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

Reserved on: 14.09.2012
Pronounced on : 11.10.2012

\+ **ITA 1246/2010**

THE COMMISSIONER OF INCOME TAX-VI ……Appellant
Through: Sh. Sanjeev Sabharwal, Sr. Standing Counsel with Sh. Puneet Gupta, Jr. Standing Counsel.

Versus

VATIKA CONSTRUCTION PVT. LTD. …..Respondent
` Through: Sh. C.S. Aggarwal, Sr. Advocate with Sh. Prakash Kumar and Ms. Pushpa Sharma, Advocates.

CORAM:
MR. JUSTICE S. RAVINDRA BHAT
MR. JUSTICE R.V. EASWAR

MR. JUSTICE S.RAVINDRA BHAT

%

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

"1. Whether the disclosure/admission of Assessee of taxing the income @ 8% when faced with detailed enquiry is a voluntary surrender and not liable for penalty under section 271(1)(c) of the Act?"

2. The assessee carries on construction business. It filed its return for the Assessment Year 2004-05. In the course of enquiry, the Assessing Officer (AO) pointed out that the assessee had purchased different materials from

small suppliers who had, in turn, bought them from big stockists. Those suppliers had insisted on cash payments and payments through bearer cheques. The assessee had issued large number of bearer cheques to such suppliers. The assessee was asked to explain as to why the cash payments made ought not to be disallowed under Section 40A(3). It was also asked to explain the substantial expenses claimed in the P&L account with the aid of vouchers and bills. The assessee explained that small suppliers who could deliver the building materials at the site of construction had insisted on early payments since they in turn had to make immediate payments to the stockists. Consequently, a large number of bearer cheques to such small suppliers had been issued. The assessee, therefore, requested as follows:

> *"...In these circumstances, the assessee would be grateful if the net profit of the company may be computed by application of a reasonable net profit rate on its contract receipts net of material supplied by the societies (employer). It is understood by the assessee that in the case of building contractors, the department normally applies a net profit rate of 8 percent on net receipts. Therefore, to buy peace of mind, to obviate unnecessary litigation and with a view to cooperate with the Department, the assessee offers that its income may be computed by applying a net profit rate of 8 percent provided penalty proceedings u/s 271(1)(c) of IT Act me not initiated."*

3. The AO accordingly accepted the assessee's contention by applying the 8% net profit rate, in terms of Section 44AD of the Income Tax Act and holding that net profit @ 8% of gross receipts was acceptable. However, the AO initiated penalty proceedings.

4. The AO appears to have, after initiation of proceedings under Section 271(1)(C), sought for particulars and verification in regard to the

genuineness of the parties to whom the payments were made on account of purchase of building materials. The Inspector's report, as borne from the AO's order showed that the premises of five of such suppliers had been visited and that the assessee's claims were unsubstantiated as the concerns or their proprietors were not found. In these circumstances, the AO held as follows:

> *"The report of the Inspector clearly indicates that the parties to whom payments were made could not be found on the address furnished by the assessee during the assessment proceedings. The assessee, during the assessment proceedings was conscious about the fact that if enquiry had been made regarding genuineness of parties and transactions the concealment of income would have been detected therefore the assessee decided to offer additional income for taxation. In fact this was not an offer but admission/confession of income concealed/filing of inaccurate particulars as it has been established beyond doubt through enquiry that the payments on a/c of purchases had been made to non-existent parties to inflate purchase which has resulted into concealment of income.*
>
> *In view of the detailed discussion made above and also considering the facts and circumstances of the case penalty u/s 271(1)(c) is imposed on the assessee.*
>
> *The quantum of the penalty is computed as under:*
>
> *Income in respect of which inaccurate particulars have been furnished/concealed- Rs.52,36,845/-*
>
> *Tax sought to be evaded - Rs.18,32,895/-*
>
> *Minimum penalty imposable @ 100% - Rs.18,32,895/-*
>
> *Maximum penalty imposable @ 300% - Rs.54,98,685/-*
>
> *I hereby impose a minimum penalty of 100% amounting to Rs.18,32,895/- (r. off 18,33,000)."*

5. The CIT(A) rejected the appellant's contention and affirmed the order of

the AO, imposing the penalty, *inter alia* observing as follows:

