

IN THE INCOME TAX APPELLATE TRIBUNAL DELHI 'F' BENCH  
BEFORE SHRI U.B.S. BEDI, JM & SHRI A.N. PAHUJA, AM

ITA No.5185 /Del/2010 Assessment year:2007-08		
Assistant CIT Circle, Aayakar Bhawan, Teacher's Colony, Bulandshahr	V/s.	M/s Rama Dairy Products Ltd., Siyana Road, District Bulandshahr
[PAN : AAACR 9937 N ]		
(Appellant)		(Respondent)

Assessee by	Shri Raj Kumar, AR
Revenue by	Shri B.R.R. Kumar,DR

Date of hearing	09-05-2012
Date of pronouncement	08 -06-2012

**ORDER**

**A.N.Pahuja:-** This appeal filed on 22.11.2010 by the Revenue against an order dated 31.08.2010 of the Id. CIT(A)-Meerut, raises the following grounds:-

1. *“Whether Id. CIT(A) has erred in law and on facts in holding that after applying net profit rate from business turn over, further addition of ₹6,88,400/- on account of insurance claim received and addition of ₹2,40,780/- on account of other income credited to P&L account cannot be made while other income was clearly taxable as such and did not comprise of or could be related to business turnover.*
2. *Whether Id. CIT(A) has erred in law and on facts in directing to apply net profit rate on declared turnover of ₹2,27,79,55,904/- as against estimated turnover of ₹2,28,00,00,000/- taken by the AO and also in making comparison of net profit rate by giving different treatment to the other income of ₹9,29,180/- included in the net profit shown by the assessee and*

*excluded from net profit by the AO without giving any cogent reason.*

3. *In the fact and circumstances of the case the order of the CIT(A) may be set aside and that of the Assessing Officer restored.*

2. Facts, in brief, as per relevant orders are that return filed by the assessee, trading in milk and milk products, was taken up for scrutiny with the service of a notice dated 26<sup>th</sup> September, 2008 u/s 143(2) of the Income-tax Act, 1961 (hereinafter referred to as the Act). None responded to this notice. In response to a notice dated 14<sup>th</sup> July, 2009 u/s 142(1) of the Act, after seeking a number of adjournments, none appeared on 10.8.2009. In response to another detailed notice dated 27.08.2009, seeking copy of the audit report and final accounts, the assessee sought adjournment for 16<sup>th</sup> September, 2009 and again for 18<sup>th</sup> September, 2009 and as usual none appeared on 18<sup>th</sup> September, 2009. Even the notice u/s 142(1) of the Act issued on 15<sup>th</sup> October, 2009 and 26.10.2009 were not complied with. Though certain details were filed on 24.11.2009 & 4.12.2009, books of accounts were not produced. As a result, purchases, sales and other expenses could not be verified. Even in response to a detailed showcause notice dated 14.12.2009, books of accounts were not produced. Since despite sufficient opportunity, the assessee did not produce the relevant books of account and vouchers, the Assessing Officer [AO in short] invoked the provisions of section 145(3) of the Act and completed the assessment in the manner provided u/s 144 of the Act.

2.1 On perusal of profit and loss account, the AO noticed that the assessee reflected sales of ₹2,24,89,89,253/- besides job work of ₹2,89,66,651/- resulting in GP of ₹6,79,02,626/- and net profit of ₹1,51,37,359/-. After excluding insurance claim of ₹6,88,400/- and interest and other income of ₹2,40,780/-, the GP worked out to 2.94% and N.P. of 0.62%. In the absence of books of accounts and vouchers, since purchase, sales and expenses could not be verified, the AO applied net profit rate of 0.70% on the estimated sales of

₹`2,28,00,00,000/- and determined net profit of ₹1,59,60,000/- besides separately adding insurance claim of ₹6,88,400/- & interest and other income of ₹2,40,780/-

3. On appeal, the Id. CIT(A) while upholding the rejection of book results and application of net profit rate of 0.70% directed the AO not to exclude insurance claim and other income while applying the net profit rate in the following terms:-

