

**IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE**

BEFORE SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER
AND
SHRI SOUNDARARAJAN K., JUDICIAL MEMBER

ITA No. 647/Bang/2023
Assessment year : 2019-20

The Deputy Commissioner of Income Tax, Central Circle-1, Mangaluru.	Vs.	USK Constructions Co. DP, 13-2-1A16, Vishwas Tower, First Floor, Court Road, Ajjarakadu, Udupi – 575 001. PAN : AAFFU 0260K
APPELLANT		RESPONDENT

Appellant by	:	Shri Thamba Mahendra, Jt.CIT(DR), Bengaluru.
Respondent by	:	Shri Shiva Prasad Reddy, ITP

Date of hearing	:	25.04.2024
Date of Pronouncement	:	12.06.2024

ORDER

Per Laxmi Prasad Sahu, Accountant Member

This appeal is filed by the assessee against the order dated 26.05.2023 of the CIT(Appeals), Pananji-2, Panaji for the AY 2019-20 on the following grounds:-

“1. Whether on the facts and in the circumstances of the case, the Ld. CIT(A) was justified in deleting the additional business income amounting to Rs.5,48,01,107/- brought to tax on account of profit from business estimated at 10% of the turnover without appreciating the fact that on the basis of serious discrepancy and

findings thereon, the AO rejected the books of account and made estimation of income after considering the industry standards and profits in similar type of business.

2. Whether on the facts and circumstances of the case, the Ld. CIT(A) was justified in deleting the addition of Rs.5,48,01,107/- and ignoring thereby the fact that the assessee had systematically booked bogus expenses under subcontract charges by making payment to several of his employee's accounts, which were subsequently withdrawn and returned in cash to him.

3. The above grounds are without prejudice to each other and appellant craves leave to modify, amend or revise the above grounds of appeal and add further grounds of appeal, if necessary.”

2. Briefly stated the facts of the case are that the assessee is a partnership firm and filed its return of income on 01.11.2019 declaring total income at Rs.5,75,01,380. The return was processed u/s. 143(1) accepting returned income. A search & seizure action u/s. 132 was carried out in the case of assessee group on 23.01.2019. During search proceedings at various premises material evidence were collected in regard to inflation of expenditure through bogus sub-contract payments, bogus fish purchases, signed cheques of sub-contractors were found in the premises of assessee and various sub-contractors have further deposed that no work was actually carried out and their bank accounts were used by the assessee, money had been found to be transferred to their accounts and cash withdrawn immediately and returned in cash for own utilization. It was also established that assessee was systematically indulged in inflation of expenses and also making payments to his employees under the guise of sub-contract

payments over a period of time. These payments towards sub-contract charges are inflated by bringing in to books bogus sub-contractors who are nothing but close confidants, employees of the assessee. They do not render any services except offering their bank account to be utilized. It was established that the assessee artificially reduces his profits by booking huge expenditure as labour expenses in the name of his employees and close associates. The assessee is also showing huge amount of Sundry Creditors over the past few years. A major part of sundry creditors relates to labour sub-contractors and labour charges booked in the name of assessee's employees and accordingly book results show very low profit.

3. During search various incriminating evidence found at various places of business of sectors like Civil Contracts, Fishing, Cashew processing, quarry and crushers and LPG transport, etc. The AO noted that the assessee is Class 1 PWD Contractor who mainly undertake government contract and the receipts are fairly accounted, while the expenses are manipulated to a great extent by dubious methods for the purpose of reducing net profit and consequential tax liability. The payments to sub-contractors is purposefully made in such a way that the turnover is below the prescribed audit limit. To disguise these bogus sub-contact payments as genuine, TDS is duly deducted and return of income is also filed by invoking presumptive provisions of taxation u/s. 44AD.

4. Further, the assessee is a firm in which Mr. Udaya Shetty is the managing partner along with his wife and Mr. Suresh Kanjali and his wife. During the course of u/s 132 of the Act proceedings, statement was recorded from employee of assessee, Mr. Prabhulinga and he confirmed the modus operandi adopted by the assessee. During the post-search proceedings, the assessee gave another statement on 28.06.2019 and voluntarily admitted that to overcome all past transgressions and all previous accounting discrepancies and errors, agreed to addition of Rs.2.5 crores as additional income for FY 2018-19 in individual capacity. Further in the case of UK Constructions, he stated that the amount declared during the course of search is on the higher side and most of the entries pertaining to unallowable expenses pertain to his proprietorship concern and agreed to addition of Rs.1 crore as additional income in the hands of UK Constructions as against Rs.3.50 crores originally agreed.

