

आयकर अपीलिय अधिकरण, अहमदाबाद।

**IN THE INCOME TAX APPELLATE TRIBUNAL
'D' BENCH, AHMEDABAD
(THROUGH VIRTUAL COURT)
BEFORESHRI MAHAVIR PRASAD, JUDICIAL MEMBER
And SHRI WASEEM AHMED, ACCOUNTANT MEMBER**

Sl. No(s)	ITA No(s)	Asset. Year(s)	Appeal(s) by	
			Appellant	Respondent
1.	1894/Ahd/2013	2008-09	Income-tax Officer, Ward-5(3), Ahmedabad	Rajkalp Mudraalaya Pvt. Ltd. 9, Punaji Estate, Dhobighate, Dhudheshwar, Ahmedabad-380004 PAN No. AABCR0460M

Revenue by :	Shri Dileep Kumar, Sr. DR.
Assessee by :	Shri Pritesh Shah, AR

सुनवाई की तारीख/Date of Hearing : 08.09.2020

घोषणा की तारीख /Date of Pronouncement : 22.10.2020

आदेश/ORDER

PER WASEEM AHMED, ACCOUNTANT MEMBER:

The appeal has been filed by the Revenue for A.Y. 2008-09 which is arising from the order of the CIT(A)-XI, Ahmedabad dated 23.04.2013, in the proceedings under section 143(3) of the Income Tax Act, 1961 (in short “the Act”).

2. The Revenue has raised the following grounds of appeal:

“i) The ld. CIT(A) has erred in law and on facts in deleting the addition of Rs. 1,40,79,756/- on account of low gross profits made by the A.O.

ii) The ld. CIT(A) has erred in law and on facts in restricting the interest expenses to the extent of Rs. 4,93,853/- to be capitalized as per the provision of proviso to sec. 36(1)(iii) as against the capitalized expenses of Rs. 16,41,611/- made in the Assessment Order and in

ignoring the working of interest of Rs. 8,04,747/- made on proportionate basis by the A.O. in the remand report.

iii) On the facts and circumstances of the case, the Ld. Commissioner of Income Tax (A) ought to have upheld the order of the Assessing Officer.

iv) It is, therefore, prayed that the order of the Ld. Commissioner of Income tax (A) may be set-aside and that of the Assessing Officer be restored.”

3. The first issue raised by the Revenue is that the Learned CIT-A erred in deleting the addition made by the AO for Rs.1,40,79,756/- on account of low gross profits after rejecting the books of accounts under Section 145(3) of the Act.

4. The facts in brief are that the assessee in the present case is a private limited company and engaged in the business of printing which is carried out along with paper as well as along with other component without the use of paper. The AO during the assessment proceedings compared the gross profit for the year under consideration shown by the assessee with the gross profit of the immediate preceding and succeeding Assessment Year's i.e. Assessment Years 2007-08 and 2009-10 and found that the gross profit of the current year has declined significantly.

5. The AO also found that the percentage of paper purchased to the sales for the year under consideration is significantly high in comparison to the immediate preceding as well as succeeding Assessment Year's i.e. Assessment Years 2007-08 and 2009-10. The relevant observation of the AO is tabulated as under:

<i>Particulars</i>	<i>Assessment Year</i>		
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>
	<i>Financial Year</i>		
	<i>2006/07</i>	<i>2007/08</i>	<i>2008/09</i>
	<i>Last Year</i>	<i>Current Year</i>	<i>Next Year</i>
<i>Sales [A]</i>	<i>16798335</i>	<i>24547218</i>	<i>57765174</i>
<i>Raw Materials Consumed [B]</i>	<i>5050536</i>	<i>14074560</i>	<i>19641800</i>
<i>Direct Expenses [C]</i>	<i>3775789</i>	<i>3660219</i>	<i>5039431</i>
<i>Gross Profit (Sales Less Cost of Goods Sold) [A-D]</i>	<i>7972010</i>	<i>6812439</i>	<i>33083943</i>
<i>Gross Profit Percentage</i>	<i>47.46%</i>	<i>27.75%</i>	<i>57.27%</i>
<i>Paper Purchase</i>	<i>2752598</i>	<i>6785785</i>	<i>9386109</i>
<i>% of Paper Purchase to Sales</i>	<i>16.386%</i>	<i>27.644%</i>	<i>16.249%</i>
	<i>16.38%</i>	<i>27.64%</i>	<i>16.24%</i>

The AO also noted that the assessee is not maintaining quantitative details of the items purchases and sales made by it.

