REPORTED

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

\+ **ITA No. 216/2006**

COMMISSIONER OF INCOME TAX,
DELHI-XI .....Appellant
Through: Mr. M.P. Sharma, Advocate

versus

M/S. AERO CLUB .....Respondent
Through: Mr. Ashish Mohan, Advocate

% Date of Decision : December 24, 2010

CORAM:
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MS. JUSTICE REVA KHETRAPAL

1. Whether reporters of local papers may be allowed to see the judgment?

2. To be referred to the Reporter or not?

3. Whether judgment should be reported in Digest?

: REVA KHETRAPAL, J.

1. This is an appeal filed by the Department relating to the assessment year 1994-95 and 1998-99 in which the following substantial questions of law arise :

> "(a) Whether, on the facts and in the circumstances of the case, the Tribunal was correct, both on facts and in law, in deleting the addition made by the AO, in the absence of books of account, by estimating the income of the assessee on the basis of the financial results of the succeeding year?

(b) Whether the Ld. ITAT was correct in law in holding that since the additions made in the case of sister concern of the assessee have been deleted therefore the statement of account as filed by the assessee should be accepted and no adverse inference can be drawn?

(c) Whether the order of the Ld. ITAT is vitiated as the Ld. ITAT and the CIT(A) have failed to appreciate and consider that when there were no account books and other details available with the assessee, how and on what basis the accounts of the assessee, without verification would be accepted as correct?"

2. Briefly delineated, the facts of the case relevant to the assessment year 1994-95 are as follows.

3. The assessee-respondent firm was engaged in the business of manufacturing and trading of footwear under the brand name of "WOODLAND" and "WOODS" during the relevant financial year. The said firm was constituted during the financial year 1992-93 as a partnership firm. On 21.07.1999, a survey operation under Section 133A of the Act was conducted at the business premises of the assessee firm and its accountants M/s A.K. Dua and Associates. During the course of the said survey, it came to the notice of the Department that the assessee had not filed its return of income after the assessment year 1993-94. Necessary legal proceedings were initiated against the assessee for non-filing of the returns of the assessment years 1994-95, 1995-96, 1996-97, 1997-98, 1998-99 and 1999-2000. A notice under Section 148 of the Act after recording reasons was issued and served upon the

assessee on 25.11.2000 requiring it to file its return of income within the time allowed. The said notice was not complied with and no return was filed by the assessee. Again, a notice under Section 142 of the Act along with questionnaire dated 12.07.2001 was issued to the assessee. Thereafter, again on 29.11.2001 and 12.12.2001, notices under Section 143(2) were issued to the assessee. Yet again, notice under Section 142 dated 14.01.2002 was issued and served upon the assessee. The assessee finally filed its return of income for the assessment year 1994-95 on 17.01.2005 declaring taxable income of ₹ 6,60,883/-. In the said return, trading results were declared as audited on 01.10.1996, however no audit report under Section 44AB was annexed with the said return. The Assessing Officer took the view that such a return of income was defective and since the return was neither filed within the time allowed under Section 139(1) nor under Section 148 of the Act, no sanctity could be attached to such a return of income.

4. The assessee's case before the A.O. was that it was prevented due to reasons beyond its control in not filing the returns within the stipulated time. It was stated that the accountancy, legal and income tax work of the group companies of the assessee was being handled by the accountants M/s A.K. Dua. All the records of the assessee and its group companies were in the custody of the said accountants, who, for their own pecuniary benefit, misled the assessee in making VDIS declarations for the years 1995-96, 1996-97 and 1997-98, even though the appellant

had incurred losses in all these years. Later, a dispute arose between the assessee and its accountants, which assumed such proportions that a criminal complaint had to be filed by the assessee against the accountants, in consequence whereof the police authorities conducted a search at the residence and business premises of the accountants and seized the entire records of the assessee and its group companies. The assessee could not receive the copies of the seized material and neither could it inspect the records.