5. The AO noted from the financial statements that assessee has declared only Rs.75 lakhs as additional income by crediting P&L account under the head "Voluntarily declared income" for AY 2019-20 and assessee has not given valid reasons for reducing income which is already declared during the course of search u/s. 132(4) of the Act. During the assessment proceedings the assessee filed a letter dated 01.03.2021 giving detailed submission about retraction of statement given during search proceedings. The assessee filed reply against the show cause notice as under:-

“Letter dated 01-03-2021 filed by the assessee:

Our concern started in the financial year 2017-18. Our one of the partner Sri Uday Shetty doing contract work for himself. When he joined as a partner to this firm our condition was to transfer all his works to the firm whatever the position on that date and whatever the deposits details that is interest earned should be transferred to the firm if he needs contract work it should be sub contract works to him on which he has to pay 2% of his business profit to the firm on whatever the contract amount received by his sub contract work from our partnership deed date even though he started the work previously. On this condition we joined as partner and

continued our business. All the works we did are allotted to Udaya Kumar Shetty on Individual but, we filed an application to all the department to make the payment to the firm from 01-04-2017. As per our letter even though the work allotted to Muniyal Uday Kumar Shetty, the bill are drawn in the name of USK Constructions.

The total amount was Rs. 41,54,28,718/- form which we received contract receipt of 41,54,28,7051-

On the above amount we granted 28,89,45,946 as sub-contract in which Udaya Shetty did the work for Rs. 25,65,93,733/-. This transaction is only on 2% business profit base along with this there are 2 to 3 other sub contractors i.e. mainly supply of material like jelly, sand and other materials required for our contract work etc i.e Umesh Shetty, Arjun Hegde, ShanthaKumar Rai, Suresh Shetty, Inspire Engineering, Abhishek Enterprises etc. Hence our contract work was Rs.15,88,34,895 only.

Even though I complied with my declaration it is found that 10% net profit proposed on my turnover in show cause notice.

There is expenses of business profit share to main contractor, there is GST which is not refunded or paid by the government even VAT, royalty, labour cess etc. which comes to nearly 20%. Again, there is cost of working capital, guarantee period maintenance etc. which are the other expenditure.

I request you sir to keep all the facts I have given above which is true and correct with the evidence of proof by the government Authorities documents and main contractor agreements.

Further, as per point No-4 of show cause notice, original declaration of undisclosed income of Rs. 3.52 crores for the A Y 2017-18 and 2018-19 on first day of survey action which is taken by the inspection authority.

They took this declaration disallowing sub contract expenses, we given our submission on 15th July 2019 DCIT 1 Mangalore, the copy of the same is attached herewith. They disallowed sub-Contract expenditure and treated it as income instead of expenditure.

Out of turnover of Rs.38,13,71,482/- the turnover of sub contract was Rs. 28,89,45,946. The main sub-contractor was Sri Uday Shetty who was the original contract allottee and finished half of the part of the work allotted but, when we joined as a partner, we given letter of authority for payment that even though contract was allotted to Sri Uday Shetty payment should be made to USK Construction Company. By this letter even though original Contractor Shri Udaya Shetty made the work before our partnership establishment our firm received the payment of that work and for that payment of work we drafted a subcontract agreement and we received the bill

for the same work which cannot be denied because there is documentary evidence proof and we are enclosing Sri Udaya Shetty Profit and loss account for showing the same turnover in his account. With this evidence we can say that the investigation authorities findings that disallowance of subcontract is not fair and not justified. Hence, we submitted our submission before DCIT Investigation Mangalore for which as per point 6 of show cause notice to overcome the lack of evidence for our final declaration of additional income.

Further, the remaining work there was material purchase and at the same time 30% labour expenditure was only considered and accounted which is allowable as per the Act.

Hence, there is no base for seeking declaration on disallowance of sub-Contract work or labour charges in the both the year that to for the year 2018-19 turnover was Rs. 125,42,06,864/- out of which sub contract was Rs. 57,95,83,321/- in which Sri Uday Shetty was the main Contractor. After the sub contract work, main contract work was Rs. 45,40,87,646/- for which the material was Rs. 35,01,14,012/- and labour was Rs. 10,62,81,613/- which is less than 30% of the contract receipt which is also acceptable hence, disallowance of sub contract or labour contract is not justified by Inspection Authority and treating it as income is unjustified way of taking declaration as stated in point No-4.

Finally, we decided to take her as partner with certain amount as remuneration to her without any Investments. This agreement was taken place in the month of October 2018 at the same time we applied of GST Registration, power supply etc. in the name of Kushal Stone crusher as a firm. Further, there was a condition from Crusher owner Smt. Rekha that we cannot raise any financial assistance more than Rs. 50 lakhs in the name of the firm. Moreover, she can nit lease out the crusher license to our firm. Hence, with no alternative we gone for al loan In the name of a USK Construction under certain terms and conditions that is repayment of Interest etc.. by Kushal Stone Crusher to USK Construction loan account o which TDS should be made. The coy of the TDS 26AS enclosed herewith Other than this we are buying jelly from Kushal Stone crusher for our business without an obligation of partners of the firm.

As per point No-11 there was a agreement or memorandum for the above statement and the same was enclosed herewith as a proof of evidence.

The partywise detail evidence provided for examination as per point No-10.

As per point No-9 regarding Net profit declared, we already explained how the expenditure occur or lease rent interest etc are connected to Kushal Stone's business which I collected from them and paid to the bank without any profit with TDS collections. Hence there is no evasion of income. Due to a very small turnover of Rs. 10 Crores and collection of TDS of sub Contractor that to original contractor for whom TDS amount refunded due to the amount repaid as sub contractor with TDS. Hence, we paid TDS amount to the government on one side and reimbursed to the sub contractor in major portion which is without any profit to the firm. Hence the collection and payment are one and the same of sub-contractors and contractors and Hence, TDS amount was asked for refund.

