
(1998) 03 AP CK 0023

In the Andhra Pradesh High Court

Case No : Case Referred No. 139 of 1989

Indwell Constructions

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 12-03-1998

Acts Referred:

Income Tax Act, 1961 — Section 145, 29, 30, 31, 32

Citation : (1999) 151 CTR 207 : (1998) 232 ITR 776

Hon'ble Judges : T.N.C. Rangarajan, J; S.V. Maruthi, J

Bench : Division Bench

Advocate : C. Kodandaram, for the Appellant; S.R. Ashok, for the Respondent

Judgement

T.N.C. Rangarajan, J.—At the instance of the assessee, the following question has been referred by the Tribunal :

"Whether, on the facts and in the circumstances of the case, it is correct in law to make a separate addition of Rs. 63,859 representing the interest and remuneration paid to partners, to the income already estimated and assessed from contracts ?"

2. The assessee is a registered firm having contract business in engineering works and some of its work was done through Sub-contractors. For the assessment year 1981-82, the gross contract receipts came to Rs. 27,20,083 and the net income shown in the profit and loss account was Rs. 1,24,830. The Income Tax Officer rejected the books and applying the proviso to Section 145, estimated the income at Rs. 2,50,000. The Commissioner of Income Tax considered that this estimate was erroneous and prejudicial to the interests of the Revenue and added a sum of Rs. 63,859 u/s 263, which was shown as interest and salary paid to the partners in the profit and loss account. This was done by following a decision of a Bench of the Tribunal in another case of contractors, Rama Krishna Contractors, Tadepalligudem, where the Appellate Tribunal had upheld the addition of the interest paid to the partner even after an

estimation of the net income was made. When the assessee appealed to the Appellate Tribunal, naturally the Tribunal followed its own decision of the Special Bench case and upheld the order of the Commissioner of Income Tax. The question stated above has, therefore, been referred at the instance of the assessee.

3. Learned counsel for the assessee relying on a decision of this court in *MADDI SUDARSANAM OIL MILLS CO. Vs. COMMISSIONER OF Income Tax, HYDERABAD AND ANDHRA.*, submitted that where the books of account have been rejected, the Revenue cannot rely on the same books for addition of cash credits. In that case certain cash credits were added back and this court held that after applying a flat rate to compute the gross profit, the rejected books cannot be relied upon for adding unexplained cash credits. Learned standing counsel for the Revenue, however, submitted that the rationale of the decision of the Special Bench of the Tribunal was that there was a big difference between earning profit with own funds and earning profit with borrowed capital and when the profit was estimated at a normal rate, it should be assumed that it was after providing for all outgoings as could be understood in a commercial profit including interest payment on borrowed capital. It was submitted that in the case of a firm which has borrowed capital from its own partners, the provisions of Section 40(b) apply as it is regarded as payment of interest to oneself and such deduction has to be disallowed. On this basis, the Special Bench upheld the addition of interest paid to the partners even after assuming the net profit. He submitted that this modification of the net profit with reference to the provisions of Section 40(b) was justified and hence the question should be answered in the affirmative.

4. The pattern of assessment under the Income Tax Act is given by Section 29 which states that the income from profits and gains of business shall be computed in accordance with the provisions contained in Sections 30 to 43D. Section 40 provides for certain disallowances in certain cases notwithstanding that those amounts are allowed generally under other sections. The computation u/s 29 is to be made u/s 145 on the basis of the books regularly maintained by the assessee. If those books are not correct or complete, the Income Tax Officer may reject those books and estimate the income to the best of his judgment. When such an estimate is made it is in substitution of the income that is to be computed u/s 29. In other words, all the deductions which are referred to u/s 29 are deemed to have been taken into account while making such an estimate. This will also mean that the embargo placed in Section 40 is also taken into account.

5. No doubt there is a big difference between profit earned with own capital and profit earned with borrowed capital and such a difference could have been taken into account by the Income Tax Officer while making an estimate. If the Commissioner had set aside the estimate on the ground that the vital fact that the business was carried on with own capital and not with borrowed capital has been ignored by the Income Tax Officer, there may not have been any difficulty

in upholding that order. But, when he proposes to add back an exact item in the profit and loss account, he was relying on the rejected books which he could not do as held by the Bench of this court in MADDI SUDARSANAM OIL MILLS CO. Vs. COMMISSIONER OF Income Tax, HYDERABAD AND ANDHRA., . There is also a further difficulty if Section 40, as argued by learned counsel, is to be taken into account even after making an estimate. When there are certain other deductions which are to be disallowed such as wealth-tax payment in Section 40, can it be said that after making an estimate, the wealth-tax charged in the profit and loss account should again be added back to the profit. This example illustrates how the contention of the Revenue, that Section 40(b) makes a difference in the situation, is untenable. In our considered opinion, the answer to the question has to be in the negative and in favour of the assesses.

6. The question is answered accordingly.