

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY  
ORDINARY ORIGINAL CIVIL JURISDICTION**

**INCOME TAX APPEAL (IT) NO.1330 OF 2017**

Pr.Commissioner of Income Tax-13, Mumbai.... Appellant  
V/s.

Rishabhdev Tachnocable Ltd. ... Respondent

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Mr.Akhileshwar Sharma, Advocate for the Appellant.

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**CORAM : UJJAL BHUYAN &  
MILIND N. JADHAV, JJ.**

**DATE : FEBRUARY 10, 2020**

**P.C.:-**

1. Heard Mr.Akhileshwar Sharma, learned standing counsel, Revenue for the appellant.

2. This appeal has been preferred by the Revenue under Section 260A of the Income Tax Act, 1961 (briefly "the Act" hereinafter) against the order dated 3<sup>rd</sup> November, 2016 passed by the Income Tax Appellate Tribunal, "D" Bench, Mumbai (briefly "the Tribunal" hereinafter) in Income Tax Appeal No.7773/Mum/2014 for the assessment year 2010-11.

3. Revenue has preferred this appeal projecting the following question as substantial question of law:-

"Whether on the facts and in the circumstances of the case and in law, Tribunal is justified in restricting the disallowance to 5% of the gross purchases when it is established that none of the

supplier parties are in existence and the assessee has just taken accommodation entries without getting actual supplies from the said parties?"

4. To appreciate the question proposed, it may be apposite to advert to the orders passed by the authorities below.

5. Respondent is an assessee under the Act. It is a company which is engaged in the business of manufacturing and dealership of all kinds of industrial power controlling instrument cables and related items. For the assessment year 2010-11 assessee filed e-return of income declaring income of Rs.1,35,31,757.00. In addition, assessee also declared income of Rs.3,64,15,007.00 under Section 115JB of the Act. The case was selected for scrutiny and in scrutiny proceedings Assessing Officer noticed that Sales Tax Department, Government of Maharashtra had provided a list of persons who had indulged in the unscrupulous act of providing bogus hawala entries and purchase bills. Names of beneficiaries were also provided. Assessing Officer noticed that assessee was one of the beneficiaries of such bogus hawala bills. Assessing Officer referred to purchases allegedly made by the assessee through four hawala entries for the assessment year under consideration, the details of which are as under :-

Name of the Party providing Bogus Bills/Hawala Entries	A.Y. of the transaction	Amount (Rs.)
SHREE GANESH TRADING COMPANY	2010-11	54670729
AKSHAT ENTERPRISES	2010-11	76998384

SHREYAS MARKETING AGENCY	2010-11	55018874
ASIT TRADERS	2010-11	55118398
		241806385

6. In this backdrop, Assessing Officer issued notice to the assessee under Section 142(1) of the Act to explain as to why suitable action should not be initiated for such undesirable act. It was mentioned in the said notice that the Assessing Officer was vested with the authority of passing an order of best judgment assessment under Section 144 of the Act. Assessee did not respond to the notice issued under Section 142(1) of the Act. Therefore, Assessing Officer drew the inference that assessee had no plausible explanation and had admitted the fact of bogus purchases mentioned in the notice under section 142(1) of the Act. Accordingly, Assessing Officer proceeded to finalize the assessment under Section 144 of the Act. For the grounds and reasons given in the assessment order dated 6<sup>th</sup> March, 2013 passed under Section 144 of the Act, Assessing Officer disallowed the entire expenditure shown as incurred by the assessee amounting to Rs.24,18,06,385.00.

7. Respondent/assessee assailed the aforesaid order of the Assessing Officer in appeal before the Commissioner of Income Tax (Appeals)-18, Mumbai, (shortly referred to as "CIT(A)" hereinafter).

