

Sub: Response to Show Cause Notice dated issued regarding rejection of Books of accounts

Respected Sir,

This is in reference to the captioned assessee in the captioned matter. On perusal of the aforesaid show cause notice, it is observed that your goodself had show caused the assessee to explain why the books of accounts of the assessee for the period under consideration shall be rejected u/s 145 of the Act as the assessee had made sales amounting to Rs. 3,77,45,364/- to M/s. XYS alleged to be paper concerns.

In this regard it is submitted that the rejection of books of accounts is to be considered, while estimating the income there must be a comparison with other similar businesses or other entities of the same industry to form the basis of an acceptable estimate of the income, which in the present case has not been referred anywhere in the show cause notice. Estimating the income without any application of mind and on a whim, without any proper basis for the same is prejudicial and not justified to the assessee, being against natural justice it cannot be sustained under law.

It is a well settled principle of law that the Revenue cannot make any additions by presuming any facts and circumstances against the assessee. It is for the Revenue to prove the allegations levelled by them really exist. It is a fundamental principle that one need not take any assumptions and presumption in the taxing statutes. In order to reject the books, the AO should bring out that there has been a clear infringement of any accounting standard or accounting principles and prove the same by the way of concrete and material evidences and not merely on the basis of some assumptions and presumptions.

It is an undisputed law of the land that suspicion, however strong cannot take place of evidences and proofs and addition can be made only on the basis of relevant material and concrete evidences and not on the basis of mere surmises, conjectures, suspicion, presumptions or assumptions.

Therefore, the rejection of books of accounts must only be even considered after providing clear and material instances of any error/ misrepresentation that gives rise to any material and quantifiable concealment of income and must be based on some material evidence, and any rejection without clearly specifying the valid reasons for such rejection or any defects in the audited books of accounts as provided by the assessee along with all vouchers/ documents/ additional evidences as required by your good self, is against the natural justice and bad in law, hence it must be quashed.

Further, without prejudice to the above, the estimation of income made on an arbitrary estimate without any proper justification or any comparative basis for the estimate and without application of mind is against the natural justice and bad in law, hence it must be quashed.

In support of the above stand of the assessee we would like to rely upon and submit the following judgements of various judiciaries, as follows:

- In the case of **Dhakeshwari Cotton Mills vs. CIT (1954) 26 ITR 775 (SC)** wherein **Hon'ble Apex Court** held that AO cannot make any addition on the account of his guess work without having any material evidence on record. The relevant extracts of the said judgement are reproduced as under:

*"...that in making the assessment under sub-section 3 of section 23 of the Income Tax Act, 1922 [corresponding to the section 143(3) of the **Income tax Act, 1961**], the Income Tax Officer is not entitled to make a pure guess and make an assessment without reference to any evidence or any material at all. There must be something more than bare suspicion to support the assessment under section 23(3)"*

- And, in the case of **CIT vs. J.J. Enterprises (2002) 122 Taxman 124 (SC)** wherein the **Hon'ble Supreme Court** approving the decision of the lower authorities affirmed that the addition made on the basis of 'pure guess work' were unsustainable.
- Also, in the case of **State of Orissa vs. Maharaja B.P. Singh Deo (1970) 76 ITR 690 (SC)** wherein the Assistant Collector has not given no reasons for enhancing the assessment and his order does not disclose the basis on which he has enhanced the assessment. The **Hon'ble Supreme Court** held that the assessment must be based on some relevant material. It is not a power that can be exercised under the sweet will and pleasure of the concerned authorities.
- Reliance is further placed on the decision in the case of **Brij Bhushan Lal Parduman Kumar vs. CIT (1978) 115 ITR 524 (SC)** wherein it was held that in the best judgment assessment an honest and fair estimate of the income should be made and the same must not be capricious but should have a reasonable nexus to the available material and the circumstances of the case.
- Further, in the case of **State of Kerala vs. C. Velukutty (1966) 60 ITR 239 (SC)** it was held that though there is an element of guesswork in a 'best judgment assessment', it should not be a wild one, but should have a reasonable nexus to the available material and the circumstances of each case. Though the section provides for a summary method because of the default of the assessee, it does not enable the assessing authority to function capriciously without regard to the available material.

- Similarly, in the case of **CIT vs. Om Overseas (2008) 173 Taxman 185 (P&H)** it was held that the AO can't reject the book of accounts provided by the assessee without specifying proper adequate and sufficient reasons. The Hon'ble High Court held that,

"We find no force in the arguments raised by the learned counsel for the revenue. While allowing the appeal of the assessee, the CIT(A) has given a finding of fact that the additions have been made by the Assessing Officer without pointing out any specific defect in the books of account. The said finding has been further upheld by the Tribunal. During the course of arguments, learned counsel was unable to point out any illegality or perversity in the said finding of fact. Thus, we find no infirmity in the order of the Tribunal."

