

**\* IN THE HIGH COURT OF DELHI AT NEW DELHI**

**% Reserved on : 19<sup>th</sup> July, 2012.**  
**Date of Decision : 3<sup>rd</sup> August, 2012.**

**+ ITA NO.896/2008**

COMMISSIONER OF INCOME TAX .... Appellant  
Through Mr. Abhishek Maratha, Sr. Standing counsel with Ms.  
Anshul Sharma, Adv.

**VERSUS**

D.D. GEARS LTD. ....Respondent  
Through Mr. Gambhir in person

**CORAM:**

**MR. JUSTICE S. RAVINDRA BHAT**

**MR. JUSTICE R.V. EASWAR**

1. Whether Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporters or not? Yes
3. Whether the judgment should be reported in the Digest? Yes

**R.V. EASWAR, J.:**

This is an appeal by the Income Tax Department and it is directed against the order of the Income Tax Appellate Tribunal in IT(SS) No.258/Del/2003 dated 28.9.2007. The following questions are sought to be raised by the revenue :

*“a) Whether ITAT was correct in law in deleting the addition of Rs.1.98 crores and Rs.1.16 crores made by the Assessing Officer as unexplained investment in excess/shortage of stock?*

*b) Whether order passed by ITAT is perverse in law and on facts when it held that the discrepancy was satisfactorily explained by the assessee and thus based its decision on irrelevant material ignoring the facts found during search and recorded by Assessing Officer?*

*c) Whether deletion by the ITAT of addition of Rs.1.98 crores and Rs.1.16 crores being based on probability and possibility as well as irrelevant consideration is unsustainable in law?*

- d) Whether finding of ITAT that the statement of Shri Sudershan Kumar should not be viewed in the context of total accuracy of the stock taking exercise, is perverse and not supported by any evidence?*
- e) Whether ITAT was correct in law in directing the Assessing Officer to allow expenses of Rs.9,62,801/- and of Rs.17,931=48 vide computing undisclosed income by way of unaccounted sales?*
- f) Whether ITAT was correct in law in cancelling levy of surcharge u/s 113 of the Act?*
- g) Whether proviso to Section 113 inserted by Finance Act 2002 with effect from 01.06.2002 is clarificatory in nature and therefore retrospective?"*

2. The assessee is a public limited company. On 29.8.1996, there was a search of its premises under Section 132 of the Income Tax Act, 1961 (hereinafter referred to as the "Act"). In the course of the search a stock inventory of raw materials, semi-finished goods and finished goods was prepared. It may be noted that the assessee is engaged in the business of manufacturing of and trading in auto and tractor parts and components. The main products are shafts, pins, crown and pinion and gears of various kinds. On a comparison of the inventory and the regular books of accounts maintained by the assessee, it was noticed that there was a difference. In respect of certain stock there was excess and in respect of certain other stock there was shortage. A reconciliation was prepared and on that basis the assessment of the undisclosed income for the block period 1.4.1996 to 29.8.1996 was completed on 29.4.1998. The assessment was made under Chapter XIV-B of the Act.

3. The aforesaid assessment was taken up in appeal before the Tribunal in ITA(SS) No.69/Del./1998 and several contentions were taken. The Tribunal in its order dated 1.3.2001 found no merit in the contention vis-à-vis limitation for completing the assessment, reference to the special audit and the defects in the grant of approval by the CIT for completing the block assessment under Section 158BC.

However, the Tribunal found merit in the assessee's claim that the block assessment was completed without regard to the rules of natural justice. It therefore set aside the assessment order and restored the same to the Assessing Officer with directions to decide the case afresh and pass a fresh assessment order after giving adequate opportunity of being heard to the assessee and in accordance with law.

