IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'D', NEW DELHI

BEFORE SH. H.S. SIDHU, JUDICIAL MEMBER
AND
SH. O.P. KANT, ACCOUNTANT MEMBER

ITA No. 1332/Del/2011
Assessment Year: 2007-08

DCIT, Circle ï 4(1), Room No. 407, C.R. Building, I.P. Estate, New Delhi	**Vs.**	M/s. Jaipuria Infrastructure Developers, 9B, Hansalaya, Connaught Place, New Delhi
PAN : AACCB1286C		
(Appellant)		**(Respondent)**

Appellant by	Sh. Umesh Chand Dubey, Sr.DR
Respondent by	S/sh. Rupesh Jain & Dipesh Jain, Adv.

Date of hearing	18.05.2017
Date of pronouncement	16.06.2017

ORDER

PER O.P. KANT, A.M.:

This appeal by the Revenue is directed against order dated 28/01/2011 of the Ld. Commissioner of Income-tax (Appeals)-VII, New Delhi [in short ñthe CIT-(A)ò] for assessment year 2007-08, raising following grounds:

"1. The order of the learned CIT(A) is erroneous & contrary to facts & law.

2. On the facts and in the circumstances of the case and in law, the learned CIT(Appeals) has erred in deleting the addition of Rs.1,18,81,368/- being the 1% of the turnover, made by the Assessing Officer on account of law G.P. Rate.

2.1 The learned CIT(A) ignored the finding recorded by the AO and the fact that the assessee could not justify the low G.P. and abnormal expenses during the course of assessment proceedings.

3. On the facts and in the circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition of Rs.5,78,70,730/- made on compounding fees paid to GDA,

3.1 The learned CIT(A) ignored the facts recorded by the Assessing Officer and the facts that the payment in question is penal in nature and is not allowable expenses under section 37 of the I.T. Act.

4. The appellant craves leave to add, alter, or amend any grounds of the appeal above at the time of hearing."

2. The briefly stated facts of the case are that during relevant period the assessee company was engaged in the business of building and developing residential and commercial complexes. On 14/03/2007 i.e. within previous year corresponding to the instant assessment year, a survey under section 133A of the Income-tax Act, 1961 (in short "the Act") was carried out at the premises of the assessee, and during which, the assessee surrendered an amount of Rs.21,01,75,000/- as additional charges received from customers. The assessee filed return of income on 26/10/2007, declaring total income of Rs.21,23,62,060/-, including the income surrendered of Rs.21,01,75,000/- during the course of survey action. The case was selected for scrutiny and notice under section 143(2) of the Act was issued and complied with. In the scrutiny assessment completed under section 143(3) of the Act on 29/12/2009, the Assessing Officer made following two additions:

1. Trading addition Rs.1,18,81,368/-

	(1% of total receipts of Rs.118,81,36,794/-)	
2.	Disallowance of payment of compounding fee	Rs. 5,78,78,830/-
	Total	Rs. 6,97,60,198/-

2.1 On further appeal, the Ld. CIT-(A) deleted both the additions. Aggrieved, the Revenue is in appeal before the Tribunal raising the grounds as reproduced above.

3. The ground No. 1 being general in nature, not required to adjudicate upon specifically, accordingly we dismiss the same as infructuous.

4. In grounds No. 2 and 2.1, the Revenue has agitated deletion of the trading addition of Rs.1,18,81,368/- made by the Assessing Officer.