6. On question by the AO, the assessee vide letter dated 3rd November 2010 submitted that it is dealing in variety of items which are plenty in numbers, therefore, it was not practicable to maintain the stock/quantity details of the items in which it was dealing.

7. The assessee further vide letter dated 25th November 2010 submitted that it has changed its entire business model and technology in the year under consideration by acquiring latest plant and machinery having very advanced technology. Accordingly, the training was provided to the staff on such machines which has resulted wastage of raw materials and ultimately it contributed in the reduction of gross profit.

8. The assessee also contended that it has provided a lot of free sampling to its customers to make them aware of the new printing technology which has resulted in reduction in the gross profit in the year under consideration. However, the assessee in the subsequent year was able to achieve higher gross profit by reducing the wastage of materials and charging the competitive price from the customers.

9. The assessee besides the above also submitted that due to change in the technology in the activity, there were expenses increased significantly such as blanket purchase, chemical purchase, coating film, Ink purchase and paper purchase, but there was no corresponding inflated sales price charged from the customer in the year under consideration which has also contributed in the reduction in the gross profit in the year under consideration.

10. However, the AO disagreed with the contention of the assessee by observing that even the contention of the assessee is assumed correct that there was change in the business model in the year under consideration viz a viz in the immediate preceding Assessment Year, then also, gross profit of the assessee for the year under consideration is significantly low in comparison to the immediate succeeding Assessment Year. Accordingly, contention of the assessee was disregarded by the AO in view of the fact that the assessee is not maintaining quantitative/stock registers of the items in which it was dealing. Hence, the AO rejected the books of accounts of the assessee by invoking the provisions of section 145(3) of the Act.

11. Nevertheless, the AO considering the contention of the assessee for the change of its business model, has considered the GP rate at 50% of the turnover for the year under consideration, despite GP rate of the subsequent

Assessment Year at 57.27% of the turnover, and worked out the suppressed gross profit amounting to Rs.1,40,79,756/- and added to the total income of the assessee.

12. Aggrieved assessee preferred an appeal to the Learned CIT-A.

13. The assessee before the Learned CIT (A) submitted that it has vide letter dated 6th December 2010 filed before the AO during the assessment proceedings claimed that it was maintaining the stock registers/quantitative details but the AO for the reasons best known to him has not considered its submission. But he (the AO) has concluded based on the letter dated 3rd November 2010 that assessee is not maintaining any stock/ quantitative details. Accordingly, the assessee contended that its books of accounts cannot be rejected merely on the reasoning that the assessee was not maintaining the stock registers which is wrong finding of the AO.

14. The assessee also submitted that it has justified based on documentary evidence for the reasons of increase in the cost of certain materials which has contributed in the reduction of gross profit ratio in the year under consideration. As such the AO has not pointed out any defect in the justification submitted by the assessee during the assessment proceedings. The fact that the assessee has filed the quantity details can be established from the finding of the AO wherein the AO has compared consumption of raw materials for the year under consideration with the subsequent Assessment Years.

15. The assessee also contended that the gross profit of the subsequent Assessment Year cannot be compared to the gross profit for the year under

consideration for holding that there was the reduction in the gross profit ratio. It is because such practice is not followed and therefore the same is not desirable.

16. The assessee also brought to the notice that AO himself has admitted the change in the business model of the assessee in the year under consideration and being the 1st year which is most crucial as it always brings difficulty in operating. As a result, the assessee could not achieve higher gross profit in the year under consideration but it was able to achieve higher gross profit in the subsequent year i.e. Assessment Year 2009-10.

