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IT-Article
Dated-17/11/11

Deduction under Section 80 HHC allowable in respect of the addition made on account of the creditors

DCIT Vs. Divine International (ITAT Delhi) – The CIT(A) has denied the deduction in respect of the addition on account of the so called sundry creditors on the ground that as per the provisions of Section 80 HHC, it is only the income derived by the assessee from the export of such merchandise which is eligible and the addition on account of creditors cannot be considered as income derived from the exports. The contention of the CIT(A) , however, is wrong. Section 80 HHC provides the complete scheme for computing the deduction. As per the provisions of Section 80 HHC (1), where an assessee is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, deduction in computing the total income of the assessee. Further, as per sub-section (3) of Section 80 HHC of the Act, where the export out of India is of goods manufactured by the assessee, the profits derived from such export shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee. Further-more, the profits of the business have been defined in Explanation (baa) below sub-section 80 HHC (4C), to mean the profits of the business as computed under the head ‘profit and gains of business or profession’.

23. Thus, for the purpose of computing deduction under Section 80 HHC, first the profits of the business have to be computed as a whole, as per the provisions of the Act and the export profit has to be then worked out proportionately, on the basis of the ratio of the export turnover to the total turnover. Therefore, as per the provisions of Section 80 HHC, profit so computed is considered to be the profit derived from exports. The whole computation is based on the profits and gains of business. In the case of the assessee, the addition made on account of trade creditors will go to increase the profit of the business. The addition under section 68 per se does not give the nature of the income. It is only a deeming fiction whereby credit is deemed to be income of the assessee and as deemed income takes the character and nature of the income of the assessee. In the case of the assessee, which is a firm, there is no income other than the business income. Addition on account of unexplained trade creditors will accordingly enhance the business income. Accordingly, the CIT(A) was not justified in denying the deduction under Section 80 HHC despite confirming the addition on account of the trade creditors.

This issue is squarely covered by the judgment of the Hon’ble Calcutta High Court in the case of ‘CIT vs. Margaret’s Hope Tea Co. Ltd.’ (1993) 201 ITR 747 (CAL), wherein, on similar facts it has been held that addition on account of cash credit under Section 68 will go to add to the business income. There, the Tribunal had found that the assessee’s main activity was of cultivation, manufacture and sale of tea. The cash credit account appeared in the assessee’s business books of account. The cash credit continued throughout the accounting period. The assessee itself wanted to include such unexplained cash credits as its income from business. The Hon’ble High Court held that the Tribunal was justified in holding that the cash credits appearing in the books of the assessee should be treated as the income of the assessee company from its tea business and not as income from undisclosed sources.

The creditors in the assessee's case represented purchases. This was evident from the list of creditors, as also the observations of the Tribunal and the findings of the Sales Tax Department. That being so, there was no reason for the benefit of section 80HHC of the Act being not allowed to the assessee.

Income Tax Appellate Tribunal, Delhi

Dy. Commissioner of Income Tax

Versus

M/s. Divine International,

ITA NO. 1995(Del)2011 and ITA NO. 1493(Del)2011

Dated – September 30, 2011

ORDER

PER A.D. JAIN, J.M.

These are cross appeals for assessment year 2001-02. ITA NO. 1995(Del)2011 has been filed by the Department. ITA NO. 1493(Del)2011 has been filed by the assessee. The Department has taken the following grounds:-

“1. Whether, the Id. CIT(A) has erred in law and on facts that even in the cases of contrary affidavits and denial of transactions provisions of section 68 of the I.T. Act, 1961 are not fulfilled.

2. Whether, the Id. CIT(A) has erred in law and on facts that even in the case of non-confirmation of identity of 10 creditors the onus on the part of the assessee of furnishing the requisite details of the claimed creditors, as per the observation of Hon'ble ITAT, New Delhi was indeed fulfilled.”

2. The grounds taken by the assessee read as follows:-

“1. The Id. CIT(A) has erred both in law and facts of the case in not appreciating the facts, i.e.,

a. That the addition was on account of sundry creditors who were only small time karigars who do assembling/finishing/polishing from their homes, spread in Roorkee and nearby villages. They were not registered or maintained any books of account or were maintaining any credit/cash memos. The only source of their identification was the receipt given on our vouchers, which contained name, complete address, amount and description of item supplied. They had no bank account and always accepted the payment in cash. All the records were burnt and there was no evidence or any identification to identify them or to prove the credit balances particularly when there were three or four suppliers like Mohd. Salim, Javed, Anil, etc.

b. That in the subsequent year most of the creditors were paid as huge cash was withdrawn for the purpose.

c. That after sometime we had almost changed our nature of business, had established our factory at Noida, UP, and had no contact as such with the creditors.

d. That almost entire stock shown at the end of the year were purchased in the last two months and had sold them in the subsequent year.

