Garden Silk Mills,, Surat vs Department Of Income Tax on 15 October, 2015

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  IN THE INCOME TAX APPELLATE TRIBUNAL
           " D " BENCH, AHMEDABAD

   -           ,                              ,
BEFORE SHRI KUL BHARAT, JUDICIAL MEMBER And
  SHRI MANISH BORAD, ACCOUNTANT MEMBER

                        ./I.T.A. No.720/Ahd/2009
             (             / Assessment Year : 2005-06)
The ACIT Central Circle-1               / Garden Silk Mills Ltd.
Room No.505Aayakar Bhavan Vs. Garden Mills Complex
Majura Gate                               Sahara Gate
Surat                                     Surat
              . /i  ¢      . / PAN/GIR No. : AAACG 8932 C
      (      ' /Appellant)           ..      (()  ' / Respondent)

         ' £     /   Appellant by   :   Shri Sanjay Agrawal,CIT-DR
     ()  '  + £    /Respondent    by :    Shri J.P. Shah, AR

        /  +    .  /
                      Date of Hearing              08/09/2015
     ¥      +    .  /Date of Pronounce ment        15/10/2015

                                   ƒ / O R D E R

PER SHRI KUL BHARAT, JUDICIAL MEMBER :
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This appeal by the Revenue is directed against the order of the Ld.Commissioner of Income Tax(Appeals)-I, Surat ['CIT(A)' in short] dated pertaining to Assessment Year (AY) 2005-06. The Revenue has raised the following grounds of appeal:-

> 1. The CIT(A) has erred in law and on facts in deleting the additions made by the Assessing Officer on account of estimation of profit by rejecting the books of accounts u/s.145 of the I.T.Act when the ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06 defects in the books of accounts were clearly pointed out and established by the Assessing Officer that there were defects in the books of accounts maintained by the assessee.

2. On the facts and in the circumstances of the case and in law, the CIT(A) ought to have upheld the order of the A.O.

3. It is, therefore, prayed that the order of the CIT(A) be set aside and that of the A.O. be restored to the above extent.

2. This Tribunal has recalled its order dated 15/02/2013 on the ground that certain facts stated in paper-book were overlooked resulting into mistake apparent from record. Accordingly, the order dated 15/02/2013 in the present appeal was recalled vide order dated 27/1/2014. The appeal was directed to be fixed for hearing afresh. Hence, the appeal is fixed for hearing today and taken up for hearing afresh.

2.1. Briefly stated facts are that the case of the assessee was picked up for scrutiny assessment and the assessment u/s.143(3) of the Income Tax Act,1961 (hereinafter referred to as "the Act") was framed vide order dated 31/12/2007, thereby the Assessing Officer (AO in short) made disallowance of commission paid to its Director of Rs.88,00,000/- and disallowance of expenditure by invoking provisions of section 14A of the Act of Rs.298/-. The AO after rejecting the books of accounts of the assessee made estimation of profit and, thereby made addition of Rs.31,31,87,129/- being 5% of net turnover considering the same as suppression of Gross Profit (GP). Further, the AO made disallowance of interest of Rs.1,88,84,000/- and made disallowance of depreciation of ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06 capital goods of Rs.62,23,134/- and computed the book profit at Rs.2,15,36,320/- as against the book profit declared by the assessee of Rs.2,02,69,269/-. The assessee aggrieved by this order, preferred an appeal before the ld.CIT(A), who after considering the submissions of the assessee deleted the addition made on account of estimation of GP by holding that AO was not justified in rejecting the books of accounts. However, ld.CIT(A) sustained the addition made on account of undervaluation of work-in-progress in the closing stock to the extent of Rs.1,15,63,596/-. Aggrieved by this order of the ld.CIT(A), the Revenue is now in appeal before us.