17. The assessee during the assessment proceedings has furnished all the necessary details which were not doubted by the AO during the assessment proceedings and no single discrepancy was pointed out with respect to the same. Accordingly, the assessee contended that its books of accounts cannot be rejected and therefore no addition is warranted.

18. The Learned CIT (A) after considering the submission of the assessee observed that higher consumption of raw material can be a ground for making further and deeper investigations but the same cannot be a ground for rejecting the books of accounts. The AO has not discharged his duty by pointing out any specific defect in the financial statements of the assessee which are duly audited by the qualified auditors.

18.1 Learned CIT (A) also found that the assessee has furnished the quantitative details vide letter dated 6th December 2010 before the AO during the assessment proceedings but the AO failed to take any cognizance of the same in the assessment order.

19. In view of the above the Learned CIT (A) held that the books of accounts of the assessee cannot be rejected without bringing any cogent defects in the books of accounts under the provisions of Section 145(3) of the Act. Accordingly, the Learned CIT (A) allowed the ground of appeal of the assessee.

20. Being aggrieved by the order of Learned CIT (A), the Revenue is in appeal before us.

21. The Learned DR before us vehemently supported the order of the AO whereas the Learned AR before us filed a Paper Book running from pages 1 to 151 and reiterated the contentions as made before the authorities below. The Learned AR vehemently supported the order of the Learned CIT (A).

22. We have heard the rival contentions of both the parties and perused the materials available on record. As per Section 145(3) of the Act, the AO is empowered to reject the books of accounts of the assessee and make best judgment assessment in the manner as specified under Section 144 of the Act, if he is not inter-alia satisfied with the completeness or correctness of the books of accounts of the assessee. Generally, the instances for the rejection of books of account include when entries in respect of certain transactions are altogether omitted or incorrect or where the accounts show an abnormally low rate of profit or where there is an inherent lacuna in the system of accounting. However, the AO cannot use this power as a tool to reject the books of accounts merely due to non-maintenance of the stock register, variation in gross profit and non-furnishing of certain vouchers or its explanation or non-confirmation of sundry creditors. Anyway, before rejecting the books of accounts, the AO must record the specific reason for rejecting the books of

accounts. Such satisfaction has to be established and substantiated based on facts and figures, which further depends on the circumstances of each case. Mere minor mistakes/typological errors/absence of stock registers/lower GP may not ipso facto amount to incorrectness/incompleteness of accounts in terms of Section 145(3) of the Act. But the case would be different where the above-mentioned mistakes are coupled with other findings.

23. In the given case, AO has rejected the book results of the assessee based on the facts and figured culled out by him that lower gross profit for the year consideration is significantly less in comparison to the immediate preceding and succeeding assessment year and Non-maintenance of quantity-wise stock register. However, in our considered view the decline in the GP rate in comparison to the immediately preceding and succeeding assessment year cannot be criteria to reject the books. It is because the assessee explained the reasons for declining the GP which were not controverted by the AO. Furthermore, the lower gross profit as compared to earlier and succeeding year cannot be the ground to reject the books of accounts. In holding so we draw the support from the order of the Hon'ble Rajasthan High court in case of *Malani Ramjivan Jagannath vs. Asstt. Commissioner of Income Tax* reported in 316 ITR 120 where it was held by Hon'ble Rajasthan High Court as detailed under:

“The Tribunal committed basic error in not appreciating the reasoning given by the Commissioner (Appeals). It was trite to say that in the facts and circumstances of the instant case, account books were maintained as they were ordinarily maintained year after years and which were found to yield a fair result. Mere deviation in gross profit rate cannot be a ground for rejecting books of account and entering realm of estimate and guesswork. Lower gross profit rate shown in the books of account during current year and fall in gross profit rate was justified and also admitted by the Assessing Officer as well as Commissioner (Appeals) as well as the Tribunal. Therefore, fall in gross profit rate lost its significance. Having accepted the reason for fall in gross profit rate, namely, stiff competition in market and also that huge loss caused in particular transaction, neither the rejection of books of

account was justified nor resort to substitution of estimated gross profit by rule of thumb merely for making certain additions was justified. Therefore, the findings arrived at by the Tribunal suffered from basic defect of not applying its mind to the existing material which were relevant and went to the root of the matter. When all the data and entries made in the trading account were not found to be incorrect in any manner, there could not have been any other result except, what had been shown by the assessee in the books of account. Therefore, the order of the Tribunal, was unsustainable. [Para 11]”

