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**(2006) 08 AHC CK 0083**  
**In the Allahabad High Court**

Commissioner of Income Tax

APPELLANT

Vs

Vijay Constructions

RESPONDENT

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**Date of Decision :** 08-08-2006

**Acts Referred:**

Income Tax Act, 1961 — Section 260A

**Citation :** (2007) 213 CTR 105 : (2007) 162 TAXMAN 34

**Hon'ble Judges :** Pradeep Kant, J;B.B. Agarwal, J

**Bench :** Division Bench

**Final Decision :** Disposed Of

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## Judgement

1. These are four appeals filed u/s 260A of the Income Tax Act against the order passed by the Income Tax Appellate Tribunal (in short "ITAT") on 24-12-2004 in respect of different assessment years consisting of 1993-94, 1994-95, 1995-96, 1996-97 and 1997-98. The assessee is a registered partnership firm, which is engaged in the work of civil construction in Public Works department. The returns were filed for the relevant assessment years. The books of account were, however, rejected by the assessing officer. Consequently, proceedings u/s 145(3) were taken following the proceedings u/s 144. The following two substantial questions of law have been pressed into service by the learned counsel for the revenue; (i) whether the determination of rate of profit ITAT the rate of 5 per cent by the Commissioner, Income Tax (Appeals) as against the flat rate of 8 per cent, as given by the assessing officer, and further reducing the same to 4 per cent by the ITAT was at all warranted under the facts and circumstances of the case; (ii) whether the assessee was entitled to the benefit of Section 40(b)( iv) and (v), namely, on the salary and interest paid to the partners.

2. In regard to the first question, suffice would be to mention that the assessing officer, on the analogy of Section 44AD, after rejecting the books of account, made assessment determining 8 per cent profit ITAT flat rate. This finding became the subject-matter of challenge in appeal and the Commissioner, Income Tax (Appeals), on consideration that since the assessee was performing the work

of civil construction as a contractor of the Public Works department, reduced the aforesaid rate of profit from 8 per cent to 5 per cent, mainly on the ground that since the turn-over of the assessee exceeds Rs. 40 lakhs, therefore, it is bound to incur more expenses and rate of profit would be less. On sub-contracts, he has applied the rate of 3.5 per cent on the reasoning that in the sub-contracts, the income is bound to be shared by the sub-contractor. In appeal before the ITAT, the rate of profit has been further reduced to 4 per cent on the ground that "the assessee was doing the work for PWD. Normally the net profit rate was much less for the work of PWD, as the contract work has to be done under certain specifications and under the supervision of the PWD authorities".

3. A bare perusal of the findings recorded by the assessing officer would indicate that he has applied the principles determining the profit, vide Section 44AD, whereas the aforesaid provision was not at all applicable in the case of assessee in the relevant assessment years. This factual position is not being disputed by either of the parties before us. That being so, the question arises as to what should be the profit rate for the purposes of determining the profit occurred or gained by the assessee. Since the assessing officer has not dealt with this question, independent of Section 44AD, we cannot uphold the rate of profit applied by him.

4. So far as the determination of profit of 5 per cent by the Commissioner (Appeals) and 3.5 per cent for sub-contracts is concerned, the Commissioner (Appeals) has also not given any reason nor any material was placed before the Commissioner, Income Tax (Appeals), or, for that matter, before the assessing officer, for arriving to a conclusion about the rate of profit. Merely on assumption that since the assessee is performing the work for the PWD and as the contract work has to be done under certain specifications and under the supervision of the PWD authorities, therefore, the rate of profit would be low or merely because the turn-over exceeded Rs. 40 lakhs, therefore, it would incur more expenses, the aforesaid rate of profit could not have been arrived at. Neither the Commissioner, Income Tax (Appeals) nor the ITAT have taken into consideration the relevant material or facts, which may be necessary for arriving at such conclusion.

5. The rate of profit cannot be assumed, merely on assumptions or surmises and conjectures. It is the first liability of the assessee to produce such records, evidence/material so as to substantiate its plea about the rate of profit that he claims and in case the books of account have been rejected, then the onus shifts upon the assessing officer to determine the rate of profit on consideration of the material which may be brought before him or even on making such enquiry, which may be necessary, which may include the requirement of having any information from the assessee also during the course of determination of such rate of profit, namely, during the assessment proceedings. In no case, simply because the turnover is more than Rs. 40 lakhs or the assessee is performing civil construction work for Public Works department, neither the rate of profit could be determined nor it could be taken to be less nor it could be reduced nor

could be arrived at on presumptions.