About GST, It is mis' calculation by our accountant by not reflecting collection and payment. Now we revised the same and filed the original refund amount with GST Cash ledger cop enclosed herewith.

Regarding point No-7 the closing stock of Rs. 4.25 crores for the year 2018-19 and Rs.5.23 crores for year 2019-20 is valid by the government engineers who will visit our site in alternative weeks to look over the proceedings of the work along with quality and they certify the work completion every month as per their terms and conditions of the agreement and its valuation by their own measure. We take the same measurement an value as stock or work in progress.

Hence, we request you to drop your proposal of considering 10% of net profit on my turnover as you mentioned in show cause notice that 10% estimation on my turnover in point no -16 of your notice.”

6. From the submissions of the assessee the AO observed as under:-

“ 1. It is noted from records that the assessee has declared a total turnover of Rs.125.42 crores for AY 2019-20 and Rs.41.54 crores for AY 2018-19. The turnover as per 26AS is found to be Rs.135,98,000,678/- AY 2019-20 Rs.41,54,28,745/- for AY 2018-19 and there is no reconciliation, with reference to books of account. Against this turnover declared in the books, the assessee has claimed net profit of Rs.5.70 crores and adjusted profits of business offered for taxation is Rs.5.62 crores.

1. 1. For AY 2018-19 the net profit declared is Rs.89.24 lakhs and adjusted profits offered is Rs.1.12 crores. The profits declared is after additional income offered during search proceedings and hence very low. The assessee has claimed more than Rs.1.60 crores as refund for these two years. The assessee was specifically asked to justify the low net profit disclosed in the returns, considering the volume of business.

1. 1. It Is also noted that the assessee **Initially disclosed Rs.3.50 crores** as undisclosed income due to examination of evidences during search/survey for AY 2019-20 and later revised the same to Rs.1 crores for AY 2019-20. This was again revised to Rs.25 lakhs for AY 2018-19 and Rs.75 lakhs for AY 2019-20. None of these disclosures are in order as there is no basis for any of them.

1. 1. The evidences found during the course of search and search proceedings, statements given by the assessee and his associates including accountant and employees, unambiguously establish that the assessee has claimed bogus expenses in order to suppress profits to be declared to the department.

1. 1. The assessee has no further counter evidences in support of the claim that the URD purchases are wrongly treated as Sub contract expenses and accordingly, it is only an accounting error. Assessee is not able to produce details and evidences establishing that the payments were actually made for service rendered.

1. 1. The Undisclosed income worked out on the basis of evidences match with the assets owned by assessee and his family members, which is unearthed during the course of post search verification.

1. 1. The admission of undisclosed income on adhoc basis is not supported by any evidences and working. The assessee is not doing any charity by disclosing income by working out undisclosed income, at his whim and fancy. As there are no further evidences produced with regard to claim of the assessee, the assessee's contention is hereby rejected and undisclosed income consequent on detection of material evidences establishing inflated expenses is brought to tax on estimated basis after rejecting the books.

2. 1. In view of the above contention, it is observed it is not in dispute that the payments to sub-contractors were indeed made by the assessee through account payee cheques after deduction of tax at source. It is not in dispute that those recipients have duly disclosed the same in their respective IT returns and had also filed their returns of income showing meager figure. The tax deducted by the assessee is claimed as refund by these parties in their return of income.

2. 16. Non submission of details:

Even though the existence of these persons is ascertainable, there is no proof of actual rendering of services by these alleged sub-contractors, who are in fact employees and associates of the assessee. No details like bills, work order, agreements or any sort of documentary evidence is in the possession of the assessee.

1. The assessee has not been able to prove with cogent material as to whether these sub-contractors possess necessary expertise and infrastructure to render the sub-contracting services to the assessee. The material evidences found clearly establish that the assessee has been fudging the records to claim bogus expenses and invested heavily into family properties.

2. The assessee has been surviving on Inferences and surmises without giving any factual evidences for verification. The assessee has a combined turnover of Rs.176.96 crores for both the years and the income from business originally declared is only Rs. 5.75 crores (87.99 lakhs + 4.88 crores) which works out to less than 3.25% of the turnover.

3. The assessee has no explanation for the ad-hoc declaration of additional income agreed during search amounting to Rs.3.5 crores which was later reduced during post search verification (Rs.1.00 crores). There are no details/ working or basis for the same and hence the same cannot be accepted.

4. Even after disclosing additional income of Rs.1.00 crore for two years, the total income is only Rs.6.75 crores for both years. Apart from this, there is a claim of refund of more than 1.60 crores for both years and effectively, the assessee wants to claim back major portion of TDS without any further tax to be paid.

5. The assessee has not produced evidences with regard to actual work done and claims of Work in progress in the books. The assessee merely relied upon the fact that the Contract work was given by Government and there is no suppression of receipts.

6. Assessee has shown GST refundable of Rs.4.16 crores and Rs.1.29 crores for above two asst. years and not details made available for verification.