5. The Assessing Officer has noted in his order that no documents/books of account relating to the assessee and its group concerns were found from the possession of the said accountants. The Assessing Officer further noted that the first FIR was filed against the said accountants by the assessee on 21.02.2000, i.e., almost five months after the date of the survey on 21.07.1999. There was also no evidence to suggest that the assessee had made sufficient efforts till the date of the survey to obtain its records/books of account from these accountants. The Assessing Officer took the stand that the assessee could not plead ignorance of law as a defence, and further that this state of affairs has arisen not due to any reasonable cause beyond the control of the assessee but due to gross negligence on its part. The Assessing Officer accordingly proceeded to estimate the profits for the assessment year in question on a fair and reasonable basis in the absence of books of

account, audit report and other details in respect of the audited accounts in the following manner:

> *"The assessee made declaration under the VDIS 1997 in respect of the A.Ys. 1995-96, 1996-97 and 1997-98 of the above said amounts as income from the firm invested in the same business. Taxes were duly paid for the above said VDIS made for which necessary certificate was also issued by the jurisdictional CIT u/s 68(2) of the Act. Since the assessee has already made declaration under the VDIS declaring more taxable income than now, refund as claimed for the above said assessment years on account of income estimated at a lower figure now without any supporting evidence or record cannot be entertained. Being fair and reasonable, the declaration made earlier by the assessee under the VDIS has not been disturbed in the assessment orders passed u/s 144 of the Act for the said years. Further, as worked out in the above said chart, the profit percentage declared under VDIS against sales comes out to 2.5%, 3.38% and 2.4% for the A.Ys. 1995-96, 1996-97 and 1997-98 respectively. Taking average of the said three years, the average profit percentage works out to 2.75% (2.5 + 3.38 + 2.4/3).*
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> *……By applying the same for the ATY 1994-95 also, the taxable income for the above said assessment year works out at ₹ 17,28,389/- (Sales * 2.75%) (₹ 62850494 * 2.75%). Thus, the income of the assessee is adopted at ₹ 17,28,389/- as against the declared income of ₹ 6,60,883/- on the basis of material on record and circumstances of the case discussed above to the best of my judgment as per the provisions of section 144 of the Act."*

6. Before the CIT(A), the delay in filing the FIR against the accountants was sought to be explained by the reasoning that had the assessee shown any haste in filing the FIR the accountants would have removed the records from their premises and that would have caused

irreparable loss to the assessee. It was submitted that during the intermittent period the assessee was trying by all possible means to retrieve as much record as possible from the custody of the accountants in a discrete manner. The voluminous seizure made by the police as a result of the search at the accountants' premises, it was submitted, confirmed the assessee's contention that the books of account and other documents relating to the assessee and its group companies were in the possession of the accountants. Contesting the estimation of profits by the Assessing Officer, it was argued on behalf of the assessee that this method of estimation on the basis of ad-hoc declaration made in the VDIS was neither rationale nor reasonable. The assessee was not given a show cause notice in this respect. It was stated that the assessee's group was merely in the business of exports to USSR, and after its disintegration, the assessee had started the business of local manufacture and sales. This being the initial year of business, the turnover was low. It was not even at the break even point and the assessee was incurring losses. It was pointed out by citing the comparable case of M/s. Bata India Limited that in the year 1994 the declared profit before tax was 0.19%, and if this rate was applied to the turnover of the assessee as accepted by the Assessing Officer, the net profit in the case of the assessee would come to ₹ 1,19,415/-, whereas the assessee had declared a profit of ₹ 6,60,883/- in its audited profit and loss account. In view of the aforesaid submissions made before the CIT(A), this data along

with the written submissions of the assessee were sent to the Assessing Officer for his comments by the CIT(A). The Assessing Officer in his remand report did not make any comments on the comparable date of M/s. Bata India Limited, however stuck to the stand taken by him in the assessment order.

7. The assessee also drew the attention of the CIT(A) to the case of M/s. Aero Traders Pvt. Ltd. – a sister concern of the assessee – for the assessment years 1993-94 to 1996-97, wherein the CIT(A) had accepted identical explanation of the assessee regarding his inability to produce the records/books of account. The assessee also filed before the CIT(A) a copy of the order dated 28.02.2000 in the case of its sister concern M/s. Aero Traders Pvt. Ltd.

8. On the basis of the aforesaid contentions raised by the assessee before the CIT(A), the CIT(A) concluded that though there was no doubt that as a result of the assessee's dispute with the accountants it could not file any return of income for the assessment years 1994-95 to 1999-2000, but the dispute with the accountants, filing of the FIR and the police raids were much later developments. These were not "the only dominating circumstances during the relevant period, preventing the appellant from filing its return of income as required by law for the assessment year 1994-95." That being so, it could not be said that the assessee was prevented by a reasonable cause from filing the required return in time. However, the best judgment assessment framed by the

Assessing Officer should have been based on some material facts rather than on the arbitrary basis of the average percentage of the net taxable income for the three subsequent years declared by the assessee under the VDIS. The CIT(A) consequently held that the net profit as declared by the assessee were not required to be disturbed. It observed as under:

> *"The Assessing Officer has not disputed that the appellant has filed a copy of the Balance Sheet and Profit & Loss Accounts alongwith the return of income. The Balance Sheet has been audited by the Chartered Accounts (sic. Accountants) and provides various details in its annexure. The audited accounts show a profit of ₹ 6,60,883/-. The Assessing Officer has not adopted the same for his calculation. It is a settled law that while making the best judgment assessment the Assessing Officer has to make (sic. take) all relevant material before him and gathered during the course of assessment proceedings and after giving an adequate opportunity of being heard to the assessee. The best judgment assessment should neither be capricious nor arbitrary and should be based on facts on record. The AO has also not brought on record any comparable case wherein the net profit declared by a tax payer in the similar business was higher than the one declared by the appellant. On the other hand the Assessing Officer in his Remand Report has not commented on the comparable case of M/s. Bata India Limited, relied upon by the appellant. It is also a settled law that profit margins of a tax payer as declared by him, could be varied and disturbed only, if the profit margins in the case of other assessee engaged in the similar business are higher. The appellant in support of his contentions has been able to bring on record the evidence that in the case of a company doing similar business, the declared profits were in fact lower than the profits declared by the appellant. Under these circumstances and looking at the facts on records, I am of the view that the net profit as declared by the appellant*

need not be disturbed. Consequently the addition made by the Assessing Officer stands deleted."

9. Against the aforesaid order of the CIT(A), the Department inter alia filed an appeal before the Income Tax Appellate Tribunal (in short "ITAT"). The ITAT, after noting that the aforesaid findings could not be controverted by the learned departmental representative who had placed strong reliance on the order of the Assessing officer only, concurred with the findings of the CIT(A) as follows:-

"The CIT(A) has taken into consideration the comparable case in case of Bata India Ltd. and the appellate order in case of M/s. Aero Traders, sister concern of the assessee wherein also the similar additions made by AO were deleted and then allowed the appeal of the assessee by deleting the ad hoc addition of ₹ 10,67,506/-. He further noted that against the order of CIT(A) in case of Aero Traders P. Ltd. for asstt. years 1993-94 to 1996-97, the department filed appeal before Tribunal taking ground that deduction u/s 80HHC were wrongly allowed by the CIT(A). The appeals of the department have been disposed of by the Tribunal whereby the appeals of the department were dismissed by holding that no deduction u/s 80HHC were allowed by the CIT(A). The explanation given by the assessee has been accepted by the ld. CIT(A) and the order of CIT(A) on merit has not been objected by the department before the Tribunal. The CIT(A) has taken into consideration this order of the CIT(A) and then came to conclusion that audited account of the assessee were correct, therefore, AO was wrong in drawing adverse inference against the assessee. In view of these facts and circumstances and in view of the detailed reasonings given by CIT(A), we confirm his order asstt. year 1994-95."

10. As regards the assessment year 1998-99, the ITAT recorded that the facts of this assessment year were similar to the facts involved for the

assessment year 1994-95. The difference in the facts was only of the figure of profits. The Assessing Officer on the basis of the results of the assessment year 1999-2000 proceeded to make the estimation of the profit of the year 1998-99. On the basis of profits of 1.96%, the taxable income of ₹ 1,47,73,246/- was computed as against the declared income of ₹ 50,95,949/-, thereby making a total addition of ₹ 96,77,297/-. In appeal, the CIT(A) again found that there was no justification for disturbing the trading results shown by the assessee. The detailed reasoning given by the CIT(A) is as under:

> *"I have considered the submissions of the appellant, the facts of the case and the contents of the remand report. The veracity of the facts relating to the appellant's dispute with its erstwhile accountants and the later developments like FIR and police search etc. has not been disputed by the AO. The facts and circumstances of the appellant's case prima facie indicate that the appellant was prevented by a sufficient cause from filing the audited accounts and the return of income within the stipulated time. I am, therefore, of the opinion that the appellant, for the reasons mentioned in the affidavit filed before me was prevented by a sufficient cause from filing the audited accounts and the return of income within stipulated time. The next argument of the appellant is that when the return for the asstt. year 1999-00 having identical facts and circumstances was accepted by the AO as correct but when he came to the asstt. year 1998-99 he did not accept the audited accounts and made variations in the accountants (sic. accounts) based on the comparative analysis of the profit and loss account of the year under appeal with that of the succeeding year and that too without giving any opportunity to the appellant. Objecting to the procedure adopted by the AO as well as additions made by him the appellant has explained that the*