8. CIT(A) in the appellate proceedings admitted additional evidence furnished by the assessee under Section 46A of the Income Tax Rules, 1962 (briefly "the Rules" hereinafter)

and allowed opportunity to the Assessing Officer to examine the documents and thereafter, to submit remand reports. Following the same, Assessing Officer submitted two remand reports dated 10<sup>th</sup> December, 2013 and 25<sup>th</sup> July, 2014. Both the remand reports were extensively considered by the CIT(A). Copies of the reports were also furnished to the assessee and based on the reports an opportunity was granted to the assessee to show cause as to why the quantum of purchases should not be enhanced from Rs.24,18,06,385.00 to Rs.65,65,30,470.00 in terms of Section 251(2) of the Act.

9. CIT(A) considered the rival submissions and noticed that assessee did not raise any objection to the higher figure of purchase because the said amount was also declared in the revised sales tax return filed by the assessee with the Sales Tax Department. Thereafter, CIT(A) enhanced the quantum of purchases from Rs.24,18,06,385.00 to Rs.65,65,30,470.00. Having enhanced the quantum of purchases as above, CIT(A) posed a question as to whether the entire purchases being bogus purchases were to be added back to the taxable income of the assessee or only the profit margin or the difference in gross profit/net profit should be added.

10. For the grounds and reasons given in the appellate order dated 14<sup>th</sup> October, 2014, CIT(A) found as a matter of fact that assessee had made circular purchases and sales from 12 parties as declared in the sales tax return. Though the genuineness of purchases and sales were not proved before

the Assessing Officer and also during the appellate proceedings, CIT (A) noted that while Assessing Officer had treated the purchases as bogus but had accepted the sales and gross profit declared in the return of income. CIT(A) held that there can be no sales without purchases. When the sales were accepted, then the corresponding purchases could not be disallowed. Therefore, CIT(A) held that only the profit element embedded in the purchases would be subject to tax and not the entire purchase amount. On due consideration CIT(A) added 2% of the purchase amount of Rs.65,65,30,470.00 as profit which worked out to Rs.1,31,30,609.00 to the income of the assessee and the balance addition was deleted.

11. Aggrieved by the said order of the CIT(A), Revenue preferred appeal before the Tribunal. Tribunal vide the order dated 3<sup>rd</sup> November, 2016 took the view that 2% of the profit which was directed to be added by the CIT (A) was on the lower side and therefore, the Assessing Officer was directed to make further addition of 3%.

12. It is against this order of the Tribunal that Revenue is before us in appeal under Section 260-A of the Act.

13. Mr.Sharma learned standing counsel, Revenue submits that when the purchases were bogus, the entire amount covered by such purchases should have been added to the total income of the assessee. There is no question of only adding the profit margin to the income of the assessee. In this

connection learned standing counsel has referred to a decision of the High Court of Allahabad in **Kaveri Rice Mills Vs. Commissioner of Income-Tax, (2006)157 Taxman 376**. He has also placed reliance on a decision of the Delhi High Court in **Commissioner of Income-Tax Vs. La Medica, 250 ITR 575**, wherein it was held that once it was accepted that the supplies made were fictitious, question of the assessee making purchases from other sources ought not to have been considered by the Tribunal. It was not open to the Tribunal to make out a third case which was not even the case of the assessee. He therefore submits that atleast an arguable case is made out by the department and therefore, the appeal should be admitted on the question of law proposed.

14. We have carefully considered the submissions made by learned standing counsel and have also perused the materials on record.

15. We have already discussed the context in which the Assessing Officer had made the additions. We have also noted that in the appellate proceedings before the first appellate authority i.e.CIT(A) the quantum of purchases was enhanced from Rs.24,18,06,385.00 to Rs.65,65,30,470.00. Having raised the quantum of purchases as above, CIT(A) posed a question to itself as to what should be the treatment of purchases; whether the same should be added back to the taxable income of the assessee as a whole or only profit margin should be added back. After referring to various case laws on the subject, CIT(A)

returned a finding of fact that assessee had made circular purchases and sales with 12 parties as disclosed in the sales tax return. Though genuineness of the purchases and sales were not proved, yet it was noted that the Assessing Officer had accepted the sales and gross profit declared in the return of income. CIT(A) held that there can be no sales without purchases. When the sales were accepted, then the entire purchases could not be disallowed. Referring to a decision of the Gujarat High Court in the case of **CIT Vs. Bholanath Polyfab Limited, 355 ITR 290 (Guj)** CIT(A) held that only the profit element embedded in purchases would be subjected to tax and not the entire amount. Having said so, CIT(A) noted that the gross profit rate of the assessee showed a decreasing trend over the years. In such circumstances, CIT(A) took the view that 2% of the purchases of Rs.65,65,30,470.00 would be a fair and reasonable profit percentage which should be added to the income of the assessee, deleting the balance amount.