4.1 The Facts in respect of issue in dispute are that the Assessing Officer observed that after excluding the additional charges of Rs.21,01,75,000/-, the net profit declared by the assessee for the year under consideration works out to Rs.23,28,090/-, which in the percentage terms on the receipts of Rs.118,81,36,794/- is only 0.19%. The Assessing Officer pointed out that the net profit rate of 0.19% during the year under consideration was abnormally low as compared to the net profit rate of 5.17% on the receipts of Rs.182,66,59,456/- declared by the assessee in the immediately preceding year. The assessee contended that net profit for the year was Rs. 21.25 crores as against Rs.9.44 crores for the year ended on 31/03/2006, which includes additional charges Rs.21.01 crores surrendered at the time of survey. Further, the assessee explained that major sales were booked in the immediately preceding years and during the year due to sluggish market, there was little booking of residential area and the installment were only received and no major fresh booking was made. The assessee also explained that due to increase in secured loans for construction, the financial charges

has increased from Rs.1.867 crores in immediately preceding year to Rs.6.10 crores during the year. The assessee also emphasized that in building & construction activities, net profit like manufacturing/trading concern are not comparable and the same depends on the extent of activity during the year. The Assessing Officer, however, was not convinced and on verification of books of accounts of the assessee found that no stock register and consumption registers were being maintained by the assessee. In view of the defect observed, the Assessing Officer made a trading addition of Rs.1,18,81,368/- being 1% of total receipts of Rs.118,81,36,794/-.

4.1.1 The Ld. CIT-(A) observed that books of accounts were rejected without any finding on the ñcorrectness or completenessò of the books of accounts or pointing out any specific defects or discrepancy in the books of accounts. According to the Ld. CIT-(A), the books of accounts were regularly maintained in the course of business and duly audited, free from any qualification by the auditors and thus should be taken as correct, unless there are strong and sufficient reasons to indicate that they are unreliable and incorrect. The learned CIT-(A) observed that the Assessing Officer has not given any finding that the assessee was not maintaining stock records of construction materials and, therefore, non-maintenance of stock register and consumption register would not render the accounts of the assessee as complete and would not give justification to the Assessing Officer to reject them under section 145(3) of the Act. According to the Ld. CIT-(A), the Assessing Officer was required to prove satisfactorily that books of accounts were unreliable or incorrect or incomplete, before he could reject the accounts and this could be done by showing that important transactions were omitted or if proper particulars and vouchers were not forthcoming or the amounts did not include entries related to particular class of business. In view of the

observation, the learned CIT-(A) held that the Assessing Officer was not justified in making addition in dispute by applying a rate of 1% on the total receipts of Rs.118,81,36,794/-.

4.2 Before us, the Ld. Senior DR submitted that the Assessing Officer not only observed low net profit rate during the year but also observed non-maintenance of stock registers and consumption registers, which constitutes defects in the books of accounts of the assessee and therefore the finding of the Ld. CIT-(A) that there are no sufficient cogent reasons and material for rejection of books of accounts, is not in accordance with law.

4.3 On the other hand, Ld. counsel of the assessee submitted that merely low net profit, cannot be a reason for rejecting books of accounts and estimation of profit. He further submitted that actually after including surrender amount on additional charges, the net profit rate of the year under consideration is higher as compared to net profit rate of the immediately preceding year. The learned counsel submitted a paper book containing pages 1 to 230. He referred to page 131 of the paper book, which is Tax Audit Report in form No. 3 CD and submitted that books of accounts mentioned in clause 9(c) included construction records. According to the Ld. counsel, the construction record consisted consumption registers also. The Ld. counsel further submitted that mere absence of a stock register or a consumption register, per se, cannot be a basis for rejecting books of accounts and framing assessment under section 144/145 of the Act. In support of the contention the Ld. counsel relied on following decisions:

1. *CIT Vs. Jackson House, 198 taxmann 385 (Del)*
2. *CIT Vs. Jas Jack Elegance Exports, 191 taxmann 386 (Del)*
3. *Neeraj Jain Vs. ITO in ITA No. 289/Del/2011 (Delhi Tribunal).*

4.4 The Ld. counsel further submitted that Assessing Officer could have made disallowances of expenses, if the expenditure was not found to be fully vouched and no trading addition at the rate of 1%, only on estimate basis without any justification of comparable results, could be made.

