

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

**BEFORE SHRI D. MANMOHAN, (VICE PRESIDENT) AND
SHRI RAJENDRA SINGH, ACCOUNTANT MEMBER**

ITA No.3719/Mum/2010

Assessment Year : 2007-08

Shri Rattan Singh Rathod B-1, Neela Apt. S.V.P. Road Borivali (W) Mumbai. PAN No. AACPR 4164 L	Vs.	Jt. CIT-25(2) Mumbai.
(Appellant)		(Respondent)

ITA No.5110/Mum/2010

Assessment Year : 2007-08

Asstt. Commissioner of Income tax -25(2), Bldg. No.C-11, 1 st Floor, Room No.108, Pratyakshkar Bhavan Bandra Kurla Complex, Bandra (E) Mumbai-400 051.	Vs.	Shri Rattan Singh Rathod Mumbai. PAN No. AACPR 4164 L
(Appellant)		(Respondent)

Cross Objection No.103/Mum/2011

Arising out of ITA No.5110/Mum/2010

Assessment Year : 2007-08

Shri Rattan Singh Rathod Mumbai. PAN No. AACPR 4164 L	Vs.	Asstt. Commissioner of Income tax -25(2) Mumbai.
(Cross Objector)		(Respondent)

Assessee by : Shri D.C. Sejpal
Department by : Shri Satish Singh

Date of hearing	:	28.6.2012
Date of Pronouncement	:	13.7.2012

ORDER

PER RAJENDRA SINGH, AM:

These cross appeals and cross objection of the assessee are directed against the order dated 24.3.2010 of CIT(A) for assessment year 2007-08. The disputes raised in these appeals relate to addition on account of cash credit, disallowance of purchases and sub-contract charges, estimation of net profit and disallowance of penalty. These appeals are being disposed of by single consolidated order for the sake of convenience.

2. The facts in brief are that the assessee who was the sole proprietor of M/s. Ratansingh & Brothers and was engaged in the business as contractor undertaking civil work contract for Municipal Corporation and semi-government organizations, had declared net profit of Rs.1,38,49,505/- @ 6.55% on the gross contract receipts of Rs.21,14,72,874/- for assessment year 2006-07. The assessee had also shown total cash credits of Rs.54,50,000/-. The AO in the assessment, treated cash credits as income of the assessee as the

same were not explained satisfactorily. The AO also disallowed the purchases to the tune of Rs.2,87,57,709/- as not supported by proper evidence. The AO further disallowed claim of sub-contract charges payable by the assessee to the tune of Rs.2,13,78,870/- in respect of related concerns and Rs.2,23,83,278/- in respect of other concerns. The AO had also disallowed claim of penalty of Rs.2,88,353/-. In appeal, CIT(A) confirmed the addition on account of cash credit to the tune of Rs.44,50,000/- and deleted the additions on account of bogus purchases and sub-contract charges and instead estimated GP profit @ 8% on the gross contract receipts. CIT(A) also deleted the addition made on account of penalty charges. Aggrieved by the decision of CIT(A), both the parties are in appeal before the Tribunal. Whereas the revenue has challenged the order of CIT(A) in allowing relief in respect of cash credit as well as in relation to disallowance of purchase, contract charges and penalty, the assessee has disputed the order of CIT(A) in confirming the cash credit addition partly and estimated net profit rate at 8%. In the cross objections, the assessee has also disputed the finding of CIT(A) that there were discrepancies in the books of account and that these were not correct and complete and for not appreciating the comparable cases while estimating net profit.