2. The Id. CIT(A) has erred both in law and facts of the case in not appreciating the facts, i.e.,

That creditors represent purchases as was evident from the list of creditors and as per the Hon'ble Members of ITAT and Sales Tax Department and there is no reason for knot allowing of benefit u/s 80HHC."

3. As per the statement of facts the assessee filed return of income for the assessment year 2001-02 on 30.10.2001 declaring total income of Rs. 5,31,300/- against gross income of Rs. 25,58,625/-. The assessee claimed deduction u/s 80HHC of Rs. 20,27,325/-. The assessment was completed u/s 143(3) of the I.T. Act at a total income of Rs. 49,16,264/- and thereafter revised u/s 154 of the Act, on 15.09.2004, at a total income of Rs. 48,75,670/-.

The AO made certain additions including that of Rs. 37,99,907/- as unexplained sundry creditors.

4. Aggrieved from the assessment order, the assessee filed appeal before the CIT(A)I, DDN, who vide order dated 14.02.2005, in appeal No. 15/HRD/2004-05/253, has partly allowed the appeal of the assessee. Aggrieved, the Revenue as well as the assessee filed appeals before the ITAT who, vide order dated 20.3.08 in ITA No. 1512(Del)05, directed the AO to decide the appeal afresh. Thereafter, in the light of the directions of the ITAT, an assessment order was passed on 12.03.2004. In this order, inter alia, an addition of Rs. 37,99,907/- on account of unexplained sundry creditors was again made to the total income of the assessee.

5. The assessee, against the assessment order dated 12.3.2004, filed appeal before the CIT(A), resulting in the order of the CIT(A) passed on 20.12.2010 vide appeal No. 50/HRD/08-09. This is the order presently under challenge by both the parties.

6. During the assessment proceedings, the assessee was required to prove and justify the sundry creditors of Rs. 37,99,907/- and to furnish complete names, addresses and PANs of all the sundry creditors. The assessee failed to furnish the same within the stipulated time and could furnish the details of only 20 creditors. The AO disallowed sundry creditors of Rs. 37,99,907/- holding that out of 75 sundry creditors, the assessee could furnish detail only in 20 cases, which were not found genuine; and that the assessee grossly failed to produce any material evidence in support of genuineness of the transaction.

7. In the impugned order, the CIT(A) observed that as per the order of the ITAT, the assessee was duty bound to furnish complete addresses of the creditors and could hope to get relief only if it furnished the same to the AO. It was further observed that it was logical to hold that the amount in respect of the remaining 55 sundry creditors should be treated as unexplained and deemed to be the assessee's income. He, therefore, directed to quantify the figures of these creditors and treat the addition to that extent as confirmed.

8. As regards the 20 remaining creditors, the Id. CIT(A), considering the regular business dealings of creditors with assessee, loss of books in fire and confirmations filed by the assessee, held that

it would not be appropriate to treat such creditors as non-genuine and directed the AO to quantify such creditors and treat the addition to that extent as deleted.

9. As such, on remand from the Tribunal, the AO, vide order dated 12.3.2004, inter alia, made an addition of Rs. 37,99,907/- observing that out of 75 sundry creditors, the assessee could furnish details only in 20 cases, which also were not found to be genuine. The Id. CIT(A) observed that the amount regarding 55 sundry creditors should be treated as unexplained income of the assessee. Regarding the remaining 20 creditors, the Id. CIT(A) held that considering the regular business dealing of the creditors with the assessee, the loss of books in fire and the confirmation filed by the assessee, such creditors could not be treated as non-genuine.

10. The Id. DR has contended that the directions of the Tribunal were clear-cut; that the assessee had to establish the genuineness of the transactions by giving the addresses of the creditors; that also, the creditors were to be shown outstanding at the end of the year; that the creditors which had not been proved to be genuine, the transactions qua them needed to be taxed as income from other sources; and that the Id. CIT(A) has not considered these facts.

11. The learned counsel for the assessee, on the other hand, has submitted that as per the directions of the Tribunal (APB 71), after having established the genuineness of the 7 creditors it would not have been necessary for the assessee to establish the credit-worthiness of such creditors; that before the AO, it was submitted vide reply dated 9.9.08, that a fire broke out in the factory premises of the assessee on 14.2.05; that the entire record was destroyed in that fire; that in the tax audit report, it had been certified by the Chartered Accountant that they had examined all the original books of account, purchase vouchers and sales tax forms of the assessee; that the Sales Tax Officer had also examined the documents and had given the findings that all the purchase vouchers were entered in the assessee's books of account and that all the purchases were examined on the basis of the sales tax forms issued and were found to be in order; that the creditors were mostly small part time karigars, who carried on their business from their homes and were not registered dealers with the Sales Tax Department; that their income being below the taxable limit, they were not filing any Income Tax return and were not maintaining any books of account; that therefore, it was not possible to file the requisite details with regard to these creditors; that confirmations along with specimen copy of bills and identity proof were being filed; that as per APB page 98, as on 31.3.2001 and 31.3.2002, the major creditors stood paid off.