- Further, in the case of **CIT vs. Vikram Plastics (1999) 239 ITR 161 (Guj.)** it was found there was no discrepancy or defects in books of account maintained by assessee and further, the books of account maintained by assessee were not found to be incorrect or incomplete and that no material was brought on record by the revenue to prove that purchases and expenses had been inflated or sales had been suppressed. In this context the Hon'ble High Court held that,

"In our opinion, in view of the finding reached by the Tribunal that there were no discrepancies or defects pointed out in the books of account and further that they were regularly maintained and also on the finding that there was no material brought on record to establish that purchases or expenses were inflated or sales suppressed and also in view of the finding that this was not a case that there was no method of regular accounting employed, the Tribunal was fully justified in coming to the conclusion that the provisions of section 145(2) could not be invoked."

- Reliance is further placed on the decision in the case of **ITO vs. Abbey Chemicals Pvt. Ltd. (ITA no. 2875/Ahd/2004)** wherein the **Hon'ble Ahmedabad Tribunal** held that there lies no justification for the rejections of books of accounts on pure guess. The Hon'ble Tribunal held as under:

*"Undisputedly and as observed by the ld. CIT(A) in the impugned order the AO did not point out any defects in the books of account while ignoring the book results...The ratio of the judgments in *Dhakeshwari Cotton Mills Ltd. v. CIT* [1954] 26 ITR 775 (SC); *Raghubir Mandal Harihar Mandal v. State of Bihar* [1957] 8 STC 770 (SC); *State of Kerala v. C. Velukutty* [1966] 60 ITR 239 (SC); *State of Orissa v. Maharaja Shri B.P. Singh Deo* [1970] 76 ITR 690 (SC); *Brij Bhusan Lal Parduman Kumar v. CIT* [1978] 115 ITR 524 (SC); *Chouthmal Agarwalla v. CIT* [1962] 46 ITR 262 (Assam); *R.V.S. and Sons Dairy Farm v. CIT* [2002] 257 ITR 764 (Mad); *International Forest Co. v. CIT* [1975] 101 ITR 721 (J & K) ; *M. Durai Raj v. CIT* [1972] 83 ITR*

484 (Ker); Ramchandra Ramnivas v. State of Orissa [1970] 25 STC 501 (Orissa); Action Electricals v. Deputy CIT [2002] 258 ITR 188 (Delhi) and Kamal Kumar Saharia v. CIT [1995] 216 ITR 217 (Gauhati) indicate that the AO is not fettered by any technical rules of evidence and pleadings, and he is entitled to act on material which are not acceptable in evidence in a court of law, but while making the assessment under the principles of best judgment, the Income-tax Officer is not entitled to make a pure guess without reference to any evidence or material. There must be something more than a mere suspicion to support the assessment"

- The Hon'ble Supreme Court in the case of **CIT v. Padamchand Ramgopal [1970] 76 ITR 719** held that insignificant mistakes noticed in the books of account of one year, like one item of interest not brought into account or one item of receipt having been incorrectly recorded, cannot form the basis for rejection of books of account.
- The Hon'ble Karnataka High Court, recently, in the case of **CIT v. Anil Kumar & Co. [2016] 386 ITR 702/67 taxmann.com 278** held that, jurisdiction to estimate assessee's income is not available when books of account have not been rejected.
- The Hon'ble Allahabad High Court, recently, in the case of **CIT v. Pashupati Nath Agro Food Products (P.) Ltd dated 4th May 2017** held that, the Assessing Officer did not reject the books of account; it shows that the assessee has maintained the books of account as prescribed under Section 145 of the Act. If so, the Assessing Officer is not entitled to make any addition on account of sale of goods out of books or for investment in stock out of undisclosed sources.
- The Hon'ble Gujarat High Court, in the case of **PCIT v. Garden Silk Mills Ltd. [2017] 81 taxmann.com 128 (Gujarat)** approving the decision of the lower authorities affirmed that the Assessing Officer had fully accepted the purchase, sales, consumption, shortage, etc., of the assessee-company and he could not pinpoint any specific item in the working results for a specific addition in the assessment as disallowable item of expenditure, etc. Therefore, the Tribunal was justified in holding that the book results were rejected by the Assessing Officer on insignificant grounds.
- The Hon'ble Bangalore Tribunal, in the case of **DCIT v. Gajanan Traders [2006] 104 TTJ 1030 (Bangalore)** held that, "*The fall in GP is not a criteria for rejecting the books of account. There is no provision in the Act, which suggests that the day-to-day stock register has to be maintained, or in absence thereof, the books of account are liable to be rejected. What is required to invoke proviso to section 145 or to reject book results is to establish the incorrectness and incompleteness of the accounts, or where method of accounting followed by the assessee is inconsistent with*

the accepted method of accounting. Since no such case had been made out by the Assessing Officer, the Assessing Officer was not justified in rejecting the book results and making addition."