3. The only effective ground in this appeal is against deletion of addition made by the AO on account of estimation of profit by rejecting the books of accounts u/s.145 of the Act. The ld.CIT-DR Shri Sanjay Agrawal argued at length and submitted that the ld.CIT(A) was not justified in holding that the books of accounts were not validly rejected by the AO. He submitted that the AO had pointed out various defects into the books of accounts of the assessee. He submitted that there was suppression of work-in-progress. He submitted that the books of accounts can be rejected if there is any suppression of work-in-progress and in support of this contention, he placed reliance on the decision of the Coordinate Bench (ITAT "D" Bench Ahmedabad) rendered in the case of Archna Dyeing & Printing Mills Pvt.Ltd. vs. ITO in ITA ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06 No.268/Ahd/2009 for AY 2005-06, dated 25/11/2011. Further, the ld.CIT-DR submitted that one of the reasons for rejecting the books of accounts was that the sundry debtors figure did not match with the corresponding company. He further submitted that the AO observed that there was a huge difference between the statement of stock furnished before the bank on 25/03/2009 and the closing stock as disclosed before the revenue authorities on 31/03/2009. He further submitted that the AO noted that the assessee has not provided the quantitative details of the ready-made garments to the auditors. The AO also observed that there were inter-group transactions, however, there was no statement to the effect is made in the balance-sheet. He further submitted that the assessee failed to furnish the separate trading accounts. The ld.CIT-DR submitted that the AO was justified in rejecting the books of accounts. In support of this contention that since there was difference in the statement of closing stock as provided to the bank the books of accounts can be validly rejected, the ld.CIT-DR placed reliance on the judgement of Hon'ble High Court of Kerala rendered in the case of S.Murugappa Chettiar vs. CIT reported at (1988) 174 ITR 0245 (Ker.). To buttress the contention that there was no slump in the business of Textile, the ld.CIT- DR placed reliance on the Annual Report 2004-05 published by the Ministry of Textiles. The ld.CIT-DR relied on the judgement of Hon'ble Apex Court rendered in the case of Arisudana Spinning Mills Ltd. vs. CIT reported at (2012) 26 taxmann.com 39(SC) in support of the ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06 contention that the assessee is required to maintain separate trading accounts for the activities undertaken by the assessee. The ld.CIT-DR also placed reliance on the judgement of Hon'ble High Court of Madras rendered in the case of Coimbatore Spinning & Weaving Co.Ltd. vs. CIT reported at (1974) 95 ITR 375 (Mad.) in support of the contention that heavy burden lies on assessee to prove that books of accounts alone give correct picture and not that declared to banks. The ld.CIT-DR drew our attention towards the assessment order and the order of ld.CIT(A) and submitted that the AO pointed out specific defects, consequently he was justified in rejecting the books of accounts. He submitted that there is no quarrel with regard to the fact that there is steep fall into gross profit in the year under appeal. He submitted that the assessee failed to give plausible explanation for such fall in gross profit. He submitted that the assessee was required to explain the reason for fall in G.P. 3.1. On the contrary, ld.counsel for the assessee opposed the submissions of the ld.CIT-DR and submitted that the submissions of ld.CIT-DR are misplaced and ill-founded. He submitted that the ld.CIT(A) has elaborately discussed the issue and rightly came to the conclusion that the AO was not justified in rejecting the books of accounts of the assessee. The ld.counsel for the assessee submitted that the reason for fall in gross profit was duly explained to the AO, but the AO on the basis of whims and fancies proceeded to reject the books of accounts. The ld.counsel for the assessee submitted that there is no ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06 dispute with regard to the fact that the AO has neither doubted the sales nor purchases. He submitted that the AO has not mentioned any instance of any bogus purchases or inflated purchases. He submitted that the assessee is a public limited company and is subjected to audit by Statutory Auditor as well as the Auditor of the Company. The Auditors have not made any adverse remarks with regard to the accounts of the assessee-company. He submitted that the ld.CIT(A) has rightly examined the point-wise objections of the AO in respect of rejection of books of accounts. The ld.counsel for the assessee submitted that at the cost of repetition the basis of the AO for rejecting the books of accounts is, firstly, with regard to improper disclosure of work-in-progress. Secondly, sundry debtors figure does not match with the balance-sheet of the corresponding company, inter-group transactions, non-furnishing of quantitative details for ready-made garments, no proper disclosure of the person covered u/s.40A(2)(b), non-furnishing of separate trading accounts and transfer to general reserve. He submitted that the AO is not correct in reaching to the conclusion that the books of accounts of the assessee do not give true and fair picture of the profit. The ld.counsel for the assessee submitted that the AO failed to appreciate the facts in right perspective. He submitted that there is no reason as to why the assessee would make an attempt to give wrong or incomplete accounts, when admittedly it is subjected to multitier auditing. The ld.counsel for the assessee submitted that the AO has not doubted the purchases and sales ACIT vs.

Garden Silk Mills Ltd.

