IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL NO. 961 of 2008
With
TAX APPEAL NO. 962 of 2008
With
TAX APPEAL NO. 963 of 2008
With
TAX APPEAL NO. 964 of 2008
With
TAX APPEAL NO. 965 of 2008
With
TAX APPEAL NO. 916 of 2008
With
TAX APPEAL NO. 917 of 2008

FOR APPROVAL AND SIGNATURE:

HONOURABLE MR.JUSTICE M.R. SHAH
and
HONOURABLE MR.JUSTICE S.H.VORA

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the Constitution of India or any order made thereunder ?

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THE COMMISSIONER OF INCOME TAX-II....Appellant(s)
Versus
GUJARAT FOILS LIMITED....Opponent(s)

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Appearance:
MRS MAUNA M BHATT, ADVOCATE for the Appellant(s) No. 1
RULE UNSERVED for the Opponent(s) No. 1

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CORAM: **HONOURABLE MR.JUSTICE M.R. SHAH**
and
HONOURABLE MR.JUSTICE S.H.VORA

Date : 13/04/2015

ORAL JUDGMENT
(PER : HONOURABLE MR.JUSTICE M.R. SHAH)

[1.0] As all these Tax Appeals arise out of the impugned common judgment and order passed by the learned Income Tax Appellate Tribunal (hereinafter referred to as the "Tribunal") and between the same parties but with respect to different Assessment Years, all these Tax Appeals are heard together, decided and disposed of by this common judgment and order.

[2.0] Feeling aggrieved and dissatisfied with the impugned common judgment and order dated 18/05/2007 passed by the learned Income Tax Appellate Tribunal, Ahmedabad Bench 'B' in ITA No.3760/Ahd/2002 for the Assessment Year 1999-2000, the revenue has preferred Tax Appeal No.961/2008 requesting to consider the following substantial questions of law;

> *(A) Whether the Appellate Tribunal is right in law and on facts in deleting the addition made on account of suppression of production by showing excess scrap, when in the statement recorded under Section 132(4) the Director of the assessee accepted that scrap generation was being entered into RG1 register on an estimate basis, and the addition was confirmed by the CIT(A)?*

(B) Whether the Appellate Tribunal is right in law and on facts in holding that as the notice under Section 143(2) was not issued within the prescribed limitation period, the assessment order passed under Section 143(3) was void ab initio?

(C) Whether the Appellate Tribunal is right in law and on facts in deleting the entire disallowance made in respect of telephone expenses on account of personal use of the telephone by the Director of the assessee?

[2.1] Tax Appeal No.917/2008 has been preferred by the revenue challenging the impugned judgment and order passed by the learned Tribunal in ITA No.3492/Ahd/2003 for the Assessment Year 2000-01 to consider the following substantial question of law;

(A) Whether the Appellate Tribunal is right in law and on facts in deleting the addition made on account of suppression of production by showing excess scrap, when in the statement recorded under Section 132(4) the Director of the assessee accepted that scrap generation was being entered into RG1 register on an estimate basis, and the addition was confirmed by the CIT(A)?

[2.2] Tax Appeal No.916/2008 has been preferred by the revenue challenging the impugned judgment and order passed by the learned Tribunal in ITA No.3620/Ahd/2004 for the

Assessment Year 2001-02 to consider the following substantial question of law;

> *"Whether the Appellate Tribunal is right in law and on facts in deleting the addition made on account of suppression of production by showing excess scrap, when in the statement recorded under Section 132(4) the Director of the assessee accepted that scrap generation was being entered into RG1 register on an estimate basis, and the addition was confirmed by the CIT(A)?*

[2.3] Tax Appeal No.962/2008 has been preferred by the revenue challenging the impugned judgment and order passed by the learned Tribunal in ITA No.1317/Ahd/2006 for the Assessment Year 2000-01 by which the learned Tribunal has deleted the penalty imposed under Section271(1)(c) of the Income Tax Act (hereinafter referred to as "the Act") to consider the following substantial question of law;