*“ I have gone through the facts of the case, findings of the Assessing Officer and the submissions of the AR. I have taken note of the fact that the appellant did not produce books of accounts even after providing several opportunities. The compliance by the appellant to the notices and filing the details and explanation as desired by the Assessing Officer and the fact that the books of accounts of the appellant were audited, were not sufficient so as to accept the declared returned income of the appellant. In my considered view, the Assessing Officer has rightly invoked the provisions of section 145(3) and proceeded to complete the assessment u/s 144 of the Income-tax Act, 1961. In this view, the action of the Assessing Officer to complete the assessment u/s 143(3) is confirmed.*

*I have considered the further submissions of the AR against the treatment of insurance claim of ₹6,88,400/- and other income consisting of interest on FDRs and discount at ₹2,40,780/-. The Assessing Officer for working out the declared N.P. has reduced the amount of insurance claim and other income from the net profit as per P&L account and thereafter after estimating and applying the N.P. rate to the total receipts @0.70%, has again added the same. In my view, once N.P. rate is applied there is no justification in reducing and adding some items of income and/or expenses in the income. It is not the case of estimation of G.P. rate where the expenses/income heads of profit and loss account are added or reduced. Net profit denotes the total profit worked out as per the profit and loss account inclusive of all types of sources and, therefore, after estimating the net profit rate, there remains no reason for making any adjustment therein. In this view, and following the judicial pronouncements as referred to by the AR, I hold that the additions of ₹6,88,400/- and ₹2,40,780/- to the income, after making computation of income by applying estimated net profit rate, cannot be made. I, therefore, delete the same.*

*The appellant has also objected to the application of estimated net profit rate of 0.70% stating that the rate adopted by*

*the Assessing Officer is highly excessive. According to him the declared net profit rate of 0.6645% deserves to have been accepted. Having confirmed the action of the Assessing Officer to invoke the provisions of section 145(3) and to complete the assessment u/s 144 read with u/s 143(3), I do not find any justification in interfering with the estimated net profit rate of 0.70% adopted by the Assessing Officer. I, therefore, confirm the adoption of net profit rate of 0.70% to the declared total receipts.*

*Regarding AR's objections against estimation of total sales and receipts at ₹228 crores as against the declared total receipts of ₹2,27,79,55,904/-, I find substance in the submissions of the AR that in absence of any information on record so as to assume unaccounted sales/receipts at the part of the appellant, the substitution of the estimated receipts is unwarranted. I, therefore, direct the Assessing Officer to accept the declared total receipts of ₹2,27,79,55,904/-."*

4. The Revenue is now in appeal before us against the aforesaid findings of the Id. CIT(A). The Id. DR supported the findings of the AO while relying upon decision in DCIT vs. Allied Construction ,105 ITD1(Delhi)(Special Bench). On the other hand, the Id. AR on behalf of the assessee contended that insurance claim was received on account of stock destroyed in fire and thus, it was normal business receipt. As regards interest and discount, the Id. AR submitted that interest on FDR taken for banking requirement for opening LC was part and parcel of business receipts, and thus, once a net profit was estimated, no further addition could be made for determining business profits. Inter alia, the Id. AR relied upon decision in CIT Vs. G.K. Contractor (Raj) (2009) 19 DTR (Raj) 305, ACIT Vs Lakshmi Industries, 135 TTJ(Che)112; CIT Vs. Aggarwal Engg. Company, 302 ITR 246 (P&H); and CIT Vs. Banwari Lal Bansidhar 229 ITR 229 (All); . To a query by the Bench, the Id. AR replied that last year net profit rate worked out to 0`664% .