Asst.Year - 2005-06 and has also not given reasoning as to how the basis taken for rejection of accounts would affect the profit. The ld.counsel for the assessee, in respect of the contention of the ld.CIT-DR made on the issue of disclosure of stock to the bank and to the Revenue, relied upon the judgement of Hon'ble High Court of Gujarat rendered in the case of CIT- Ahmedabad-III vs. Riddhi Steel and Tubes (P.) Ltd. reported at (2013) 40 taxmann.com 177 (Gujarat). The ld.counsel for the assessee submitted that the AO failed to appreciate the fact that fall in gross profit was due to steep rise into the cost of raw-material. He submitted that the assessee is engaged in the business of manufacturing and is substantially dependent on raw-material. He submitted that in the instant case, there is increase in raw-material price and decrease in sale price due to tough competition. Further, he submitted that looking to the volume of turnover, the activity of ready-made garment is miniscule. It will have negligible impact on the GP of the assessee, hence has no significance. Under these facts, the observation of AO that if there is increase in turnover, it would automatic give rise to the gross profit is misplaced. Moreover, the AO failed to appreciate the fact that there is fall in sale realization. Therefore, he submitted that the entire edifice of reasoning for rejection of books of accounts is ill-founded, misplaced and is based on conjectures and surmises. The ld.CIT(A) has dealt with each objection of the AO in right perspective.

ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

4. We have heard the rival submissions, perused the material available on record and gone through the orders of the authorities below. The only issue that needs to be examined is whether the AO was justified in rejecting the books of accounts consequently estimating the profit. The reasons for rejection of the books of accounts as enumerated in assessment order are reproduced herein below:-

(i) Improper disclosure of work-in-progress.

(ii) Sundry Debtors figure does not match with the balance sheet of corresponding company.

(iii) Huge difference between stock declared in the books of accounts and stock statement submitted to banks for securing work in capital.

(iv) Non-furnishing of quantitative details for readymade garments.

(v) No proper disclosure of the person covered u/s.40A(2)(b).

(vi) Inter-group transactions.

(vii) Non-furnishing of separate trading accounts.

(viii) Transfer to General reserve.

4.1. There is no dispute that the AO is empowered to reject the books of accounts. The question is whether such powers are unfettered can be exercised on the basis of whims and fancies only or the powers to be exercised on the basis of settled principles of law. As per section 145(3) of the Act, the books of accounts can be rejected where the AO is not satisfied about the correctness or completeness of the accounts of the assessee. In that event, the AO is empowered to proceed for making an assessment in the manner provided u/s.144 of the Act. The test of ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06 validity of action of the AO for rejecting the books of accounts and estimation of profit would be on touch stone of a conjoint reading of both the section 145 and 144 of the Act. Any violation thereof would vitiate the action of AO. As per section 145 of the Act, at the outset, the AO has to satisfy himself about the correctness or completeness of the accounts or about the method of accounting applied by the Assessee. In the absence of such satisfaction, the powers so exercised would become illegal and unjustified. In the case in hand, the AO has stated about eight grounds for rejection of books of accounts. However, the ld.CIT(A) dealt with each defect and rejected the reasons of AO by observing as under:-

"5.3.3 The grounds of which the A.O. has rejected the books of account are now discussed with appellant's arguments: -

> 1) Improper disclosure of work-in-progress:- The A.O. has argued that the assessee has not completely disclosed the work-in-progress. In the assessment order, the A.O. has stated that the assessee has shown work-in-progress of Rs.3,42,654/- in the closing stock, which is not correct. The A.O. has thereafter worked out the closing stock as per calculation given in the assessment order on page-17 & 18. As per this calculation, the A.O. has stated that in general a beam mounted a moon is of 50 Kgs.

of yarn. There are 1314 looms. The cloth and yarn on the looms has to be taken as work-in-progress. The value of the work-in-progress worked out by the A.O. is Rs.1,19,06,250/-. During the appellate proceedings, the appellant has argued that it has been consistently followed the method from earlier years and the Department had accepted its calculation. The A.O. has not disputed the method of accounting and, therefore, provisions of Section 145(3) cannot be invoked. The appellant has stated that the A.O. has not understood the manufacturing process. The yarn and cloth on the loom have been included in the closing stock. The appellant argued that as and when the cloth is ready the same is cut from the beam and taken into finished product. The A.O. has stated that the appellant has not given any evidence of following this method. The appellant has also not produced the physical inventory taken at the end of the year in this regard as an evidence. He, therefore, rejected the ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 10 -

books of account. The appellant has on the other hand argued that without prejudice to the above argument even if the work-in-progress in the closing stock has not been shown correctly the right and accepted method of the Department is to make an addition to the work-in-progress and not reject the entire books of account. I agree with this submission. If the closing stock value of work-in-progress is not correctly shown then the right action is to make an addition in respect of undervaluation of work-in-progress. Since the appellant has not produced the copy of physical inventory taken at the end of the year as an evidence for the work-in- progress in the closing stock the valuation made by the A.O. is correct. An addition of Rs. 1,15,63,596/- (Rs.l,19,06,250 - Rs.3,42,654) needs to be made to the total income. This ground however cannot be the ground for rejecting the books of account.