7. Party wise details of sundry creditors and trade payables (Rs.17.91 crores AY 2018-19, 11.32 crores for AY 2019-20) not furnished for verification. The year end balances claimed are not verifiable in the absence of details. Nature of loans obtained and purpose of its usage is not furnished. It is noted that the assessee has certain loans taken on behalf of associate concerns and there are no proper details for verification.

8. As regards, the correctness of expenses claimed, the assessee has no further evidences in support. The incriminating evidences found during the course of search, over weigh the submissions of the assessee and accordingly, no credence could be given. The evidences found in the associate concerns clearly indicate that the expenses are Inflated by Introducing bogus sub contractors and additions have been made on this ground.

9. Assessee did not have any details/basis for WIP or closing stock declared of Rs.4.52 crores for AY 2018-19 and Rs.5.23 crores for AY 2019-20. The Closing stock is valued as certified by the proprietor and there is no basis for the same. Assessee merely stated that the same Is based on the measurement by agencies and no specific details furnished.

10. Adequate opportunities have been given for submission of details and the assessee has only furnished copies of VAT returns, 26AS and financial statements. Specific details as per notice u/s 142(1) not furnished for examination.

1. Considering all the above issues, I have no option but to reject books of accounts and estimate the income. The income is therefore proposed to be estimated at 10% of the turnover and considering the industry standards and profits of business in similar line of business, I estimate the profits of business at 10% of the turnover and conclude assessment. The total turnover as per 26AS as reduced by the Contract amount allotted to Mr.Udaya Shetty, is considered as gross receipts of the assessee-firm for estimation of income. A separate asst. order is passed on the basis of evidence in the case of Mr.Udaya Shetty and accordingly the turnover relatable to him is excluded.

2. 16. Income determined on the above basis is worked out as below.:

Asst.year	Additional Income originally admitted	Additional income admitted during post search	Profits of business estimated at 10% of turnover	Other income as declared
2019-20	3.50 crores	75,00,000	11,11,74,238/- (10% of TO as per 26AS - Rs136,00,65,958 - 24,83,23,582).	12,08,595 1,33,47,200
Less : Income from business disclosed in revised computation			5,63,46,602	
Additional income brought to tax			5,48,01,107	--
Total Income determined	3.5 Cr.	75,00,000	11,11,47,709	1,45,55,795

7. Accordingly the AO completed the assessment. Aggrieved from the assessment order, the assessee filed appeal before the CIT(Appeals).

8. The CIT(Appeals) after considering the detailed written submissions partly allowed the appeal of the assessee. He allowed ground No.3 of the assessee as under:-

“5.3 I have gone through the assessment order, argument made by the AR of the appellant and submissions made by the AR. The AO made addition on estimation basis without bringing on record any comparable case of similar nature or give reasons for adopting such rate of net profit. The AO has to bring on record certain material to support his finding with regard to rate of profit admitted for estimation of profit with some comparable cases of similar nature or the profit declared in the similar industry. In the instant case the AO adopted the profit at 10% but failed to bring on record any comparable case of similar nature nor give reasons for adopting such rate of net profit. On the other hand, the appellant had declared net profit of Rs. 5,70,72,957/- on the turnover of Rs.73,67,21,756/- which is nearly 7.75% on this net turnover which is very much on higher side, considering the nature of business and place of work. As seen in construction work, the rate of profit varies from nature of contract executed by the appellant and place of such contracts. Therefore, no uniform yardsticks can be applied for estimating net profit. The appellant placed reliance in the case of Shri LakshmananVs ITO,ITAT wherein it was held that:

It is an admitted fact that if books of accounts maintained by the assessee are incomplete or not supported by necessary evidences then the AO is empowered to complete assessment in the manner provided in section 144 of the Act. But fact remains that still in the best judgement assessment, the AO has to bring on record material on the basis of which he has arrived at the conclusion with regard to rate of profit for estimation of income from the business. No doubt, under the best judgement assessment there is an element of guesswork but it should not be arbitrary. Therefore, while completing the assessment under best judgement assessment, the AO has to bring on record certain material to support his finding with regard to rate of profit admitted for estimation of profit with some comparable cases of similar nature or the profit declared in the similar industry. In this case,

although the AO has adopted 5% net profit on gross receipts, but failed to bring on record any comparable case of similar nature nor give reasons for adopting such rate of net profit. On the other hand, the assessee has agreed for estimation of 3% profit on gross receipts considering the nature of business and place of work. Further in the civil construction work, the rate of profit varies from nature of contract executed by the assessee and place of such contracts. Therefore, no uniform yardsticks can be applied for estimating net profit. Therefore, considering the fact that the assessee is into civil construction business and also the AO has not given any reasons for adopting 5% net profit rate, we are of the considered view that a reasonable profit of 3% on total receipts would meet the ends of justice. Therefore, we direct the AO to estimate 3% profit on total gross receipts received by the assessee for the year.