We also note that the AO has not pointed out any specific defect in the details submitted by the assessee and in the audited financial statements furnished by the assessee. Therefore, in our considered view, the books of accounts of the assessee cannot be rejected until and unless the AO points out the specific mistakes. A similar principle has been laid down by the Hon’ble Allahabad High Court in case of Awadhesh Pratap Singh Adbul Rehman & Bros v/s. CIT 201 ITR 404(All) which reads as;

“It is difficult to catalogue the various types of defects in the account books of an assessee which may render rejection of account books on the ground that the accounts are not complete or correct from which the correct profit cannot be deduced. Whether presence or absence of stock register is material or not, would depend upon the type of the business. It is true that absence of stock register or cash memos in a given situation may not per se lead to an inference that accounts are false or incomplete. However, where a stock register, cash memos, etc., coupled with other factors like vouchers in support of the expenses and purchases made are not forthcoming and the profits are low, it may give rise to a legitimate inference that all is not well with the books and the same cannot be relied upon to assess the income, profits or gains of an assessee. In such a situation the authorities would be justified to reject the account books under Section 145(3) and to make the assessment in the manner contemplated in these provisions.”

We also note that the books of accounts cannot be rejected if the assessee does not maintain the stock registers until and unless it is coupled with other defects such as it is found that sales/ purchase made outside the books of accounts. But in the instant case, we note that there was no such allegation by the authorities below. We also find support and guidance from the order of ITAT Bench in the case of Haridas Parikh vs. ITO reported in 113 TTJ 274 wherein it was held as under:

“Unless the Assessing Officer is able to point out certain transactions which have been left to be entered in the books of account or that the assessee has sold some of the items at a price higher than what is disclosed in the books of account or if proper particulars, bills, vouchers are not forthcoming, etc., the books of account cannot be rejected without assigning specific reasons. In the instant case merely because different range and nature of items were being dealt with by the assessee and the maintenance of quantitative stock of each and every item was not practically possible, the books of account maintained by the assessee which were free from any defect could not be rejected merely because the average GP rate was slightly lower than the average GP rate of the earlier year. In the instant case, the sales of the assessee during the year under consideration had increased substantially from Rs. 1.24 crores to Rs. 1.54 crores which resulted in marginal decline in GP rate from 11.51 per cent to 9.94 per cent, the same could not be made reason for rejecting the book results. It is well-settled business proposition that for having increase in sales, a businessman has to sacrifice a small margin of profit rate. During the year the total sales of the assessee had increased from Rs. 1.24 crores to Rs. 1.54 crores. No defect was found in the books of account. There was no valid reason for rejection of books of account during the year under consideration and thereby applying higher GP rate of 11.51 per cent, which was earned by the assessee on low sales of Rs. 1.24 crores in the preceding year. The other reason stated by the Assessing Officer of making trading addition was that in the Assessment Year 2001-02, GP rate declared by the assessee at 9.64 per cent was not accepted and trading addition so made by rejecting the books of account was confirmed by the Commissioner (Appeals), therefore, by following the order of the earlier year the Assessing Officer had made an addition by rejecting the GP rate of 9.64 per cent declared during the year under consideration. The assessee placed on record the order of the Tribunal in the assessee's own case in the Assessment Year 2001-02 wherein addition made by the Assessing Officer by applying GP rate of 10.14 per cent was deleted by the Tribunal and the GP rate of 9.64 per cent declared by the assessee was found to be reasonable and correct. As the facts and circumstances during the year under consideration were the same, the issue was squarely covered by the order of the Tribunal in the preceding year. Respectfully following the same, the findings and conclusion of the lower authorities were to be rejected and the Assessing Officer was to be directed to delete the impugned trading addition made by him.”

