
(2000) 02 KL CK 0045

In the High Court Of Kerala

Case No : Income-tax Reference No. 36 of 1997

Commissioner of Income Tax

APPELLANT

Vs

K.N. Satyapalan

RESPONDENT

Date of Decision : 28-02-2000

Acts Referred:

Income Tax Act, 1961 — Section 256(2)

Citation : (2001) 247 ITR 105

Hon'ble Judges : Arijit Pasayat, C.J;K.S. Radhakrishnan, J

Bench : Division Bench

Advocate : P.K.R. Menon, for the Appellant; C. Kochunny Nair, K.G. Anil Babu and S. Arun Raj, for the Respondent

Judgement

Arijit Pasayat, C.J.—Pursuant to a direction given by this court in O. P. No. 11914 of 1994, dated November 7, 1994, the following questions have been referred for the opinion of this court u/s 256(2) of the Income Tax Act, 1961 (in short, "the Act"), by the Income Tax Appellate Tribunal, Cochin Bench (in short, "the Tribunal") :

"(1) Whether, the Tribunal was justified, on the facts and in the circumstances of the case, in deleting the addition of Rs. 22,26,538 ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law and on facts to hold that the assessee had utilised the secret profits of the firm for his proprietary business ?"

2. The factual position, as stated in the statement of case, is as follows : The assessee is a partner in the firm, K. N. Sathyapalan and Co., which was carrying on contract business. He was also doing independent contract work on a proprietary basis. During the accounting year ending on March 31, 1989, relevant to the assessment year 1989-90, the assessee had undertaken a contract work in respect of Ghimini Dam and Kanjirapuzha Dam. In respect of these works, he had disclosed gross receipts of Rs. 99,73,121, which included

the value of the materials supplied by the State Public Works Department for a sum of Rs. 25,50,068. The Assessing Officer determined a total income at Rs. 48,96,660, which included addition of Rs. 22,26,538 as income by way of unexplained investment. The reason for such addition was that the assessee had made certain deposits and advances and incurred expenditure, the sum total of which comes to Rs. 30,15,050. The assessee was able to explain the sources only to the extent of Rs. 7,10,300 and the balance was treated as unexplained investments. The assessee preferred an appeal before the Commissioner of Income Tax (Appeals), Trivandrum (in short, "the CIT(A)"), who sustained the addition. The matter was taken in appeal before the Tribunal by the assessee. The Tribunal deleted the addition by holding that the income disclosed by the firm before the Settlement Commission was available to be utilised by the assessee. Reliance was placed on the decision of the apex court in *Anantharam Veerasinghaiah and Co. Vs. Commissioner of Income Tax , Andhra Pradesh*, to hold that funds siphoned off from the firm were available with the assessee for explaining the investments in his books for the previous year ending on March 31, 1989. The Revenue prayed for reference to this court, which was rejected. But, pursuant to the direction given as indicated above, the questions as quoted above have been referred for opinion.

3. In support of the application, learned counsel for the Revenue submitted that the Tribunal lost sight of the actual background of the facts and proceeded to base its conclusions on surmises and conjectures. A reference was made to the balance-sheets which were available before the Settlement Commission. After disclosure, it was noticed that the credit balances of all the partners excepting K. N. Sathyapalan and K. N. Mohanan were in the liability side along with the creditors for materials. The position was completely transformed after the disclosure made to the Settlement Commission. By the end of March 31, 1987, the credit balance of all the partners excepting Shri Sathyapalan had correspondingly increased. Two items of creditors for materials and wages payable were deleted as was noticed by the Commissioner of Income Tax (Appeals). A revised balance-sheet was possible to be prepared only after the firm had filed a petition before the Settlement Commission, or only after the Settlement Commission gave their order on February 21, 1991. If that is so, the revised balance-sheet is only a readjustment of the credit and debit balances of various partners. An amount of Rs. 31,75,000 was reduced only in respect of the creditors for materials and wages payable. Therefore, the question of availability of cash in the books of account does not arise, as there is no change in respect of the assets mentioned in the balance-sheet.

4. According to learned counsel for the assessee, the conclusions of the Tribunal are factual giving rise to no question of law. It clearly held that there was availability of funds flowing from the settlements made in respect of the firm and settled amount was utilised by the assessee only.