5.4 In the case of Shri LakshmananVs ITO (supra) it was also held that if the AO rejected the books of account then the AO is bound to complete the assessment as per the provisions of Section 144 of the Act. However, in the instant case the AO completed the assessment under Section 153C r.w.s. 143(3) of the Act and not followed the provision of Section 144 of the Act nor provide any finding to support his claim. Therefore, without going into the technicality and following the decisions of Shri LakshmananVs ITO (supra) and considering the fact that the appellant is into construction business and also the AO has not given any reasons for adopting 10% net profit rate, I am of the considered view that a reasonable profit as declared by the appellant would meet the ends of justice. Therefore, the AO is directed to delete the said addition which is made by adopting 10% profit rate and re-estimate the profit on total gross receipts received and additional income declared by the appellant of Rs.75.00,000/- for the year under consideration. In view of the above discussion ground no. 3 may be treated as allowed.”

9. Aggrieved from the above order, the assessee is in appeal before the ITAT.

10. The Id. DR relied on the orders of the AO and submitted that during the course of search proceedings various incriminating documents were found and assessee indulged in inflating expenses by giving sub-contract to close associates and employees of assessee. The cheques issued in favour of sub-contractors were lying with the assessee and when the cheques were issued to sub-contractors the amount was immediately withdrawn. The assessee also manipulated the amount declared during the course of search proceedings, the amount declared in the return of income is only Rs.75 lakhs and after the search proceedings the assessee retracted the statements recorded during the search u/s. 132(4). The statements of assessee's employees were also recorded and they accepted the modus operandi adopted by the assessee. The assessee has not explained the adhoc declaration of additional income agreed during the search amounting to Rs.3.5 crores which was later on reduced during the post search verification to Rs.1 crore without any cogent documents and Rs.75 lakhs was declared in the return of income during the impugned year. The assessee did not produce evidence with regard to actual work done and claimed work-in-progress in the books of assessee. The assessee has merely stated that there is no suppression of receipts because contract work was given by the Government . The assessee had not given evidence in respect of claim that URD purchases are wrongly agreed as sub-contract expenses and there was no accounting error. Mere deduction of TDS from payments made to sub-contracts do not reflect true and correct nature of expenses incurred by the assessee. There is no proof

for rendering services by sub-contractors who were in fact employees and associates of assessee. No details like bills, work order, agreement or any sort of documentary evidence were produced by the assessee in support of sub-contract payment. Accordingly he requested that the order of the CIT(Appeals) should be reversed and order of AO should be restored.

11. The Id. AR relied on the order of the CIT(Appeals) and submitted that assessee started its business in FY 2017-18. One of the partner Mr. Uday Shetty was doing contract work for himself. He was doing business in the name of proprietorship concerned and when he joined as partner in the firm, the entire work was transferred to partnership firm and he has to pay 2% of the business profit to the firm. Out of turnover of Rs.38,13,71,482/- the turnover of sub contract was Rs. 28,89,45,946. The main sub-contractor was Sri Uday Shetty who was the original contract allottee and finished half of the part of the work allotted but, when he joined as a partner, letter of authority was given for payment that even though contract was allotted to Sri Uday Shetty payment should be made to USK Construction Company. By this letter even though original Contractor Shri Udaya Shetty made the work, partnership firm received the payment of that work and for that payment of work the assessee drafted a sub-contract agreement and received the bill for the same work which cannot be denied because there is documentary evidence proof of Sri Udaya Shetty Profit and loss account for showing the same turnover in his account. With this evidence, the investigation authorities findings and

disallowance of sub-contract is not fair and not justified. Hence, the assessee made submission before DCIT Investigation Mangalore as per point 6 of show cause notice to overcome the lack of evidence for final declaration of additional income.

12. The ld. AR filed written submissions as under:-

“ As could be seen from the Grounds of Appeal - No.1 and No.2 – taken by the Revenue, the only objection is against the relief given by the learned CIT Appeals directing the learned AO to delete the addition, made by estimation of income by adopting net profit at 10% of Gross receipts. The CIT Appeals has held that estimation of income as aforesaid by taking 10% profit margin is unjustified and the admission of additional income of Rs.75,00,000/- in the return of income by the assessee, over and above the regular profits as per the statement made during the Searches, is more than enough to meet the alleged deficiencies.

2. In Ground No.1, the Revenue has stated that the learned AO has considered the industry standards and profit in similar type of cases as basis for estimation of profit at 10%, which is contrary to the material facts on record; there is no whisper either about the industry standards or any comparable case as submitted in the later part of these submissions.

3. In Ground No.2, the Revenue has stated that the expenses are inflated by making bogus sub-contract payments. The alleged bogus sub-contract payment is only Rs.41,50,000/- para-6.3 of pages 5 & 6 of the assessment order, whereas the assessee has admitted Rs.75,00,000/- in the return of income as additional income over and above the regular profits in order to buy peace and avoid protracted litigation, even though there was no evidence of receipt of any such money back by the assessee, as submitted more clearly in later part of these submissions.

4. It is submitted that the learned AO estimated the net profit at Rs. 11,11,74,238/ - by adopting profit ratio of 10% on turnover of Rs.11,17,42,376/-, which was computed after reducing the

subcontract amount of Rs.24,83,23,582/-. Certain mistakes crept into the working of the turnover by the learned AO at Rs.111,17,42,376/- which has been reconciled and reworked by the learned CIT Appeals at Rs.73,67,21,756/- vide para 5.2 of pages of 11 and 12 of his order.