4. Pursuant thereto the Assessing Officer completed the block assessment on 26.3.2003. In the order, the undisclosed income of the assessee for the block period was computed at ₹3,45,32,275/- and this was spread over the various assessment years comprised in the block period. Aggrieved by the assessment, the assessee preferred an appeal before the Tribunal in ITA (SS) No.258/Del./2003 questioning the additions made in the block assessment order. The Tribunal deleted the additions of ₹1.98 crores and ₹1.16 crores made on account of stock discrepancy. The disallowance of the expenses of ₹9,62,801 and ₹17,93,148/-, recorded in the seized material and claimed as deduction in computing the undisclosed income, was also deleted by the Tribunal. The Tribunal also held that the surcharge levied under Section 113 of the Act was contrary to law and deleted the same. It is this order of the Tribunal that is challenged in further appeal before us under Section 260A of the Act.

5. As per the directions of this Court, the ld. standing counsel for the income tax department has filed a chart reframing the questions, stated to be substantial questions of law, as follows :

*“(1) Whether ITAT was correct in the eyes of law in deleting the addition of ₹1.98 Crores and ₹1.16 Crores made by the AO on account of unexplained investment in excess/shortage of stock?*

*(2) Whether the ITAT was correct in the eyes of law in directing the AO to allow the expenses of ₹9,62,801/- and ₹17,931,48/-, while computing the undisclosed income by way of unaccounted sales?*

(3) *Whether the ITAT was correct in the eyes of law in cancelling the levy of the surcharge u/s 113 of the Act?*

(4) *Whether the impugned order passed by the ITAT is perverse both in law and facts of the case?"*

We have heard him as well as the assessee, which was represented through its Director at length.

6. So far as the first question is concerned, the discrepancies in the stock as inventorised by the officers of the revenue are set out in the table below :

| S.No. | Description         | Total value of stock found in Excess (Rs.) | Total value of stock found Short (Rs.) |
|-------|---------------------|--------------------------------------------|----------------------------------------|
| 1     | Raw material        | 40,87,001/-                                | 36,85,816/-                            |
| 2.    | Semi Finished Goods | 23,44,789/-                                | 2,49,44,618/-                          |
| 3.    | Finished Goods      | 1,04,05,264/-                              | 29,077/-                               |
| Total |                     | 1,68,37,054/-                              | 2,86,59,512/-                          |

Before the Assessing Officer the assessee contended that the inventory prepared as above by the income tax authorities was wrong and unreliable and cannot form the basis of any addition. It was pointed out that the physical verification of the stock at the time of the search was not properly carried out by the revenue authorities. There were several omissions and commissions while taking stock such as incorrect names of items being taken and in some instances raw material was taken as semi-finished goods and vice versa, etc. It was submitted that it was impossible for the income tax authorities to have completed the inventorisation of such huge stock amounting to crores of rupees in value and consisting innumerable items in such a short time of one day. The assessee also submitted that the process of inventorisation took place in the absence of Directors and that has given rise to several mistakes, discrepancies and

inconsistencies in the inventory and in estimating the value of the stock. The assessee also pointed that physical inventory of the stock had been taken by its bankers much earlier to the date of search i.e., on 12.3.1996 and 1.8.1996 and also after the search i.e., on 23.11.1996 and no discrepancy was found by them and this fact was also brought to the notice of the income tax authorities. In addition to the above stock reports the assessee also submitted before the Assessing Officer that the discrepancies in the stock inventory and the reasons therefore were highlighted by it to the investigation wing of the department immediately after search by filing written submissions dated 3.10.1996, 9.10.1996, 11.9.1996 and 18.11.1996. In these submissions it was pointed out by the assessee that having regard to the nature of the items manufactured, it is not possible for an untrained person to make any distinction between the different items of stock and it is quite probable that the income tax authorities had inventorised the stock without being in a position to make a proper technical appraisal of the different items of stock. More importantly it was submitted to the Assessing Officer and as soon as the restraint order on the stock, placed under Section 132(3) of the Act, was vacated on 7.10.1996, the assessee itself undertook physical verification of the entire stock and communicated the same to the income tax authorities on 18.11.1996 and in this inventory, the assessee had reconciled the alleged discrepancies observed by the income tax authorities during the search.