4.5 We have heard the rival submissions and perused the relevant material on record. We agree with the contention of the Ld. counsel of the assessee that books of accounts cannot be rejected merely on the reason that gross/net profit rate in the year under consideration is lower as compared to gross/net profit rate of immediately preceding year. In the case of the assessee, reasons for lower net profit rate have been explained by the assessee due to higher interest liability. But we are not convinced with the argument of the Ld. counsel that non-maintenance of stock register/consumption register cannot be a ground for rejection of books of accounts. We find that the assessee was engaged in building and development of residential/commercial building and maintenance of record of consumption of material is very relevant for computing the gross profit earned during the year. In absence of the consumption register, the Assessing Officer cannot verify the closing stock appearing in the trading/ manufacturing account. The facts of the cases relied upon by the Ld. counsel are distinguishable. In the case of Jackson House (supra) the Hon'ble High Court observed that assessee was not maintaining stock in the form expected by the Assessing Officer and the explanation given by the assessee, had been accepted by the Commissioner (Appeals) as well as by the Tribunal and both of them had given a finding of the fact that a stock register of that nature was not feasible considering the nature of the business being run by the assessee engaged in the business of manufacturing of ready-made garments by purchasing fabrics which was then subjected to embroidery,

dyeing and finishing and then was converted into ready-made garments by stitching. Similar finding has been given by the Hon'ble Delhi High Court in the case of Jas Jack Elegance Exports (supra). In the case of Neeraj Jain (supra) also the assessee was engaged in buying timber of different, quality and then after cutting into pieces of different size and same was sold, therefore, the Tribunal held that it was not feasible for the assessee to maintain item-wise stock record of each and every timber. In the case of instant assessee, the assessee failed to show any record of consumption of material to the Assessing Officer. In our opinion, the Ld. CIT-(A) has not appreciated the facts properly and ignored the facts of non-maintenance of consumption register. In the case of M Durai Raj V. CIT (1972) 83 ITR 484 (ker) relied upon by the Ld. CIT-(A), also the stock register was maintained by the assessee in terms of bags purchased and sold and the issue was that it was not maintained as desired by the Assessing Officer. Thus the facts of the said case are also distinguishable from the facts of the instant assessee.

4.6 In the case of Harish Ahuja Vs. CIT (2015) 93 CCH 0239, the Hon'ble High Court of Punjab and Haryana has held that in order to check the veracity of the gross profit declared by the assessee, maintenance of stock register was essential and, thus, the action of the Assessing Officer in rejecting books of accounts was held as justified.

4.7 In view of above reasons, we reverse the findings of the order of the Ld. CIT-(A) as far as rejection of books of accounts is concerned. Regarding the estimation of addition at the rate of 1% of the sales is concerned, we are of the opinion that there has to some basis for estimating the net profit of the assessee and no addition can be made on ad hoc basis. The estimation has to be made on the basis of comparable cases of same industry for relevant period. In the interest of justice, we feel it appropriate to restore the issue of estimation of addition to the

trading results of the assessee, to the Assessing Officer. It is needless to mention that assessee shall be afforded sufficient opportunity of hearing on the issue. Accordingly, the ground of appeal is allowed for statistical purpose.

5. The grounds No. 3 and 3.1 relates to deletion of addition of Rs.5,78,70,730/- made on compounding fee paid.

5.1 The facts related to the issue in dispute are that during the previous year corresponding to the assessment year in consideration, the assessee paid Rs.5,78,78,830/- to the ñGhaziabad Development Authorityò (GDA) as compounding fee. The Assessing Officer relied on the decision of the Hon'ble Karnataka High Court in the case of CIT Vs. Mamta Enterprises (2004) 266 ITR 356, wherein it is held that compounding fee paid to municipal Corporation for condoning violation of law relating to construction of property is not deductible in view of Explanation to section 37 of the Act. In the instant case, before the Assessing Officer, the assessee submitted a certificate from a architect firm, namely, M/s Anuj Aggarwal Architects Private Limited that the fee paid was not towards any unauthorized construction and payment of compounding charges was neither an offence nor prohibited by the law. The Assessing Officer also written a letter to the GDA and also issued summon under section 131 of the Act to find out the details regarding payment of compounding fee, however, no information was received from the GDA . Not convinced with the submission of the assessee, the Assessing Officer, disallowed the payment of Rs.5,78,78,830/-.