5. The only Ground taken by the Revenue against the deletion of addition made by the learned AO by adopting 10 profit rate on the Gross Receipts, is not maintainable for the following reasons:

(i). The assessee has declared net profit of Rs.5,70,19,137 -in the return of income which includes, Business income of Rs.5,62,92,781 which translates into profit margin of 7.62. The said business income includes an amount of Rs.75,00,000/- declared during the Searches as additional income over and above the regular profits and admitted in the return of income. The alleged difference in the income by way of bogus sub-contract payment as for the learned AO himself is Rs.41,50,000/- for the subject AY, 2019-20 - para 6.4 of pages 5 & 6 of the impugned assessment order. Hence the additional income of Rs.75,00,000/- admitted in the return of income is more than the amount of Rs.41,50,000/- alleged to be the bogus sub-contract payment.

(ii). The learned CIT Appeals has relied on the decision of the Hon'ble Tribunal, Chennai in the case of Shri Lakshmanan vs ITO (2021-189ITD 499 (Chennai-Trib) which has laid down the guidelines for estimation of Profit in the civil construction work and applying these guidelines, held that net profit of 3 on Gross Receipts would be reasonable and, not 5 as was determined by the AO. Applying these guidelines, it is seen that the learned AO has not brought on record any material to support his net profit rate of 10 and therefore, the estimation is unsustainable. The finding of the learned CIT Appeals in Para 5.3 of Page-19 of the order is as under:-

“XXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXX”

The learned CIT Appeals has thus recorded an unassailable finding that the AO has not brought on record any material or any comparable case of similar nature for adopting 10% net profit as

income. The case of the Respondent Assessee stands on a better footing because the net profit rate 7.62 is more than 3% profit in civil construction, considered as reasonable by Hon'ble ITAT, Chennai in Shri Lakshmanan (supra).

(iii). The Hon'ble jurisdictional Tribunal in the case of M/ s JSR Constructions (P) Ltd (2016), 71 taxmann.com 184, held that estimation of net profit at 8 was not justified as no justification was provided by the AO and average net profit for the two preceding assessment years- at 1.70 and 2.21—should be taken to estimate the net profit. The Hon'ble Tribunal referred to the judgement of the Hon'ble Apex Court in the case of Ragubhar Mandal and Harihar Mandal (Para 27), which had laid down the law that no estimation should be made without bringing in evidences on record and or the comparable cases in similar business. Reverting to the case of the assessee, the learned AO has not brought on record any comparable case of similar business to justify the adaptation of 10% as the net profit in the business.

In the light of the above, it is respectfully submitted that the Appeal of the Revenue is devoid of any merit and therefore, the Hon'ble Tribunal may be pleased to dismiss.”

13. The assessee has filed written submissions No.2 which is as under:-

“1. It is respectfully submitted that the Respondent-assessee has already filed the written submissions on 29-01-2024 explaining how the appeal of the Revenue is not maintainable on merits. In continuation of the same, the present submissions are filed, since:

(i). The learned Principal Commissioner of Income Tax (PCIT) has set aside the assessment order vide order u/s 263 dated, 21-02-2023 on the ground that the assessment order was erroneous as well as prejudicial to the interests of the Revenue, insofar the learned AO has excluded sub-contract amount of Rs.24,83,23,582/- in estimating profits applying net profit ratio of 10. (Copy enclosed herewith marked as Annexure - A)

(ii). The learned AO has passed the assessment order u/ s 143(3) r.w.s 263 on 27-03-2024 accepting the claim of the assessee that certain sub-contracts allotted to others should be excluded from the turnover of the assessee. (Copy enclosed herewith marked as Annexure - B)

2. The learned CIT(A) has allowed the appeal recording a categorical finding that the net profit margin of 7.75% on turnover of Rs.73,67,21,756/- declared by the assessee is on higher side and the learned AO was not justified in estimating the net profit applying 10% margin. Further, the learned CIT(A) has rightly observed that the learned AO has not brought on record any evidence or a comparable case to justify his estimation of income for applying net profit margin of 10%.

3. As could be seen from the impugned assessment order itself, the learned AO has excluded the sub-contract amount of Rs.24,83,23,582/- allotted to Shri. Udaya Shetty and thereafter estimated the net profit at 10% of the turnover of Rs.111,17,42,376/- (Rs.136,00,65,958 - Rs.24,83,23,582).

4. While the learned AO excluded this amount of Rs.24,83,23,582/- from the turnover, he did not exclude other sub-contract amounts from the turnover in estimating the net profit as above-submitted, which was a mistake. The learned CIT(A) has corrected the said mistake and rightly computed the turnover of Rs.73,67,21,756/- and observed that the net profit of Rs.5,70,72,957/- which translates into net profit margin of 7.75% is on the higher side.

5. Even otherwise and without prejudice to the submissions & the objections, the following working would demonstrate that the appeal of the Revenue is devoid of any merit:

(i). As per the learned PCIT himself, the net profit of 2% is reasonable to be added in respect of sub-contract work - para 2.0 of page 3 of the said order u/s 263 of the Act. The total turnover is Rs.125,42,06,864/- without excluding the sub-contract amounts. The own turnover is Rs.73,67,21,756/- as worked in the order of the learned CIT(A); and the profit on the same would be Rs.4,42,03,305/- applying net profit margin of 6%.