7. The above submissions of the assessee were rejected by the Assessing Officer who predominantly relied on the statement of one Sudershan Kumar, who was the assessee's factory manager. His statement was recorded during the search. According to the Assessing Officer, the factory manager was competent to appreciate the method and accuracy of the physical verification of the stock, and since he had not raised any objection to the stock inventory prepared by the various officers during the search, the objections of the assessee were devoid of merit.

8. A perusal of the order of the Tribunal shows in detail the claims and contentions raised before it on behalf of the assessee, particularly in relation to the stock inventory. In different heads prepared in the form of a chart, the assessee pointed out before the Tribunal that the authorized officers did not count several items of raw material, semi-finished goods and finished goods and these details are set out in the form of a chart at page 9 of the Tribunal's order. According to this chart, about 15,66,990 items of raw material and 33,182 items of semi-finished goods had not been counted by the authorities conducting the search. It was also pointed out that the difference in the finished goods was minor, being only 299 items. In the same chart presented before the Tribunal the assessee has also set out the reasons for the variations in the inventory prepared by the income tax authorities. These reasons are the following:

- A. Some items were omitted while counting the stock though they were physically present in the factory premises and this amounted to 15,66,990 items of raw material and 33,182 items of semi-finished goods;
- B. There were some raw materials purchased but yet to be used in the processing and they were considered as semi-finished goods. Details of these were given in annexure to the chart;
- C. 118 items were specifically noted to have been omitted from the list when these were physically present. Details given in Annexure II;
- D. During the inventory taken on 23.10.1996, some items which were found on 29.8.1996 (date of search) were still found lying in the stock;
- E. In some cases there was double counting of the same items, as for instance 1,960 pieces of Tata 1312 UJ Cross 1 were included as serial No.24 and again at serial

No.96 and this fact had been brought to the notice of the Assessing Officer by letter dated 17.1.2003;

F. In several instances the Assessing Officer had taken wrong figures to arrive at excess or shortage of the stock. Several examples were given such as Ground Wheel Tata 1210 SE, Rear Teeth Tata 1210 SE etc. These mistakes were pointed out to the Assessing Officer by a letter dated 3.10.1996 but were ignored. The seriousness of the errors can be gauged from the fact that even in respect of these two items the errors were of the value of ₹9,84,471/- and ₹1,04,712/-, in favour of the revenue.

9. In addition to the aforesaid submission, the assessee also submitted before the Tribunal that the inability or the lack of technical qualifications on the part of the income tax authorities had resulted in the several serious errors. Instances of such errors were given to the Tribunal and the same have been recorded at page 13 of its order. It was further explained before the Tribunal on behalf of the assessee that the lack of technical knowledge and expertise and the intricacies of the production process resulted in confusion or mixing up between raw materials and semi-finished goods. It was further explained to the Tribunal as to how it was impossible to physically verify the inventory of over 5 lakh high value items consisting of more than 600 varieties of stock lying in the factory premises measuring about 5,000 sq.yds. in different stages of completion, in less than one day and that too by persons who were not technically qualified. It was submitted that even for technically qualified people who knew the production process it would have taken anywhere between 7 to 10 days to complete what the income tax authorities claimed to have done in one day.

10. The assessee further submitted before the Tribunal that even though it carried out physical verification of the stock after the restraint order was lifted and prepared and submitted a detailed reconciliation of the stock considering the purchases and issue of stock after the date of search, and even though the Assessing Officer has not

disputed the purchases and issues recorded in the stock ledger, still he did not accept the reconciliation prepared by the assessee. There was no reason given for doing so. According to the assessee, despite clear direction of the Tribunal in its order dated 1.3.2001 that the assessee has to be given adequate opportunity to put forth its case and it has to be told the reasons for rejecting its submissions, the direction was not carried out in letter and spirit. According to the assessee the Assessing Officer simply repeated the earlier assessment order and the additions made therein.

11. Before the Tribunal the assessee explained how stock checking is to be carried out and what are the steps involved in the same and submitted that the departmental personnel had not followed any of the basic steps and had proceeded to inventorise the stock in a haphazard manner. These steps are recorded by the Tribunal at pages 19 to 21 of its order.