6. Since the assessing officer as well as the Commissioner, Income Tax (Appeals) as also the ITAT has not recorded any finding based on any material, and the findings recorded are merely on surmises and conjectures or, so to say, on purely guess work and imagination of the authorities, as it has not been brought to our notice that any such rate of profit can be assessed under the rules or any law in this manner, the findings of rate of profit, therefore, cannot be sustained and are liable to be set aside, and the matter deserves to be remanded to the assessing authority for re-determination thereof.

7. So far as the second question is concerned, lot of arguments have been advanced by Sri D.D. Chopra that in a matter of best judgment assessment, namely, where the books of account have been rejected, the provisions of Section 40(b)(iv) and (v) would not be available to the assessee and he would not be entitled for the benefit of deduction of salary and interest paid to the partners. His further submission is that even if such a deduction can be made, the same cannot be given in the instant case, as the assessee has not said anywhere that the partners were entitled for remuneration or salary in terms of the partnership deed and, therefore, the matter in any case has to be remanded for this purpose.

8. The aforesaid argument consists of two aspects, one, legal aspect and the other, factual aspect. In regard to the legal aspect, whether in a case where the best judgment assessment is made on rejection of books of account, deduction as permissible under the provisions of the Act otherwise would not be available to such assessee, has to be seen in the light of the provisions of the Income Tax Act and the scheme laid down therein.

9. Sri Rajan Roy, appearing for the assessee, has drawn our attention to the provisions of Sections 144 and 145 of the Act and also Section 139 to rebut the submission of the learned counsel for the revenue in a case of best judgment assessment, statutory deduction would not be available to him where flat rate is to be applied.

10. Section 144 of the Act prescribes the procedure for best judgment assessment, whereas Section 145 is the method of accounting and reads as under :

145(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of Sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessee or in respect of any class of income.

(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) or accounting standards as notified under Sub-section (2), have not been regularly followed by the assessee, the assessing officer may make an assessment in the manner provided in Section 144.

11. The aforesaid provision gives power to the assessing officer, if he is not satisfied about the correctness or the completeness of the accounts of the assessee, or where no method of accounting has been regularly employed by the assessee to make an assessment in the manner provided in Section 144. The provision in Sub-section (1) with regard to the income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" has been made subject to the provisions of Sub-section (2). This has to be computed with either cash or mercantile system of accounting regularly.

12. Section 144 provides the manner in which the best judgment assessment is to be made, which require opportunity to be afforded to the assessee to show cause as to why the assessment be not completed to the best of his judgment.

13. Sections 28 to 43 deal with the statutory deductions, which are available to an assessee. Section 40(b)(iv) and (v), which is the provision applicable in the instant case, reads as under :

(iv) any payment of interest to any partner which is authorised by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed insofar as such amount exceeds the amount calculated at the rate of twelve per cent simple interest per annum; or

(v) any payment of remuneration to any partner who is a working partner, which is authorised by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed insofar as the amount of such payment to all the partners during the previous year exceeds the aggregate amount computed as hereunder.

14. Sri D.D. Chopra does not dispute that these statutory deductions would be permissible to till assessee's whose return have been submitted u/s 139(1) and even if they are not accepted and regular assessment proceedings are taken, but he argues that if the assessment has been made by best judgment assessment of the assessing officer, then these deductions would not be available to such assessee.

15. Learned counsel, however, has not been able to substantiate from any provision of the Act or the Rules framed under the Income Tax Act which makes any such distinction between the assessee, who has been assessed by the assessing officer u/s 139(1) or Section 143 of the Act or even u/s 144. u/s 139, when return is filed, the assessing officer has power to see whether the return, as has been filed, has to be accepted and an intimation has to be sent u/s 143(1) and in case the assessing officer finds that the return submitted by the assessee

requires some modification or change, he will accordingly call the assessee to produce the evidence in support of the claim, and shall take recourse to regular assessment.

16. The procedure for making assessment in a matter where voluntary return submitted by the assessee u/s 139(1) is not accepted by the assessing officer has been given u/s 143(3) whereas procedure for giving best judgment assessment is given u/s 144. Merely because the procedures for such assessment have been separately provided in the aforesaid two sections relating to an assessee where the voluntary return has not been found as acceptable by the assessing officer and where the books of account have been rejected and best judgment assessment has been made, it would not in itself be sufficient to hold that the statutory deductions which are otherwise: available to the assessee, would not be available to the assessee who has been assessed under best judgment assessment by the assessing officer, unless, of course, any rule or provision of the Act expressly excludes the benefit of statutory deductions to such an assessee, the plea taken by the revenue cannot be accepted.