(ii). On the balance turnover of Rs.57,95,83,321/- (sub-contract amount), the net profit would be Rs. 1,15,91,666/- applying profit margin of 2%, which is considered reasonable in his order u/ s 263 of the Act.

6. On the basis of the above, it may be thus seen that the profit margin is on the higher side as per the following:

Sl. No.	Particulars	Amount (in Rs.)
(i)	Profit of 6% on own contract work	4,42,03,305
(ii)	Profit of 2% on sub-contract work – which as per the learned AO cannot be included in the turnover	1,15,91,666
(iii)	Total profits from contract work (i + ii)	5,63,46,602
(iv)	Total profits declared by the assessee as per the learned AO - kindly refer the computation page in the assessment order.	5,63,46,602

7. In the light of the above, it is submitted that the assessee has declared net income of Rs.5,63,46,602/- from the contract work which is 7.62% net profit on the actual contract receipt of Rs.73,67,21,756/-. The above working would show that the assessee has declared more than 6% profit on own turnover and 2% on sub-contract amounts, which have been rightly excluded by the learned CIT(A) since these have been sub-contracted without any profit element because the assessee was not able to meet the time-lines for completion of the contract work.

8. As submitted in the earlier Paper-book, the case of the assessee is squarely covered decision of the Hon'ble Chennai Tribunal in the case of Shri Lakshmanan vs. ITO (2021-189) ITD 499 (Chennai-Trib) and the decision of the Hon'ble Jurisdictional Tribunal in the case of M/ s. JSR Constructions (P) Limited (2016) 71 taxmann.com 184 (Bangalore-Trib).

9. In the light of the above, it is submitted that the appeal of the Revenue is completely devoid of any merit and liable to Be dismissed in the interest of equity & justice.”

14. The Id. AR further submitted that Id. PCIT in his order dated 22.02.2023 u/s. 263 observed that AO has not considered the sub-contract amount of Rs.24,83,23,582 given to Sri Uday Shetty on which

Uday Shetty had to pay 2% on business profit to the firm. Accordingly AO passed consequential order u/s. 143(3) r.w.s. 263 on 27.03.2024 and accepted the returned income filed by the assessee and no any further addition was made. Therefore addition made by the AO @ 10% on the turnover considering the entire shortcomings noted by the AO for enhancing the expenditure by treating bogus sub-contract expenses is totally wrong & very higher side. Accordingly he submitted that the CIT(Appeals) order is correct.

15. Considering the rival submissions, we note that assessee has declared business income of Rs.5,62,92,782 and Rs.12,08,595 as income from other source in its return of income filed u/s. 139(1). During search proceedings various incriminating documents have been found and statements were also recorded. The AO observed that the assessee has given sub-contract of its work for inflating expenses and reducing profit. The assessment was completed u/s. 144 on the basis of estimation of profit @ 10% on the contract amount as reported in Form 26AS after reducing the sub-contract expenses given to Mr. Uday Shetty of Rs.24,83,23,582 and has calculated business income of Rs.11,11,47,709. The assessee has disclosed revised business income of Rs.5,63,46,602 and additional income was brought to tax of Rs.5,48,01,107. During the course of post search enquiry, the assessee declared Rs.1 crore as additional income in the hands of assessee for FY 2018-19 as against Rs.3.5 crores originally agreed and offered Rs.75 lakhs in return of income and Rs.25 lakhs for FY 2017-18. The assessee contested addition of Rs.5,48,01,107 before the Id. CIT (A)

and filed detailed written submissions. During the course of appellate proceedings, the details of sub-contract amount was submitted which is as under:-

Name of the subcontractor	Amount of subcontract payment
Udaya Shetty	Rs.24,83,23,582/-
Umesh Shetty	Rs.6,43,67,789/-
Arjun Hegde	Rs.22,12,637/-
Suresh V Shetty	Rs.1,33,929/-
Inspire Engineering	Rs.65,59,364/-

A. I. 2017-20	
Anush M	56,81,818/-
Rajesh Karanth	Rs.23,07,67,209/-
Suhan M	Rs.36,26,263/-
Suresh Kanaji	Rs.42,87,000/-
VadirajShetty	Rs.1,00,00,000/-
Sujan Shetty	Rs.32,00,000/-
Durga Electricals	Rs.4,23,730/-
Total	Rs.57,95,83,321/-

16. The Id. CIT(A) after considering the details filed by the assessee calculated that the assessee has declared Net Profit rate @ 7.75% on the balance turnover of Rs.73,67,21,756 (1,31,63,05,077-57,95,83,321). From the order of the CIT(A) we note that total turnover including sub-contract work as noted above is of Rs.131,63,05,077 including GST on Sub-contract works. As per para No. 5.2 of the Id.CIT (A) order The Net Sub-contract works are Rs. 51,74,85,108 (57,95,83,321 minus GST Tax Rs. 6,20,98,213) which is