In view of the above, we opined that the AO cannot reject the books of accounts for the reasons as discussed above in a situation where the assessee does not maintain the stock register. Accordingly, we note that the reasons which were based by the AO for rejecting the books of accounts are not sufficient enough and cogent. Thus in the backdrop of the facts as stated above and after considering the facts in totality, we are of the view that the books of accounts of the assessee are not liable to be rejected as per the provisions of Section 145(3) of the Act. Accordingly, we conclude that once the books of accounts of the assessee are not liable to be rejected then its book profit should

be accepted in the given facts and circumstances. Accordingly, in the backdrop of the aforesaid discussion and precedent, we find no infirmity in the order of the Learned CIT (A) and direct the AO to delete the addition made by him.

Hence the ground of appeal of the Revenue is dismissed.

24. The second issue raised by the Revenue is that the Learned CIT (A) erred in reducing the disallowance of interest expenses made by the AO from Rs.8,04,747/- to Rs.4,93,853/- to be capitalized under Section 36(1)(iii) of the Act.

25. The AO during the assessment proceedings found that the assessee has acquired a machinery loan which was put to use only after 2nd July 2007. Accordingly, the AO was of the view that the interest paid by the assessee up to the date i.e. 2nd July 2007 when the machinery was put to use should be capitalized under Section 36(1)(iii) of the Act. On question, by the AO the assessee failed to make any reply. Accordingly, the AO worked out the proportionate amount of interest expenses up to the date 2nd July 2007 when the machine was put to use amounting to Rs.16,41,611/- and added the same to the total income of the assessee.

26. Aggrieved assessee preferred an appeal to the Learned CIT (A).

27. The assessee before the Learned CIT (A) submitted that the amount of interest attributable in the purchase of such machinery stands at Rs.42,08,928/- only which should be considered for the purpose of the disallowance. Further, out of such amount there was an opening written down value of the machinery amounting to Rs.2,46,51,138/-, therefore, the amount of interest pertaining to such opening written down value should be ignored.

28. The assessee further submitted that the machine was installed on 2nd June 2007 therefore if the interest needs to be disallowed then it should be limited to the extent of Rs.3,02,129/- for the period of two months only instead of three months and that too after considering the fact of its own fund utilization.

29. The submission of the assessee was forwarded to the AO for the remand report who admitted the contention of the assessee in part by observing as under:

“4. Thus the total interest paid on machinery loan is Rs.42,08,928/-only. Further it can be seen that opening WDV of machinery was Rs.2,46,51,138/- and additions of machinery and plant during the year was of Rs.10,42,23,301/- . Thus the opening value of plant and machineries constituted 19.12% of entire plant and machinery and the addition during the year of plant and machineries constituted 80.88% of entire plant and machinery. Thus the interest payment during the year was for the machineries already in use and for the machineries which were put to use from July 2007 onwards. On working of proportionate interest expenditure for already existing machineries, it comes to Rs.8,04,747/- (19.12% of Rs.42,08,928/-). The balance amount of Rs.34,04,181/- of interest expenditure can be termed as having been paid for the machineries purchased during the year and were put to use in July 2007. As the machineries purchased during the year were put to use on 02.07.2007, interest paid for the period April, 2007 to June, 2007 needed to be capitalized. Therefore, in my opinion 1A of Rs.34,04,181/- being Rs.8,51,045/- should have been capitalized instead of Rs.16,41,611/-.”

30. The Learned CIT (A) after considering the submission of the assessee and the remand report of the AO has confirmed the order of the AO in part by observing as under:

“....In the instant case the A.O. has not brought cogent evidences on record to prove the quantum of borrowed capital as well as the interest liability has also not been quantified. The A.O. had simply proposed to capitalize one fourth of interest expenses incurred against “Machinery loan account”. The fact of inclusion of old Plant & Machinery in the “Machinery loan account” has not been examined by the A.O. The A.O. has also not examined the fact of purchasing Plant & Machinery from non interest bearing funds. Since the proportionate capitalization of interest is not prescribed by the provisions of proviso to sec.36(1)(iii), accordingly, I am not inclined to agree with the contentions of Ld. A.O.