5. We have heard both the parties and gone through the facts of the case as also the aforesaid decisions. Indisputably, the assessee did not produce

relevant books of account and bills/vouchers before the AO or the Id. CIT(A). As a result, rejection of book results by the AO having recourse to provisions of sec. 145(3) of the Act and completion of assessment in the manner provided u/s 144 of the Act, was upheld by the Id. CIT(A). The AO applied NP rate of 0.70% on estimated sales of ₹228 crores and determined net profit after excluding insurance receipt of ₹6,88,400/- & interest and other income of ₹2,40,780/-. However, the Id. CIT(A) applied the net profit rate of 0.70% to disclosed sales of ₹2,27,79,55,904/- in the absence of any information on record regarding unaccounted receipts/sales. The Id. CIT(A) also accepted the submissions of the assessee for inclusion of insurance receipt of ₹6,88,400/- and interest and discount of ₹2,40,780/- while applying the net profit rate, without ascertaining the nature of these receipts and without recording any findings as to whether or not these receipts were assessable under the head 'profits and gains of the business or profession'. Despite being fully aware that assessment was completed after rejection of book results, the assessee having not produced books of accounts before the AO, the Id. CIT(A) did not give any opportunity to the AO before accepting the submissions of the assessee. The Id. AR appearing before us contended that these receipts were business receipts while the Id DR contended that interest on FDR could not be assessed as business receipts even if FDR was purchased from the bank for opening LC etc.. There is no dispute regarding rejection of book results or application of net profit rate of 0.70% before us. The dispute is application of net profit rate of 0.70% after exclusion of insurance receipts and interest income, on estimated sales. Admittedly, the assessee did not dispute the findings of the AO, rejecting the book results in terms of provisions of sec. 145(3) of the Act. The assessee is not in appeal before us in respect of findings of the Id. CIT(A), upholding rejection of book results for want of books of accounts. The Revenue in their appeal seeks application of net profit rate of 0.70% on estimated sales of ₹228 crores apart from separate additions on account of insurance receipts and interest income credited in the profit and loss account. After rejection of book results, no doubt the

AO/CIT(A) should try to make an honest and fair estimate of the income even in a best judgment assessment and should not act totally arbitrarily, but there is necessarily some amount of guess work involved in a best judgment assessment, and it is the assessee himself who is to blame as he did not submit proper accounts and details.[Kachwala Gems Vs JCIT, 288 ITR 10 (2007)(SC) ]. It is true that AO or the CIT(A) are not fettered by technical rules of evidence and are entitled to act on materials which may not be accepted as evidence in court of law, nevertheless, the AO should adopt a method which must reflect the profits truly and justly[ Gemini Pictures Ltd. vs CIT (1958) 33 ITR 547 (Mad).] For estimating the profit, the Id. CIT(A) can always have a look at the margin returned in comparable cases or even in assessee's own case in the preceding years. In the instant case, the Id. CIT(A) was well aware that the assessee did not produce relevant books of accounts and bills/vouchers. In their absence, the AO did not have any recourse but to estimate sales and chose to apply NP rate. According to the AO , exceptional items of insurance receipts and interest income etc. were to be excluded while applying NP rate on estimated sales. However, the Id. CIT(A) without even having a look at the relevant books of accounts or bills/vouchers or even past history of the case, accepted disclosed sales and rejected the treatment given to insurance receipts and interest income by the AO, ignoring the fact that the best judgment assessment involves an element of guess work. When the assessee has not proved the correctness of the books of account and has not produced any record to support his claim as to the taxable income, it is always open to the AO to estimate the income and profit therein as per similar business data, whether in the assessee's own case in the preceding years or of comparable instances..Admittedly, the assessee did not substantiate the book results with any cogent evidence before the AO or the Id. CIT(A) nor

