

**IN THE INCOME TAX APPELLATE TRIBUNAL,  
MUMBAI BENCH "C", MUMBAI**

**BEFORE SHRI SANJAY GARG, JUDICIAL MEMBER AND  
SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER**

**ITA No.4695/M/2013  
Assessment Year: 2006-07**

DCIT, Cir. 7(1), Room No.622, Aayakar Bhavan, M.K. Road, Churchgate, Mumbai - 400020  (Appellant)	Vs.	M/s. Paper Print India Pvt. Ltd., A2, 274, Shah & Nahar Ind. Estate, S. J. Marg, Lower Parel, Mumbai – 400 013 <b>PAN: AADCP 5122C</b>  (Respondent)
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**Present for:**

Assessee by : None  
Revenue by : Dr. S. Pandian, D.R.

Date of Hearing : 29.03.2016  
Date of Pronouncement : 31.03.2016

**ORDER**

**Per Sanjay Garg, Judicial Member:**

The present appeal has been preferred by the Revenue against the order dated 29.01.2009 of the Commissioner of Income Tax (Appeals) [hereinafter referred to as the CIT(A)] relevant to assessment year 2006-07.

2. The Revenue has taken the following grounds of appeal:

“(i) The Learned CIT(A) has erred on facts and in law in deleting the disallowance of interest expenditure of Rs.15,62,583/- u/s.36(1)(iii) of the Income Tax Act, 1961, without properly appreciating the factual and legal matrix as clearly brought out by the Assessing Officer.

(ii) The Learned CIT(A) has erred on facts and in law in deleting the addition made by the Assessing Officer by estimating the net profit @ 8% of the total sales as against 2.33% as disclosed by the assessee, without properly appreciating the factual and legal matrix as clearly brought out by the Assessing Officer.

(iii) The Learned CIT(A) has erred on facts and in law in deleting the addition made by the Assessing Officer by estimating the net profit @ 8% of the total sales as against 2.33% as disclosed by the assessee, without

appreciating the fact that the assessee failed to furnish the relevant details during assessment and remand report proceedings.”

3. The first ground of appeal is regarding the action of the Ld. CIT(A) in deleting the addition made by the Assessing Officer (hereinafter referred to as the AO) while disallowing interest of Rs.15,62,583/- paid on term loan of Rs.1,08,00,904/- under the Proviso to Section 36(1)(iii) of the Income Tax Act. The AO, while examining the balance sheet of the assessee, noticed that the assessee had enhanced the reserves by revaluing the fixed assets like plant and machinery etc. It was also seen that the assessee company had come into existence as a ‘company’ on conversion of the erstwhile firm M/s Paper Prints during the year under consideration and most of the unsecured loans had been transferred to the company. The AO also called for necessary details for the various expenditure claimed as deductions by the assessee under section 37 (1) of the Act. However, the assessee did not furnish the required details. The AO noted that an amount of Rs.1,15,62,808/- was shown by the assessee as capital work in progress under the head "loans and advances (Assets)" in the balance sheet, but the assessee had not explained the financial expenditure of Rs.1,08,99,904/- with reference to the Proviso to Section 36 (1) (iii) of the income Tax Act. The AO therefore disallowed certain amount, as proportionate to the capital work in progress, out of interest expenditure under the Proviso to Section 36 (1) (iii) calculated at Rs. 15,62,583/- .

In appellate proceedings before the CIT(A), the assessee furnished certain details. The Ld. CIT(A) called for a remand report from the AO in this respect. However the AO reported that the assessee had failed to furnish the required details, hence the additions made by him were required to be upheld. However, the assessee demonstrated before the CIT(A) that the required details were furnished before the AO. The assessee also filed letter dated 21.3.2013 before the CIT(A) explaining as under:

"In the above reference case we would like to bring to your honors notice that during the course of remand the client was never called by A.O. to presents its case and the report was prepared without providing any hearing which is

prejudicial to the interest of the assessee and copy of the remand report was also not serviced to assessee.

As per the instruction of my client we are submitting the details as per the Annexure attached herewith to justify the net profit of the company, which as per the Ld. A.O. it should be 8% but has failed to appreciate that this a service industry and thus buyers are the king and they dictate terms and price due to which the profit stated by the A.O. is merely on presumption basis and for which we are submitting the stock register and other related expenditure ledger which will evident that the net profit is adequate.

As regards to the capitalization of the interest on term loan is concerned the learned A.O. erred in disallowing the interest as the same is to be capitalized as the same is used for land and building for which we forward you the ledger copy in which we have capitalized Rs.12,36,180/- as capital W.I.P thus the adhoc disallowance is not justifiable and the company has also taken term loan for machinery which was to repay the old machinery loan of the Citi Co. Op. bank and for purchase of machinery from Sneha Prints and interest which is treated as expenditure.”

Along with the said letter the assessee also filed balance sheet for assessment years 2004-05 and 2005-06, closing stock and quantitative details, Ledger accounts of expenses, copies of purchase bill, copies of sale bills, bank statement in respect of term loan and CC Account, bank interest Ledger both for term loan and CC Account before the ld. CIT(A).

4. After examining the above records and considering the submissions of the assessee, the Ld. CIT(A) observed that the assessee had itself taken action to capitalize a specific amount of interest of Rs.12,36,180/- paid on term loan in its books of accounts holding it to be related to factory WIP. He therefore held that since the assessee had itself taken action under the Proviso to Section 36 (1) (iii) of the Income Tax Act and that the same was very much evident from the records of the assessee, the addition made by the AO on adhoc basis were not justified. He accordingly deleted the addition made by the AO in respect to the above issue.

