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The Commissioner of Income Tax Vs Taj Borewells

Court: Madras High Court

Date of Decision: April 2, 2007

Acts Referred: Evidence Act, 1872 â€" Section 34
Finance Act, 2001 â€" Section 2(12A)
Income Tax Act, 1922 â€" Section 10(2)
Income Tax Act, 1961 â€" Section 143(1), 143(2), 143(3), 260A, 68

Citation: (2007) 291 ITR 232

Hon'ble Judges: P.P.S. Janarthana Raja, J; P.D. Dinakaran, J

Bench: Division Bench

Advocate: J. Naresh Kumar, for the Appellant; No appearance, for the Respondent

Judgement

P.P.S. Janarthana Raja, J.
This appeal is filed u/s 260A of the Income Tax Act, 1961 by the Revenue, against the order of the Income

Tax Appellate Tribunal, Chennai Bench "B", Chennai in I.T.A. No. 891(Mds)/2001 dated 18.07.2003. On 28.01.2004, this Court admitted the

appeal and formulated the following substantial questions of law.

1. Whether on the facts and in the circumstances of the case, the Income Tax Tribunal is right in law in not considering the balance sheet and profit

and loss account wherein contribution of the partners have been shown could be taken to be the books of account and the credits appearing

therein have to be explained?

2. Whether on the facts and in the circumstances of the case, the Income Tax Tribunal is right in law especially when the appellant firm has not

been able to explain the source of the capital invested by the partners which accordingly has to be treated as unaccounted income u/s 68 of the

Income Tax Act?

3. Whether on the facts and in the circumstances of the case, the Income Tax Tribunal is right in law in not following the judgment rendered in 216

ITR 9?

2. The facts leading to the above substantial questions of law are as under:

The assessee is a firm. It consists of seven partners with equal share. It claimed the status of Association of Person. The relevant assessment year

is 1995-96 and the corresponding accounting year ended on 31.03.1995. The main business of the assessee-firm is deriving income from digging

borewells at various places in and around Virudhunagar. The assessee-firm did not maintain any books of account for the reason that the total

gross receipts were below Rs. 5 lakhs. The assessee-firm had admitted gross receipts at Rs. 34,000/- from which it had claimed expenses like

diesel, salary to staff etc. to the extent of Rs. 28,000/- and the balance net receipt of Rs. 6,000/- was returned. From this, the assessee-firm

claimed depreciation of Rs. 81,500/-. The assessee-firm filed Return of loss on 31.12.1996. The said Return was processed u/s 143(1)(a) of the

Act on 27.03.1997 and the said claim of Rs. 81,500/- was accepted. Subsequently the case was selected for scrutiny and notice u/s 143(2) was

issued on 23.07.1997. Later, assessment was completed u/s 143(3) of the Act on 31.03.1998, determining the total income at Rs. 4,84,250/-.

While completing the assessment, the Assessing Officer treated the amount of Rs. 5,25,000/- which was shown as invested by the partners, was

not accepted and the Assessing Officer concluded that this amount was to be added under the head ""Other Sources"" u/s 68 of the Income Tax Act

(""Act"" in short). Aggrieved by the order of assessment, the assessee-firm filed an appeal to the Commissioner of Income Tax (Appeals). The

C.I.T.(A) confirmed the additions made by the Assessing Officer u/s 68 of the Act. Aggrieved by the order of the C.I.T.(A), the assessee-firm

filed an appeal to the Income Tax Appellate Tribunal (""Tribunal"" in short). The Tribunal deleted the addition of Rs. 5,25,000/- under the head

Other Sources"" from the income of the firm and allowed the appeal.

3. Learned Standing Counsel appearing for the Revenue submitted that there had been unexplained credits in the accounts of the firm in the form of

partners" contribution towards the capital and hence the Assessing Officer is right in making addition and the order passed by the Assessing

Officer is in confirmity with law. Further it is submitted that the amount introduced by the partners are not properly explained and hence the

Assessing Officer is justified in treating the same as income from undisclosed sources. It is also further submitted that the Assessing Officer has

brought sufficient evidence and material on record to show that the amount introduced in the assessee firm had not been properly explained.