> *"The appellant has pleaded that the AO has failed to establish that appellant had deliberately concealed taxable income. It is a matter of record that Income Tax Department is accepting 97% of returns of income without making any scrutiny of income disclosed in return of income filed and only in 3% of cases detailed scrutiny of particulars of income filed along with the return of income are being made. In these circumstances, the possibility of getting scot-free by furnishing inaccurate particulars of income is very high. Had there been no scrutiny in the case of the appellant, it would not have been possible for the department to detect and tax the concealed income. These facts clearly lead to a conclusion that the appellant has deliberately furnished inaccurate particulars of income. Even though, as per amended provisions of Section 271(1)(c), the department need not prove that the appellant has furnished incorrect particulars of income, 'deliberately'.*

6. The assessee's appeal to the ITAT was allowed. The Tribunal reasoned as follows:

> *"4.3 This brings us to the crux of the matter, which is that the addition was made not only specific item but by applying 8% net profit rate. This was done in spite of the facts that the AO was in the knowledge that provisions of Section 40A(3) were violated, which was not intimated to the AO in any manner. He had also required the assessee to substantiate the expenditure apart from furnishing explanation u/s 40A(3). Yet, instead of proceeding further with the enquiry to establish genuineness or otherwise of the payments, he accepted the offer, leading to an addition of Rs.51,71,720/-. This amount was neither the amount involved in purchases from five parties nor the amount disallowable by application of the provision contained in Section 40A(3). Thus, it can be said that the assessment was made by applying 8% net profit rate, which was found to be reasonable in accordance with the provision contained in section 44 AD of the Act, a provision not applicable to the case of the assessee. Upon making such addition, the case of the*

assessee was that all the bills and vouchers had been produced and facts other than non-available of the parties at the given address were not considered before levying the penalty or even by the learned CIT (Appeals) while upholding the penalty.

XXXXXX XXXXXX XXXXXX

Therefore, the whole question is to be seen in the light of the provision and the Explanation thereto. The explanation was that the income has been computed by applying a flat rate of 8% to the receipts for determining the income. No evidence was cited that any inaccurate particulars were furnished because the bills etc. were not investigated into in detail. Further, no fact exists to show that the income was concealed as the income was computed by applying a flat rate. If it was the case of the AO that bogus purchase entries have been made in the books, he ought to have rejected the books and then the could estimate the income on the basis of facts on record. The books were not rejected. However, the offer of the assessee was accepted as it was found to be in the interest of revenue and a reasonable offer. In these circumstances, we find that the explanation could not be held to be mala fide."

7. It is argued that the Tribunal fell into error in setting-aside the penalty. Learned counsel submitted that the impugned judgment is founded on misappreciation of law and is premised merely on the fact that the assessee had offered to be taxed at 8% of the net profits on the gross receipts under Section 44 after its lapses had been pointed out. Even though it sought to wriggle out of the situation by offering to be taxed, the AO nevertheless was satisfied that the particulars furnished in the return were unsubstantiated and, therefore, inaccurate within the meaning of the expression under Section 271(1)(c). This was a clear case of deliberate and intentional withholding of particulars in order to gain or enrich itself.

8. Learned counsel for the Revenue relied upon the decision in *Electrical Agencies Corporation v. CIT* 253 ITR 619 and emphasized that the object of a presumption indicated was precisely to put the assessee to notice that in the event of relevant or material particulars being withheld, it could face penalty proceedings. In the present case, the assessee's claims were found to be completely inaccurate factually. As a result, the penalty proceedings and imposition of penalty were warranted in law.

9. It was argued on behalf of the assessee that the imposition of penalty in this case was completely unwarranted. Learned counsel highlighted that the Tribunal had correctly deduced from the materials on record that the figure of Rs. 51,71,270/- relied on by the AO does not correlate with any cash payment. All the five names mentioned in the show cause notice issued to the assessee under Section 271(1)(c), did not supply any material. The addition of Rs. 51,71,270/- was on the assumption that expenditure incurred was bogus. On the contrary, the total amount shown against these four suppliers was Rs.74,11,084/-. What was added or disallowed was Rs.51,71,270/-. Thus, the AO had in fact accepted or rather allowed the payment made in respect of the balance as being admissible in law. Learned counsel highlighted that the amount paid otherwise by way of a crossed cheque was Rs.40,73,180/-. If that was to be taken into consideration under Section 40A(3), the penalty amount would be 20% of the said sum, i.e. Rs.8,14,636/-. It was submitted that the assessee had provided a detailed chart along with its reply to the AO, who was satisfied that taxing @ 8% net profits on the gross receipts was sound and reasonable. This was in the form of a chart which showed that the rate of profit brought to tax never touched 8% except for three years in the preceding ten years. Consequently, the AO

and the CIT (A) completely overlooked the fact that apart from an erroneous assumption of the sum of money paid otherwise than by crossed cheque, the Revenue had benefited on an overall basis by the offer to bring the assessee's income to tax under Section 44AD.