2) Sundry Debtors figures do not match with the balance sheet of corresponding company.- In the assessment order, the A.O. has stated that the assessee has shown in the balance sheet of Creative Processing Ltd. (CPL) as sundry debtors of Rs.2.5 crores whereas the balance sheet of CPL shows sundry creditors of Rs.1.26 crores. Similarly, the assessee has shown sundry debtors of Rs.26.16 crores in the name of Surat Textile Mills Ltd. (STML) whereas STML shows total sundry creditors of only Rs.4.26 crores. According to the A.O., the appellant could not explain the above discrepancy and tried to reconcile the same with the figure of Rs.27.7 crores appearing as advance payment in the balance sheet of STN1L. The appellant has however stated that the contention of the A.O. is totally wrong. I have gone through the submission of the appellant as discussed in the paragraphs above. The A.O. has not compared the detailed accounts. He has gone on the basis of total sundry creditors instead of going into the details of groupings. The said groupings of CPL shows the following:-

Account Group Account Name Cr. Balance Dr. Balance Code Code 153073 070501 Cur. Ass: S. 0 1,81,74,209 Deb, control job charges 153090 070501 CA: S. Debtors 0 55,700 cont. computer design Mills Limited ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 11 -

164107	070501	Kamla Associates	0	59,39,823
		Sub-total	2,05,84,620	2,41,69,732
Net Disclosed in Balance Sheet				3585112

From the above table, it is very clear that the balance of the appellant company of Rs.2.50 crores has been shown by the appellant but it has been grouped under different head. Both the companies, CPL as well as the appellant company are assessed with the same A.O. and hence this could have easily verified by the A.O. With respect to the difference in balances of STML and the appellant company, the detailed groupings in the books of STML are as under:-

Account Group Account Name Cr. Balance Dr. Balance Code Code B17001 080201 Garden Silk 0 17260245 Mills Ltd.

Mills Ltd.

Sub-total	278832575	17260245
Net Balance		261572330

From the above table it is clear that the balance of Rs.26.16 crores is clearly reflected in the books of STML but has been grouped as above. If the A.O. had compared the detailed groupings the reconciliation given by the appellant would have been clearly seen. The appellant has also filed confirmation from both STML as well as CPL in this regard. The appellant has further argued that once the reconciliation is done it is immaterial as to the groupings of balance sheet. The presentation of debtors and creditors in different groups does not change the income and do not render the books unreliable or incomplete. I have verified the above detailed groupings. I agree with the appellant that there is no discrepancy in the balances of the appellant with CPL as well as STML. Hence, this ground for rejecting the books of account is not sustainable.

ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 12 -

3) Huge difference between stock declared in the books of account and stock statement submitted to the Bank for securing work in capital:- In the assessment order, the A.O. has stated that as per the statement submitted to the Bank the assessee has shown stock of finished goods of Rs.37 crores whereas as per the books of account as on 31.03.2005 the stock of finished goods was Rs.32.85 crores.

Similarly, the stock of raw material submitted to the Bank shows a stock of Rs.16.18 crores whereas as per the books of account as on 31.03.2005 the stock of raw material is Rs.33.14 crores. This shows that there was a huge difference in the stock statement submitted to the Bank as compared with stock statement in the books of account. The assessee stated that the details of textile hypothecation stock were as on 25.03.2005. However, in his letter to the Bank the assessee mentioned that this statement is for March 2005 which was submitted on 18.04.2005. The assessee, therefore, cannot say that the stock statement submitted is dated 25.03.2005 whereas it should actually been 31.03.2005. The appellant has on the other hand argued that the statements given to the bank clearly show that the stock statement submitted to the Bank was as on 25.03.2005. There is no requirement under the Law that the statement to be submitted to the Bank should also be as on 31.03.2005. If the Banks are accepting the statement as on 25.03.2005 this does not mean that the books of accounts are wrong. The appellant further argued that the stock mentioned in the books of account in respect of each item is more than the stock statement submitted to the Bank and hence the Department cannot have any case that either there should be an addition or the books of accounts are wrong. The stock statement only shows the value and not the quantity. Further, the stock statement to the Bank shows Rs.37.11 crores of total finished product and work-in- progress and not only finished goods as stated by the A.O. The comparison of the stock as per the books and stock as per statement given to the Bank is as under:-

Details of stock as per books as on Details of stock as on 25-3-

31-3-2005			2005 as submitted to Bank	
No.	Particulars	Rs.	Particulars	Rs.
1.	Stores, Spare parts, chemicals	82,857,209	Stores, Spares	44,963,000
2.	Finished Goods	328,525,795	Finished goods	29,38,90,000
3.	Stock in process	342,652	Stock in process	32,253,000

ACIT vs. Garden Silk Mills Ltd.
Asst.Year - 2005-06

- 13 -

4.	Raw materials	331,495,383	Raw materials	161,898,000
	Total	750,089,927		533,004,000

From the above table, it is clear that the value of stores, spares and chemicals as per books is more than the statement given to the Bank. The value of finished goods as per books is more than given to the Banks. The value of stock in process is less but for that the A.O. has already made separate addition of Rs.1.19 crore. The value of raw-materials as per books is more than as per Bank statement. I agree with the appellant except for stock in process all the other closing stock value are higher in the books of account than shown in the statement with the Bank. Therefore, this ground cannot be reason for rejecting the books of account. The addition on respect of stock in process has already been made as discussed under the first head above. Hence this ground is not the correct ground for rejecting the books of account.