5.2 Before the Ld. CIT-(A), the assessee submitted that during the previous year relevant to the year under appeal, the assessee was in the process of construction of residential/commercial complex at 12A, Ahimsa Khand, Indrapuram, Ghaziabad. The Plans for the building were approved by the GDA on 11/07/2005. According to the GDA, the

assessee made some deviation by constructing sum additional area. The assessee requested for regularizing the additional area on payment of prescribed compounding fee of Rs.5,78,78,830/- which was accepted and accordingly, the assessee paid the said sum and revised building plans was approved by the GDA. The assessee submitted before the Ld. CIT-(A) that there was no unauthorized construction in the project and such compounding charges were neither an offence nor prohibited by law and therefore there was no occasion to disallow the aforesaid expenditure invoking explanation to section 37 of the Act. The assessee also brought to the knowledge of Ld. CIT-(A), a letter issued by the Secretary GDA to the Assessing Officer intimating that the compounding fee was paid by the assessee for violation of building norms.

5.3 The Ld. CIT-(A) was of view that the assessee has not breached any statutory provisions or carried out any Act which may be termed as illegal and the compounding fee was paid as per relevant GDA by-laws which required payment of compounding fee for regularization of excess construction not carried out strictly as per the guidelines of the GDA by laws. The Ld. CIT-(A), accordingly deleted the disallowance made by the Assessing Officer holding that the expenditure was not in contravention of Explanation to section 37 of the Act.

5.4 Before us, the Ld. Senior DR relying on the order of the Assessing Officer submitted that the assessee violated the rules of the GDA and the said offence has been compounded as per the Rules of the GDA. He submitted that merely compounding of the offence, cannot take away rigours of Explanation to section 37(1) of the Act. In support of the contention, he relied on the decision of the Tribunal Delhi ÓAôbench in the case of Arun Kumar Gupta (HUF) Vs. ACIT , Circle 39(1), New Delhi reported in (2012) 27 taxmann.com 230 (Delhi). The Ld. Senior DR referred to page 101 of the assesseeÕs paper book, which is a copy of

letter of the Secretary GDA, addressed to the Addl. Commissioner of Income Tax and submitted that the Secretary, GDA has clearly mentioned that the compounding fee was charged for the contravention of rules on construction against the map approved by the GDA. He further referred to page 102 to 103 of the assessee's paper book, which is a copy of notification issued by the Government of Uttar Pradesh making by-laws for compounding of offences by the GDA and laying down guiding principle in this regard. According to the Ld. Senior DR, the contravention committed by the assessee has been compounded under said bylaws, for compounding of offences by the GDA. The Ld. Senior DR submitted that in view of contravention of the by-laws of GDA, which is an compoundable offence, the compounding fee paid by the assessee is in violation of Explanation to section 37(1) of the Act, and not allowable expenditure.

5.5 On the other hand, the Ld. counsel referred to the pages 86 and 87 of the paper book, which are a copy of demand note for compounding fee and a compounding map and submitted that in said letters the construction done by the assessee in excess of approved map has been regularized against the fee, which cannot be treated as offence. According to the Ld. counsel it was only compensatory in nature, and therefore allowable under Explanation to section 37(1) of the Act. In support of contention, the Ld. counsel relied on the decision of the Hon'ble Supreme Court in the case of CIT versus Ahmedabad cotton manufacturing company limited 205 ITR 163 (SC) and decision of the Hon'ble Delhi High Court in the case of CIT Vs. Loke Nath and Company (Construction), 147 ITR 624 (Del).

