

AO couldn't reject books of account if assessee proved that profits decreased due to increase in cost of materials

Summary – The Jaipur ITAT in a recent case of British Health Products (I) Ltd., (the Assessee) held that Where Assessing Officer had rejected books of account of assessee on ground that there was decline in GP/NP and that accounts of three parties had not been reconciled, however, assessee explained that decrease in GP and NP were due to increase in cost of material and excise duty and also filed reconciliation of accounts of three parties, books of account could not have been rejected

Facts

- The assessee Company was engaged in the manufacturing of health food and Ayurvedic products and during the year under consideration it had started manufacturing a new product.
- During the assessment proceedings the Assessing officer verified that there was decline in the gross profit as well as in net profit and major part of the purchases were not verifiable and the quantitative details and stock register had not been produced for verification. Thus, the Assessing Officer rejected books of account of the assessee under section 145(3) on ground that there was decline in GP/NP and that accounts of three parties had not been reconciled. Accordingly, addition of Rs. 64.90 lakhs was made.
- On appeal, the Commissioner (Appeals) partly allowed the appeal by observing that the assessee had explained reasons for fall in GP and NP, which was due to increase in price of raw material, packing material and other factory expenses besides reduction in selling price. He thus applied GP at the rate of 12.23 per cent as against GP rate of 10.23 per cent declared by the assessee. Thus, he confirmed addition of Rs. 25.84 lakhs and remaining addition was deleted.
- On further appeal to the Tribunal the Judicial Member noted that where the accounts were consistently maintained by the assessee and accepted in past and there was no material to indicate how the method of accounting was defective, the Assessing Officer could not have rejected method of accounting. The Judicial Member also noted that mere fall in GP rate by itself was no ground of rejecting the books of account of the assessee. He therefore, deleted the addition confirmed by the Commissioner (Appeals) and dismissed the revenue's appeal.
- The Accountant Member however upheld the order of the Commissioner (Appeals) for rejection of books of account under section 145(3). He held that the Judicial Member had deleted the addition confirmed by the Commissioner (Appeals) and also dismissed the revenue's appeal by giving general finding and not considering the specific defects pointed out by the Assessing Officer and directed that matter be remanded to the Assessing Officer for taking a decision as per law.
- Since there was a difference of opinion between the Judicial Member and the Accountant Member, therefore, following questions were being referred to be answered by the Third Member ;

- (i) Whether justification given by the assessee before the Commissioner (Appeals) about the decline in GP and NP was reasonable?
- (ii) Whether defects pointed out by the Assessing Officer for rejection of books of account under section 145(3) were reasonable?

Held

- The Assessing Officer examined the books of account of the assessee at the assessment proceedings as well as at the remand proceedings. The Assessing Officer found that there was low GP and NP ratio in the year under consideration as compared to earlier years. The assessee filed details before the Assessing Officer and it was explained that the decrease in GP and NP were due to increase in the cost of material and excise duty. The assessee also produced bills for consideration of the Assessing Officer. It is not in dispute that during the year under consideration the assessee has also started manufacturing of new produce *i.e.* Glucose. The assessee had prepared a recasted trading/manufacturing account which was before the Assessing Officer in the remand proceedings and said details were filed before the Commissioner (Appeals). The assessee filed its reply before the Commissioner (Appeals) in which it was explained that the assessee produced annual stock register providing details of opening stock, total annual purchase item-wise, consumption and closing stock. All original bills of purchase and ledger were produced. The fall in GP was mainly for increase in the cost of raw material as compared to the earlier years which is clarified and is also reproduced in the order of the Judicial Member. It was, therefore, explained that due to increase in the cost of consumption of raw material and packaging material there was a fall in GP and NP. These details were on consolidated basis including the start of commercial production of glucose during the year under consideration. The GP margin of the Glucose was lesser as compared to other items. The Assessing Officer has not adversely commented upon the explanation of the assessee in the remand report. The Assessing officer has not pointed out any specific defect in maintenance of book of account what so ever in the remand report on the explanation of the assessee. The assessee also filed reconciliation of the accounts of three parties. The remand report has also been reproduced in the order of the Judicial Member in which the Assessing Officer asked for complete details of all the three parties which were submitted before the Assessing Officer and the Assessing Officer accepted the explanation of the assessee with regard to the reconciliation in the account balance of two parties. However, no adverse comments have been given against the third party. The assessee filed complete details in respect of third party before the Commissioner (Appeals) as well as before the Assessing officer in the remand proceedings and also furnished complete details including the confirmation of account and current address of the said party, therefore, on the face of evidences and material on record in the light of remand report of the Assessing Officer, no adverse inference can be drawn in respect of the alleged difference in the accounts of three parties. The Assessing Officer in the remand report also mentioned that the assessee produced printouts of computerized day-to-day stock register of raw material and packed material and produced the manual register of stock of furnished goods. It is also admitted fact that the assessee at the assessment stage had filed

quantitative details of valuation of stock. The Judicial Member in the light of the evidence and material available on record and remand report of the Assessing Officer noted that the entire transaction with third party were conducted through banking channel. The Judicial Member also addressed the issue whether the Assessing Officer was justified in invoking the provisions of section 145(3). The Judicial Member correctly noted that where the accounts are consistently maintained by the assessee and accepted in past and there is no material to indicate how the method of accounting was defective, the Assessing Officer cannot reject method of accounting. The Judicial Member rightly noted that mere fall in GP rate by itself is no ground of rejecting the books of account of the assessee. In the instant case, the Assessing Officer has alleged mainly two reasons for rejection of books of account *i.e.* there was decline in GP/NP and that accounts of three parties have not been reconciled. The assessee, however, explained both the issues before the Assessing Officer at the assessment stages as well as in the remand proceedings. The stock registered along with quantitative details were also furnished and all the items of the assessee were subject to scrutiny by excise department have not been adversely commented upon by the Assessing Officer. The assessee, therefore, successfully explained the fall in GP/NP rate which have been rightly considered by the Judicial member, therefore, there is no material on record to justify the rejection of methods of accounting or books of account in the matter or to apply higher GP/NP rate in the matter.

- Thus, in the light of the material on record, it is clear that on both the points raised by the Assessing Officer, the assessee explained the issues satisfactorily. There was no reason to reject the books of account under section 145(3). It is not always necessary that the profit rate would remain static because it would depend upon several other factors which should be considered from the point of the view of the businessman. Mere low profit by itself is no ground for rejection of books of account of the assessee. The Judicial Member was therefore, justified in allowing the appeal of the assessee and dismissing the Departmental appeal. The Accountant Member, however, confirmed the rejection of the books of account under section 145(3) and directed that matter be remanded to the Assessing Officer for taking a decision as per law. When sufficient material was available on record and the Commissioner (Appeals) has already called for the remand report from the Assessing Officer at appellate stage, there was no reason to restore the matter back to the Assessing Officer for taking decision in the matter. The matter should have been decided by the Tribunal itself at the second appellate stage in such circumstances. Therefore, the findings of the Accountant member are not agreeable. The view of the Judicial Member that books of account should not be rejected and profit declared by the assessee for the year under consideration should not be disturbed is agreeable. Therefore, it is held that the assessee had given reasonable justification for the decline in GP and NP rate and, therefore, books of account should not be rejected under section 145(3). Therefore, the view of the Judicial Member is agreeable.