4) Non-furnishing of quantitative details for readymade garments:- In the assessment order, the A.O. has stated that the turnover of readymade garment is

Rs.18,46,131/-

and the assessee has not given quantitative details and, therefore, he has rejected the books of account. The appellant has stated that this objection has been raised without application of mind because the return of income vide point No. 14 clearly shows that complete quantitative information for garments was furnished, the annual accounts for 2004-05 gives the opening stock, closing stock, purchase details of these garments. The appellant however argued that on a total turnover of the appellant of almost Rs.626.37 crores the garment turnover of Rs.18.46 lacs does not constitute major item and hence this ground for rejecting the books of account is wrong. I agree with the appellant. The annual accounts show the details of quantity and value of opening stock and closing stock. There are no purchases during the year and hence the sales figure is also automatically obtained by subtracting the closing stock quantity from the opening stock quantity. In any case, the entire turnover of readymade garments is very small and hence it cannot be made grounds for rejecting the books of account.

5) No proper disclosure of the persons covered u/s.40A(2)(b):- In the assessment order, the A.O. has stated that the name of Kamla Associates and Creative Processing Ltd. (CPL) are shown under 40A(2)(b) even though there are large number of transactions with them. The appellant has on the other hand stated that the ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 14 -

group concern Kamla Associates and CPL has no common Directors with the appellant company's Directors which is clear from the following table:-

No	Name of the Concern	Names of the trustees/ directors
1.	Kamla Associates	1.Smt. Sonia Firoz Khan 2. Shri Kanubhai B. Patwa
2.	Creative Processing Limited	1. Shri Tejas Manubhai Jani 2. Shri Harish Bharuchi 3. Shri Abhijit Barua
3.	Garden Silk Mills Limited	1.Shri Praful A. Shah 2.Shri Alok P.Shah 3. Smt. Shilpa P.Shah 4.Shri S.B. Bhesania 5.Shri Rajen P.Shah 6.Shri S.J.Bhesania 7. Shri H.F.Shah 8.Shri J.P.Shah 9.Shri A.N.Jariwala 10.Shri Sunil Sheth 11.Smt.Smita Shah 12.Shri Madanlal Lankapati 13.Shri Y.N.Ramamurty (Nominee)

In view of the above, the appellant says that the provisions of Section 40A(2)(b) is not applicable. The observation of the A.O. that Kamla Associates is holding 95.95% of shares of CPL does not make either of them or both of them covered u/s.40A(2)(b) with respect to the appellant. The appellant further argued that even if they are taken as group concerns and covered u/s.40A(2)(b) still without finding any defects books of account cannot be rejected. The appellant has further argued that if an addition is required to be made u/s.40A(2)(b) then the Act provides for such specific addition but rejection of books of account is not warranted. I agree with the appellant. An issue of addition u/s.40A(2)(b) requires specific addition and not rejection of books of account. Hence this ground cannot be made as a ground for rejection of books of account.

ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 15 -

6) Inter group transactions:- In the assessment order, the A.O. has stated that there are certain payments against the expenses of the assessee company which are routed through the books of CPL and vice versa. According to the A.O., this shows that the maintenance of books of account is not proper. The appellant has stated that there are no adverse qualifications by the auditors in this regard as stated above CPL is not covered by provisions of Section 40A(2)(b) and, therefore, these payments were not qualified in the tax audit report. The appellant argued that the A.O. has made no mention of specific disallowances on account of such transactions in the assessment order and in the absence of the same this ground cannot be made a ground for rejection of books of account. I agree with the appellant. The A.O. has brought no instance or specific transaction on record which warrants disallowance or addition. In the absence of any such findings of a major amount the books of accounts cannot be rejected.

