



IN THE INCOME TAX APPELLATE TRIBUNAL, PANAJI BENCH, PANAJI



BEFORE HON'BLE SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER

AND

SHRI G. D. PADMAHSHALI, ACCOUNTANT MEMBER

ITA Nos. 011/PAN/2025

Assessment Year : 2017-18

M/s Virupakaxappa Sidramappa Bembalgi
580, Saraf Katta,
Shahapur, Belgaum-590003.
PAN : AADFV3936F

..... Appellant

V/s

Income Tax Officer,
Ward-2, Belgaum.

..... Respondent

Appearances

Assessee by : Mr A S Patil ['Ld. AR']

Revenue by : Ms Rijjula Uniyal ['Ld. DR']

Date of conclusive Hearing : 03/04/2025

Date of Pronouncement : 08/04/2025

ORDER

PER G. D. PADMAHSHALI;

The captioned appeal of the assessee filed against DIN & Order 1070470789(1) dt. 19/11/2024 is passed by the National Faceless Appeal Centre, Delhi ['Ld. NFAC' hereinafter] u/s 250 of the Income-tax Act, 1961 ['the Act' hereinafter] which in turn arisen out of order of assessment dt. 13/11/2019 passed u/s 143(3) of the Act by the Income Tax Officer, Ward-2, Belgaum ['Ld. AO' hereinafter] anent to assessment year 2017-18 ['AY' hereinafter].

2. Tersely stated facts of the case are that; the assessee is partnership firm engaged in trading business of precious metal. The return of income filed on 20/10/2017 by the assessee declaring total income of ₹NIL was selected for scrutiny wherein the books of account were rejected by the Ld. AO and estimated a gross profit @40% of estimated sales of ₹250Lakhs and made a consequential addition of ₹45,29,674/- while assessing the total income u/s 143(3) of the Act. Aggrieved by the estimated sales & gross profit and assessment, the assessee instituted an appeal thereagainst before Ld. NFAC, which came to be dismissed. Dissatisfied with the impugned order, the assessee came in present appeal agitating the impugned order precisely on following three substantive reasons/grounds as;

- (i) as being against law and facts of the case.*
- (ii) ad-hoc estimation of sales/turnover is without any material on record and is baseless.*
- (iii) ad-hoc estimation of gross profit is without any material on record and is baseless.*

3. We have heard the rival party's submission and subject to rule 18 of ITAT-Rules, 1963 perused material placed on record and considered the facts in the light of settled position of law which was forewarned to parties present for their rebuttal.

4. We note that, the appellant partnership firm was engaged in wholesale & retail trading of gold, silver and other small jewellery items. The appellant's total sales turnover for the year under consideration from said business was ₹2,26,41,526/- from which the appellant earned a gross profit of ₹54,63,881/- & net profit of ₹7,65,092/-. For purpose said trading business, the assessee maintained regular books of account as prescribed u/s 44AA of the Act and subjected them to audit u/s 44AB of the Act. With the former details the appellant filed NIL return of income after claiming a set-off of carried forward loss & deduction u/c VI-A of the Act etc. The case of the appellant was selected u/s 143(2) of the Act primarily to scrutinise impact of tax auditor's

comment/reporting made against **‘clause 13(e)’** of Form No 3CD i.e. Tax Audit Report [‘TAR’]. In the course of such scrutiny, after considering submission & explanations offered by the appellant, the Ld. AO rejected the appellant’s books, audited results and the returned income. While doing so the Ld. AO founded his rejection on twofold premises viz; (i) the assessee in addition to regular purchases from registered dealers [‘RD’ hereinafter] also had purchases from unregistered dealers [‘URD’ hereinafter], and details of such URD purchases brought on record were insufficient to prove their genuineness as they lacked entire details for their confirmation and (ii) the assessee failed to maintain item-wise stock of small jewellery items along-with stock of gold & silver etc., and details of stock so maintained & produced for verification in view of the Ld. AO were insufficient to effectively demonstrate quantitative corroboration of stock-items with the corresponding amount of total purchases *vis-à-vis* sales turnovers reported by the appellant firm.

