

ITAT affirms rejection of books in absence of adequate particulars necessary to deduce correct operating results

Summary – The Mumbai ITAT in a recent case of Mahesh Enterprises., (the Assessee) held that where assessee had not maintained any stock register and there was no basis to verify material consumption, assessee's books of account as maintained were not amenable to yield correct operating result and therefore, same was rightly rejected under section 145(3). Under circumstances of rejection of books of account in case of assessee being a civil contractor, presumptive statutory rate as prescribed under section 44AD provide a good guideline for purpose of estimation of income.

Facts

- The assessee was a civil contractor. It executed contracts for labour as well as on labour plus material basis. It followed the 'method' of writing off its purchases for the year to the operating statement, treating the same as 'consumed'.
- The Assessing Officer found that assessee has not maintained any stock register and thus, there was no record to verify the consumption of material. The Assessing Officer invoked section 145(3) and rejected the books of account of the assessee.
- The Assessing Officer further assumed material consumption rate at 36 per cent and worked out the excess consumption at Rs. 40.66 lakh.
- On appeal, the Commissioner (Appeals) deleted the addition made by the Assessing Officer. On revenue's appeal:

Held

Assessee's books of account stand rightly rejected by Assessing officer

- The ITAT held that the assessee is not maintaining any stock register, so that there is no basis to verify the material consumption, which constitutes a very significant part of its operating cost. The assessee is following the 'method' of writing off its purchases for the year to the operating statement, treating the same as consumed. There is no basis to state that the material is actually consumed as soon as it is purchased, or that the assessee maintains no inventory thereof. The accounts as maintained are thus admittedly inconsistent with the actual, obtaining state of affairs, which the books of account of any entity or enterprise are supposed to reflect. That this method of accounting has been followed from year to year, does not in any manner mitigate the defect, or justify its adoption.
- The assessee's books of account, as maintained, cannot yield correct operating results, and the same have rightly been not accepted by Assessing Officer by applying section 145(3).

Presumptive statutory rate under section 44AD provides a good guideline for estimation of income

- Section 145(3) mandates for making the assessment in the manner as provided in section 144, i.e., according to the best judgment of the assessing authority, taking all the relevant material into account. The assessee has relied on case law, i.e., *Kesharbhai Ghamarbhai Chaudhary v. ITO* [2012] 23 taxmann.com 273 (Ahd.), to the effect that under the circumstance of rejection of books of account, the prescription of section 44AE; the assessee in that case being a transport operator, is a good guideline for the purpose of estimation of income.
- The presumptive provision in the case of civil contractors is section 44AD, which provides for a net profit rate of 8 per cent. The matter is purely factual, though the prescribed presumptive statutory rate, applicable for assessees with a turnover of up to Rs. 40 lakh, without doubt provides a good guideline. The Apex Court in *Brij Bushan Lal Parduman Kumar v. CIT* [1978] 115 ITR 524 approved a profit rate of 10 per cent. The Tribunal has in such cases upheld profit rates varying from 8 per cent upwards to as much as 20 per cent, or even higher. A net profit rate of 10 per cent on the assessee's contract receipt of Rs. 360.86 lakh, i.e., involving material consumption, would be a reasonable estimate. *Qua* its labour receipt of Rs. 82.95 lakh, a net profit rate of 20 per cent, in view of a much lower base, as appropriate under the given facts and circumstances of the case.
- The ITAT therefore directed the Assessing Officer to work out the assessee's income for the year by applying the said percentages.