17. Taking a queue from Section 44AD, Sri Rajan Roy has submitted that the aforesaid provision, which prescribes flat rate of 8 per cent profit, itself provides for deduction, as may be available to an assessee, which is a firm.

18. Relying upon the proviso to Sub-section (2) of Section 44AD, he has submitted that the salary and interest paid to its partners by the assessee firm shall be deducted from the income computed under Sub-section (1) subject to the conditions and limits specified in Clause (b) of Section 40. The argument, therefore, is that the revenue's contention that in a matter where best judgment assessment has been made and flat rate of profit has been levied, statutory deduction would not be available in respect of salary and interest paid to the partners of the firm stands negated by the aforesaid provision under the Act itself. The flat rate principle, which is being put into service by the revenue does not mean that the statutory deduction which is otherwise available to the assessee firm and which has not been excluded in any manner under the provisions of the Act and rather the same having been allowed under the provision aforesaid, the plea of non-availability of the said deduction to an assessee firm, who has been assessed under the best judgment assessment, cannot be supported by any provision of the Act.

19. This argument can be tested by another angle, namely, in other words, if the interpretation given by the revenue is accepted, it would mean that in a case where the assessee's books of account have been rejected or, for any other reason, whatsoever, best judgment assessment has been made, that would entail penalty or adverse civil consequences of depriving the assessee from having the statutory deductions, which would have been otherwise available to him, in case his voluntary return filed u/s 139(1) has been accepted or regular proceedings u/s 143(3) of the Act were taken. This interpretation would lead to an anomalous situation, besides the same does not flow from the scheme of assessment under

the Act. It is only the method of assessing the income of the assessee firm which either has to be done by accepting the voluntary return filed u/s 139(1) or it has to be regularly assessed u/s 143(3) or best judgment assessment is to be made u/s 144. The final outcome of the assessment of the income of the assessee firm calls for consequential imposition of tax and realisation thereof. The statutory deductions thus which are available to the assessee firm cannot be taken away or snatched away from the firm merely because their books of account have been rejected and best judgment assessment has been made.

20. Another argument raised by Sri Rajan Roy, that salary and interest in the hands of the partners has to be separately assessed and it has to be treated as business income u/s 28(v), could not be satisfactorily answered/rebutted by the learned counsel for the revenue. Salary and interest, which is given to the partners in terms of the partnership deed, the tax liability of the said amount shifts upon the partners and cannot be taken as tax liability of the firm. The applicability of Section 28(v) cannot be excluded in the matter of best judgment assessment in respect of an assessee firm.

21. The next argument is regarding the fact as to whether the assessee had put forward the case before the assessing officer that the assessee was a registered partnership firm, which was working under the registered partnership deed and that in the partnership deed there was any clause for payment of salary and that the partners were the working partners.

22. Though this plea was never raised by the revenue, either before the assessing officer or before the Commissioner in appeal or the ITAT nor in this memo of appeal but even then we have been taken though the record by Sri Rajan Roy to negate the plea of the revenue, that the matter need be remanded to the assessing officer and to indicate that it was the specific case of the assessee before the assessing authority that they were registered partnership firm and were having registered partnership deed. It was also the specific case that these partners were working partners and they were entitled to salary and interest, as per terms of the deed in accordance with Section 40(b) of the Act. In the absence of any material having brought by the revenue in rebuttal and more so when no such plea was ever taken or raised in the appeal, as also no substantial question of law has been framed in this regard, the aforesaid plea is bound to fail.

23. Even before the Tribunal, it appears that no such question was raised. We have been informed by the learned counsel for the parties that for the last two assessment years, the assessing officer himself has granted deductions treating the firm to be entitled for the same.

24. For the reasons stated above, we allow the appeals in part and remit the matter to the assessing officer for only recording findings on question (1) referred to above, namely, to determine the rate of profit on the basis of the evidence/material on record, after affording opportunity of hearing and also

giving opportunity to the parties to lead such evidence, as may be necessary, in the light of the observations made above. The findings regarding availability of deductions u/s 40(b)(iv) and (v) stand concluded and this question shall not be opened by the assessing officer.

25. All the appeals are disposed of accordingly.