produced the relevant books of accounts before them. No reasons have been adduced before us as to why books of accounts were not produced before the lower authorities; rather the assessee accepted the findings of the Id. CIT(A), rejecting the book results. The next step was estimation of profits. The Id. CIT(A) rejected the method adopted by the AO, without adducing any cogent reasons. The Id. CIT(A) did not record any findings as to whether or not interest income and insurance receipts were part of business receipts for determining NP rate nor recorded any findings on the nature of insurance receipts. Admittedly, the investment in fixed deposits was made out of the surplus generated from the business and the assessee was free to utilize these funds in any manner. The assessee chose to invest these funds in fixed deposits. The fact that the fixed deposits were offered as security for the various facilities availed by the assessee from the banks would not make the income from the fixed deposits as business income. The taking of the FDRs and pledging them as securities for taking loans are two different transactions. Hon'ble Supreme Court, in the case of Pandian Chemicals Ltd., held that interest earned on deposit with the Electricity Board for supply of electricity could not be said to flow from the undertaking and, therefore, it was not income derived from the undertaking. In CIT v. Raja Bahadur Kamakhaya Narayan Singh [1948] [16 ITR 325](#), the Privy Council held interest on arrears of rent payable in respect of agricultural land was not agricultural income. The decision of the Hon'ble Madras High Court in the case of South India Shipping Corpn. Ltd. supports the plea of the Id. DR. The Hon'ble Madras High Court relied on the decision of the Hon'ble Supreme Court in the case of Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT [1997] [227 ITR 172](#). Hon'ble Allahabad High Court in the case of CIT v. Kisan Sahakari Chini Mills Ltd. [IT Reference No. 219 of 1992 by order dated 7-4-2005] - [2006] [280 ITR 617](#) also came to the same conclusion by relying on the decision in the case of Tuticorin Alkali Chemicals & Fertilizers Ltd. Source of interest income is FDRs, which is different from business receipts. Even if business is stopped, the assessee can continue to receive interest and vice versa. Interest on FDR does not have direct and immediate nexus with the business of the assessee. In other

words, the immediate and effective source of the interest is the deposit and not from the actual conduct of the business of the assessee. Thus, interest received cannot be considered as part of the business receipts while estimating income from the business of the assessee.

5.1 The Hon'ble Rajasthan High Court in CIT vs. Gotan Lime Khanij Udhyog (2001)25,6 ITR 243 (Raj) held that the books of account together with past history of the case as also material collected should be considered for estimation of income. The past history is the best guide where provisions of s. 145(3) of the Act are invoked as held in Ajay Goyal vs. ITO (2006) 99 TTJ (Jd)164, Madan Lal vs. ITO (2006) 99 TTJ (Jd) 538, CIT vs. Popular Electric Co. (P) Ltd. (1993) 203 ITR 630(Cal) and M.A. Rauf vs. CIT (1958) 33 ITR 843 (Pat). Once book results were rejected in terms of provisions of sec. 145(3) of the Act, it is not the ipse dixit of the AO to compute the income either u/s 144(1) or sec. 145(3) of the Act nor the computation and determination of income can be at the whims and fancies of the AO or the Id. CIT(A). Law on this point, i.e., law in respect of assessments made on the basis of best judgment or estimate is well-settled. Hon'ble Supreme Court in the case of Commissioner of Sales Tax v. H. M. Esufali H. M. Abdulali [1973] [90 ITR 271](#), 276, 277 ; 32 STC 77 (SC), lays down the law as follows:

*" The distinction between a ' best judgment ' assessment and assessment based on the accounts submitted by an assessee must be borne in mind. Sometimes there may be innocent or trivial mistakes in the accounts maintained by the assessee. There may be even certain unintended or unimportant omissions in those accounts; but yet the accounts may be accepted as genuine and substantially correct. In such cases, the assessments are made on the basis of the accounts maintained even though the assessing officer may add back to the accounts price of items that might have been omitted to be included in the accounts. In such a case, the assessment made is not a ' best judgment ' assessment. It is primarily made on the basis of the accounts maintained by the assessee. But, when the assessing officer comes to the conclusion that no reliance can be placed on the accounts maintained by the assessee, he proceeds to assess the assessee on the basis of his ' best judgment '. In doing so, he may take such assistance as the assessee's accounts may afford; he may also rely on other information gathered by him as well as the surrounding circumstances of the case. The assessments made on the*

*basis of the assessee's accounts and those made on best judgment , basis are totally different types of assessments .....*"