12. The learned counsel for the assessee has further submitted that since the trading results have been accepted, the purchases made obviously stand accepted too; and that therefore, no addition could have been made.

13. The learned counsel for the assessee has also contended that the Id. CIT(A) has failed to consider that the creditors represented purchases and there was no reason not to allow the benefit u/s 80HHC of the Act to the assessee.

14. We have heard the parties and have perused the material on record. Undeniably, the addition of Rs. 37,99,907/- was on account of sundry creditors. These, as per the stand of the assessee, were only small time karigars, doing job works of finishing and polishing from their homes located in Roorkee and nearby villages. Admittedly, they were not registered, nor were maintaining any books of account. Their income being below the prescribed limit, no Income Tax returns were being filed. So to say, they did not have any record from which to confirm the transactions. The records of the assessee were burnt in the fire which broke out in the assessee's factory premises. This also remains un rebutted. However, the trading account of the assessee has

been accepted, meaning thereby, that the purchases made have also been accepted. Now, the applicability of section 68 of the Act is not mandatory and automatic. True, the assessee has not been able to prove the transactions. However, the element of probability in the given set of circumstances has to be duly taken into consideration. The AO was supposed and required to apply his mind to the issue and thereby considering the applicability of the provisions of section 68 of the Act. In the peculiar facts and circumstances, when the trading results have been accepted, thereby also accepting the purchases made, in our opinion, the applicability of the provisions of section 68 is entirely suspect. The same ought not to have been applied in a mechanical manner.

15. The assessee is engaged in the business of exports and during the year it has made a sale of Rs. 2,51,55,930/- and purchases of Rs. 1,79,49,253/-. The total creditors' outstanding as on the last date of the Balance Sheet are Rs. 37,99,907/-. These are all trade creditors and there is no dispute on this aspect. It is an admitted position that the assessee could not submit the addresses of these creditors except the seven which have been discussed in the assessment order, and for which the CIT(A) has given benefit.

16. In these circumstances, whether the creditors of whom the assessee has failed to give the address should be added by invoking the provisions of Section 68 of the Act?

17. It remains an admitted position that the trading results have been accepted and there is no dispute on the trading results as on date. Also, neither the sales, nor the purchases made by the assessee are not in dispute. The dispute is limited to the verification of the creditors' outstanding as on 31st March, 2001. The explanation of the assessee is that in view of the record having been destroyed in the fire, it is not in a position to get these outstanding creditors verified and that these were of petty karigars engaged in doing work for the assessee pertaining to a very old period.

18. It is also important to note that as per the Balance Sheet as on 31st March, 2001 the assessee has an outstanding liability of sundry creditors of Rs. 37,99,907/- and at the same time, it has advances to the suppliers of Rs. 24,45,951/-, sundry debtors of Rs. 19,37,520/- and closing stock of Rs. 39,25,000/-. This clearly demonstrates that on the one hand the assessee has liability towards these creditors and on the other hand it has assets in the form of advances to suppliers, debtors, stock, etc. Had these creditors being not genuine, the assessee could have squared up or not shown these advances to suppliers, etc. Accordingly, the overall circumstances also do not suggest that any adverse inference should be drawn against the assessee. Further, as per the provisions of Section 68 of the Act, it is not mandatory that in case the assessee fails to satisfy the assessing officer about the outstanding credits, the same are mandatorily required to be added as income of the assessee. Section 68 gives a discretion to the assessing officer, as can be seen from its provisions, which read as under:-

“68. Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.”

19. This view has also been upheld by the Hon'ble Supreme Court in the case of 'CIT vs. Smt. P.K. Noorjahan' (1999) 237 ITR 570 (SC). The assessing officer has to take into account the overall facts. Accordingly, in the case of the assessee the overall facts need to be considered. The amount outstanding being credit on account of purchases which have been exported by the

assessee, it is not mandatory that in the absence of verification of the creditors, the same need to be added statutorily.