difference between the two asstt. years was primarily due to the write off of the stocks amounting to ₹ 3.20 crores. These stocks comprising of unsaleble half manufacturer shoe uppers and leather rejects deteriorated due to their lying in stock since 1992, were written off during the previous year relevant to the asstt. year under appeal as these had NIL realizable value. Due to the said write off the higher cost of consumption was reported in the audited accounts even though in quantum terms the consumption was almost similar to the subsequent years. The AO in his remand reports has neither made any comments on the claim of the appellant for excess consumption of material due to the write off of stock nor he has refuted the contentions of the appellant in this respect. Further, the appellant has shown through the statistical statements submitted before me and remanded to the AO that it has reached its break even point only in the asstt. year 1999-2000 when it achieved the turnover of ₹ 90 crores while in the asstt. year under appeal it has a turnover of ₹ 75.35 crores which was much below its break even point. Looking at the facts and circumstances of the case and the reasons given higher consumption of raw material shown in this regard viz-a-viz the subsequent year not refuted by the AO, I am of the opinion that the book results of the appellant as per its audited accounts should not have been disturbed and the AO should not have resorted to the statistical extrapolation exercise in increasing the sales by 21% on the basis of the trading results of the subsequent year. The business profits are not determined by mathematical precision. It was, therefore, not a fair and reasonable exercise on the part of the AO to estimate the profits of the appellant for the year under appeal. The ad hoc additions so made are thus deleted."

11. An appeal filed before the ITAT for this assessment year met with the same fate and the Tribunal noting that the facts for the year under consideration were similar to the facts for the assessment year 1994-95

confirmed the order of the CIT(A) on the reasoning given by the CIT(A). Resultantly, the appeal of the department was dismissed.

12. Before us, it was contended by Mr. M.P. Sharma in respect of the assessment year 1994-95 that the return was filed belatedly by the assessee only after notice under Section 148 of the Act as well as several notices under Sections 143(2)/142(1) had been issued to the assessee. As per this return, the assessee had declared an income of ₹ 6,60,883/-. In support of this, however, the assessee could not produce the books of account, though filed a copy of the balance-sheet and the profit and loss account along with the return of income. In the absence of the books of account, the Assessing Officer had been compelled to make best judgment assessment under Section 144 of the Income Tax Act, 1961. The basis for making the said assessment by the Assessing Officer was the percentage of profits disclosed by the assessee itself in the subsequent years as per the declaration made under the Voluntary Disclosure of Income Scheme, 1997 (VDIS) and no fault could be found with the same.

13. Mr. Ashish Mohan, the learned counsel for the respondent-assessee, on the other hand, vehemently contended that the Assessing Officer was not entitled to rely upon the information given by the assessee in the declaration filed under the VDIS. Such a course of action was not at all permissible for the Assessing Officer having regard to the provisions of Section 72 of the Finance Act, 1997 incorporating the text

of VDIS, 1997. Even otherwise, both the appellate authorities had rightly concluded that the net profit declared by the assessee was not liable to be disturbed in view of the fact that the Assessing Officer had not disputed that the assessee had filed a copy of the balance sheet and profit and loss account along with the return of income and the said balance sheet had been duly audited by the chartered accountants and contained various details in its annexures. The audited accounts showed a profit of ₹ 6,60,883/-, which was much higher than the profit margins in the case of other assessees engaged in similar business. There was, therefore, no justifiable cause for rejecting the return of income filed by the assessee.

14. In view of the contention raised by Mr. Mohan that the Assessing Officer was not entitled to rely upon the profit percentages declared by the assessee itself in the subsequent assessment years as per the declaration made under the Voluntary Disclosure of Income Scheme, 1997 (VDIS), it is deemed expedient to reproduce Section 72 of the Finance Act, 1997, which act incorporates the text of VDIS, 1997:

> *"**Secrecy of declaration.***
> *72. (1) All particulars contained in a declaration made under sub-section (1) of section 64 shall be treated as confidential and, notwithstanding anything contained in any law for the time being in force, no court or any other authority shall be entitled to require any public servant or the declarant to produce before it any such declaration or any part thereof or to give any evidence before it in respect thereof.*
> *(2) No public servant shall disclose any particulars contained in any such declaration*

except to any officer employed in the execution of the Income-tax Act or the Wealth-tax Act, or to any officer appointed by the Comptroller and Auditor General of India or the Board to audit income-tax receipts or refunds."