7) Non furnishing of separate trading account:- In the assessment order the A.O. has stated that the assessee was asked again and again to furnish separate trading account of different activities undertaken by the assessee. Since the G.P. rate has drastically fallen this information is required. But despite several opportunities the assessee did not give these separate trading accounts and, therefore, the A.O. rejected the books of account. During the appellate proceedings, the appellant has stated that it has given detailed reasons and quantified the same for fall in G.P. rate which is as under:-

> 1 Decrease in manufacturing cost Rs.(+)3294728 59 2 Increase in raw material cost Rs.(-)416127256 3 Fall in sales realization Rs.(-)472525614 Net effect on Gross Profit Rs.(-)559180011 Effect on Gross Profit (in %) 8.90% The table very clearly shows that there was increase in the raw-material cost and decrease in the sales realization. The A.O. has brought no material on record to show bogus purchases or inflated purchases. The A.O. has also not brought any material on record of under billing of

sales or sales outside the books of account. In view of this reason, simply because separate trading account of each activity could not be given, the books of accounts cannot be rejected. The appellant argued that its various activities of making chips, yarn from chips, grey from yarn and dyed/printed fabric ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 16 -

from grey involves not only sales to the outside parties at each stage but also captive consumption of various products. The yarn is a raw material for grey cloth activity but it is a finished goods the activity of making yarn similarly for fabric. The appellant has stated that for making separate trading accounts of each activity it will have to give value to the inter division transfers and that will not give correct picture. The appellant stated that the separate trading accounts are not made for this reason and also because it would take lot of time. I agree with the appellant. In the absence of any instance of bogus purchase or inflated purchase or under billing of sales or sales outside the books of account, the books of account cannot be rejected merely because separate trading accounts could not be made as discussed above.

8) Transfer of general reserves:- In the assessment order the A.O. has stated that as per Board's Resolution dated 29.09.2004, the Board had proposed dividend @15% for the year ended 30.06.2004. It has proposed corporate dividend tax of Rs.75.06 lacs and transfer of Rs.200 lacs to the general reserve. According to the A.O. the assessee company did not provide this general reserve and hence it raises doubts about the correctness of audited books of account. The appellant has stated that for transferring the account under the Companies Act it is following the accounting period from 1st April to 30th June and for income-tax purposes it is following the accounting period from 1st April to 31st March. For this purpose two separate Balance Sheets and Profit & Loss Account, etc., are being prepared and are submitted to the auditors for audit. A perusal of the audit report, both under the IT Act as well as the Companies Act does not provide any adverse qualification by either of the auditors with reference to the non-transfer of general reserve as alleged by the Income-Tax Officer. Further there is no provision in the income tax act provides transfer of such and non-transfer of such reserve should not be viewed as violation of section 145 of the act. The said non-transfer of reserve does not in any manner affects the computation of income for the Assessment Year in question. I agree with the appellant that the issue of transfer of reserve is an issue below the line and it has nothing to do with computation of income. In any case as stated by the appellant such reserve is relevant only for the purpose of shareholders. In view of this reason, this ground cannot be the ground for rejection of books of account. From the aforesaid discussion, it is clear that none of the eight grounds taken by the A.O. for rejecting the books of account are valid in this regard. The fall in the G.P. rate has been fully explained by the appellant as under:-

ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 17 -

1	Decrease in manufacturing cost	Rs.(+)329472859
2	Increase in raw material cost	Rs.(-)416127256
3	Fall in sales realization	Rs.(-)472525614
	Net effect on Gross Profit	Rs.(-)559180011
	Effect on Gross Profit (in %)	8.90%

The Assessing Officer has not even once doubted or made any adverse remarks with reference to the yield of yarn/grey cloth of the appellant company. This would mean that the Assessing Officer has fully accepted the purchase, sales, consumption, shortage, etc., of the appellant company. The Assessing Officer could not quantify any particular item of deduction as disallowable item for the tax purposes. In other words, Assessing Officer could not pinpoint any specific item in the working results for a specific addition in the assessment as disallowable item of expenditure etc. The only point of addition pointed out is with respect to undervaluation of WIP. This clearly supports the argument that the book results were rejected by the Assessing Officer on insignificant grounds. The only ground valid is with respect to addition in the closing stock of work-in-progress as discussed in ground No.1 for rejecting the books of account. As discussed above, the G.P. addition made by the A.O. is restricted to only addition on account of undervaluation of work-in-progress in the closing stock to the extent of Rs.l,15,63,596/-. Hence the addition is sustained only to the extent of Rs.1,15,63,596/- as undervaluation in work-in-progress and the balance is deleted.

This ground of appeal is, therefore, partly allowed."

4.2. From the above, it is clear that the ld.CIT(A) has considered all the defect as recorded by the AO and has given a finding that the AO was not justified in rejecting the books of accounts, consequently, estimating the profit.

ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 18 -

4.3. Now the question arises whether the ld.CIT(A) is correct in reaching to this conclusion or not. The ld.CIT(A) has given a finding that the AO was not correct for rejecting the books of accounts as the grounds for rejection of books of accounts were found to be inconsistent. It is a settled position of law that the AO is expected to make assessment on the basis of the material available on record and basis should be tenable in the eyes of law. In the present case, the AO after rejecting the books of accounts estimated the profit. It was incumbent upon the AO when he rejected the books of accounts he had to make the assessment in the manner prescribed u/s.144 of the Act. As per this provision, the AO after taking into account all relevant material which he had gathered and was required to give the assessee an opportunity of being heard before making the assessment, of the total income or loss to the best of his judgement and determine the sum payable by the assessee on the basis of such assessment. It is also settled position of law that the books of accounts cannot be rejected on insignificant grounds. The AO should point out the specific defects, whereby the accounts of the assessee cannot be treated as correct or complete giving rise to distorted figure of GP. The Hon'ble Apex Court in the case of Sanjeev Woolen Mills vs. CIT reported at [2005] 279 ITR 434 (SC) has held as under:-

> "9. Section 145 provides that in case AO is of the view that the assessee's accounts are incomplete or incorrect or method of accounting has not been regularly followed by the assessee, the AO may resort to make best judgment assessment in the manner provided under ACIT vs. Garden Silk Mills Ltd.
>
> Asst.Year - 2005-06
>
> - 19 -
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> s. 144 of the Act instead of making assessment under s. 145 (143) of the Act. To attract s. 145 of the Act, it is necessary that:
>
> (a) the assessee has computed the income in accordance with the method of accounting regularly employed by the assessee; and
>
> (b) provided where the accounts are correct and complete to the satisfaction of the AO; but
>
> (c) the method employed is such that in the opinion of the AO, the income cannot be deduced therefrom then the AO may adopt a different method of computation of the income as he may determine.

10. The assessee may employ whichever basis of valuation of stock in hand, but it must adhere to that consistently year after year. Casual departure of valuation of trading stock in hand at cost or market value is not permissible. The method adopted of maintaining the accounts should be definite method of valuation which is carried by the assessee from year to year. To attract the provision of s. 145 of the Act the consistent method of maintaining accounts books is a first condition thereafter the AO should be of the view that the accounts are correct and complete but the method employed is

such that in the opinion of the AO the income cannot properly be deduced therefrom. The choice of method of accounting regularly employed by the assessee lies with the assessee but the assessee would be required to show that he has followed the chosen method regularly. The Department is bound by the assessee's choice of method regularly employed unless by this method the true income, profit of accounts cannot be arrived at. The assessee's regular method would not be rejected as improper merely because it gives him the benefit in certain years or that as per the AO the other method would have been more preferable. The method of accounting cannot be substituted by the AO merely because it is unsatisfactory. What is material for the purpose of s. 145 is, the method to be such that the real income, profit and gain can be properly deduced therefrom. If the method adopted does not afford true picture of profit, it would be rejected, but then such rejection should be based on cogent evidence and would be done with caution. The power can be exercised by the ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 20 -

assessing authority to choose the basis and manner in computation of income but he must exercise his discretion and judgment judicially and reasonably."

4.3. From the above, it is clear that the AO should have based his finding on the basis of the material available on record. The provision also envisages that opportunity of being heard to the assessee, meaning thereby before making assessment, the AO is required to take into account the submissions/explanations of the assessee with regard to the profit likely to be computed by the AO. The case of the assessee had been that the fall in Gross Profit was due to increase in the cost of raw-material and decrease in sale realization. We find that the AO did not give any finding on this aspect. However, the ld.CIT(A) accepted the contention of assessee after verifying the details furnished before him. The basic factor for fall in G.P. in the case of the assessee was found to be increase in crude oil price and decline in realization of POY Yarn sale as per ld.CIT(A). This finding on fact is not rebutted by the Revenue. Further, we find merit in this contention of the assessee that the gross profit would fall if the sale of price remains same or lower than the earlier year but the cost of raw-material increases. The earning of gross profit is dependent on various factors, for example, in the case of manufacturer cost of raw-material plays a vital role. If there is rise into cost of raw-material, naturally cost of production would increase and badly effect the profit if there is not corresponding increase in sale price. As per AO, there is increase in turnover, therefore the gross profit ought ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 21 -

to have been increased instead of decreasing. We are of the view that such reasoning cannot be universally applied and becomes fallacious in certain conditions. In the case in hand, the assessee is a company subjected to internal audit as well as statutory audit. The auditors have not pointed out any defect and or there is no adverse remarks. The AO has not made any adverse comment upon sale & purchase. Undisputedly, no defect has been noticed by the Central Excise Department in the registers maintained under the Central Excise Act, regarding raw- material and furnished goods, which is subjected to inspection and audit. In our considered view, the rejection of books of accounts should not be in a mechanical fashion, the AO has to come to a definite conclusion that the accounts so placed before him are not correct or not complete, consequently, it has distorted the true picture of profit. The AO is required to make analysis of each item and factor which has impact on the profit of the assessee. Assuming that a particular item of account is found to be not correct or complete, the AO is required to find out its impact on the profit of the assessee, if it is found that there is no impact or very miniscule impact on profit. Such defect becomes insignificant. In such a situation, there would be no need of rejection of entire books of accounts, the AO would be justified to make addition into the profit to the extent of such item. The law is well settled that the insignificant defects in the books of accounts should not be the basis of rejection of the entire books of accounts. In the present case, we find that the ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