5. Having rejected the books on former twofold reasons; the Ld. AO proceeded to determine the taxable income with two options viz; **Option-(A)** addition of ₹1,65,61,814/- on account of 100% disallowance of (i) total URD purchases of ₹1,61,75,480/- and (ii) Labour charges paid for ornamentation ₹3,86,340/- or **Option-(B)** addition of ₹45,29,674/- on account of estimation of gross profit @40% of estimated ad-hoc sales/turnover of ₹250Lakhs. Since the first option(A) will result into profit of more than the turnover, the Ld. AO chose option (B) over (A) in assessing the total income of the appellant and culminated the assessment vide order dt. 13/11/2019 u/s 143(3) of the Act.

6. When matter climbed up in first appeal, the Ld. NFAC reconsidered the factual matrix and then countenanced the addition and assessment. While doing so the Ld. NFAC requoted the discrepancies noted by the Ld. AO in relation to URD purchases, discrepancies in stock records and turnover of sales & purchases etc.

7. For adjudicating the dispute the appellant assessee has brought out following contentions to decide;

- (i) *whether in facts & circumstance of case the rejection of audited books was warranted & valid?*
- (ii) *whether it was incumbent upon the Ld. AO to framed assessment u/s 144 of the Act once books are rejected u/s 145(3) of the Act?*
- (iii) *whether it was incumbent upon the Ld. AO to cause for special audit u/s 142(2A) once audited books are rejected u/s 145(3) of the Act before determining the income to the best of judgement u/s 144 of the Act?*
- (iv) *whether estimation of income at an ad-hoc % of gross profit based on an ad-hoc estimated figure of sales/turnover is permissible u/s 143(3) of the Act?*

8. Let us deal with the issues chronologically first with rejection of books; The audited financial statements placed on records (P/b, Pg-12) reveals that, for the year under consideration the appellant had silver & gold purchases to the tune of ₹38,35,342/- & ₹1,65,80,728/- respectively. The corresponding figures of sales were ₹45,20,991/- & ₹1,63,13,531/-. Admittedly, total purchases of silver & gold included URD purchases from small customers to whom effective sale of silver / gold ornaments were made in exchange of old ornaments etc.

These transactions of such URD purchases entered in purchase register lacked full name, address and contract numbers with some identity proof details like Aadhar Number, Driving License or PAN etc. This insufficiency in records of URD purchases prompted the tax authorities to disbelieve their genuineness in first place. When appellant failed to demonstrate the corroborative quantitative figures of movement in stock with cogent evidences, i.e. opening stock, RD & URD purchases & sales and closing stock etc., it ironclad the belief of the tax authorities that, the books results of appellant cannot be relied to deduce correct taxable income. In consequence books were rejected u/s 145(3) of the Act and assessed the income resultantly u/s 144 of the Act.

9. Now first coming to provision of section 145 of the Act, which reads as under;

145 Method of accounting.

(1) *Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall,*

(2) *The Central Government may notify in the Official Gazette*

(3) *Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of*

*accounting provided in sub-section (1) has not been regularly followed by the assessee, or income has not been computed in accordance with the standards notified under sub-section (2), **the Assessing Officer may make an assessment in the manner provided in section 144.*** (Emphasis supplied)

10. An austere reading of section 145(3) of the Act, envisages that there could be existence of three situations where assessing officer can resort to rejection of books of account of assessee. And one of such situations with which we are concerned in the present appeals is satisfaction of the Ld. AO about incorrectness or incompleteness of stock register, trading figure of gold & silver and the net results declared of business declared by the appellant assessee. The rejection on such ground however can only be triggered or considered when accounts are found substantially incorrect or incomplete, that is to say incorrectness or incompleteness of substantial accounts shall only form reasonable basis for rejection of books.

11. Largely based upon books of accounts the taxable income of assessee is determined, wherein the stock/inventory records undisputedly forms substantial

part of books/accounts, hence in absence thereof any determination of income for taxation under the Act would be meaningless.

12. In present case, non-maintenance or non-production of product-wise and item-wise trading as well inventory records pertaining to silver & gold ornaments coupled with appellant's failure to establish genuineness of URD purchases formed a basis in holding accounts as incorrect or incomplete, which in turn triggered rejection u/s 145(3) of the Act. Since the stock/inventory records/details forms significant part of accounts which severally capable of influencing the determination of total income of the appellant assessee hence the non-maintenance *vis-à-vis* non-production of such records so has to enable the tax authorities to deduce therefrom correct taxable income, in our considered view is capable of construing accounts of the appellant were substantially incomplete & incorrect, thus valid reason for rejection of books u/s 145(3) of the Act.