> *"Whether the Appellate Tribunal is right in law and on facts in cancelling the penalty of Rs.20,87,776/- levied by the Assessing Officer under Section 271(1)(c) of the Act, as confirmed by the CIT(A)?"*

[2.4] Tax Appeal No.963/2008 has been preferred by the revenue challenging the impugned judgment and order passed by the learned Tribunal in ITA No.1318/Ahd/2006 for the Assessment Year 2002-03 to consider the following substantial question of law;

"Whether the Appellate Tribunal is right in law and on facts in deleting the disallowance of interest expenses under Section 36(1)(iii) of the Act?"

[2.5] Tax Appeal No.964/2008 has been preferred by the revenue challenging the impugned judgment and order passed by the learned Tribunal in ITA No.1004/Ahd/2007 for the Assessment Year 2003-04 to consider the following substantial question of law;

"Whether the Appellate Tribunal is right in law and on facts in deleting the disallowance of interest expenses under Section 36(1)(iii) of the Act?"

[2.6] Tax Appeal No.965/2008 has been preferred by the revenue challenging the impugned judgment and order passed by the learned Tribunal in ITA No.1111/Ahd/2007 for the Assessment Year 2003-04 to consider the following substantial question of law;

"Whether the Appellate Tribunal is right in law and on facts in upholding the order of the CIT(A) wherein he has deleted 2/3rd of the addition of Rs.10,78,930/- made by the Assessing Officer under Section 40(A)(2)(b), being excessive commission payment to M/s. Maitri Metals Pvt. Ltd.?"

[3.0] For the sake of convenience Tax Appeal No.961/2008 is considered as the lead matter and the facts of Tax Appeal No.961/2008 are narrated and considered.

[4.0] The assessee Company is engaged in the business of manufacturing aluminium strips / foils. The assessee filed the return of income for the Assessment Year 1999-2000 declaring the total income as 'NIL'. The income of the assessee was declared at 30% of the book profit under Section 115 JA of the Act. A notice under Section 143(2) of the Act was served on the assessee on 25/08/2001 and subsequently a detailed notice under Section 142(1) of the Act was issued and served upon the assessee on 02/01/2002. During the previous year, the assessee-Company was subjected to search under Section 132 of the Act on 09/09/1998. During the search action, various evidences regarding mis-reporting of scrap generation were found. The said issue was dealt with by the Assessing Officer in the block assessment. In the said order, after considering all the contentions raised by the assessee, the scrap was restricted to 15%.

[4.1] As part of the previous year, relevant to Assessment Year 1999-00, which is already covered in the block period, the assessee was asked to furnish the percentage figure of the scrap yield separately for the post search part of the previous year. The assessee was served with the show cause notice and was called upon to show cause and to explain the method of quantifying the scrap generated during the production and how quantity wise details of the scrap generated are entered into the RG1 register. The attention of the assessee was also drawn upon the statement of Shri Navneet Mittal recorded under Section 132(4) on 09/09/1998 where he accepted that the scrap generated was being entered into the RG1 register on an estimate basis and, therefore, the assessee was called upon to show cause as to

how the scrap be not restricted to 15% and the sale value of the scrap in excess of this percentage be taken to be that of the finished goods. It appears that no submissions were furnished in reply to the aforesaid show cause notice and, therefore, one another notice was issued and served upon the assessee. In response to the same, the assessee produced the original RG1 register for perusal. The Assessing Officer was not satisfied with the explanation and made the addition of Rs.18,77,727/- in respect of excess generation of scrap. The Assessing Officer also disallowed the expenses of Rs.3,10,000/- on account of personal use of telephone by the Directors.