3. We first take up the dispute relating to addition on account of cash credits. The AO noted that the assessee had taken fresh loans

during the year from seven agriculturists aggregating to Rs.24,50,000/- as per details given below :-

S.No.	Name of the Loan Creditor	Loan amount(Rs.)	In name of
1.	Bhanwarsingh Medtiya	5,00,000/-	M/s. Ratansingh & Bros
2.	Bhawanishingh Champawat	3,00,000/-	M/s. Ratansingh & Bros.
3.	Dhansingh S. Dahiya	2,00,000/-	M/s. Ratansingh & Bros.
4.	D.I. Deora	50,000/-	M/s. Ratansingh & Bros.
5.	Lalsingh B. Rathore	4,00,000/-	M/s. Ratabsingh & Bros.
6.	Dungarsingh H. Deora	6,00,000/-	Shri Ratabsingh
7.	Mohansingh H. Deora	4,00,000/-	Shri Ratabsingh
	Total	24,50,000/-	

3.1 The assessee during the assessment proceedings filed the confirmations from the agriculturists the land record documents and copy of ledger accounts. It was submitted that the loans had been given out of their income from agricultural land. The assessee also submitted that he could produce the parties if time was allowed. The AO observed that the agriculturists were not assessed to tax and their addresses were not given in the confirmations and submitted only in response to show cause notice. The AO further observed that the onus was on the assessee to prove the identity of the loan creditors, their credit worthiness and genuineness of transactions which had not been discharged in this case. The AO, therefore, treated the sum of Rs.24.50 lacs as income of the assessee under section 68 of the Act.

3.2 The AO also noted that the assessee had taken fresh loans from five other persons aggregating to Rs.30.00 lacs as per details given below:-

S.No.	Name of the Loan Creditor	Loan Amount(Rs.)	In name of
1.	P. Nainmal & Co.	5,00,000/-	M/s. Ratansingh & Bros.
2.	Shaila Enterprise	10,00,000/-	M/s. Ratansingh & Bros.
3.	Mansukhlal & Co.	5,00,000/-	Sh. Ratansingh
4.	M.M. Trading Co.	5,00,000/-	Sh. Ratansingh
5.	P. Nainmal & Co.	5,00,000/-	Sh. Ratansingh
	Total	30,00,000/-	

3.3 The assessee submitted before the AO that the loan creditors were assessed to tax and filed loan confirmations giving their Income tax acknowledgement receipt, P.A. Number etc. The AO made enquiry through notice server who reported that the parties were not found at the given address. This was pointed out to the assessee whereupon the assessee furnished the new addresses. The AO got enquiries made through inspector who, in the report dated 14.12.2009 mentioned that the parties at Sl.No.1,2, & 3 were not residing at the new addresses given and instead some other parties were residing and in respect of party No.4 it was reported that the address was incomplete. The AO also verified the Income tax returns of the parties and noted that they had not filed their balance sheet and P&L account and that the loan

advanced to the assessee was not reflected in their Income tax returns. The AO therefore, concluded that the credit worthiness of the party was not proved. The AO therefore, treated the loans of Rs.30.00 lacs as unexplained income of the assessee. Thus total addition made under section 68 was Rs.54,50,000/-.

3.4 The assessee disputed the decision of AO and submitted before CIT(A) that the loans had been received through account payee cheques and were genuine. It was also submitted that the agriculturists had substantial land holdings to advance loans. It was pointed out that other creditors were assessed to tax. However, the assessee vide letter dated 16.3.2010 submitted that peak credit on all loans could be added as income to avoid litigation and assessee was ready to accept peak credit of Rs.44,50,000/-. CIT(A) observed that in case of agriculturists, the assessee had given addresses as well as their land holding details and though the other creditors did not exist on the addresses given, the assessee had given details of their Income tax returns filed. The AO had not conducted any enquiry to disprove the claim of the assessee. But, since the assessee had agreed for peak credit addition, CIT(A) computed the peak credit as under :-

Name of the party	Date of Loan taken	Amount Recd.	Date of Repayment	Amount paid	Aggregate loan balance outstanding