5. A few factual aspects, which have relevance, need to be noted. It is true, as

contended by learned counsel for the assessee, that if factual conclusions are arrived at by the Tribunal, which is the final fact-finding authority, no question of law would arise for consideration. But, if the Tribunal takes into account irrelevant materials or leaves out of consideration relevant materials, the conclusions will be vitiated giving rise to a question of law. It has to be noted that the assessee accepted certain factual aspects. These are relatable to a settlement made in the case of the firm. Bogus entries in relation to expenses were made thereby reducing the profits. Correspondingly, bogus entries were made in respect of alleged creditors. After the settlement, what was done was to reverse the entries relating to alleged creditors vis-a-vis corresponding bogus entries in respect of the expenses. The net effect of such reversal of the entries was deletion of entries from the balance-sheet, profit and loss account, and corresponding increase in the capital account of the partners of the firm. This did not lead to generation of cash inflow into the firm. Consequently, there was no question of any outgoing from the corpus of the firm to the hands of the assessee. Additionally, the Tribunal seems to have lost sight of the fact that if a sum of Rs. 22,00,000 was available as cash, the assessee and the firm would not have obtained overdraft facility of more than Rs. 25,00,000 from banks. Right from the assessment year 1986-87 onwards, cash credit from various parties aggregating to Rs. 28,00,000 was claimed by the assessee. As has been rightly observed by the Assessing Officer and the first appellate authority, there was no correlation between withdrawals made on various dates. In fact, small amounts were withdrawn on various dates. The Tribunal was of the view that when inflated wages and materials were shown by setting up bogus creditors, it meant that the inflated liabilities are paid off in the course of the year or in a subsequent year and in the cash, book, cash which was obtained through receipts is reduced and thus the money is siphoned off from the firm and this is possible because of generation of funds. Such a conclusion, to say the least, is erroneous and confusing. The procedure adopted by the firm was, as contended by the assessee, to show bogus expenses by inflation of wages and materials. It was not the case of the assessee, at any stage, that expenses were, in fact, made from undisclosed sources and they were not reflected in the accounts. That being the case, there would not have been any generation of cash. It is also not the case of the assessee that by showing bogus expenditure, the firm was keeping the money to itself. An admitted fact being that the firm was inflating expenses and showing bogus credits, actually no cash is involved in the transaction. By reversal of the entries, the effect of credits and debits was neutralised. There was no question of generation of any cash as contended by the assessee and accepted by the Tribunal. The position would not have also been different had actually expenses been made from undisclosed sources, against which bogus entries of creditors had been made. In such a case also, cash would have also been spent and no longer available. The case at hand, as noted above, is one of inflation of expenses when in fact no expenses were made. To explain the expenses, the entries in respect of bogus creditors were made. Had it been a case of bogus expenditure without actual payment, to

reduce the profit, cash would have been available. That is because, without cash being spent out of funds available, it is claimed to have been spent. Consequently, the conclusion of the Tribunal about the availability of cash is clearly untenable. Merely because secret profits were made by the firm as claimed, that was not relatable to existence of cash. Another plea that was raised was that the Tribunal brushed aside the factual aspect regarding discharge of liability in respect of purchase of 178.58 acres of estate for Rs. 15 lakhs. Long after the completion of assessment, a revised return was filed admitting a further sum of Rs. 7,01,550 as additional income. This was held to be not of much consequence by the Tribunal on the ground that the assessee was not expected to be a paragon of virtue. In the purported revised return, it was slated that the loans were raised by two persons who were in charge of the execution of work, and such funds were in the saving's bank account of the respective persons. We find that the Tribunal did not attach much importance to the question whether the other 13 partners had a share in the profits and whether the amount was distributed. It was for the assessee to establish that there was no distribution among other partners, which it failed to do. These aspects are really not of any importance, in view of our conclusion that no cash was available to be invested. The Tribunal acted on irrelevant materials, leaving out of consideration relevant materials and, therefore, its order is vitiated. Its conclusions are not supportable on the basis of the materials on record.

6. Our answer to both the questions referred to above is, in the negative, in favour of the Revenue and against the assessee.