3.6 Perusal of facts available on record indicate that the appellant has agreed for capitalization of interest on borrowed capital to purchase Plant & Machinery of Rs.

4,93,853/-. The appellant has made this computation strictly as per the provisions of proviso to sec.36(1)(iii). This computation has been filed before the A.O. and the A.O. has not brought any evidence to controvert this computation in view of above, I am of the considered opinion that interest expenses to the extent of Rs. 4,93,853/- should be capitalized as per the provisions of proviso to sec.36(1)(iii). The A.O. is further directed to allow depreciation on capitalization of interest as per the provisions of Income-tax Act.

3.7 It is also seen that in the assessment order the A.O. had disallowed interest under section 36(1)(iii) of the I. T. Act, 1961. The interest expenses are allowable u/s.36(1)(iii) of the I. T. Act, if the following conditions are fulfilled:-

- (a) The capital must have been borrowed by the assessee.
- (b) It should have been borrowed for the purposes of
- (c) The assessee should Have paid the amount of interest claimed as an allowance under clause (iii) of section 36(1).

Perusal of the record reveals that the A.O. has not brought any evidence on record to prove that the above mentioned conditions were not fulfilled. Since in the case of appellant all the above mentioned conditions are fulfilled and accordingly, I am of the firm view that the interest expenses claimed are allowable expenses as per the provisions of section 36(1)(iii) of the I.T. Act, 1961 and there is no justification for disallowance of interest expenses.

3.8 As a result this ground of appeal is partly allowed.”

31. Being aggrieved by the order of the Learned CIT (A), the Revenue is in appeal before us.

32. Both the Learned DR and the AR before us vehemently supported the order of the authorities below to the extent favorable to them.

33. We have heard the rival contentions of both the parties and perused the materials available on record. In the present case the AO in the remand report has proposed to restrict the disallowance of interest expenses to the extent of Rs.8,51,045/- against the disallowances of Rs.16,41,611/- made in assessment order. However, the Learned CIT (A) was pleased to restrict the disallowance of interest expenses to the extent of Rs.4,93,853/- only which has not been challenged by the assessee in the appeal before us . Thus, the issue in the case

on hand is limited to the extent of Rs.3,57,192/- whether it should be capitalized under the provisions of Section 36(1)(iii) of the Act.

34. In the case on hand, the first issue arises for our consideration whether the date 2nd June 2007 or 2nd July 2007 should be taken as the date put to use. On perusal of the installation report placed on page 115 of the Paper Book, we note that the machine was installed on 2nd June 2007 which implies that it was ready to use on that date. Therefore, the disallowance of the interest expenses should be limited to the extent pertaining to two months only.

Besides the above, we also note that the assessee has also utilized its own funds in the purchase of machineries in addition to the borrowed fund from the bank. Accordingly, the Learned CIT (A) excluded the amount of own fund utilized by the assessee while working out the amount of interest expenses to be capitalized. These facts, have not been disputed by the Learned DR at the time of hearing. Accordingly, we do not find any infirmity in the order of the Learned CIT (A). Hence, the ground of appeal of the Revenue is dismissed.

35. In the result, the appeal filed by the Revenue is dismissed.

Order pronounced in the Court on 22nd October, 2020 at Ahmedabad.

**Sd/-
(MAHAVIR PRASAD)
JUDICIAL MEMBER**

Ahmedabad; Dated 22/10/2020
TANMAY, Sr. PS

**Sd/-
(WASEEM AHMED)
ACCOUNTANT MEMBER**

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त(अपील) / The CIT(A)-
5. विभागीय प्रतिलिपि, आयकर अपीलीय अधिकरण, अहमदाबाद / DR, ITAT, Ahmedabad.
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt.Registrar)
आयकर अपीलीय अधिकरण, अहमदाबाद / ITAT, Ahmedabad