					(Peak Credit)
Shaila Enterprises	27.04.2006	5,00,000	-	-	5,00,000/-
P. Nainmal & Co.	10.05.2006	5,00,000	-	-	10,00,000/-
P. Nainmal & Co.	10.5.2006	5,00,000	-	-	15,00,000/-
Shaila Enterprises	10.5.2006	5,00,000	-	-	20,00,000/-
Dungarsingh H. Deora	17.5.2006	4,00,000	-	-	24,00,000/-
Mohansingh H. Deora	20.5.2006	4,00,000	-	-	28,00,000/-
Dhansingh S. Dalmiya	23.5.2006	2,00,000	-	-	30,00,000/-
Lalsingh B. Rathore	23.5.2005	4,00,000	-	-	34,00,000/-
Bhawansingh Meditya	25.5.2006	5,00,000	-	-	39,00,000/-
Bhawansingh Champawat	25.5.2006	3,00,000	-	-	42,00,000/-
Dungarsingh H. Deora	29.5.2006	2,00,000	-	-	44,00,000/-
D.I. Deora	24.8.2006	50,000	-	-	44,50,000/-
P. Nainmal & Co.	-	-	06.11.2006	5,00,000	39,50,000/-
D.I. Deora	-	-	31.01.2007	50,000	39,00,000/-
Lalsingh B. Rathore	-	-	28.2.2007	4,00,000	35,00,000/-
Bhanwarsingh Meditya	-	-	28.2.2007	50,000	34,50,000/-
M.M. Trading Co.	13.03.2007	5,00,000	-	-	39,50,000/-
Mansukhlal & Co.	13.3.2007	5,00,000	-	-	44,50,000/-

3.5 CIT(A) after analysis of the peak credit computation observed that there was no evidence that total sum of Rs.10.00 lacs withdrawn by the assessee had been utilized for some other purpose. Therefore, he computed the peak credit at Rs.44,50,000/- and addition to that extent was confirmed and balance addition was deleted. Aggrieved by the said decision both the parties are in appeal.

3.6 Before us, the Id. AR submitted that the assessee had given details of land holdings as well as addresses with confirmations from the agriculturists and therefore without producing any diverse material AO was not justified in making addition and CIT(A) was not justified in confirming the addition of peak credit. It was also submitted that the assessee had not agreed for peak addition before CIT(A). It was further submitted that the assessee is a semi literate person who had signed the letter dated 16.3.2010 filed before CIT(A), which had been prepared by his tax practitioner, without explaining the contents and implications of the said letter. An affidavit dated 22.6.2012 to the above effect has been filed from the assessee. The Id. DR on the other hand submitted that burden was on the assessee to prove not only the identity of the creditors but also credit worthiness of the creditors which had not been discharged by the assessee and therefore, the entire cash credit was required to be treated as income.

4. We have perused the records and considered the rival contentions carefully. The dispute raised is regarding addition on account of cash credit to the tune of Rs.54,50,000/- made by the AO which consisted of a sum of Rs.24.50 lacs claimed to be received from seven agriculturists and Rs.30.00 lacs from five other persons. The AO treated the cash credits as income of the assessee under section 68 of

the Income tax Act on the ground that the assessee failed to prove the credit worthiness and genuineness of transactions. In appeal, CIT(A) observed that the assessee had given addresses as well as land holding details of the agriculturists but the AO had not made any enquiries to disprove the loan. CIT(A) also observed that though other creditors did not exist on the addresses given, the assessee had given details of income tax returns filed. However, as per CIT(A), since the assessee had agreed vide letter dated 16.3.2010 for peak addition to avoid litigation, he confirmed the peak credit of Rs.44.50 lacs.

4.1 The Id. AR for the assessee has argued that the assessee had not agreed for addition of peak credit. He has filed an affidavit dated 22.6.2012 from the assessee stating that the assessee is a semi literate person who had only signed the letter dated 16.3.2010 prepared by the tax practitioner who had not explained the contents and the implications of the letter to the assessee. In view of the denial by the assessee and the affidavit filed, in our view, it would not be appropriate to make any addition of peak credit on agreed basis and matter is required to be examined on merit. As for the merit of the addition, we find that the assessee had filed confirmations from agriculturists and had also given land holding details. However, only on the basis of land holdings, it could not be established that the agriculturists had substantial income from which loans had been

