

Only Profit element can be added to income, not sales amount

The Income Tax Appellate Tribunal, Jaipur (“**the ITAT**”) in the case of **Mr. Nikhil Garg v. Income Tax Officer (ITA No. 180/JP/2018) dated February 14, 2022** held that in no case the entire sales amount can be treated as income and only the profit embedded should be treated as income for the purpose of computation of income under Income Tax Act, 1961 (“**the IT Act**”).

Facts:

Mr. Nikhil Garg (“**the Appellant**”) was engaged in the business of wholesale trading of Ghee, Edible oil, Vanaspati Ghee under the legal name of M/s. Kanoria Enterprises. The Appellant filed income tax return (“**ITR**”) under the relevant provision of the IT Act, on February 28, 2009. The Appellant in the ITR claimed a loss of Rs. 2,63,660/- under the head of Income from Other Sources which relates to interest of loan which Appellant sourced from open market and was regularly paying the interest and deducting and depositing the TDS on the same.

The Assessing Officer (“**the AO**”) completed the assessment under Section 143(3) of the IT Act, and vide order dated December 27, 2011 (“**the Assessment Order**”) made lump sum addition of Rs. 80,000/- in the income against which no appeal was preferred by the Appellant before Commissioner of Income Tax (Appeal) (“**the CITA**”).

Also, Audit team of the Income Tax department conducted audit under the provision of IT Act and observed difference of Rs. 66,35,957/- arose due to difference between the turnover declared as per Profit and Loss Accounts (“**P&L Account**”) and Sales tax return (“**VAT Returns**”). On February 19, 2014, the Commissioner of Income Tax (Admin) (“**CIT Admin**”) passed an Order under Section 263 of the Income Tax Act setting aside the Assessment Order passed by the AO dated December 27, 2011 and directing the AO to make the necessary verification of the total turnover declared in Profit and Loss Accounts and VAT Returns and other related

documents to verify the genuineness of the loss claimed by the Appellant under the head of income from Other Sources.

Pursuant to the direction of the CIT Admin, the AO completed the reassessment under Sections 143(3) read with Section 263 of the Income Tax Act vide Order dated March 05, 2015 (**“the Reassessment Order”**) making addition in income of amount (Rs.66,35,957/-) equal to difference between sales as per Profit and Loss and VAT Returns and also disallowed the loss claimed by the Appellant under the head of other sources amounting to (Rs.2,63,660/-) on the ground of non-submission of details.

Aggrieved by the Reassessment Order of the AO, the Appellant filed an appeal before the CITA. The CITA vide Order dated January 30, 2017 (**“the Impugned Order”**) dismissed the Appeal filed by the Appellant and hence, confirmed the additional demand of Rs. 66,35,957/- (difference amount of sales as per Profit and Loss Account and VAT Return) and disallowed the loss of Rs. 2,63,660/- (claimed under the head of income from Other Sources) on the ground that entire loan amount was not utilized in business and the interest amount was very high as compared closing balance of loan which was Rs. 8.01 Lakhs.

Against the Impugned Order, the Appellant filed appeal in the ITAT.

The Appellant contended that the difference of Rs. 66,35,957/- was due to consignment sale which was made on the behalf of the consigner (independent parties) which should not be included in the income of the Appellant. More so, if it is to be included the amount only to the extent of profit should be included in the income not the entire sales amount.

Further, the loss booked by the Appellant under the head of Income from Other Sources was interest paid on loan which was utilized for the business purpose and therefore should be allowed as expense.

Issues:

In the present case the issues involved are as follows:

1. Whether the entire sales amount should form part of income of the Appellant?
2. Whether the interest paid on loan can be disallowed on the ground contended by CITA?

Held:

The ITAT held that:

- In case where the Appellant was not able to prove the consignment sales of Rs. 66,35,957/- the entire disputed sales amount cannot be treated as income of the Appellant and only amount to the extent of estimated profits embedded in sales can be added in income of the Appellant.
- The same has been decided in the case of ***CIT vs. President Industries [2000(158) CTR 372 (Guj.)*** by Coordinate Bench, Bangalore and in the case of ***K Venkatesh vs. ITO [2016 (47) CCH 0447]*** by Hon'ble Gujarat High Court that the entire sales could not be added as income of the assessee but addition could be made only to the extent of estimated profits embedded in sales.
- Further, on the issue of interest disallowance, on perusal of the financial statement of the Appellant (Personal) and M/s. Kanoria Enterprises (Business), the entire capital of M/s. Kanoria Enterprise was sourced from the loan and there is no contrary evidence that the loan was utilized elsewhere than making investment in the business.
- Furthermore, the allegation of the CITA that interest was very high as compared to closing balance was not tenable as the whole interest amount was paid through banking channels to various parties. Hence, contention of the CITA was wrong.
- Therefore, the entire amount of interest was allowed as business expense under Section 36(1)(i) or 37(1) of the Income Tax Act.

- The ITAT found merits in the contention of the Appellant and allowed the appeal and ordered to delete the addition of difference amount of Rs. 66,35,957/- and disallowance of interest of Rs. 2,63,660/-.

Relevant Provisions:

Section 36(1)(i) of the IT Act

(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28-

(i) the amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession;

Section 37(1) of the IT Act

(1) Any expenditure not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession.

Section 143(3) of the IT Act

(3) On the day specified in the notice issued under sub-section (2), or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment

Section 263 of the IT Act

(1) The Principal Commissioner, Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the Assessing Officer or the Transfer Pricing Officer, as the case may be, is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including,-

(i) an order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment; or

(ii) an order modifying the order under section 92CA; or

(iii) an order cancelling the order under section 92CA and directing a fresh order under the said section.

(1) No order shall be made under sub-section (1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed.

(2) Notwithstanding anything contained in sub-section (2), an order in revision under this section may be passed at any time in the case of an order which has been passed in consequence of, or to give effect to, any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court.

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