- In the case of **DCIT v. Hanuman Sugar (Khandsari) Mills (P.) Ltd. [2014] 221 Taxman 156 (Allahabad)** the Hon'ble Allahabad High Court approving the decision of the lower authorities affirmed that, the assessee cannot be penalized, especially when its books of account were properly audited and relevant vouchers were made available.
- The Hon'ble Mumbai Tribunal, in the case of **ACIT v. ITD Cementation India Ltd. [2013] 36 taxmann.com 74 (Mumbai - Trib.)** held that, where books of account of assessee were audited and auditor had not given any adverse comments in maintenance of books of account or stock register, it was apparent that assessee had maintained proper books of account and Assessing Officer was wrong in rejecting same.
- The Hon'ble Chandigarh Tribunal, in the case of **ACIT v. Maghan Paper Mills (P.) Ltd. [2018] 97 taxmann.com 281 (Chandigarh - Trib.)** held that, In the face of the complete quantitative information in connection with purchases, production and sales details available to the Assessing Officer who has not pointed out any defect with evidence in the audited books of account and there is no such finding of fact that the assessee has inflated the cost of raw material or cost of manufacturing or suppressed its sale prices order, or that it has made purchases of raw material or sale of finished goods outside the books. Since the quantum of production and turnover has been accepted, the rejection of books of account in the peculiar facts and circumstances has been held to be inapplicable and there is no good reason available on record on the basis of which the said conclusion can be varied.
- In the case of **Mayank kumar Natwarlal Soni v. ACIT, [2019] 111 taxmann.com 6 (Ahmedabad - Trib.)**, It was noted that Assessing Officer had rejected assessee's books of account without giving any specific details and cogent material which was in violation of principles of natural justice.
- The Hon'ble High Court of Punjab and Haryana, in the case of **CIT v. Patiala Distt. Co-op. Milk Producers' Union Ltd. [2011] 197 Taxman 172 (Punjab & Haryana)**, affirmed the order of the hon'ble tribunal that held, *"we have not found any infirmity in the impugned order specially when the Assessing Officer has not assigned any reason while coming to a particular conclusion specially when no defect was pointed out in the valuation of closing stock. The assessee has followed the FIFO method while valuing the stock at cost and copies of bills were submitted during the assessment proceedings and the latest rates were available with the assessee in respect of its products. In the light of these facts it can be said that the learned Commissioner of Income-tax (Appeals) is justified in coming to a particular conclusion specially when the ACIT, vide letter dated February 28, 2008, addressed to the learned first appellate authority has merely affirmed the stand taken in assessment*

order and nothing adverse had been pinpointed. This letter was duly considered in the impugned order which was passed on April 21, 2008. In the light of these facts, the stand of the learned Commissioner of Income-tax (Appeals) is upheld."

- The Hon'ble Jabalpur Tribunal, in the case of **Waidhan Engineering & Industries (P.) Ltd. v. JCIT [2015] 60 taxmann.com 440 (Jabalpur - Trib.)** held that, *"no defects have been noticed in the books of account. As for the Assessing Officer's observation that some of the expenditure is supported by self-made vouchers, the mere fact that some expenditure is supported with self-made vouchers can never be reason enough which is sustainable in the eyes of law to reject the books of account as a whole. In case, the Assessing Officer was not satisfied about the authenticity of the support for this expenditure, nothing prevented him from exploring the possibilities of disallowance with respect to that expenditure. However, the course of action he adopted, i.e., in rejecting the books of account though only to the extent of consumption of material cannot be given any judicial approval."*
- The Hon'ble Jaipur Tribunal, in the case of **Zuberi Engineering Company v. DCIT [2019] 103 taxmann.com 196 (Jaipur - Trib.)** affirmed that, rejection of books of account in preceding year could not be a reason for rejection of books of account for year under consideration. And that, where there were no material defects found in books of account then same could not have been rejected on reason that assessee had declared less gross profit for year under consideration or day-to-day movement of material was not reflected in stock register.

The ratio laid down by the Hon'ble Courts of our Country clearly shows that if the proceedings have been concluded merely with a preconceived notion, guided by mere presumptions, surmises and conjecture on the premise that the assessee's books were incorrect without having any concrete evidentiary material evidence on record then such rejection cannot be sustained in the eyes of law.

In view of the above, it is requested that the rejection of books of accounts devoid of any logical reasoning and against legal precedents is liable to be quashed.

We hope that you are in agreement with the above submission, in case your good self is not in agreement with the above you are requested to please provide your reasons for the same in writing and a reasonable opportunity of being heard may please be provided to the assessee in due course, we shall be pleased to submit any other information as required by your good self in this regard. Please do the needful and oblige.

Thanking You,