12. The assessee also pointed out that its products are excisable and the excise authorities were present in the premises to monitor the production and dispatches from the bonded section. They had not reported any discrepancy in the production or sale of the products for the period under consideration or any of the earlier years. This fact was missed by the Assessing Officer who, contrary to the excise records, erroneously concluded that there were discrepancies, in the finished goods produced by the assessee and that it had indulged in selling the materials/goods outside the books of account. On the basis of the above submissions it was pleaded before the Tribunal that the addition of the undisclosed investment of ₹1,98,37,054/- for the stock made under Section 69 should be deleted as also the gross profit addition of ₹1,16,73,099/- made in respect of the shortage of stock.

13. The argument of the revenue before the Tribunal, summarized in para 9 of the impugned order, was that the assessee did not properly avail of the opportunity granted by the Tribunal by its earlier order and even if it is accepted that the assessee

had reconciled the discrepancies in the stock inventory which was not given due weightage by the Assessing Officer, the additions cannot be deleted but the matter should be restored again to the Assessing Officer to enable him to examine the details and work out the exact excess/shortage of stock and to make an addition to the extent to which the assessee is unable to reconcile the discrepancy.

14. The Tribunal, on a consideration of the rival submissions arrived at the following findings:

a. The search commenced on 29.8.1996 and was finally concluded on 30.8.1996. It is impossible for anybody to accurately take stock in a span of just one day and this itself vitiated the entire process of inventorisation followed by the income tax authorities.

b. Even on the very first opportunity vide letter dated 11.9.1996, 09.10.1996 and 18.11.1996 the assessee challenged the method of taking stock of physical count on the ground that it was humanly impossible to complete the exercise in a single day. The assessee also explained the shortage/excess of the stock by letters dated 3.10.1996, 9.10.1996 and 18.11.1996 but the Assessing Officer did not bother to refer to these submissions while completing the assessment.

c. The Assessing Officer both in the original assessment proceedings and in the fresh assessment proceedings pursuant to the directions of the Tribunal did not comment upon the reconciliation of stock filed by the assessee.

d. When the restraint order was lifted on 7.10.1996 the assessee itself carried out physical verification and explained the discrepancies and submitted the reconciliation to the Assessing Officer which was not looked into by him. The omission of the Assessing Officer to duly consider the explanation and reconciliation furnished by the

assessee in the course of the remand proceedings was in violation of the clear directions of the Tribunal in its order dated 1.3.2001.

e. The reliance placed by the Assessing Officer on the statement of Sudershan Kumar the factory manager, without putting it to test by calling for the assessee's explanation vis-à-vis the statement also amounted to violation of the direction of the Tribunal in its earlier order. There were at least five different teams which carried out the exercise of stock taking and in the face of these exercises, the Assessing Officer was not justified in placing reliance on the stock inventory prepared by the income tax authorities in the span of just one day and seeking to support the same by the statement of Sudershan Kumar, who is stated to have assisted them during the search in the inventorisation. Therefore, the statement of Sudershan Kumar, according to the Tribunal, should not be given importance in the context of total accuracy of the stock taking exercises. What is apparently improbable cannot become sacrosanct merely because it was so agreed by the person stating so. The statement cannot therefore form the basis of the addition.

f. The allegation of the assessee that the income tax authorities adopted an incorrect classification of the raw material has sufficient weight. The total value of the raw material found during the search was ₹2.32 crores which tallied with the stock records maintained by the assessee. The shortage found in the semi-finished goods was ₹2.49 crores, the total value of such goods being ₹2.85 crores. The value as per the books of account was however ₹3.57 crores and the difference was because of the value addition of approximately 25% during the different stages of process to which the particular item of raw material was subjected to. The assessee cannot maintain books of accounts for semi-finished goods as they are in the process of manufacturing. Therefore, it is incorrect to say that there was any difference, in so far as semi-finished goods are concerned, between the books of account and the physical verification.