advanced. The assessee had not given any further details and evidence in support of agricultural income to prove credit worthiness. The AO had also failed to examine the issue in detail by either summoning the creditors or for calling for further details. CIT(A) who has power co-terminus with AO in such matters has also failed to examine the issue in detail as he proceeded to make addition on agreed basis. In respect of other creditors, also the parties were either not found at the addresses given or the addresses given by the assessee were incomplete. The AO also verified their income tax returns as per P.A. Number given on confirmations and has given a finding that loans advanced to the assessee were not reflected in the income tax returns. The AO, therefore, proceeded to conclude that the credit worthiness of the parties was not proved, without giving any further opportunity to the assessee to explain the credit. CIT(A) has also not examined this aspect as he confirmed the peak credit on the basis of admission of the assessee which has since been denied, and is supported by an affidavit. Therefore, in our view matter is required to be examined by CIT(A) afresh for giving finding on merit of the case i.e., the credit worthiness and genuineness of transactions both in relation to agriculturists and other creditors. We, therefore, set aside the order of CIT(A) and restore the matter back to him for passing a

fresh order after necessary examination and after allowing opportunity of hearing to the assessee.

5. The second dispute is regarding disallowance of bogus purchases and sub-contract charges. The AO during the assessment proceedings noted that the assessee had shown purchases of Rs.2,87,57,709/- from three parties as per details given below:-

S.No.	Name of the Purchase Party	Amount Purchased (Rs.)	Amount outstanding as on 31.3.2007	Purchased by
1.	N.B. Enterprises	94,39,722/-	74,64,389/-	M/s. Ratansigh & Bros.
2.	Shri Sai Sales Corporation	93,15,283/-	68,80,592/-	M/s. Ratansigh & Bros.
3.	P.K. Trading Co.	1,00,02,704/-	74,43,585/-	M/s. Ratansigh & Bros.
	Total	2,87,57,709/-		

5.1 The AO got enquiries made through notice server at the addresses of the parties given by the assessee but found that the concerns were not found at the addresses given. On being confronted, the assessee provided the present address and also confirmations from the parties giving their P.A. No. The AO got further verifications made and noted that P.A. Nos. given in respect of parties at Sl.No.1 and 3 i.e. AAYPL 7154 J and AAFPC 4789 H respectively were wrong and belonged to some other persons The Inspector on enquiry also

reported that party No.1 did not exist at the address given. The address of the party at Sl.No.2 was a chawl and no office was found there. The third concern was found in existence but the proprietor was M/s. Prakash Chedda and not Rajesh who had signed the confirmation. The Inspector also reported that name of the assessee did not appear in the list of debtors of P.K. Trading Co. Later, in response to notice under section 133(6), the proprietor of Shri Sai Sales Corpn. informed the AO that he had not done any business activities during the assessment year 2007-08 with the assessee. His signature also did not match with the confirmation given. Further, on perusal of balance sheet filed with the return of income in case of P.K. Trading Co., the AO noted that sundry debtors were only Rs.3,27,938/- and turnover for assessment year 2007-08 was Rs.37,91,849/- whereas the assessee is said to have made purchases of Rs.1,00,02,704/- from the said party and a sum of Rs.74,43,585/- was outstanding. Considering the various discrepancies found, the AO concluded that the purchases shown from these parties were not genuine and these were only accommodation entries. The AO therefore, disallowed the sum of Rs.2,87,57,709/- and added to the total income.