13. The Hon'ble Jurisdictional High Court in similar circumstances in '*Dhondiram Dalichand Vs CIT*' [1970, 81 ITR 609 (BHC)] upheld rejection of books holding that, absence of quantitative tally regarding sales & purchases made by assessee was such that it was necessary to exercise powers available for rejection of books and determine income to the best of judgement. Similarly in '*Bastiram Narayandas Vs CIT*' [1994, 210 ITR 438 (BHC)] their Hon'ble Lordships have upheld the rejection of books and framing of assessment to the best assessing officer's judgment where assessee Bidi manufacturer failed to produce relevant inventory/stock records of its day-to-day manufacture of Bidis. Further, a similar view can be traced in '*Kachwala Gems Vs Jt. CIT*' [2007, 288 ITR 10 (SC)] wherein the Hon'ble Apex Court also espoused the rejection of books for incompleteness owing to non-maintenance of stock/inventory records.

14. In view of former judicial precedents, we upheld the rejection of books owing to defects in

inventory/stock records & appellant's failure to establish the genuineness of URD purchases. The respective contention/question thus answered accordingly.

15. Now, once books of account are rejected, the Ld. AO in view of prescription contained in s/s (3) of section 145 of the Act was duty bound to make an assessment **in the manner** provided u/s 144 of the Act. The appellant on the other hand by second contention puts ice on the cake asserting that, since books of account of the assessee were rejected u/s 145(3) of the Act therefore the assessment was required to be framed u/s 144 of the Act. Contrary to the former provision, since in the present case the assessment is framed u/s 143(3) of the Act, therefore such assessment is bad in law.

16. The sanction for framing assessment to the best of judgement is provided in section 144 of the Act which reads as under;

Best judgment assessment.

144. (1) If any person—

(a) fails to make the return required under sub-section (1) of section 139 and has not made a return or a revised return under sub-section (4) or sub-section (5) of that section, or

(b) fails to comply with all the terms of a notice issued under sub-section (1) of section 142 or fails to comply with a direction issued under sub-section (2A) of that section, or

(c) having made a return, fails to comply with all the terms of a notice issued under sub-section (2) of section 143,

the Assessing Officer, after taking into account all relevant material which the Assessing Officer has gathered, shall, after giving the assessee an opportunity of being heard, make the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment :

Provided that such opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgment :

Provided further that it shall not be necessary to give such opportunity in a case where a notice under sub-section (1) of section 142 has been issued prior to the making of an assessment under this section.

(Emphasis supplied)

17. From the bare reading of aforesaid provision it is intelligible that, the section predominantly coins with twofold facets viz; (i) authority or sanction for framing of assessment and (ii) manner of determination of income to the best of judgement. The s/s (1) of section 144 prescribes that where a person fails in terms of clause (a) or (b) or (c) as the case may be, the assessing officer is empowered to frame an assessment to best of his judgement and determine taxable income on the basis of material already gathered. That is to say, where income of assessee is determined owing to failure on the part

of assessee to comply with either of the clauses of s/s (1), then assessing officer is bound to frame such assessment u/s 144 of the Act. Then comes with the manner of determination, which mandates for assessing officer to ‘take into consideration **all relevant material gathered** during such proceedings and to provide **an opportunity of being heard** to the assessee’ while arriving at total income/loss to the best of his judgement. The manner thus is of twofold prescription. *Au contraire* where the books of accounts of an assessee for reasons stated in s/s (1) & (2) of section 145 of the Act are rejected, upon such rejection the s/s (3) comes into play which mandates the assessing officer to determine the taxable **in the manner provided** u/s (1) of section 144 of the Act. Such direction of s/s (3) of section 145 of the Act do not in any way direct framing of assessment u/s 144 of the Act but the manner of determination of income to best of judgement on the basis of material already gathered on record but after the assessee is put to show cause notice[‘SCN’].

18. In view of the above discussion, in our considered view the appellant's assertion of not framing the assessment u/s 144 of the Act when the books of the assessee are rejected u/s 145(3) is purely misconceived, baseless, therefore stands rejected.