[4.2] Feeling aggrieved and dissatisfied with the order passed by the Assessing Officer making the addition of Rs.18,77,727/- on scarp generation at the rate of 15% as well as disallowing the expenses of Rs.3,10,000/- on account of personal use of telephone by the Directors, the assessee preferred appeal before the learned CIT(A). The learned CIT(A) partly allowed the said appeal by restricting the disallowance of the expenses on account of personal use of telephone to Rs.1.7 lacs, however, confirmed the addition of Rs.18,77,727/- made by the Assessing Officer on the scrap generation at the rate of 15%.

[4.3] Feeling aggrieved and dissatisfied with the order passed by the learned CIT(A), the assessee preferred appeal before the learned Tribunal, being ITA No.3760/Ahd/2002. One additional ground was made before the learned Tribunal i.e. the issuance of the notice under Section 143(2) of the Act was beyond the period of limitation i.e. beyond the period of 12 months from the end of the month in which the return was

filed under Section 139 of the Act.

[4.4] By the impugned judgment and order, the learned Tribunal has allowed the appeal preferred by the assessee and has deleted the addition of Rs.18,77,727/- made by the Assessing Officer on scrap generation at the rate of 15% for all the three Assessment Years. The learned Tribunal also held that the assessment order passed under Section 143(3) of the Act was *void ab initio* as notice under Section 143(2) of the Act was barred by limitation as it was not issued within 12 months from the end of the month in which the return was filed under Section 129 of the Act.

[4.5] Feeling aggrieved and dissatisfied with the impugned judgment and order passed by the learned Tribunal in holding the assessment under Section 143(3) of the Act *void ab initio* as well as deleting the addition of Rs.18,77,727/- made by the Assessing Officer on scrap generation at the rate of 15%, the revenue has preferred Tax Appeal No.961/2008 to consider the aforesaid substantial questions of law.

[4.6] It is required to be noted that for the Assessment Years 2000-01 and 2001-02 similar additions were made by the Assessing Officer on scrap generation at the rate of 15% and the same came to be confirmed by the learned CIT(A). However, for the reasons stated in ITA No.3760/Ahd/2002 for the Assessment Year 1999-2000, the learned Tribunal has also deleted the addition made by the Assessing Officer on the scrap generation at the rate of 15% in ITA No.3620/Ahd/2004 & ITA No.3492/Ahd/2003, which have given rise to Tax Appeal Nos.916/2008 & 917/2008.

[4.7] It appears that for the Assessment Year 2000-01, the Assessing Officer imposed the penalty under Section 271(1)(c) of the Act, which came to be confirmed by the learned CIT(A). However, on deleting the addition made by the Assessing Officer on scrap generation at the rate of 15%, the learned Tribunal by the impugned judgment and order has allowed the appeal preferred by the assessee and has deleted the penalty imposed under Section 271(1)(c) of the Act.

[4.8] It appears that for the Assessment Year 2002-03 and 2003-04 the assessee claimed deduction of interest expenses under Section 36(1)(iii) of the Act. However, the Assessing Officer disallowed the sum of Rs.5,41,415/- and on appeal before the learned CIT(A) confirmed the disallowance of interest of Rs.2,22,415/-, which has been set aside by the learned Tribunal by the impugned judgment and order. Similar disallowance of interest expenses claimed by the assessee for the Assessment Year 2003-04 was claimed by the assessee at Rs.3,86,415/- and the learned CIT(A) on appeal sustained the addition to the extent of Rs.2,22,415/- relating to third party and on further appeal, the learned Tribunal by impugned judgment and order has set aside the said disallowance out of the interest expenses and has allowed the appeal. The aforesaid has given rise to Tax Appeal No.963/2008 for the Assessment Year 2002-03 and Tax Appeal No.964/2008 for the Assessment Year 2003-04.

[4.9] Now Tax Appeal No.965/2008 remains, which is arising out of the impugned judgment and order passed by the learned Tribunal in ITA No.1111/Ahd/2007 for the Assessment

Year 2003-04 by which the learned Tribunal has deleted the addition under Section 40A(2)(b) of the Act made by the Assessing Officer.