- 22 -

ld.CIT(A) has explained point-wise as to how the reasoning of the AO for rejection of books is not tenable in law. We are in agreement with the reasoning of the ld.CIT(A), as the finding is based on uncontroverted facts. The judicial pronouncements as relied by the ld.CIT-DR would not apply on the facts of the present case, as the facts are distinguishable. The ld.CIT-DR has relied on the judgement of Hon'ble High Court of Kerala in the case of S.Murugappa Chettiar vs. CIT(supra) in support of contention that difference in statement of stock to the bank and that disclosed to Revenue is a justified ground for rejection of books of accounts. The ld.counsel for the assessee has relied upon the judgement of the Hon'ble Jurisdictional High Court in the case of CIT vs. Riddhi Steel and Tubes (P.) Ltd. (supra), wherein the Hon'ble High Court has held as under:

> "9.2. It is a settled law, as rightly held by the Tribunal, that only on account of inflated statements furnished to the banking authorities for the purpose of availing of larger credit facilities, no addition can be made if there appears to be a difference between the stock shown in the books of account and the statement furnished to the banking authorities. If, for the purpose of fulfilling the margin requirements of the bank purely on inflated estimate basis, when the stock statement had reflected inflated value of the stock in wake of otherwise satisfactory explanation, both - for the purpose of value as well as quantity, we find no reason to interfere with the order of the Tribunal."

4.4. In the light of the above judgement of the Hon'ble Jurisdictional High Court, the contention of the ld.CIT-DR is unacceptable. The ACIT vs. Garden Silk Mills Ltd.

Asst.Year - 2005-06

ld.CIT(A) has also given finding after verifying the facts in respect of objections of the AO regarding sundry debtor, which has been duly reconciled. Difference in work-in-progress is added back by the ld.CIT(A). Taking a holistic view of the entire matter, we do not see any reason to disturb the finding of the ld.CIT(A). Accordingly, same is upheld. Moreover, in our considered view, the AO has not given any basis for estimation of net profit @ 5% of turnover. Thus, ground No.1 of Revenue's appeal is rejected.

5. Ground Nos.2 & 3 are general in nature which require no independent adjudication.

6. In the result, the appeal of the Revenue is dismissed.

Order pronounced in the Court on Thursday, the 15th day of October, 2015 at Ahmedabad.

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                     Sd/-                                               Sd/-
                 (          )                                        (         )

             ( MANISH BORAD )                                     ( KUL BHARAT )
           ACCOUNTANT MEMBER                                     JUDICIAL MEMBER

       Ahmedabad;             Dated             15/ 10 /2015
       §..  .    ,  .  . ./T.C. NAIR, Sr. PS

                                                                   ACIT vs. Garden Silk Mills Lt
                                                                             Asst.Year - 2005-0
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ƒ "# % & ' & /Copy of the Order forwarded to :

1. ' / The Appellant

2. () ' / The Respondent.

3. 5 7 / Concerned CIT

4. 7 ( ) / The CIT(A)-I, Ahmedabad

5. 8 ¤ (5 , . 5 , / DR, ITAT, Ahmedabad

6. ¤ < ' ☐ / Guard file.

ƒ / BY ORDER,) 8 (//True Copy// “ / ¡ (Dy./Asstt.Registrar) , / ITAT, Ahmedabad

1. Date of dictation .. 30.9.15/8.10.15 (dictation-pad 12+ 6pages attached with the File)

2. Date on which the typed draft is placed before the Dictating Member ..30.9.15/01-09.10.15/13.10.15

3. Other Member...

4. Date on which the approved draft comes to the Sr.P.S./P.S................

5. Date on which the fair order is placed before the Dictating Member for pronouncement......

6. Date on which the fair order comes back to the Sr.P.S./P.S.......15.10.2015

7. Date on which the file goes to the Bench Clerk....................15.10.2015

8. Date on which the file goes to the Head Clerk..

9. The date on which the file goes to the Assistant Registrar for signature on the order.........................

10. Date of Despatch of the Order.................