5.2 The AO also noted that the assessee had claimed the deduction on account of sub-contract chages payable to 8 persons which were related parties under section 40A(2)(b), as per details given below:-

S.No.	Name of the subcontractor	Amount (Rs.)	Sub contracted by
1.	Kedarnath Enterprises	29,81,000/-	M/s. Ratansingh & Bros.
2.	Mallikaarjun Const. Co.	30,72,000/-	M/s. Ratansingh & Bros.
3.	Nageshwar Construction Co.	30,21,300/-	M/s. Ratansingh & Bros.
4.	Omkareshwar Enterprises	29,67,650/-	M/s. Ratansingh & Bros.
5.	Parlevejnath Conctruction Co.	29,86,380/-	M/s. Ratansingh & Bros.
6.	Somnath Construction Co.	30,41,850/-	M/s. Ratansingh & Bros.
7.	Trambakeshwar Enterprises	29,96,300/-	M/s. Ratansingh & Bros.
8.	Bhimashanker construction Co.	30,12,390/-	M/s. Ratansingh & Bros.
	Total	2,13,78,870/-	

5.3 The assessee submitted that the sub-contract charges were bonafide and parties were assessed to tax and payments were made in subsequent year by cheque. The AO however collected information from the parties under section 133(6) which was compiled as under :-

S.No.	Name of the subcontractor	Receipts other than from assessee	Capital introduced by partners	Returned income	Method of computation of income	Date of Partnership Deed	Payment of Outstanding from assessee as on 31.3.2007
1.	Kedarnath Enterprises	Nil	50,000/-	2,38,480/-	u/s. 44AD	1.1.2007	29,14,106/-
2.	Nallikaarjun Const. Co.	Nil	50,000/-	2,45,760/-	u/s. 44AD	1.1.2007	30,03,065/-
3.	Nageshwar Construction Co.	Nil	50,000/-	2,41,700/-	u/s. 44AD	1.1.2007	29,53,502/-
4.	Omkareshwar Enterprises	Nil	50,000/-	2,37,410/-	u/s. 44AD	1.1.2007	29,00,756/-
5.	Parlevejnath Construction Co.	Nil	50,000/-	2,38,910/-	u/s. 44AD	1.1.2007	29,19,366/-
6.	Somnath Conctruction Co.	Nil	50,000/-	2,43,350/-	u/s. 44AD	1.1.2007	29,73,591/-

7.	Trambakeshwar Enterprises	Nil	50,000/-	2,39,700/-	u/s. 44AD	1.1.2007	29,29,063/-
8.	Bhimashanker Construction Co.	Nil	50,000/-	2,40,990/-	u/s. 44AD	1.1.2007	29,44,792/-

5.4 From the information collected, the AO noted that all these firms were created on the same date i.e. 1.1.2007 with capital of Rs.50,000/- each. These were claimed to have done work worth Rs.30.00 lacs each during the period of three months with almost no capital. They had not received any payment during the year. They had done job relating to excavation of roads, drains, fixing of paver blocks etc. which are labour intensive work and it was not possible to do the work with mere capital of Rs.50,000/-. All these concerns had filed returns under section 44AD on estimate basis with actual income subject to tax being Rs.2.5 to Rs.3.00 lacs whereas the assessee got full deduction of Rs.30.00 lacs in each case. The addresses of all firms were either office or residential address of the assessee and they were having bank account in the same bank in which assessee was having account. The accounts were opened during financial year 2007-08 and payment made by assessee by cheque were immediately withdrawn in cash. None of the parties had shown expenses by way of cheques. The assessee had also filed the sub-contract agreements with the parties which were entered on 1.9.2006 which was before the parties came into existence on 1.1.2007. The AO therefore, concluded that sub-

contract charges claimed by the assessee were not genuine and assessee had only adopted the devices to reduce income. He, therefore, disallowed claim and added the sum of Rs.2,13,78,870/- to the total income.