5. Before us, the Ld. DR could not bring out any differentiating fact or proposition of law, which may justify our interference in the above findings arrived at by the CIT(A). We therefore do not find any infirmity in the order of

the CIT(A) relating to this issue and the same is accordingly upheld.

6. The 2<sup>nd</sup> ground of appeal is regarding the action of the CIT(A) in deleting the addition made by the AO by estimating net profit @ 8% of the total sales as against 2.33% as disclosed by the assessee.

7. A reading of the assessment order shows that the impugned additions on this issue had been made by the AO observing as under:

"7. As per the audit report, the auditor, though mentioned the quantitative details in the manufacturing, as per Annexure III, no such Annexure has been enclosed with the audit report. Therefore, it is not possible to verify the correctness or otherwise of the consumption/cost of goods as per the accounts, nor even the valuation of closing stock.

8. Taking the overall position, therefore, the gross profit shown by the assessee at 21% and the net profit at 2.33% does not appear to be reasonably disclosed. In a manufacturing business, the net profit margin cannot be as low as 2.33%. Since the assessee has not produced books of accounts nor the submissions made before the Central Excise authorities regarding the production at their factory, the book result gets exposed to challenge, since the Central excise Department has found prima facie discrepancy. From the accounts of the assessee, it also appears that the assessee does not pay any excise duty at all. Thus, the production, sale and the closing stock cannot be said to be on any reasonable basis.

9. Considering the above the undersigned is left with no option but to estimate the net profit at a reasonable level, in the line of the business of the assessee. An estimate net profit of 8% is adopted on the total sales. The net profit on such estimate comes to Rs.87,64,896/- which will be considered for the computation of income."

8. In appeal, the assessee submitted before the Ld. CIT(A) that an adhoc addition made by the AO was not justified as the AO had failed to appreciate that in service industry the profits can not be estimated on presumptions as much of it depends upon the prices offered by the customers. The assessee also furnished the quantitative tally in respect of products concerned and Ledger account details to show that the net profit declared was adequate.

9. After considering the submissions of the assessee, the Ld. CIT(A) observed that the remand report sent by the AO could not be relied upon as it

transpired that the same had been sent without taking into consideration the books of account, sale and purchase bills etc. submitted by the assessee for verification. The Id. CIT(A), thereafter, himself proceeded to examine the details. He noted that the assessee had constantly been declaring net profit at 2.01% to 2.23% while gross profit had varied from 31% to 21 %. The main reason for the difference between gross profit and the net profit was stated to be the expenses incurred in respect of financial charges and depreciation. The Id. CIT(A) observed after considering the profit and loss account that in the year concerned, the assessee had incurred, interest on bank charges of Rs.1,0899,904/- as recorded by the AO also. Besides that, depreciation incurred was of Rs.7,59,953/-. The assessee had also declared electricity charges of Rs.12,71,984/- under the head administrative expenses. As none of these expenses could be doubted being depreciation, interest paid on term loan etc, and electricity expenses, the net profit ratio as declared by the assessee was required to accepted. He further observed that the estimation made by the assessing officer during the course of assessment proceedings was on account of presumptions holding that a business that gives the gross profit of 21% cannot have a net profit of only 2.33%. Even the AO had not mentioned any comparative case in the assessment order. For making an addition in the gross profit or net profit it was very imperative that a study be made of financials of like concerns, market, demand and supply etc. However, none of these methods found a reflection in the assessment order to show that the Assessing Officer had considered them while estimating the net profit. It has not been elaborated as to how an estimated net profit of 8% adopted on total sales has been considered as reasonable net profit by the Assessing Officer. He also noted that the Assessing Officer had not elaborated on the discrepancy found by the Central Excise Department in the case of the assessee and what was the final result of the investigation undertaken by them. He observed that a presumption had been made by the Assessing Officer that if an assessee does not pay excise duty the books of accounts specially the closing stock cannot be

held to be accurate. That such presumptions unless later established by way of evidences cannot be accepted. He further observed that even during the course of remand proceedings also, the AO had not made any comments on the estimated net profit addition made at the time of assessment proceedings. He accordingly held that under such circumstances, an adhoc addition based on presumptions and surmises could not be upheld. That the assessee by way of production of records has been able to establish that the net profit as declared by him was correct. He accordingly deleted the addition made by the assessing officer by estimating the net profit.

10. After hearing the Ld. Representatives of the parties, we do not find any infirmity in the reasoned order of the Ld. CIT(A) in respect of the issue under consideration and the same is accordingly upheld.

11. In the result, the appeal of the revenue is hereby dismissed.

**Order pronounced in the open court on 31.03.2016.**

**Sd/-**  
**(Ramit Kochar)**  
**ACCOUNTANT MEMBER**

**Sd/-**  
**(Sanjay Garg)**  
**JUDICIAL MEMBER**

Mumbai, Dated: 31.03.2016.

\* Kishore, Sr. P.S.

Copy to: The Appellant  
The Respondent  
The CIT, Concerned, Mumbai  
The CIT (A) Concerned, Mumbai  
The DR Concerned Bench

//True Copy//

By Order

Dy/Asstt. Registrar, ITAT, Mumbai.