16. While doing so, CIT (A) observed that only reasonable profit on the purchases made from the hawala party should be added back to the income of the assessee. Relevant portion of the order of the CIT (A) is extracted hereunder:-

“2.7 From the perusal of the decisions of the Hon’ble courts on this issue, specially the decision of the Hon’ble Bombay High Court in the case of CIT Vs. Nikunj Eximp Enterprises Pvt. Ltd. (supra), it was clearly held that the A.O. and the CIT (A) had disallowed the amount of Rs.1.33 crores on account of purchases merely on the basis of suspicion because the sellers and the canvassing agents have not been produced before them. The

Hon'ble Mumbai Tribunal in the case of Saroj Anil Steel Pvt. Ltd. Vs. ITO vide order dated 30-10-2012 has also decided this issue that only profit margin @ 1 % is to be added back. Similar view has been taken by the Hon'ble Tribunal Mumbai in the case of Anil Goyal Exim (P) Ltd. Vs. ITO vide order dated 25-04-2005. The Hon'ble Gujarat High Court in the case of CIT Vs. Bholanath Polyfab Pvt. Ltd., 40 Taxman.com 494 has held that whether the assessee did purchase cloth and sell finished goods and purchasers were not traceable, profit element embedded in purchases would be subject to tax and not entire amount. From the facts of the present case, it is noticed that the assessee has made circular purchases and sales with 12 parties as declared in sales tax return. The genuineness of purchases and sales were not proved before the A.O. and even during the appellate proceedings. The A.O. has treated the purchases as bogus but accepted the sales and gross profit declared in the return of income. Now question arise whether there can be any sales without purchases. The answer is always in the negative that no sales can be made without purchases. The situation can be that purchases may not be made from the parties from whom invoices have been obtained as mentioned by the A.O. in the assessment order. But when the sales are accepted then the whole purchases cannot be disallowed as held by various courts stated above. As per the decision of the Hon'ble Gujarat High Court in the case of CIT Vs. Bholanath Polyfab Pvt. Ltd., it is clearly held that only the profit element embedded in purchases would be subject to tax and not the entire amount. Now the question arises how to determine the profit element. For this purpose, the total turnover and percentage of gross profit for the earlier three years was obtained from the AR of the appellant. It is noticed that in earlier years, the main business of the assessee was manufacturing and dealership of all kinds of industrial power control instruments and related items but in the year under consideration it has shown trading of



Rs.65,65,30,470/- out of the total purchases at Rs.67,34,02,306/-. The gross profit shown in the year under consideration was at 5.71 % as against 8.77% in the preceding year. From the perusal of the submissions made by the AR of the appellant, it is noticed that the contention of the appellant was correct that in the earlier years the main business of the assessee was manufacturing and in the year under consideration the major activity is of trading. The gross profit rate was also decreasing every year and in the year under consideration it has decreased to 3%. It is also an established fact that the gross profit of trading activity is lower than the manufacturing activity. The AR of the appellant has also offered that additional gross profit @ ½% of the turnover can be added back. But there is no reasonableness in adopting this ½% G.P. Keeping in view the principles of natural justice and the decision of the Hon'ble Courts on this issue, only the reasonable profit has to be added back on the purchases made from the hawala parties. The gross profit has been reduced from 8.77 % to 5.71% during the year under consideration which is explained as major manufacturing activity in the last year and major part of the trading activity in the year under consideration. Keeping in view of these facts and circumstances, I am of the view that 2% of the purchases made from the hawala parties amounting to Rs.65,65,30,470/- which works out at Rs.1,31,30,609/- is fair and reasonable, hence, upheld and the balance addition made is deleted. Ground of appeal is partly allowed."