[5.0] We have heard Ms. Mauna Bhatt, learned advocate appearing on behalf of the revenue at length. Now so far as the common substantial question of law that arises in Tax Appeal Nos.961/2008, 917/2008 and 916/2008 with respect to deletion of the additions made by the Assessing Officer on scrap generation at the rate of 15% is concerned, while deleting such an addition in paras 13.1 to 14, the learned Tribunal has observed and held as under;

> *"13.1. The additions made in the block assessment even if confirmed by the Tribunal, cannot be the basis for making addition in the regular assessment. In the block assessment the additions are made on the basis of material found during the course of search and which relates to the undisclosed income. The regular assessment is entirely different from the block assessment. We are therefore of the view that the finding given or estimate made in the block assessment is not at all relevant evidence for making addition in the regular assessment. In the absence of any material or evidence being brought to our knowledge for the estimation of scrap generation @ 15%, we do not agree fro the basis of addition made by the A.O. We also note that the assessee has submitted a letter dated 30/09/1992 written by the Superintendent of Central Excise (Preventive),*

Gandhinagar during the course of assessment proceedings for Assessment Year 2000-01, copy of which was filed before us and available at pages 16. In this letter, we noted that the Superintendent of Central Excise (Preventive) has clearly stated as under:-

> *"With reference to your letter it is brought to your kind attention that as per the investigations carried out by the Department no clearance of aluminium sheet / foils in the guise of aluminium foil / sheet scrap has been noticed and it appears that the subject case does not lead to any case of evasion of central excise duty by Gujarat Foils Ltd., Chhatral."*

14. The A.O., we noted, has rejected this letter merely by observing that no details of inquiries conducted by the Central Excise were furnished and the inquiries referred to in the letter do not relate to the Assessment Year but relates to the period 1996 to September, 1998. We do not find any basis for rejecting this vital evidence by the A.O. This is a fact that there had been search in the case of the assessee and the period 1996 to September, 1998 relates to the search period. On one side when the AO is making the addition and estimating the generation of scrap the AO has relied on the statement of Shri Navneet Mittal recorded under Section 132(4) while on the other hand, the AO is rejecting the evidence which has been procured by

the assessee from the Central Excise Department which also relates to the same period. We have already given a finding that the generation of scrap as mentioned in the statement recorded under Section 132(4) are not in accordance with the scrap generation shown in the books of account. The AO cannot be permitted to rely on the statement recorded under Section 132(4) while making the addition to reject the independent evidence produced from the Central Excise Department for the same period while dealing with the addition on the generation of the scrap. In our opinion, the AO is not correct in rejecting the letter produced by the assessee from the Superintendent of Central Excise (Preventive) especially when the Excise Department is also one of the Departments of the Government and is mainly concerned with the production of finished products for levying and collecting correct excise duty. Thus, we are of the view that the addition has been made without any evidence or material in the possession of the AO and the addition so made can not be sustained. We have also noted that the assessee is regularly maintaining the books of account on mercantile system of accounting. The books were duly audited Tax Audit under Section 44AB has been carried out. The assessee has duly produced the books of account which were verified by the AO. The Excise Department has also duly verified and checked the excise records for the raw material and finished goods. The AO has not pointed out any defects in

the books of account regularly maintained by the assessee. Even no finding has been given that the AO is not satisfied about the correctness or completeness of the books of account of the assessee. No contravention in respect of provisions of Section 143(2) has been pointed out by the AO. The gross profit of the assessee has also not been disputed by the A.O. Rather the gross profit ratio has increased during the year though the sales have increased by 83% as compared to Assessment Year 1998-99. The AO has not rejected the books of account. In our opinion, without rejecting the books of account no trading addition can be made."

[5.1] Considering the aforesaid facts and circumstances and more particularly when the Assessing Officer did not reject the books of accounts and / or did not point out any defects in the books of accounts regularly maintained by the assessee and when considering the fact that the Excise Department also fully verified and checked the records for the raw materials and the finished goods, the learned Tribunal has rightly deleted the additions made by the Assessing Officer on scrap generation at the rate of 15%.

