

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT:

THE HONOURABLE MR.JUSTICE ANTONY DOMINIC
&
THE HONOURABLE MR. JUSTICE DAMA SESHADRI NAIDU

WEDNESDAY, THE 25TH DAY OF JANUARY 2017/5TH MAGHA, 1938

ITA.No. 104 of 2013

AGAINST THE ORDER IN ITA 61/2006 of I.T.A.TRIBUNAL,COCHIN BENCH DATED
10-08-2012

APPELLANT/APPELLANT:

THE COMMISSIONER OF INCOME TAX -I, COCHIN

BY ADVS.SRI.P.K.R.MENON,SR.COUNSEL, GOI(TAXES)
SRI.JOSE JOSEPH, SC, FOR INCOME TAX

RESPONDENT/RESPONDENT:

M/S.UNIVERSAL EMPIRE EDUCATIONAL SOCIETY
MERCY ESTATE, KOCHI-35.

R1 BY ADV. SRI.S.ARUN RAJ
R1 BY ADV. SRI.S.VINODKUMAR

THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD ON
25-01-2017, ALONG WITH ITA. 210/2010, THE COURT ON THE SAME DAY
DELIVERED THE FOLLOWING:

**ANTONY DOMINIC
&
DAMA SESHADRI NAIDU, JJ.**

I. T. Appeal Nos.210 of 2010 & 104 of 2013

Dated this the 25th day of January, 2017

JUDGMENT

Antony Dominic, J.

These appeals filed by the Revenue are directed against the order passed by the Income Tax Appellate Tribunal in I.T. (S&S) A. No.07/Coch/2005 and I.T. (S&S) A. No.61/Coch/2006 concerning the block period 01.04.1996 to 11.06.2002. The assessee is a private limited company. A search operation under Section 132 of the Income Tax Act was carried out on 11.06.2002 and consequently notice under Section 158BC of the Income Tax Act, 1961 was served on the assessee on 20.03.2003 requiring it to file return in Form 2B. The assessee filed return on 05.05.2003 declaring "nil" undisclosed income. In the assessment that was completed, apart from other additions, the unexplained

credit for ₹1,17,33,055/-, ₹10,88,212/- being service charges from sister concern of the assessee at Nepal and ₹22 lakh, being service charges from students were also added towards the income of the assessee. The first appellate authority, after retaining certain additions made by the assessing officer, deleted the aforesaid three additions. This was impugned by the revenue before the Tribunal. By the order impugned, Tribunal confirmed the order of the first appellate authority. It is this order which is impugned before us by the revenue and the questions of law framed are the following:

"1. a) Whether on the facts and in the circumstances of the case and also in the light of the materials and documents relied on in the assessment order the ITAT is right in law and fact in deleting the addition of Rs. 1,17,33,055/- made of unexplained credits?

b) did the assessee legally and factually prove the ingredients necessary to prove the credits?

c) did the assessee discharge the burden of proof that lay on him?

2. a) Whether on the facts and in the circumstances of the case and also in the light of the materials and documents relied on in the assessment order the ITAT is right in law and fact in deleting the additions made of Rs. 10,88,212/- and Rs. 22,00,000/- towards service charges from sister concerns at Nepal and from students?

b) is the finding of the ITAT that "in the present case, accrual itself is doubtful" baseless, perverse and against law and logic?

3. Whether, on the facts and in the circumstances of the case is not the order of the Tribunal deleting all the additions based on the submissions of the assessee without putting the assessee to proof and hence vitiated?"

2. We heard the Senior Counsel for the revenue and the learned counsel appearing for the assessee.

3. Insofar as the deletion of the unexplained credit of ₹1,17,33,055/- is concerned, a reading of the assessment order itself would show that though the assessee had claimed that the said credit balance was from its Nepal company, despite various requests and opportunities provided, the assessee did not produce copies of audited

accounts of the Nepal company for each of the years falling in the block period. Despite that, both the first appellate authority and the Tribunal erroneously proceeded on the basis that the assessee had produced audited accounts of Nepal company.

4. Insofar as unexplained credits are concerned, a reading of Section 68 shows that the conditions that are required to be established by the assessee are the identity of the creditor, genuineness of the transactions and the credit worthiness of the creditor. Once these three essential requirements are prima facie proved by the assessee, then the onus would shift to the Department. Law is trite that merely by establishing the identity of the creditor or anyone of the other conditions, the assessee cannot claim to have discharged its burden. Insofar as this case is concerned, a reading of the order passed by the Tribunal itself would show not only that the Tribunal and the first appellate authority had not even examined whether the assessee has

established these three essential conditions, on the other hand, a reading of the order passed by the Tribunal would show that the Tribunal has given undue importance to its erroneous assumption that the assessee has produced audited accounts. Further, the Tribunal has also swayed by the fact that the mode of transaction of funds was transparent, ignoring the fact that even if the money came by way of bank cheques and was paid through the process of banking transaction that by itself is of no consequence. [See in this connection **CIT v. P. Mohanakala (SC) [2007] 291 ITR 278 (SC)**]. Thus it is essentially by putting the burden of proof entirely on the revenue that the Tribunal has sustained to the deletion of the addition made by the Assessing Officer towards unexplained credits of ₹1,17,33,055/-. For the aforesaid reasons, we are not in a position to sustain this conclusion of the Tribunal.

5. Insofar as the deletion of the additions towards service charges from sister concern at Nepal and the service

charges from students is concerned, a reading of the impugned orders would show that while the company had initially was following the mercantile system of accounting, the assessee was following cash system, it is by upholding this dual method of accounting that the first appellate authority has deleted the additions and the Tribunal has confirmed it. In the judgment in **Keshav Mills Ltd. v. Commr. of Inc.-Tax [1953] ITR 230**, the Apex Court has explained the mercantile system of accounting at page 239 which reads as follows:

“The mercantile system of accounting or what is otherwise known as the double entry system is opposed to the cash system of book keeping under which a record is kept of actual cash receipts and actual cash payments, entries being made only when money is actually collected or disbursed. That system brings into credit what is due, immediately it becomes legally due and before it is actually received and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed. The profits or gains of the business which are thus credited are not realised but having been earned are treated as received though in fact there is nothing more than an

accrual or arising of the profits at that stage. They are book profits. Receipt being not the sole test of chargeability and profits and gains that have accrued or arisen or are deemed to have accrued or arisen being also liable to be charged for income-tax the accessibility of these profits which are thus credited in the books of account arises not because they are received but because they have accrued or arisen."

6. As is evident from the orders impugned before us, it is this system which has been following by the Nepal company whereas the assessee was following cash system. The justification assigned by the Tribunal for upholding the cash system of accounting adopted by the assessee is the uncertainty involved in realisation of the amounts due. According to us, even if it is later realised by the assessee that some of the receivables as per mercantile system were not actually realised, the remedy available to the assessee, is to seek rectification. This has been recognised by the Apex Court in its judgment in **C.I.T. v. United Provinces Electric Supply Co. (S. C.) [Vol.244 ITR 764]**. For these reasons, we are unable to sustain this finding of the Tribunal

as well.

In such circumstances, setting aside the orders passed by the Tribunal and answering the question of law in favour of the revenue, these appeals are disposed of.

Sd/-
**ANTONY DOMINIC
JUDGE**

Sd/-
**DAMA SESHADRI NAIDU
JUDGE**

kns/-

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P.S. TO JUDGE