Hence, the Assessing Officer rightly made the addition u/s 68 of the Act and also relied on various judgments to support his contention, which are

as follows:

a) Jagmohan Ram Ram Chandra Vs. Commissioner of Income Tax,

b) Commissioner of Income Tax v. Kishorilal Santoshilal reported in 216 ITR 9 .

c) Rakesh Kalia Vs. Commissioner of Income Tax,

d) Commissioner of Income Tax Vs. Nivedan Vanijya Niyojan Ltd.,

e) C.K. Gopinathan Vs. Commissioner of Income Tax,

f) Ram Lal Agrawal Vs. Commissioner of Income Tax,

g) Income Tax Officer, Ward 1, Division I, Ernakulam (Now Deputy Commissioner of Income Tax, Company Circle 1, Division I, Ernakulam)

Vs. Diza Holdings (P.) Ltd.,

4. There is no representation on behalf of the respondent inspite of notice served on them.

5. Heard the counsel. It is an admitted fact that the present assessment year is the first year of assessment of the assessee. The assessee did not

maintain books of account and the amounts represented are capital contribution of the partners in the firm. The assessee had explained that these

amounts were represented only as capital contribution made by the partners. So, it cannot be said that the assessee had not explained the source.

If the Assessing Officer has any doubt with regard to the genuineness of the source, he should have considered the same in the hands of the partner

and not in the hands of the firm. In the present case, the assessee invoked Section 68 of the Act and made an addition of Rs. 5,25,000/- under the

head ""other sources"". Section 68 of the Act reads as follows:

68. Cash credits - Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no

explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the

sum so credited may be charged to Income Tax as the income of the assessee of that previous year.

Section 68 is a charging section and it is also a deeming provision. Unless the following circumstances exist, the Revenue cannot rely on Section 68

of the Act.

a) Credit in the books of an assessee; maintained for the year.

b) Assessee offers no explanation or if the assessee offers explanation and if the Assessing Officer is of the opinion that the same is not satisfactory,

the sum so credited is chargeable to tax as ""income from other sources.

In the present case, there is no dispute that the assessee-firm did not maintain any books of account during the year. The assessee-firm filed only

the Return of loss and along with the Return, affidavits given by each partner for source of capital invested by them were also furnished. There is no

written Partnership Deed. The assessee-firm shown the contributions of the partners in the Profit and Loss Account and the Balance Sheet. The

Assessing Officer was of the view that the accounts of the assessee-firm are in the form of Profit and Loss Account and Balance Sheet and held

that they are the books of account. One of the issues here is, whether the Profit and Loss Account and Balance Sheet are books of account or not.

6. In the judgment reported in S. Rajagopala Vandayar Vs. Commissioner of Income Tax, , this Court has taken a view that Profit and Loss

Account does not form part of the books of account and held as follows:

We may point out that that is not the situation here, as it had not been disputed by the assessee right through that no account books at all had been

maintained. The Supreme Court, in The Commissioner of Income Tax, Bombay Circle II Vs. The National Syndicate, Bombay, , dealing with

Section 10(2)(vii) of the Indian Income Tax Act, 1922, laid down that in order to claim deduction of the loss sustained under that provision, one of

the essential conditions to be fulfilled was that the loss should have been brought into the books of the assessee and written off as provided by the

first proviso to Section 10(2)(vii) of the Indian Income Tax Act, 1922. At page 234, the Supreme Court has catalogued the four conditions

required to be fulfilled and the fourth condition, according to the Supreme court, to be fulfilled is that in the books of account of the assessee, the

loss should have been brought in and written off. It follows, therefore, that if this requirement is not fulfilled, the assessee is not entitled to the relief

of allowance of the loss. We may now refer to the decision of this Court in P. Appavu Pillai Vs. Commissioner of Income Tax, Madras, . In that

case, the Tribunal took the view that relief u/s 10(2)(vii) of the Indian Income Tax Act, 1922, could be given only in cases where the assessee

maintains regular books of accounts and the loss had been written off in the books and that as the assessee did not keep any accounts, the