15. Sub-section (1) of the said Section refers to the confidential nature of the declaration made under Section 64(1) and indubitably lays down that no Court or any other authority shall be entitled to require any public servant or the declarant to produce before it any such declaration or any part thereof or to give any evidence before it in respect thereof. Significantly also, a non-obstante clause has also been inserted in the sub-section. Sub-section (2) of Section 72 is, however, in our view, in the nature of an exception to sub-section (1), though not couched as an exception. The said sub-section in effect states that it shall be open to a public servant to disclose the particulars of the declaration to an officer employed in the execution of the IT Act or the Wealth-tax Act or to any officer appointed by the Comptroller and Auditor-General of India or the Board to audit IT receipts or refunds.

16. We are buttressed in coming to the above conclusion from the fact that we find on a perusal of the Voluntary Disclosure of Income Scheme, 1997 and in particular Section 70(1) of the Scheme that though nothing contained in the declaration made under sub-section (1) of Section 64 shall be admissible in evidence against a declarant relating to the imposition of penalty or for purposes of prosecution under the Income Tax Act, the Wealth Tax Act, the Foreign Exchange Regulation Act,

1973, or the Companies Act, 1956, the scheme does not contain any provision declaring as inadmissible in evidence against the declarant the particulars contained in the declaration filed for the purpose of proceedings under the Income Tax Act. Thus, in our view, it is not open to the assessee to contend that the declarations filed by him could not have been looked into by the Assessing Officer for the purpose of estimating his income for the assessment year in question.

17. We also concur with the findings of the CIT(A) and the Income Tax Appellate Tribunal that the assessee was not prevented by circumstances beyond its control from filing the required return in time and this being so, the Assessing Officer was not estopped from framing the best judgment assessment, if so warranted. The issue before us, however, is as whether the Assessing Officer was entitled to draw adverse inference against the assessee even after the assessee had filed its return of income duly supported with the balance sheet and the profit and loss account, certified to be audited by the auditors.

18. It is well settled that while making the best judgment assessment, the Assessing Officer should do so on a rational basis and without any bias. The scope of "best judgment" assessment under the Income Tax law came up for consideration before the Judicial Committee as early as 1937 in ***Commissioner of Incom-tax vs. Laxminarain Badridas***. Therein, the Lord Russell of Killowen, speaking for the Judicial Committee, observed:

> *"The Officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by and assessments of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be guess-work in the matter, it must be honest guess-work. In that sense, too, the assessment must be to some extent arbitrary."*

19. In ***Ganga Ram Balmokand vs. Commissioner of Income-tax,*** the following pertinent observations were made by Din Mohammad, J.:

> *"It cannot be denied that there must be some material before the Income-tax Officer on which to base his estimate, but no hard and fast rule can be laid down by the court to define what sort of material is required on which his estimate can be founded."*

20. In ***Commissioner of Sales-Tax, Madhya Pradesh vs. H.M. Esufali H.M. Abdulali, 90 ITR 271***, the Supreme Court while holding that the Assessing Officer is the best judge of the situation and the High Court could not substitute its "best judgment" for that of the assessing authority, held that in the case of "best judgment" assessments, the Courts will have to first see whether the accounts maintained by the assessee were rightly rejected as unreliable. If they come to the conclusion that they were rightly rejected, the next question that arises for consideration is whether the basis adopted in estimating the turnover

has reasonable nexus with the estimate made. If the basis adopted is held to be a relevant basis even though the Courts may think that it is not the most appropriate basis, the estimate made by the Assessing Officer cannot be disturbed.

21. Thus, even assuming for the sake of argument that the assessee's profit and loss account was rightly discarded by the Assessing Officer, it is for this Court to examine whether a rational basis was adopted by the Assessing Officer. The answer is our opinion must be an emphatic no. In our opinion, the CIT(A) and the Income Tax Appellate Tribunal rightly set aside the "best judgment" assessment of the Assessing Officer on the ground that the Assessing Officer had "not brought on record any comparable case wherein the net profit declared by a tax payer in the similar business was higher than the one declared by the assessee." We also concur with the findings of the Income Tax Appellate Tribunal that the profit margins of a tax payer as declared by him, could be varied and disturbed only if the profit margins in the case of other assesses engaged in similar business are higher. In the instant case, the assessee has brought on record evidence that in the case of a company having similar business, the declared profits were in fact lower than the profits declared by the assessee. The Assessing Officer in his Remand Report was also unable to comment on the comparable case of M/s. Bata India Limited and Aero Traders relied upon by the assessee. In the circumstances, we

are of the view that the Tribunal rightly held that the net profit as declared by the assessee was not required to be disturbed.

22. We accordingly answer the questions framed above in the negative, that is, in favour of the assessee and against the revenue.

REVA KHETRAPAL
(JUDGE)

A.K. SIKRI
(JUDGE)

December 24, 2010
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