*" In estimating any escaped turnover, it is inevitable that there is some guess-work. The assessing authority while making the ' best judgment ' assessment, no doubt, should arrive at its conclusion without any bias and on rational basis. That authority should not be vindictive or capricious. If the estimate made by the assessing authority is a bona fide estimate and is based on a rational basis, the fact that there is no good proof in support of that estimate is immaterial. Prima facie, the assessing authority is the best judge of the situation. It is his ' best judgment ' and not of anyone else. The High Court could not substitute its ' best judgment ' for that of the assessing authority. 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 authority cannot be disturbed."*

5.2 In the above case the Hon'ble Supreme Court also quoted with approval an observation of Subba Rao J. (as he then was) in an earlier decision of the Supreme Court in the case of State of Kerala v. C. Velukutty [1966] [60 ITR 239](#) (SC). This observation is at page 244 of the report and is as follows :

*" The limits of the power are implicit in the expression ' best of his judgment '. Judgment is a faculty to decide matters with wisdom, truly and legally. Judgment does not depend upon the arbitrary caprice of a judge, but on settled and invariable principles of justice. Though there is an element of guess-work in a ' best judgment ' assessment, it shall not be a wild one, but shall have a reasonable nexus to the available material and the circumstances of each case."*

5.3 The following observations of Lord Russell Killoven in CIT v. Laxminarain Badridas [1937] 5 ITR 170 (PC) ; AIR 1937 PC 133, are apt in the present context :

*"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."*

5.4 In *S. M. Hasan, STO v. New Gramophone House*, AIR 1977 SC 1788, a Division Bench of the Hon'ble Supreme Court held that, "if the conditions for the best judgment assessment are present, the Assessing Officer will make it not on speculative or fanciful grounds, but on reasonable guess since the best judgment assessment does not negate the exercise of judgment on the part of the officer , . a tax officer who makes a best judgment assessment should make an intelligent well grounded estimate rather than launch upon pure surmises".

6. From the decisions referred to hereinabove, it is well established that (i) The power to make assessment on the basis of best judgment is not an arbitrary power. It is an assessment on the basis of best judgment of the officer ; (ii) when best judgment assessment is under-taken it cannot be as per the whims and fancies of the AO and it should base on some material either produced by the assessee or gathered by the taxing officer. If for any reason the material like books of account produced by the assessee is rejected as unreliable or unsatisfactory, there should be some valid reasons for doing so ; and (iii) whenever best judgment assessment is made, the court would not call for proof from the officer if there is some nexus between the amount arrived at after some guess work and the facts of the case.

7. In view of the foregoing, especially when it is not possible to discover any basis rational or otherwise from the order of the Id. CIT(A) in the instant case in accepting the submissions of the assessee on the basis of books results, which have discarded by him earlier , this order is apparently arbitrary. Since the Id.

CIT(A) ignored the principles laid down in the aforesaid decisions while estimating profits in a best judgment, we consider it fair and appropriate to set aside the order of the Id. CIT(A) and restore the matter to his file for deciding the aforesaid issues, afresh in accordance with law in the light of aforesaid decisions, after allowing sufficient opportunity to both the parties. Needless to say that while redeciding the appeal, the Id. CIT(A) shall pass a speaking order, keeping in mind, inter alia, the mandate of provisions of sec. 250(6) of the Act. With these observations, ground nos. 1 & 2 in the appeal are disposed of.

8.. Ground no.3 in the appeal being general in nature, does not require any separate adjudication and is, therefore, dismissed.

9. In the result, appeal is allowed but for statistical purposes.

*Order pronounced in open Court*

Sd/-  
(U.B.S. BEDI)  
(Judicial Member)

Sd/-  
(A.N. PAHUJA)  
(Accountant Member)

Copy of the Order forwarded to:-

1. Assessee
2. ACIT, Circle, Bulandshahr
3. CIT concerned
4. CIT (A)- Meerut
5. DR, ITAT, 'F' Bench, New Delhi
6. Guard File.

By Order,

Deputy/Asstt.Registrar  
ITAT, Delhi