5.5 The AO also noted that the assessee had claimed deduction of Rs.2,23,83,278/- on account of sub-contract charges payable to nine other parties as per details given below:-

S.No.	Name of the subcontractor	Amount (Rs.)	Payment Outstanding from assessee
1.	Parbhat Singh	31,15,000/-	11,86,685/-
2.	Hansraj Prajapati	19,85,000/-	19,62,975/-
3.	Chhelsingh Deora (HUF)	30,68,865/-	42,19,832/-
4.	Babusingh B. Deora	19,75,450/-	19,53,531/-
5.	Bhimsingh B. Deora (HUF)	20,15,000/-	19,92,643/-
6.	Sheela S. Jain	10,22,694/-	-
7.	Karan Enterprises	30,38,637/-	20,70,790/-
8.	Prahlad Singh Deora	30,21,032/-	29,54,000/-
9.	Anil R. Gupta	31,41,600/-	30,07,473/-
	Total	2,23,83,278/-	2,02,47,929/-

5.6 In these cases also, the assessee claimed that the transactions were genuine and parties were assessed to tax and also enclosed the contract order and invoice. It was also submitted that the payments had been made to the parties in the subsequent year by cheque.

5.7 The AO was, however, not satisfied by the explanation given. It was observed by him that out of total claim of contract charges of Rs.2,23,83,278/-, a sum of Rs.2,02,47,929/- was outstanding at the

end of the year. These parties were claimed to have done work valued up to Rs.20-30 lacs each during the year with almost no capital when the job was labour intensive for which payments are required to be made regularly. They had filed returns of income under section 44AD showing income of Rs.2.5 to 3 lacs on estimation whereas assessee had claimed full deduction of Rs.20-30 lacs in each case. These parties had not done business with any other concern. The AO also noted that date of agreements with the parties was 1.4.2006 whereas date of stamp paper was 30.6.2006. The AO therefore, concluded that the claim of sub-contract charges was not genuine and it was a colourable device to reduce income by the assessee. The AO accordingly disallowed the sum of Rs.2,23,83,278/- and added to the total income.

5.8 The assessee disputed the decision of AO regarding disallowance of purchases and sub-contract charges aggregating to Rs.7,25,19,857/- . The assessee submitted before CIT(A) that the AO was not justified in disallowing the purchases when the AO had produced the bills and payments had been made by cheque in subsequent year and corresponding income in the form of contract receipts had been taxed. The assessee could not do business without purchases. Merely because the parties were not found at the addresses, disallowance could not be made. Similarly in respect of sub-contract payments, assessee had filed copies of work contract

order and ledger account and payments had been made by cheque which were cleared in the subsequent year. It was further submitted that on total contract receipt of Rs.21,14,72,874/- assessee had declared net profit @ 6.55% which was quite reasonable. The assessee filed seven comparable cases in which net profit had been declared from 2.93% to 9.96% as per details given below:-

S.No.	Name of Company	Net Profit in percentage
1.	Larsen & Toubro	8.46%
2.	Jaiprakash Associates	9.96%
3.	Gammon India Ltd.	4.14%
4.	Hindustan Construction	4.25%
5.	IVRCL Infrastructure	3.57%
6.	Nagarjuna Construction	3.97%
7.	Punj Lyod	2.93%
	Total.....	37.28
Average Net Profit in percentage workout to		$\frac{37.28}{7} = 5.33$

5.9 The assessee pointed out that after considering the disallowances of purchases and sub-contract charges made by AO, net profit came to 34.43% which was not possible in this line of business. It was also submitted that due to various discrepancies and omissions pointed out by AO, he could have rejected the books of account and was required to make proper estimation of net profit which in any case could not be 34.43%. The net profit rate declared by the assessee was reasonable.

5.10 CIT(A) agreed with the assessee that the AO was not justified in disallowing total purchases and sub-contract charges and thus assessing net profit at 34.43%. It was observed by him that no doubt there were many discrepancies in the books of account which could not be considered as correct and complete. But the AO had brought no material or any comparative material to show that net profit rate in case of Government contractors could be 34.43%. He referred to the decision of the Tribunal in the case of Singhal & Bros. in ITA No.7253/Mum/2004 dated 24.7.2007 for assessment year 2001-02 in which net profit had been estimated at 5% of gross contract receipts. CIT(A) further observed that the assessee had filed details of comparative cases in which net profit varied from 3% to 10%. CIT(A) therefore, held that net profit rate of 8% would be reasonable in case of the assessee who had shown contract receipts of Rs.21,14,74,874/-. Accordingly he estimated net profit at Rs.1,69,17,830/- in place of declared net profit of Rs.1,38,49,505/- and thus upheld the addition of Rs.30,68,325/- and deleted the balance addition of Rs.6,94,51,532/-. Aggrieved by the decision of CIT(A), both the parties are in appeal before the Tribunal. Whereas the assessee has disputed the decision of CIT(A) to estimate net profit rate at 8%, the department has challenged the order allowing substantial relief of Rs.6.94 crores.