[6.0] We are in complete agreement with the view taken by the learned Tribunal in so far as deleting the additions made by the Assessing Officer for the respective Assessment Years i.e. 1999-00, 2000-01 and 2001-02 on scrap generation at the rate of 15%. Under the circumstances, question no.(A) in Tax Appeal No.961/2008 and the sole question in Tax Appeal Nos.916/2008 & 917/2008 are held against the revenue

and in favour of the assessee.

[6.1] Now so far as question No.(B) in Tax Appeal No.961/2008 by which the learned Tribunal has held the assessment order under Section 143(3) as *void ab initio* by observing that notice under Section 143(2) of the Act was issued beyond the period of limitation i.e. beyond the period of 12 months or the end of the month for which the return was filed under section 139 is concerned, it is required to be noted that the return was filed by the assessee on 31/12/1999 and notice under Section 143(2) of the Act was served upon the assessee on 25/08/2001. Under the circumstances, when notice under Section 143(2) of the Act was issued beyond the period of one year considering the decision of the Hon'ble Supreme Court in the case of **Assistant Commissioner of Income Tax and Anr. Vs. Hotel Blue Moon** reported in **[2010] 321 ITR 362 (SC)**, question no.(B) in Tax Appeal No.961/2008 is held against the revenue and in favour of the assessee.

[6.2] Now so far as question no.(C) in Tax Appeal No.961/2008 i.e. with respect to disallowance of telephone expenses on account of personal use of the telephone by the Director is concerned, it is required to be noted that the Assessing Officer disallowed the expenses of Rs.3,10,000/-, which was restricted by the learned CIT(A) to Rs.1.7 lacs. The learned Tribunal deleted the entire disallowance. However, in the facts and circumstances of the case and keeping the question of law, if any, open solely on the ground that the amount involved is a small amount, question no.(C) in Tax Appeal No.961/2008 also stands dismissed.

[7.0] Now so far as Tax Appeal No.962/2008 arising out of ITA No.1317/Ahd/2006 by which the learned Tribunal has deleted the penalty under Section 271(1)(c) of the Act is concerned, on considering the impugned judgment and order passed by the learned Tribunal, the learned Tribunal has observed that since the addition made by the Assessing Officer of the scrap generation at the rate of 15% has been deleted, the learned Tribunal has rightly observed and held that there is no question of imposition of penalty arising. Considering the above, Tax Appeal No.962/2008 stands dismissed as it cannot be said that the learned Tribunal has committed any error in deleting the penalty under Section 271(1)(c) of the Act.

[8.0] Now so far as Tax Appeal No.963/2008 for the Assessment Year 2002-03 and Tax Appeal No.964/2008 for the Assessment year 2003-04 with respect to disallowance of interest expenses claimed under Section 36(1)(iii) of the Act is concerned, the learned Tribunal has observed that the assessee was having interest free funds available with it. The learned Tribunal has observed that the advances were given by the assessee to various parties to the extent of Rs.2,62,48,341/- during the Financial Year 1996-97. The learned Tribunal has also found that even the assessee was having interest free funds to the extent of Rs.3,93,65,572/- as on 31/03/2002. It is required to be noted that in the earlier preceding year no disallowance was made out of the interest claimed by the assessee. Considering the aforesaid facts and circumstances of the case, the learned Tribunal has rightly deleted the disallowance on interest expenses. We are in complete agreement with the view taken by the learned

Tribunal. Under the circumstances, the sole question of law in Tax Appeal Nos.963/2008 & 964/2008 are held against the revenue and in favour of the assessee.