20. In the case of the assessee these creditors represent the outstanding amount on account of the purchases. There can be three alternative allegations against the assessee. One can be that these credits represent the credit for earlier years. If that be the case, no addition can be made in this year under Section 68 of the Act. The second allegation can be that these credits represent the purchases for which payments have been made by the assessee during the year itself. If this is so, the onus will be on the department to establish that assessee has made payment to these creditors. This is not even the allegation of the assessing officer, much less his case against the assessee. The third allegation can be that these credits do not represent the purchases which have been made by the assessee. The implication of this will be that the purchases debited in the trading account are not genuine to that extent and accordingly, that the trading account is not correct. However, on going through the assessment order, the CIT(A)'s order and the order passed by the ITAT in the earlier round, it is evident that the trading results have been accepted. Despite this, for the sake of analysis, if it is considered that the assessee has failed to prove the genuineness of the creditors and consequently, the purchases to that extent are not genuine, then the declared gross profit of Rs. 32,16,564/- will get further enhanced by Rs. 37,99,907/-, i.e., a GP of Rs. 70,16,471/- on a total turnover of Rs. 2,51,55,930/- giving an exorbitant gross profit rate of 27.89%, which is not the case. It is also important to note that the assessee is in the business of exports and its entire income is exempt. There is, as such, no reason for the assessee to suppress the profit as its income.

21. Taking into consideration the above facts of the assessee, it is a fit case not to make any addition by invoking the deeming fiction of Section 68 in respect of the sundry creditors, despite the fact that the assessee could not supply the addresses of these creditors. All the facts and circumstances of the case, including that of destruction of books of accounts, old period, petty karigars, advances to the suppliers, debtors and the closing stock, and particularly the fact that all these creditors have been paid off in the subsequent year and the return for that year has been accepted by the department clearly show that in the case of the assessee it is not necessary to add these creditors.

22. Ground No. 2 of the assessee's appeal is regarding the denial of deduction under Section 80 HHC in respect of the addition made on account of the creditors. The CIT(A) has denied the deduction in respect of the addition on account of the so called sundry creditors on the ground that as per the provisions of Section 80 HHC, it is only the income derived by the assessee from the export of such merchandise which is eligible and the addition on account of creditors cannot be considered as income derived from the exports. The contention of the CIT(A), however, is wrong. Section 80 HHC provides the complete scheme for computing the deduction. As per the provisions of Section 80 HHC (1), where an assessee is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, deduction in computing the total income of the assessee. Further, as per sub-section (3) of Section 80 HHC of the Act, where the export out of India is of goods manufactured by the assessee, the profits derived from such export shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee. Further-more, the profits of the business have been defined in Explanation (baa) below sub-section 80 HHC (4C), to mean the profits of the business as computed under the head 'profit and gains of business or profession'.

23. Thus, for the purpose of computing deduction under Section 80 HHC, first the profits of the business have to be computed as a whole, as per the provisions of the Act and the export profit has to be then worked out proportionately, on the basis of the ratio of the export turnover to the total turnover. Therefore, as per the provisions of Section 80 HHC, profit so computed is considered to be the profit derived from exports. The whole computation is based on the profits and gains of business. In the case of the assessee, the addition made on account of trade creditors will go to increase the profit of the business. The addition under section 68 per se does not give the nature of the income. It is only a deeming fiction whereby credit is deemed to be income of the assessee and as deemed income takes the character and nature of the income of the assessee. In the case of the assessee, which is a firm, there is no income other than the business income. Addition on account of unexplained trade creditors will accordingly enhance the business income. Accordingly, the CIT(A) was not justified in denying the deduction under Section 80 HHC despite confirming the addition on account of the trade creditors.

24. This issue is squarely covered by the judgment of the Hon'ble Calcutta High Court in the case of 'CIT vs. Margaret's Hope Tea Co. Ltd.' (1993) 201 ITR 747 (CAL), wherein, on similar facts it has been held that addition on account of cash credit under Section 68 will go to add to the business income. There, the Tribunal had found that the assessee's main activity was of cultivation, manufacture and sale of tea. The cash credit account appeared in the assessee's business books of account. The cash credit continued throughout the accounting period. The assessee itself wanted to include such unexplained cash credits as its income from business. The Hon'ble High Court held that the Tribunal was justified in holding that the cash credits appearing in the books of the assessee should be treated as the income of the assessee company from its tea business and not as income from undisclosed sources.

25. The creditors in the assessee's case represented purchases. This was evident from the list of creditors, as also the observations of the Tribunal and the findings of the Sales Tax Department. That being so, there was no reason for the benefit of section 80HHC of the Act being not allowed to the assessee.

26. In view of the above, the grievance of the Department by way of its appeal, is found to be shorn of merit and is rejected, whereas that of the assessee is found justified and is accepted as such.

27. In the result, the appeal filed by the assessee is allowed, whereas that filed by the Department is dismissed.

Order pronounced in the open court on 30.09.2011.