g. If 25% is taken as the value addition to the semi-finished goods it comes to ₹3.57 crores. The value of finished goods found during the search was ₹36.84 lakhs, which as per the books of account was ₹12.52 lakhs. The assessee was offering 35% trade discount and 4% cash discount. The gross profit earned was in the range of 42-45%. If the value of the finished goods is taken after reduction of the discounts and after eliminating the gross profit, the value as per accounts, shown as ₹12.52 lakhs stands explained. Thus in the finished goods there is no discrepancy.

h. As regards semi-finished goods, the conclusion of the Assessing Officer that they were found short to the extent of ₹2.49 crores is a presumption which cannot be accepted for two reasons: firstly, there was no evidence found during the search suggesting that such stock was sold outside the books and secondly, it is improbable that any person would buy goods in a semi-processed or semi-finished condition since that would involve further processing, transport etc which cannot be easily done, apart from being non-profitable.

i. Due weightage should be given to the fact that for the finished goods the assessee was maintaining complete records as required by the excise laws.

j. All the above facts were properly explained in the letters filed by the assessee and reiterated in the second round of proceedings before the Assessing Officer by letters dated 17.1.2003, 14.2.2003 and 24.2.2003, but none of these contentions or explanations were considered by the Assessing Officer.

On the basis of the above findings, the Tribunal deleted the additions of ₹1,98,37,054/- and ₹1,16,73,019/-.

15. It will be seen from the above discussion that the findings of the Tribunal are findings of fact arrived at on the basis of the assessment record and the contentions advanced before the Assessing Officer as well as before it. The findings are the result

of appreciation of the evidence and the rival submissions. No material has been brought before us to show that the findings are perverse. In this regard, we may note that since the revenue had raised the question of perversity in the conclusion/ findings of the Tribunal, this Court had directed it to place on record documents and material on the basis of which the charge can be established. By orders dated 10.2.2012 which were reiterated by order dated 23.4.2012, the revenue was directed to place on record the documents or material on the basis of which it can be said that the factual findings recorded by the Tribunal are mentioned. In fact costs of ₹5,000/- were also imposed on the revenue for not filing the documents within the period allowed by order dated 10.2.2012. The costs were paid by the revenue; however, till the date of final hearing of the appeal i.e. 19<sup>th</sup> July, 2012, the revenue has not been able to produce any document or material to buttress its challenge to the Tribunal's findings on the ground of perversity. The ld. standing counsel could not also point out to any serious flaw or perversity in the findings of the Tribunal, ex-facie. In these circumstances, we are of the view that no substantial question of law arises out of findings of the Tribunal vis-à-vis the addition of ₹1.98 crore and ₹1.16 crore made on account of unexplained investment in stock and gross profit of shortage of stock.

16. Coming to the second question which concerns the decision of the Tribunal to delete the disallowance of the expenses of ₹9,62,801/- and ₹17,93,148/-, here too we find that no substantial question of law can be said to arise. The relevant findings of the Tribunal are contained in paras 11 to 14 of its order. To briefly summarize them, during the search some papers (17 pages) were seized from the residential premises of the Directors. These papers consisted of handwritten slips for cash receipts and cash expense. According to the assessee the receipts were for sale of second quality goods and the proceeds thereof were disbursed among the labourers as incentive and no surplus was left. Some papers indicated receipts from scrap dealers for lifting second quality material and the same pages also included details for payment of overtime,

incentives etc. to the labourers. These transactions were also not recorded. The total receipts amounted to ₹10,36,750/- and the total payments amounted to ₹9,62,801/-. Certain another receipts aggregating to ₹19.85 lakhs were also found not recorded, in the books of accounts which according to the assessee represented sale of replacements, proceeds of which were also disbursed to the workers to the extent of ₹17,19,148/-. The Assessing Officer added the receipts but did not give corresponding reduction for the expenses though both the receipts and the payments were found recorded in the seized material. The Tribunal examined the seized material which was produced before them in the form of paper books and held that it should be considered in its entirety and the Assessing Officer was not justified in taking only that portion which suited the revenue. The objection of the department before the Tribunal was that though the expenses were also recorded in the seized papers, it should be examined whether those expenses were incurred for the purpose of business, for which there was no evidence. The Tribunal on a consideration of the facts in the light of the rival submissions and the seized material deleted the additions on the following reasoning :