5.11 Before us the Id. AR reiterated the submissions made before CIT(A) that disallowance of entire purchases and sub-contract charges could not be justified as the same resulted into highly abnormal net profit rate in support of which AO had given no evidence. The assessee had filed a list of comparative cases in which net profit rate varied from 3% to 10% and therefore, net profit of 6.5% declared by the assessee was reasonable. It was also submitted that the books of account of the assessee were audited and purchases and sub-contract charges were supported by documents and, therefore, the results declared could not be rejected. It was accordingly urged that profit declared by the assessee should be accepted. The Id. DR on the other hand strongly supported the order of AO and argued that the purchases and sub-contract charges were not properly substantiated and there were serious discrepancies and AO was, therefore, justified in disallowing the claim.

5.12 We have perused the records and considered the rival contentions carefully. The dispute is regarding addition on account of contract business done by the assessee. The assessee had shown total contract receipts of Rs.21,14,72,874/- on which it had declared net profit of Rs.1,38,49,505/- @ 6.5%. The AO disallowed the purchases of Rs.2,87,57,709/- from three parties, details of which have been

given in para-5 earlier on the ground that the purchases were not properly substantiated. The AO also disallowed the sub-contract payments of Rs.2,13,78,870/- made by the assessee to eight related parties as per details in para 5.2 and other sub contract charges of Rs.2,23,83,278/- to nine other parties on account of several discrepancies noticed as mentioned earlier. CIT(A) has observed that total disallowance on account of purchases and sub-contract charges aggregating to Rs.7,25,19,857/- would result into abnormally high net profit rate of 34.43%. CIT(A) held that on account of various discrepancies pointed out by AO the books of account could be rejected and in that case net profit has to be estimated reasonably. He has estimated net profit rate at 8%. The case of the assessee is that the purchases and sub contract charges were supported by bills and sub-contract orders, and books of the assessee were audited and, therefore, no addition is called for.

5.13 The case of the department is that the purchases and sub-contract charges are not supported by proper evidence in view of several discrepancies pointed out and, therefore, these were required to be disallowed fully and CIT(A) was not justified in confirming the addition only on the basis of 8% of net profit rate.

5.14 We have given careful thought to various aspects of the matter. In our view, the arguments of the assessee that the books of account could not be rejected can not be accepted. The assessee had shown total purchases of Rs.2,87,57,790/- from three parties. The income tax P.A. Number given by the assessee of the two parties was found to be wrong. The proprietor of the third party was found to be a different person than the person who had signed the confirmation. Further the said party had shown turnover of only Rs.37,91,849/- whereas the purchases claimed to be made by the assessee from the party was Rs.1,00,02,704/-. Further, the assessee had shown the outstanding amount of Rs.74,43,585/- payable to the party whereas the said party had shown debit of only Rs.3,27,938/-. Under these circumstances the purchases shown by the assessee can not be said to be supported by proper evidence. As regards the sub-contract payment to related parties, AO has placed material on record to show that the said parties had been created only on 1.1.2007 but sub-contract agreements were dated 1.9.2006. They had meager capital of Rs.50,000/- each. The assessee had not made any payment to them during the year and entire payment made by cheque in the subsequent year immediately withdrawn in cash. It has not been explained as to how those parties had done work worth Rs.30.00 lacs in each case with meager capital of Rs.50,000/- when the work was