19. Now coming to arbitrary estimation of sales and gross profit. We note that, after rejecting the books, the Ld. AO forthwith proceeded and for the purpose of determination of taxable income estimated sales/turnover @ 250 Lakhs & gross profit @ 40% of such estimated sales/turnover. The said estimation *prima-facie* did fail to consider all the material already taken on record by him during the course of assessment proceedings which inter-alia consisted of (i) TAR (ii) Stock Records (iii) Bank Statements (iv) Purchase & Sales Registers etc. Further the records nowhere clearly deciphers that while resorting to such estimation *vis-à-vis* determination the appellant was put to show cause in terms of first proviso to section 144 of the Act. Thus

while determining the income in the manner provided u/s 144 of the Act, the Ld. AO neither provided hearing to the appellant nor considered all essential & decisive material brought on record by the appellant during the course of assessment proceedings. The determination thus not only rendered erratic but also opposed to law.

20. A clear-cut distinction between Best Judgement assessment and in the manner provided u/s 144 of the Act is required to be understood while resorting to the provision of section 145(3) of the Act. It is well settled law that, in the case of Best Judgement assessment u/s 144 of the Act, the Assessing Officer exercising his jurisdiction cannot act arbitrarily or capriciously. The assessing officer must proceed on judicial considerations in the light of relevant material that may be brought on record by the assessee. Though such assessment would be based on some element of guess work but should clearly have nexus with material placed on records and should not been exercised arbitrarily or capriciously. In

quoting so, a reliance can be placed on the Hon'ble Allahabad High Court's decision in the case of CIT V/s. Surjeet Singh Mahesh Kumar [1994, 210 ITR 83]

21. In the present case, the appellant is engaged in precious metal business which by very nature is complex for the reason of involving intricate processes, high-value transactions with low margins, and a highly competitive market, demanding careful management of inventory, high volatility in pricing, and everchanging customer needs/experience, high risk of fluctuating cost etc. Admittedly, due to complex nature & high-volume transactions involved and insufficiency of inventory the audited books of account & financial results of the appellant were rejected. When such audited results are rejected, then the assessing officer not being an expert of accounts, having regard to complexity of business of the appellant was duty bound to invoke & direct a special audit u/s 142(2A) of the Act. The outcome of such direction could have to rightly enabled the Ld. AO in

deducing taxable income in the manner & spirit provided u/s 144 of the Act. The ad-hoc determination of taxable income without such assistance from expert in the present case not only jostled ad-hoc & irrational estimations but led to farfetched determination. The said capricious determination of income since based upon ad-hoc estimation of sales/turnover and ad-hoc estimation of gross profit which in turn was devoid of all pivotal information & cogent material taken on records and without putting the appellant to notice is inconsonance with the provisions of section 144 of the Act.

22. Therefore respectfully following the former judicial precedents, we disapprove the estimations and resultant determination of income and for the reason deem it fit to remand the matter to the Ld. AO for fresh determination of income in accordance with law after complying with the provisions of section 142(2A) of the Act. The contention thus stands accepted and ground number 2 & 3 stands accordingly partly allowed.



23. Since we have already set-aside the impugned order hereinbefore, we for the aforestated reasons set-aside the assessment order as well and remit the matter back to the file of Ld. AO with a direction to frame the assessment *de-novo* in accordance with law after taking on record the audit report in terms of section 142(2A) of the Act. Needless to mention that, the appellant shall be accorded a reasonable opportunity of being heard against audit report so obtained for the determination of taxable income/loss etc. The grounds thus stands partly allowed.

24. The appeal in result allowed for statistical purposes in aforestated terms.

In terms of rule 34 of ITAT Rules, 1963 the order pronounced in the open court on date mentioned herein before.

**-S/d-
PAVAN KUMAR GADALE
JUDICIAL MEMBER**

**-S/d-
G. D. PADMAHSHALI
ACCOUNTANT MEMBER**

Panaji/Dt: 08th April, 2025.

Copy of the Order forwarded to :

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|-------------------|-----------------------------------|-------------------------|
| 1. The Appellant. | 2. The Respondent. | 3. The CIT(A) Concerned |
| 4. PCIT Concerned | 5. DR, ITAT, Panaji Bench, Panaji | 6. Guard File |

By Order,
Sr. Private Secretary / AR ITAT, Panaji.