allowance was rightly refused. The court found that though there is no indication in Section 10(2)(vii) of the Indian Income Tax Act, 1922, as to

the particular type of account book which should be maintained by the assessee, if accounts are produced, in which the relevant entry with regard

to the allowance appeared, that would be sufficient compliance with the first proviso to Section 10(2)(vii) of the Indian Income Tax Act, 1922. In

that case, the assessee produced before the assessing authority the daily collection and expenditure account and notwithstanding the absence of a

day-book and a ledger, the Income Tax Officer was satisfied that the obsolescence allowance claimed could be granted. But a contrary view was

taken by the Appellate Assistant Commissioner and the Tribunal that the loss could be allowed only if such amount is actually written off in the

books of the assessee and that books in that context would mean the books of account maintained by the assessee in the course of the business.

However, the court took the view that though the accounts maintained by the assessee may be defective in that the entries therein do not lead to a

correct assessment of trhe income profit and gains of the business, that has nothing whatever to do with the allowance that can be granted u/s

10(2)(vii) of the Indian Income Tax Act, 1922, if such accounts are available in which the relevant entry with regard to the allowance appears, that

would be sufficient compliance with the requirement of the proviso and in that view, it was held that the details in the accounts produced in that

case would be sufficient to comply with the requirements of the first proviso to Section 10(2)(vii) of the Indian Income Tax Act, 1922. We may, in

this connection, point out that the argument of the Revenue in that case that the profit and loss account is the account which can be said to be a

book of account was rejected and it was characterised as a statement representing the state of business as at the end of the accounting year with

details culled from other books of account, which may be characterised as the primary books which a businessman generally maintains. In other

words, according to that decision, a profit and loss account is not a book of account. We are, therefore, of the view that merely by relying upon

the profit and loss account, the assessee in this case cannot claim the benefit of allowance of loss sustained on the sale of the cars.

The word ""books of account"" is not defined during the relevant assessment year. Later, Section 2(12A) was introduced in the Act defining ""books

or books of account"" by the Finance Act, 2001 with effect from 01.06.2001 and the same reads as follows:

(12A) ""books or books of account"" includes ledgers, day-books, cash books, account-books and other books, whether kept in the written form

or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device;

The above definition is inclusive definition and it includes not only ledgers, day-books, cash books, account-books and other books, but also the

print-outs of data stored in a floppy disc, tape or any other form of electro-magnetic data storage device. P.Ramanatha Aiyar"s Advanced Law

Lexicon, 3rd Edition 2005, also defines ""Books of account"" as follows:

Books in which merchants, businessmen, and traders generally keep their accounts. ""Books of Accounts"" mean such books of account as are usual

in the business, and do not extend to ""letters, cheques, and vouchers from which books of account can be made up"" (Per CAVE, J., Re Winslow,

55 LJQB 238)

If the word "account" is to be given wider meaning to include a record of financial transactions reckoned, a book containing a statement of

monetary transaction would attract the definition of "book of account" u/s 34 of the Act. Central Bureau of Investigation Vs. v.C. Shukla and

Others, . [Indian Evidence Act (1 of 1872), Section 34]

Company''s books in which business transactions are recorded, often consisting of journals, ledgers and various other records of accounts. They

are normally held to be legal documents and should indicate the financial position of the business at any time. (International Accounting; Business

Term)

So, the books of account is defined as any book which forms an integral part of system of book keeping employed in any particular business and

consequently includes both the ledger and the books of original entry. The Profit and Loss Account of a trade is the statement wherein the various

items of profit and revenue on the one hand and the losses and expenditure on the other hand, are collected and offset, the one class against the

other, that is, in compiling such an account being - debit all the losses, credit all the gains. The resulting balance of this account represents the Net

Profits or the Net Losses for the period under review. The object of a Profit and Loss Account is to ascertain the income of a business and by

offsetting the expenses of earning that income, to ascertain the net increase (profit) or decrease (loss) in the traders'' ""net worth"" for the period.

