margin of profit. This again is a relevant fact and it is well-known that imported goods fetch a very handsome margin of profit. Accordingly, we hold that there is material in support of the impugned finding of the Appellate Tribunal. We may point out that we are not concerned with the correctness of the conclusion and we are only concerned with the question whether there is any material in support of the finding of the Appellate Tribunal. In cases involving the applicability of the proviso to section 13, the question to be determined by the Income-tax Officer is a question of fact, namely, whether the income, profits and gains can or cannot be properly deduced from the method of accounting regularly adopted by the assessee."

35. Recently in ***Sanjeev Woolen Mills Vs. Commissioner of Income-Tax*** *[2005] 279 ITR 434 (SC)*, it was observed by the Supreme Court that the true trading result of business for an accounting period cannot be ascertained without taking into account the stock-in-trade at the end of the accounting period. It was held that valuation of closing stock cannot be dispensed

with. The true purpose of crediting the value of unsold stock is balance the cost of those goods entered on the other side of the accounts at the time of purchase, so that cancelling of the entries relating to the same stock from both sides of the accounts would leave only the transactions on which there have been actual sales in the course of the year showing the profit or loss actually realized. In the said case, the assessee was valuing the opening stock and closing stock by applying different parameters and the profit disclosed was only notional.

36. Recently this Court in ***Commissioner of Income Tax Vs. Jas Jack Elegance Exports*** *[2010] 324 ITR 95 (Delhi)* had occasion to deal with the said contention and it was observed as under:-

> "This is not the case of the Revenue that the assessee had not followed either cash or mercantile system of accounting stipulated in sub-section (1) of section 145 of the Act. This is also not the case of the Revenue that the Central Government had notified any particular accounting standards to be followed by manufacturers and exporters of readymade garments. Hence, the second part of sub-section (3) of section 145 does not apply to this case. As noted by the Commissioner of Income-tax (Appeals) as well as by the Income-tax Appellate Tribunal, the Assessing Officer had not pointed out any defect in the account books maintained by the assessee, which, admittedly, were produced before the Assessing Officer for his

> consideration. This is also not the finding of the Assessing Officer that the account of the assessee was not complete. No provision either in the Act or in the rules requiring an assessee carrying business of this nature, to maintain a stock register, as a part of its accounts has been brought to our notice. As regards non-production of stock register, the assessee has given an explanation which has been accepted not only by the Commissioner of Income-tax (Appeals) but also by the Tribunal and both of them have given a concurrent finding of fact that maintaining stock register was not feasible considering the nature of the business being run by the assessee which was engaged in the business of manufacturing readymade garments by purchasing fabric which was then subjected to embroidery, dyeing and finishing and then converted into readymade garments by stitching. Section 145(3) of the Act therefore could not have been applied by the Assessing Officer to the present case."

37. A similar view has been taken by the Gauhati High Court in ***Swapna Rani Sarkar Vs. Commissioner of Income Tax and Others*** *(2010) 320 ITR 70 (Gauhati)* and it was observed that no law has been laid down that if stock register is not maintained, the only consequence would be rejection of the books of accounts. Rajasthan High Court in the case of ***Commissioner of Income Tax Vs. Inani Marbles P. Ltd.*** *(2009) 316 ITR 125* had reiterated the aforesaid principle.

38. Thus, the contention of the Revenue that stock register was not maintained and the relevant column of the auditor's report record indicate absence of the stock register, justify rejection of the books of accounts, cannot be accepted.

39. It is now important and relevant to notice and examine the other contentions raised by the Revenue for rejecting the books of accounts and the cumulative effect in the absence of the stock register. The other grounds and reasons given by the assessing Officer were specifically dealt with and examined by the tribunal in their order for the assessment year 2002-03 and no merit in the same was found. The contention with regard to the sale to sister concerns has already been examined above in ITR 244/2009 and the contention of the Revenue has been rejected. Similarly, the objection raised with regard to the payments made to the contractors such as R.A. Exports, Sensational Exports and Prakash Fabrication Unit has not been accepted. The aforesaid aspects do not constitute a ground for rejection of books of account or indicate inability of the Assessing Officer to compute true and correct profits. The same were in nature of specific disallowances. We may further notice that the payments made to the contractors, transfer of raw material to sister concern have been made subject matter of a

separate additions by the Assessing Officer himself in tl assessment order for the year in question. He was able to examine the said entries and made specific additions. On a perusal of the order passed by the Assessing Officer, it is evident that the rejection of books is based upon reasons/grounds stated in the assessment order for the assessment year 2002-2003. In the said assessment year, there was a special audit. The special auditor did not report and state that it was not possible to decipher and compute income/profits from the books of account. The special auditor had examined the books of account, vouchers, invoices etc., but did not suggest that books of accounts should be rejected. The Assessing Officer for the assessment year 2002-03 did not reject the books of accounts. In the said year, the Assessing Officer did make additions/disallowances, but not after rejecting the books of accounts. In the said assessment year, similar disallowance and additions were made for identical grounds/reasons given by the Assessing Officer as in the assessment year 2001-02. Therefore, we do not agree with the counsel for the Revenue that rejection of books of accounts was justified and findings recorded by the tribunal are perverse.

Accordingly, we do not think that on this aspect any substantial question of law arises for consideration.

40. The next contention raised by the Revenue pertains to the payments made to the contractors such as R.A. Exports, Sensational Exports and Prakash Fabrication Unit. The Assessing Officer has recorded that the assessee was asked to prove genuineness of the transactions for which payment was made to the contractors and whether the work was actually executed in the business premises of the assessee and infact the expenses were incurred.

41. For the reasons given in ITA 244/2009, we do not think that any substantial question of law arises for consideration on this aspect. We may only note that there is no finding of the Assessing Officer that no work was done or extra or additional payment above/more than the market rate were made to R.A. Exports, Sensational Exports and Prakash Fabrication Unit. The Assessing Officer did not invoke Section 40A(2) (b) of the Act.

42. We do not think that the order passed by the tribunal is perverse and, therefore, requires interference.

ITA 547/2011 & 615/2011

43. These appeals relate to the assessment years 2005-06 and 2001-02, respectively. The Revenue is aggrieved in these

two appeals as the tribunal has upset the finding of tl Assessing Officer that the books of accounts should be rejected and the profit should be calculated by applying G.P. rate of 32%. The second contention raised by the Revenue is again with regard to the payment made to the contractors, namely, R.A. Exports, Sensational Exports and Prakash Fabrication Unit.

44. The observations and findings given in ITA 548/2011 on the aforesaid contentions are equally applicable to the facts of the present case.

45. In ITA No.547/2011, which relates to the assessment year 2005-06, another issue relating to addition of Rs.71,949/- has been raised. The Assessing Officer noticed that the opening and closing balance of some of the creditors were same and no business transactions had taken place during the year in question. He accordingly added back the said amount to the income as unverified creditors. The CIT (Appeals) deleted the said addition holding that there is no basis for the Assessing Officer to make the said addition. Merely because the assessee had no transactions with some creditors and their opening and closing balances remained the same, cannot be a ground to add the said amount. The tribunal has affirmed the

said finding. We do not see any reason to interfere with the sa finding.

In view of the aforesaid discussion, the appeals are dismissed holding that no substantial question of law arises for consideration.

SANJIV KHANNA, J.

R.V. EASWAR, J.

MARCH 06, 2012
VKR/NA