*“14. We have considered rival submissions. We are in agreement with the submission by Id. Counsel for the assessee. The seized material is to be considered in its entirety and no part there of can be ignored for the purpose of computing undisclosed income. If the seized material contains details of income, the very same seized material also contains details of expenses incurred. We have perused the pages 215 to 240 of the paper book. The expenses are in respect of expenses for turning charges, overtime charges, payment to temporary workers, excise consultants remuneration, incentives etc. Thus, these expenses are found to be incurred out of such unaccounted sales. In the circumstances such expenses, which are recorded in the very same seized material, should be reduced while computing undisclosed income. While computing undisclosed income no part there of can be ignored or no entry stated in such material can also be ignored if it do not suite the convenience of the Assessing Officer. The material is to*

*be considered as a whole and not selectively. In the circumstances, we hold that the expenses of Rs.9,62,801/- and Rs.17,93,148/- as recorded in such seized material should be reduced while computing the undisclosed income by way of unaccounted sales.”*

17. A perusal of the order of the Tribunal shows that it has followed a common sense approach that the seized material should be followed in its entirety and both the receipts and the payments are to be taken into consideration. The revenue is no doubt correct in contending that the payments are allowable as deduction only if they represent expenses allowable as business expenditure. However, the Tribunal has found that the expenses represent turning charges, overtime payments, payments to temporary workers, remuneration to excise consultants, incentives etc. The finding of the Tribunal that these are expenses incurred by the assessee for the purpose of the business is a finding of fact based on the seized material itself. The Tribunal's approach to consider the seized material in its entirety is a correct approach, for it would be unjust and contrary to the principles of income tax law to take note of only the income part reflected in the seized material, excluding the expenditure part reflected in the same seized material, provided the expenditure part is allowable as business expenditure. In our view the findings of the Tribunal, both of facts and law, do not suffer from any perversity. We may add that no documents or material was produced before us on behalf of the revenue, despite several opportunities, to show any perversity in the decision of the Tribunal. We therefore, do not think any substantial question of law arises out of the aforesaid decision of the Tribunal.

18. So far as the third question regarding surcharge is concerned, the matter is no longer res integra. Section 113 provides for tax of 60% on the total undisclosed income of the block period, determined under Section 158BC of the Act. The proviso to the section inserted by the Finance Act, 2002 w.e.f. 1.6.2002 provides that the tax shall be increased by a surcharge, if any, provided by any Central Act and applicable

in the assessment year relevant to the previous year in which the search is initiated under Section 132 or the requisition is made under Section 132A. In the present case, the search was conducted on 29.8.1996 under Section 132. This falls in the previous year ended 31.3.1997, relevant to the assessment year 1997-98. According to the judgment of the Supreme Court in *Commissioner of Income Tax v. Suresh N. Gupta*, (2008) 297 ITR 322 (SC) it was held that “*even without the proviso under Section 113, the Finance Act, 2001 was applicable to a block assessment year passed under Chapter XIV-B. The amendment made by inserting the proviso to Section 113 was merely clarificatory. The Supreme Court further clarified that the Finance Act of the year in which the search was initiated would apply*”. In respect of the assessment year 1997-98, the Finance Act of 1996 would apply. If that Finance Act provides for the levy of surcharge, then the levy of surcharge in the present case would be valid. The Finance Act (No.2) of 1996 authorises the levy of surcharge of 15% of the tax. The Tribunal therefore was in error in holding that since the search was conducted on 29.08.1996, at a time when the proviso to Section 113 was not in existence, the levy of surcharge was not proper. This reasoning no longer holds good in view of the judgment of the Supreme Court cited above. We therefore, answer the third question raised by the revenue, which according to us is a substantial question of law, in the negative, in favour of the revenue and against the assessee. In the result the appeal of the revenue is allowed in part, as indicated above. In the circumstances, there will be no order as to costs.

**(R.V. EASWAR)**  
**JUDGE**

**(S. RAVINDRA BHAT)**  
**JUDGE**

**August 03, 2012**  
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