Balance Sheet lists the assets and liabilities and equity accounts of the company. It is prepared ''as on'' a particular day and the accounts reflect the

balances that existed at the close of business on that day. By following the judgment of the Madras High Court cited supra and taking note of the

definition of the books or books of account in the Income Tax Act as well as in P.Ramanatha Aiyar''s Advanced Law Lexicon, 3rd Edition 2005,

and also the meaning of the Profit and Loss Account and Balance Sheet, we can safely conclude that the Profit and Loss Account and the Balance

Sheet are not the books of account as contemplated under the provisions of the Act. The learned Standing Counsel for the Revenue has not placed

any authority or any case law or any other material or evidence to show that the books of account includes Profit and Loss Account and Balance

Sheet.

7. In the present case, the assessee-firm had explained the source of capital. So, there was an explanation offered by the assessee-firm. The said

explanation has not been rejected by the Assessing Officer. Later, the Assessing Officer examined the partners and the partners had also made

explanation in respect of the source for the contribution of the capital to the assessee-firm. The Assessing Officer had also partially accepted the

explanation offered by the partners. The Assessing Officer had not rejected the explanation offered by the firm. Unless and until the explanation

offered by the firm is rejected and the same is not genuine, the Assessing Officer cannot invoke the provision of Section 68 of the Act. In the

present case, the explanation offered by the firm was accepted and later, the Assessing Officer examined the partners and not accepted the

explanation. The Assessing Officer cannot ask the assessee-firm to prove source of a source. Once the firm had offered an explanation and

established that the capital was contributed by the partners, the same could not be assessible in the hands of the firm. Unless there are

contradictions and inconsistencies in the statement of the partners, the credit cannot be treated as unexplained and cannot be added u/s 68 of the

Act in the hands of the assessee-firm. Also, it is clear from the language employed u/s 68 of the Act that only the assessee alone has to offer

explanation. If the assessee makes explanation, it is for the Assessing Officer to accept or reject the same. Finding given by the Tribunal is that the

assessee-firm had explained the source of the capital and hence the same cannot be assessed as undisclosed income in the hands of the assessee

firm. The order of the Tribunal reads as follows:

When the assessee has explained the amounts as capital contributions by the partners, the Revenue authorities are not justified in holding that the

assessee has not explained the source and the same is to be added under the head ''Other Sources'' in the hands of the firm. In case the Assessing

Officer doubted the genuineness of the source, he should have considered the same in the hands of the partners only and not in the case of the firm.

This view of ours is supported by the decisions of the Allahabad High Court in the cases reported in Commissioner of Income Tax Vs. Jaiswal

Motor Finance, and Surendra Mahan Seth Vs. Commissioner of Income Tax, . Under these circumstances, we delete the addition of Rs.

5,25,000/- under the head ''Other Sources'' from the income of the assessee-firm.

From a reading of the above, it is clear that the Tribunal had given a finding that the assessee had offered explanation and hence the Revenue

Authorities are wrong in holding that the assessee had not explained the source. If the Assessing Officer doubted the genuineness of the source of

the partners, he should have considered the same in the hands of the partners only and not in the hands of the firm. We feel that the reasons given

by the Tribunal are based on valid materials and evidence and hence the view taken by the Tribunal is in accordance with law.

8. In the case of India Rice Mills Vs. Commissioner of Income Tax, , the Allahabad High Court considered the scope of Section 68 of the Act. In

that case, the assessee is a partnership firm. There were ten partners in the firm and they made capital contribution totalling to Rs. 1,43,000/-.

Since this was credited in the books of the firm, the firm was called upon by the Assessing Authority to explain the source of the deposit. All the

partners had filed their Returns after the close of the accounting year of the firm and they had not filed any Return in the earlier years. Therefore,

the Assessing Officer held that the amount represented the income of the assessee-firm from undisclosed sources and on appeal, the Commissioner

of Income Tax (Appeals) held that as the deposits were made by the partners before the firm started its business, the same could not be taken to

be the income of the firm from undisclosed sources. The Tribunal held that as the amount was credited in the books of the firm, it was for the

assessee-firm to explain the source of deposit. On a reference, the Court held that all the deposits came to be made during the accounting year in

the books of the firm before it started its business and the deposits represented the capital contribution of the partners, and it was for the partners

to explain the source of deposits and if they failed to discharge the onus, then such deposits could in no case be the income of the assessee-firm

because the firm started its business only after the credits had been made in its books. Hence the Allahabad High Court held that the same cannot

be assessed in the hands of the assessee-firm. We also agree with the view expressed by the by the Allahabad High Court. The said Allahabad

High Court judgment was followed by the subsequent judgment of the Allahabad High Court in the case of Surendra Mahan Seth Vs.