10. Learned counsel argued that the material relied upon by the AO and affirmed by the CIT (A) in this case, was gathered after assessment order was made. The inspection report was clearly obtained after the assessment order was made on 07.12.2006 whereas the Inspector's report was made available to the AO after that event was made available on 24.06.2007 to the assessee. Learned counsel emphasized that the non-explanation about the bearer cheques issued could not, at the stage of the assessment proceedings, be related to the inspection report which was procured later. The AO did not have any materials to conclude that the assessee had concealed particulars to evade taxes on the date when he confirmed the assessment. The satisfaction recorded by him, therefore, was without authority of law.

11. There can be no two opinions about the public interest element underlying Section 271(1)(c); that it puts all those who file returns, on notice about the consequences they would face in the event they withhold particulars that have a material bearing in their cases, or attempt to mislead the revenue. At the same time, the Assessing Officer, while deciding to initiate proceedings, has to base his opinion on the materials available on record. Here, the assessee had claimed deduction in the computation of expenses; a part of that amount was actually accepted. The amount added back as a result of the assessee's offer, did not correspond with the total amount representing the payments made through bearer cheques or cash; that was Rs.40,73,180/- (evident from the calculation and documents placed

on record before the Tribunal). The impugned judgment has taken notice of this fact.

12. The offer made by the assessee was on the basis that it could not give the details of the parties, and in order to buy peace, the AO was requested to tax the gross receipts on net profits basis. This, as noticed earlier, resulted in addition of over Rs. 51 lakh, which represented more than the amount disallowable under Section 40A(3).

13. The relevant portions of Section 40A(3) are extracted below, for the sake of convenience:

> *"3) Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure.*
> *(3A) Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year (hereinafter referred to as subsequent year) the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payment or aggregate of payments made to a person in a day, exceeds twenty thousand rupees:*
> Provided *that no disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3) and this sub-section where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities*

available, considerations of business expediency and other relevant factors.

The provision was considered in some detail by the Supreme Court in its judgment reported as *Attar Singh Gurmukh Singh v ITO* AIR 1991 SC 2109, while examining its constitutional validity. The Court also held that:

> *"Section 40A(3) only empowers the assessing officer to disallow the deduction claimed as expenditure in respect of which payment is not made by crossed cheque or crossed bank draft. The payment by crossed cheque or crossed bank draft is insisted on to enable the assessing authority to ascertain whether the payment was genuine or whether it was out of the income from disclosed sources. The terms of Section 40A(3) are not absolute. Consideration of business expediency and other relevant factors are not excluded. The genuine and bona fide transactions are not taken out of the sweep of the Section. It is open to the assessee to furnish to the satisfaction of the assessing officer the circumstances under which the payment in the manner prescribed in Section 40A(3) was not practicable or would have caused genuine difficulty to the payee."*

14. In the present case, the assessee's cash payments were concededly not the amount which was disallowed; they had no co-relation to what could not be established, and were disallowable. Further, the judicial record would show that when the AO decided to initiate penalty proceeding, he had no material to conclude that the assessee had concealed income or provided inaccurate particulars. The assessee did provide particulars, but could not back up its claim with confirmation; its explanation was that the payees insisted on immediate payment, to fulfill their contractual commitment to their suppliers. The payees were small vendors, willing to ensure supply of materials to the assessee's site. Clearly, a case for business expediency had been urged. Most importantly, the material which led to the penalty order –

i.e. absence of the payees at their places or address provided, was gathered *after* notice under Section 271 (1) (c) was issued. The assessee complained of this procedure, calling it unfair, as it ought to have been provided with opportunity in this regard during the assessment and that material which did not exist at time of initiation of the penalty proceeding ought not to have been put against it. This Court is of opinion that the objection is well-founded, because the AO did not have the benefit of such material, and therefore could not have, only on the basis of the assessee's offer to be taxed at 8% on gross receipts, have concluded that it had provided inaccurate particulars in its returns. Moreover, the course of action suggested by the AO was in fact accepted by the assessee, as reasonable. In these circumstances, the imposition of penalty was not justified. The court therefore, is of opinion that there is no infirmity in the impugned order of the Tribunal. The question of law is therefore answered against the revenue, and in favour of the assessee; the appeal is accordingly dismissed. No costs.

S. RAVINDRA BHAT, J

R.V.EASWAR, J

OCTOBER 11, 2012