[9.0] Now so far as the substantial question of law raised in Tax Appeal No.965/2008 arising out of the impugned judgment and order passed by the learned Tribunal in ITA No.1111/Ahd/2007 for the Assessment Year 2003-04 deleting the addition made by the Assessing Officer under Section 40A(2)(b) of the Act is concerned, it is required to be noted that the Assessing Officer found that commission of sales at the rate of 1.50 per kg had been made to M/s. Maitri Metals Pvt. Ltd and it is covered under Section 40A(2)(b) of the Act. The assessee made the commission to the said party at Rs.1.50 per kg and, therefore, the Assessing Officer disallowed the entire commission of Rs.10,78,930/- under Section 40A(2)(b) of the Act as being unreasonable and for extra commercial considerations. However, on appeal, the learned CIT(A) held that the commission of Rs.1 per kg was reasonable and balance of Rs.0.50 kg was excessive within the meaning of Section 40A(2)(b) of the Act and, therefore, the learned CIT(A) sustained the addition of 2/3rd of Rs.10,78,930/-. Against the order passed by the learned CIT(A) both the assessee and the revenue preferred appeal before the learned Tribunal. The revenue preferred ITA No.1111/Ahd/1007 against the order passed by the learned CIT(A) deleting 2/3rd of Rs.10,78,930/- and the assessee also preferred appeal before the learned Tribunal against the order passed by the learned CIT(A) sustaining the addition of 1/3rd of Rs.10,78,930/-. By the impugned judgment and order, the learned Tribunal has dismissed the appeal preferred by the assessee on the

aforesaid issue and consequently the learned Tribunal dismissed the appeal preferred by the revenue i.e. ITA No.1111/Ahd/1007 confirming the order passed by the learned CIT(A) deleting the disallowance to the extent of Rs.10,78,930/-. From the reasoning given by the learned CIT(A) deleting the disallowance of 2/3rd of Rs.10,78,930/- under Section 40A(2)(b) of the Act i.e. with respect to the commission paid to M/s. Maitree Metals Pvt. Ltd. is concerned, the learned CIT(A) in paragraph 3.2 has observed as under;

> *"3.2 I have carefully considered the submissions of the appellant and also perused the relevant portion of the assessment order. The fact remains that the increase in commission was 3 times but there was no commensurate increase in profit. No doubt, as per the agreement between the consignor (appellant) and the consignee, over all business benefits have to be taken into account, though however, the increase in commission payment to an interested party in the light of Section 40A(2)(b) will have to be examined with reference to the benefit derived by the appellant. I have also considered the appellate order for the preceding year wherein the commission payment was allowed in appeal, the rate being at Rs.0.5 per kg. As the payment was on the basis of mutual consent, it cannot be said that the increase in commission payment this year was fully justifiable. Taking into account the larger business benefits accruing to the appellant and the connectivity between the appellant and the recipient, I hold that*

the commission of Rs.1 per kg would be reasonable and balance of Rs.0.5 per kg is considered as excessive within the meaning of Section 40A(2)(b). The AO is accordingly directed to delete 2/3rd of addition of Rs.10,78,930/-. In other words, addition sustained is 1/3rd of the said amount."

The aforesaid has been confirmed by the learned Tribunal. We are in complete agreement with the view taken by the learned CIT(A) confirmed by the learned Tribunal. As such, taking into account the larger business benefits accruing to the assessee and the connectivity between the assessee and the recipient, the learned CIT(A) has held that commission of Rs.1 per kg would be reasonable and balance 0.5 per kg is considered as excessive withing the meaning of Section 40A(2)(b) of the Act.

No substantial question of law arises so far as deleting the addition under Section 40A(2)(b) of the Act to the extent of 2/3rd of Rs.10,78,930/- is concerned. Under the circumstances, Tax Appeal No.965/2008 also deserves to be dismissed and is accordingly dismissed.

[10.0] In view of the above and for the reasons stated hereinabove, all these appeal deserve to be dismissed and are accordingly dismissed. No order as to costs.

(M.R. SHAH, J.)

(S.H. VORA, J.)

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