Commissioner of Income Tax, . The facts in both the judgments of the Allahabad High Court are similar to the facts involved in the present case.

The Tribunal also correctly followed the judgment of the Allahabad High Court, reported in Surendra Mahan Seth Vs. Commissioner of Income

Tax, , wherein it was held that the onus was on the partners to explain the source of the deposits made on the very first day when the partnership

firm came into existence and if they failed to explain the source of the deposits, the amount would be added in the hands of the partners only and

not in the hands of the assessee-firm.

9. The Standing Counsel for the Revenue relied on later Allahabad High Court judgment reported in Jagmohan Ram Ram Chandra Vs.

Commissioner of Income Tax, to support his contention. In that case the assessee is a firm consisting of six partners. The Assessing Officer

required the firm to explain the nature of source of two cash credits standing in the names of two partners. The explanation offered by the firm was

that these two partners had surrendered the amounts in question in their individual Returns and they had been assessed thereon. The Assessing

Officer rejected the explanation treating the credit as income of the assessee-firm by invoking the provision of Section 68 of the Act. Also, in the

individual assessment of the partner, the Income Tax Officer assessed the surrendered income which was the amount deposited and standing in his

name in the firm by way of protective measure. The Tribunal also upheld the additions. The assessee-firm filed an appeal to the High Court and the

High Court held that with regard to entry of cash credits found in the books of account of the firm, it is for the firm to give explanation regarding the

identity and source of such deposits and if the explanation is disbelieved, then it has to be added as income u/s 68 of the Act in the hands of the

firm. Similarly, if the assessee who is a partner in the firm has made investment which is not recorded in the books of account maintained by him for

any source of income, and the explanation given by the partner regarding the source of deposits is disbelieved, then such deposits which are an

investment, can be brought to tax as income from undisclosed sources u/s 69 of the Act. It was also further held that there was no question of

double taxation and the full effect of deeming provision provided under Sections 68 and 69 of the Act are to be given. Finally the Allahabad High

Court held that the firm and the partners, being treated as separate assessees under the Act, the assessment of the income in the hands of different

assessees under different provisions of the Act is permissible and on the facts and in the circumstances of the case, the Tribunal was justified in

upholding the addition in the total income of the assessee even though the said amount was also assessed in the hands of two partners. In the above

judgment, the explanation offered by the assessee-firm was not accepted and hence there was an addition. These facts are materially different from

the facts involved in the present case. The most striking feature of the present case is that all the partners made contribution during the accounting

year and the assessee-firm also explained the source and the same was not rejected and only the partners'' explanations were rejected. Hence the

Tribunal, in the present case, had rightly taken a view that if at all, the Assessing Officer can assess the same in the hands of the partners.

10. The Standing Counsel for the Revenue relied on number of other High Court judgments, cited supra. The facts in these judgments are

materially different from the facts involved in the present case. Hence they have no relevance and do not also help the case of the Revenue.

11. The most striking features involved in the present case are as follows:

a) Since there are no books of account, there can be no credits in such books.

b) It is the first year of assessment of the assessee.

c) Explanation offered by the assessee-firm not rejected and only the explanation offered by the partners were rejected.

Hence, it is not a fit case for making addition u/s 68 of the Act.

12. Under these circumstances, we are of the view that the order of the Tribunal is in confirmity with law. The reasons given by the Tribunal are

based on valid materials and evidence and we find no error or legal infirmity in the order of the Tribunal so as to warrant interference. Hence we

answer all the questions in favour of the assessee and against the Revenue. No costs.