5.6 We have heard the rival submission and perused the relevant material on record. The facts that payment of Rs.5,78,78,730/-has been made as compounding fee to the GDA has not been disputed by the

assessee, which is evident from the affidavit filed by the assessee before the GDA, order of the Secretary, GDA and letter sent by the Secretary, GDA to the Addl. Commissioner of Income Tax. The affidavit dated 28/10/2006 filed by Sh. Praveen Bhatia, Director of the assessee company, before the GDA , is placed on page 92 to 94 of the assesseeôs paper book. An English translation of the said affidavit is also available on pages 95 to 97 of the assesseeôs paper book. In clause 5 of the said affidavit it is deposed that on the plot of land construction has been done in violation of the final approved map and now he wanted to compound the same and therefore this affidavit and compounded map were enclosed along with application for compounding. The demand note issued by the GDA for compounding fee is available on pages 84 and 85 of the paper book. An English translation of the demand note and compounded map are available on page 86 to 87 of the assesses paper book. The title of the said demand note clearly shows that it is for compounding fee and with reference to the application of the assessee for compounding of violations. The Secretary, GDA, in his letter addressed to the Addl. Commissioner of Income Tax, which is available on page 101 of the paper book, has clearly held the assessee of contravening the rules of GDA. The relevant part of the letter, is reproduced as under:

> *ñ3. That Compounding fee was charged of the contravention of rules on construction against the Map No. 32/T.H.A./Zone-3/G.H./05 dated 11/07/2005 approved before by M/s. Jaipuria Infrastructure Developers Pvt. Ltd., which he has deposited Rs.5,78,70,730.00/- vide Receipts No. 115210 dated 22/12/2006.ò*

5.7 Further, a copy of notification though which by-laws for compounding of offences by the GDA have been framed, is also

available on page 102 to 104 of the paper book, which provide for compounding of offences and in case of failure to comply with the conditions provided, the GDA would be free to initiate prosecution proceedings against the defaulters.

5.8 Though, the Ld. counsel of the assessee contended before us that the fee paid was for regularization of the extra construction carried out by the assessee and it was merely in the nature of the compensation and not a penalty. However, in view of the documentary evidence above, there is no doubt that it is fee for compounding of offences committed by the assessee.

5.9 In the case of Ahmedabad Cotton Manufacturing Company Limited (supra) the assessee failed to produce and pack the minimum quantity specified by the Textile Commissioner and also failed to fulfill its export obligation under a bond and thus paid amount to the Textile Commissioner. The Hon'ble High Court held that those amounts were not in the nature of penalty or something akin to penalty and allowable as business expenditure. Thus, in the above case the amount paid was for not fulfilling a positive obligation fixed on the assessee, whereas in the instant case the assessee has infringed the obligation fixed and made construction in violation of said obligation. Thus, the facts of the above case are different from the instant case before us. Similarly, in the case of Lok Nath and Company (Construction) (supra), the Hon'ble High Court observed that the compensation was not a penalty payment to save the assessee from criminal liability or criminal prosecution or to compound the offence committed by the assessee. In the instant case, the payment is for compounding the offences and, therefore, ratio of the said case is also not applicable in the facts of the instant case. In the case of Arun Kumar Gupta (HUF) (supra) as a fallout of the decision of the Hon'ble Supreme Court in the case of MC Mehta Vs. Union of India (CWP No.

4677 of 1985 dated 16/02/2006, in pursuance to public notice issued by the Municipal Corporation of Delhi, regarding mixed-use regulations in respect of mixed-use/commercial activities permissible in residential revises, the assessee carrying on business paid certain amount towards annual conversion charges to the civic agency for carrying out commercial activities besides one-time charges for parking and registration of commercial property. The assessee claimed the said amount as revenue expenditure while the Assessing Officer concluded that the amount having been paid for violation of municipal laws for misuse of the property is not allowable in view of Explanation - 1 to section 37(1) of the Act. The Tribunal held the aforesaid charges in violation of section 37(1) of the Act. The relevant finding of the Tribunal is reproduced as under:

"9.3 Now coming to the other aspect on the basis of which the AO disallowed the claim as to whether or not expenditure incurred as a result of compounding of violation of municipal laws & Environmental laws falls within the ambit of aforesaid explanation to sec. 37(1) of the Act , Hon'ble Karnataka High Court in CIT vs. Mamta Enterprises (Kar) 266 ITR 356 (Kar.), held that compounding of the offence cannot take away the rigors of the Explanation to S.37(1) in view of the expression 'shall not be deemed to have been incurred' used in that Explanation. In the said decision, after taking into consideration the legal position in the context of the provisions of Karnataka Municipal Corporation Act, 1976 and the building regulations and bye laws thereunder, their Lordships considering the language employed in Clause (b) of S.483 of the Karnataka Corporation Act which empowered the Commissioner to compound any offence committed in breach of the provisions of the Act, Rules, bye laws or materials which may by rules made by the Government be declared compoundable , held that there cannot be any doubt that offence has been committed by the assessee; what has been done is to permit the assessee to compound the offence committed by the assessee by putting up unauthorized construction of 8th floor in the building in 14 ITA no.871/Del./2012 question of payment of compounding fee of `89,960/-.Their Lordships thus held that when

the Explanation to S.37 of the Act defines that the expenditure incurred for any purpose which is an offence or which is prohibited by law is not entitled for deduction it is not possible to take the view that the compounding of the offence or violation of the provisions of the Act for the purpose of saving the offender of the law from the consequences of the commission of such an offence or violation of law should also be given the benefit of S.37 of the Act by permitting the assessee to pay the compounding fee as fine. A similar view was taken in Millennia Develops (P) Ltd. Vs DCIT (2010) 188 Taxman 388 (Kar.). Here it may be pointed out that in Haji Aziz & Abdul Shakoor Brothers (1961) 41 ITR 350 (SC) relied upon by the Hon'ble Karnataka High Court in aforesaid decision in Mamta Enterprises(supra),their Lordships of the Hon'ble Supreme Court held that infraction of law is not a normal incident of business thus, proceedings launched against an assessee for an infraction of law cannot be called a commercial loss. Expenses which are permitted as deductions are such as are made for the purpose of carrying on the business and if a sum is paid by an assessee conducting his business because in conducting it he has acted in a manner which has rendered him liable to penalty for breach of laws, it cannot be claimed as a deductible expense. The assessee is expected to carry on the business in accordance with law. If the assessee contravenes the provisions of law to cut down the losses or to make larger profits while carrying on the business it was only to be expected that proceedings will be taken against the assessee for violation of the Act. The evasion of law cannot be a trade pursuit. In these circumstances, the expenditure in this case could not be allowed as wholly and exclusively laid out for the purpose of assessee's business. Since in the instant case, MCD demanded the aforesaid compounding charges only when Hon'ble Apex Court directed the MCD to act and seal the premises in view of flagrant violations of various laws including Municipal Laws, Master Plan and other plans besides Environmental laws and indisputably , the assessee misused its property and violated the civic and Environmental laws, we are of the opinion that aforesaid charges paid by the assessee to MCD, could not be allowed in 15 ITA no.871/Del./2012 view of explanation to sec. 37(1)of the Act. In view thereof, the issue as to whether expenditure is revenue or capital ,becomes academic and therefore, does not survive for our adjudication. In the light of aforesaid discussion, ground nos. 3 & 4 in the appeal, are dismissed."

5.10 In view of above discussion, following the finding of the Hon'ble Karnataka High Court in the case of CIT Vs. Mamta Enterprises (supra) and finding of the Tribunal in the case of Arun Kumar Gupta (HUF) (supra), we hold that the compounding fee paid by the assessee to GDA is not allowable in terms of Explanation -1 to section 37(1) of the Act. Accordingly, we set aside the order of the learned CIT-(A) on the issue in dispute and restore that of the Assessing Officer. The ground of the appeal of the revenue is accordingly allowed.

6. In the result, appeal of the Revenue is allowed partly for statistical purpose.

The decision is pronounced in the open court on 16th June, 2017.

Sd/-	Sd/-
(H.S. SIDHU)	**(O.P. KANT)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated: 16th June, 2017.
RK/-(D.T.D)

Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, New Delhi