17. Before the Tribunal, Revenue expressed the grievance that CIT (A) had erred in disallowing bogus purchases at 2% being profit on purchases made by the assessee from the

grey market. Tribunal vide its order dated 3<sup>rd</sup> November, 2016 held as under :-

“4. We have heard rival contentions and gone through the facts and circumstances of the case. Admitted facts are that the AO neither in the original proceedings nor during remand proceedings objected to sales made by assessee. In that eventuality it is imperative on our part to hold that there must be purchases. Whether the purchases are from Grey Market or whatever the assessee has made purchases although payments are made to hawala dealers. In that eventuality it is to be seen whether the payments are recorded in the books of account or not. This fatum is not denied by Revenue, rather the assessee has proved that the payments are made through accounts payee cheques and purchases are entered in its books of account. Once the assessee is able to prove that the purchases were made only in alternative way, the revenue is to estimate the excess profit at a rate. Here, our difference is that 2% is reasonable or some higher profit is to be estimated. We are of the view that the assessee's gross profit varies from 5% to 8.77%, but these purchases are from Grey Market and its profit element is little higher and accordingly, we direct the Assessing Officer to make further addition of 3% of the bogus purchases and accordingly estimate the income. We direct the Assessing Officer accordingly. This issue of Revenue's appeal is partly allowed.”

18. Tribunal noted that it was an admitted fact that the Assessing Officer did not object to the sales made by the assessee. Therefore, it was evident that they were corresponding purchases. Having noted the above, Tribunal examined the books of accounts of the assessee wherefrom it was found that the assessee had made payments on account of the purchases through account payee cheques

and the purchases were entered in its books of account. Thus, assessee was able to prove that the purchases were made only in the alternative way. If that be so, then Revenue was only required to estimate the profit at a particular rate. Referring to the figure of 2% arrived by the CIT(A), Tribunal observed that assessee's gross profit varied from 5% to 8.77%. Since the purchases were made from the grey market, the corresponding profit element would be little higher. Therefore, Tribunal directed the Assessing Officer to make further addition of 3% on the bogus purchases and to estimate the income on such basis.

19. On thorough consideration of the matter, we do not find any error or infirmity in the view taken by the Tribunal. The lower appellate authorities had enhanced the quantum of purchases much beyond that of the Assessing Officer i.e., from Rs.24,18,06,385.00 to Rs.65,65,30,470.00 but having found that the purchases corresponded to sales which were reflected in the returns of the assessee in sales tax proceedings and in addition, were also recorded in the books of accounts with payments made through account payee cheques, the purchases were accepted by the two appellate authorities and following judicial dictum decided to add the profit percentage on such purchases to the income of the assessee. While the CIT (A) had assessed profit at 2% which was added to the income of the assessee, Tribunal made further addition of 3% profit, thereby protecting the interest of the Revenue. We have also considered the two decisions relied upon by learned standing counsel and we

find that facts of the present case are clearly distinguishable from the facts of those two cases to warrant application of the legal principles enunciated in the two cited decisions.

20. In **Bholanath Polyfab Limited (supra)**, Gujarat High Court was also confronted with a similar issue. In that case Tribunal was of the opinion that the purchases might have been made from bogus parties but the purchases themselves were not bogus. Considering the fact situation, Tribunal was of the opinion that not the entire amount of purchases but the profit margin embedded in such amount would be subjected to tax. Gujarat High Court upheld the finding of the Tribunal. It was held that whether the purchases were bogus or whether the parties from whom such purchases were allegedly made were bogus was essentially a question of fact. When the Tribunal had concluded that the assessee did make the purchase, as a natural corollary not the entire amount covered by such purchase but the profit element embedded therein would be subject to tax.

21. We are in respectful agreement with the view expressed by the Gujarat High Court.

22. Thus, we do not find any merit in this appeal. No substantial question of law arises from the order passed by the Tribunal. Consequently, the appeal is dismissed. However, there shall be no order as to cost.

**(MILIND N. JADHAV, J.)**

**(UJJAL BHUYAN, J.)**