labour intensive. Similar was the position of other sub-contract parties. Almost the entire amount remained outstanding at the end of the year and it was not explained as to how the parties did work worth Rs.20-30 lacs for the assessee during the year with almost no capital. The agreement with them was dated 1.4.2006 whereas the stamp paper was dated 30.6.2006. Obviously the sub-contract charges under these circumstances can not be said to be properly substantiated. Only making payment by cheque is not enough as the amount paid by cheque can be taken back in cash. In our view considering the facts and circumstances of the case, the accounts of the assessee in relation to contract charges and purchases can not be taken as reliable and these had been rightly rejected by the authorities below. However, it is also an established fact that the assessee had done the contract work and had shown total contract receipts of Rs.21,14,72,874/-. The business can not be done without purchases and other expenses, and therefore, the entire claim can not be disallowed. We agree with CIT(A) that after rejecting the accounts, net profit has to be determined on estimate. The assessee had declared net profit rate of 6.5% . The net profit rate after considering the disallowances of expenses and sub-contract charges by AO comes to 34.43% which is highly abnormal can not be considered as reasonable. The assessee had given comparative cases of net profit varying from 2.93% to

9.96% as per details in para 5.8 earlier. The Id. AR for the assessee has argued that 6.65% net profit rate declared by the assessee is reasonable and net profit rate of 8% adopted by the AO is not correct as rate of 8% is to be taken under section 44AD which is applicable only in case of assesseees having turnover of less than 40.00 lacs. We are unable to accept the arguments advanced on behalf of the assessee. Section 44AD deems the net profit rate at 8% in cases where accounts are not maintained and turnover is up to Rs.40.00 lacs. This however, does not mean that profit will lower when the turnover is more than Rs.40.00 lacs. In fact with rise in volume, working becomes more economical and profitability may normally be higher. Each case has to be decided on its own facts and circumstances. Even in the comparable cases cited, the net profit rate had varied from 2.93% to 9.96%. These are big concerns who maintain proper accounts and also maintain quality standards. In case of the assessee as held earlier, accounts are not reliable and therefore, in our view on the facts of the case, estimation of net profit rate of 8% by CIT(A) is justified. The order of CIT(A) is accordingly upheld.

6. In the departmental appeal, a ground has also been raised regarding deletion of addition of Rs.2,88,353/- made by AO on account

of penal charges on delayed execution of contract work. The AO disallowed the claim under the provisions of section 37(1) holding it of penal in nature. In appeal, the assessee submitted before CIT(A) that AO had made addition without giving proper opportunity of hearing to the assessee. It was submitted that the payment had been made to Municipal Corporation and other government authorities for delayed execution of contract work and not towards any infraction of law. Therefore, provisions of Explanation to Section 37(1) were not applicable. CIT(A) agreed with the submission of the assessee that the penal charges were not for infraction of law and accordingly he deleted the addition aggrieved by which, the revenue is in appeal before the Tribunal.

6.1 We have heard both the parties, perused the records and considered the matter carefully. The dispute is regarding allowability of penal charges of Rs.2,88,353/- paid to Municipal Corporation and other government authorities. The AO had treated the payment as penalty for infraction of law. The case of the assessee is that the penal charges were for delayed execution of contract and not for infraction of law. The claim that the payments were for delay in execution of contract work has not been controverted before us. Therefore, the finding of CIT(A) that the payment was not for infraction of law can not be faulted with. Any payment for violation for contractual

obligation has to be allowed as normal business expenditure. We, see no infirmity in allowing the claim and same is therefore upheld.

7. In the result, both the appeals and the cross objection are partly allowed.

Order pronounced in the open court on 13.7.2012.

Sd/-
(D. MANMOHAN)
VICE PRESIDENT

Sd/-
(RAJENDRA SINGH)
ACCOUNTANT MEMBER

Mumbai, Dated: 13.7.2012.
Jv.

Copy to: The Appellant
The Respondent
The CIT, Concerned, Mumbai
The CIT(A) Concerned, Mumbai
The DR " " Bench

True Copy

By Order

Dy/Asstt. Registrar, ITAT, Mumbai.