net of GST accordingly the net turnover excluding GST is Rs. 1,25,42,06,864 (73,67,21,756+51,7485,108). The CIT(A) has relied on the judgment of Lakshmanan v. ITO in which 3% reasonable profit has been considered as net profit. The CIT(A) in the impugned case also noted that AO has failed to bring on record any comparable cases of similar nature nor given reasons for adopting the net profit @ 10%. This observation noted by the CIT (A) is not correct, since this is the second year of business and the partner Shri Uday Shetty has converted his proprietorship business into partnership and still getting some works in the proprietorship and there is agreement also between the Uday Shetty and assessee. Further the CIT(A) is wrong because while calculating Net Profit rate @ 7.75% he has entirely set aside the sub-contract amount of Rs.51,74,85,108 net of GST (57,95,83,321 minus GST of Rs. 6,20,98,213) noted supra. There is no doubt that sum of Rs.57,95,83,321(including GST of Rs. 6,20,98,213) has been given on sub-contract basis which clearly shows that there is share of profit transferred to sub-contract and other sub-contractors have also offered income and filed their return on presumptive basis and they have got the benefit of minimum threshold tax limit and tax slab rates i.e., 10%, 20% & 30%. The assessee is covered under the maximum marginal rate of tax.

17. We also note from the written submissions of the assessee filed before the CIT(Appeals) that the turnover of the assessee excluding and including GST is as under: -

“The point wise submission on the addition made is as under:

1. Addition of Rs.5,48,01,107/- on account of estimation of income @10% of the turnover
 - a) The learned AO has estimated the income @10% of the turnover. The total turnover has been taken at Rs.136,00,65,958/- and after reducing the subcontract given to Shri. Udaya Shetty, the turnover has been taken at Rs.111,17,42,374/-. The income has been estimated at Rs.11,11,74,234/- being 10% of this turnover. After taking into account the income already accounted for at Rs.5,63,46,602/-, the additional income has been brought to tax at Rs.5,48,01,107/-.

- b) The working of the turnover as below :

Total Contract Receipts as per GSTR 9C (Excluding GST)	Rs. 127,53,19,344
Add: GST	Rs. 15,83,55,068
Total	Rs. 143,36,74,412
Less: Rent Income and Tax	Rs. 1,60,62,726
Net Contract Receipts with Tax	Rs. 141,76,11,686
Net Contract Service	Rs. 126,17,06,864
Less : Additional Declared Income	Rs. 75,00,000
Net Contract Service/Turnover	Rs. 125,42,06,864
Tax On contract	Rs. 15,14,04,822

Net Contract Service **Rs. 125,42,06,864**

(Excluding GST)

Less: Sub Contract allotted Rs. 57,95,83,321

Less : GST Tax Rs. 6,20,98,213Rs. 51,74,85,108

Main Contract Work Done **Rs. 73,67,21,756**

18. From the above it is clear that the net turnover of the assessee is Rs.125,42,06,864 out of which net of GST is Rs.51,74,85,108 has been given on sub-contract basis. However the CIT(A) has not considered sub-contract amount including GST of Rs.57,95,83,321. From the above it is also clear that there is GST of Rs.15,83,55,068 in which net profit cannot be estimated. In the tax audit report contract receipt has been shown at Rs.125,42,06,864 which tallies with the turnover as given by the assessee noted supra. The assessee has also earned income from other heads like scrap sales, hire purchase received, machinery lease rent, discount received, all this is part of business activity of the assessee. The Id. CIT(A) has not considered all these income disclosed in the credit side of the P&L account while calculating net profit @ 7.75%, accordingly this is not the true picture of the net profit rate arrived by the Id. CIT(A).

19. We note that as per audit report in Form 3CD at sl.no.40 under the head accounting ratio, the turnover of the assessee is Rs.126,34,94,064. The AO has considered the turnover as per Form 26AS while calculating the income of the assessee at Rs.136,00,65,958 and he has reduced Rs.24,83,23,582 from the turnover reported in Form 26AS. Resultantly he has considered the net turnover of Rs.1,11,17,42,376. During the appellate proceedings the assessee has considered the net contract service/turnover of Rs.125,42,06,864, However the assessee has also other income under the head scrap sales,

hire purchase received, machinery rent lease and discount received. The turnover disclosed in the tax audit report is net of GST. We further note that a sum of Rs.24,83,23,582 was given as sub-contract to Uday Shetty on which element of profit has not been considered by the AO and this was taken up by Id. PCIT u/s. 263 by his order dated 22.02.2023. Accordingly AO has passed order u/s. 143(3) r.w.s. 263 vide order dated 27.03.2024. However the AO has not made any separate addition of the amount on the sub-contract work given to Uday Shetty and accepted the profit of Rs.5,62,92,782 as declared business profit in return u/s 139(1) of the Act. The sub-contract work of Rs.24.83 crore given to Uday Shetty is not considered as part of assessee's turnover in the 143(3) order. Further we note that as per submission of the assessee the total sub-contract amount is Rs.57,95,83,321 which includes sub-contract given to Uday Shetty and assessee has calculated the GST amount included in the entire sub-contract of Rs.6,20,98,213. It might be that GST is also included on the sub-contract given to Uday Shetty. As per various decisions for calculating profit for income tax purpose, the GST is not considered as part of turnover.

20. We also note that during the course of search and seizure proceedings and assessment proceedings the AO has noted various short comings for inflating expenditure and we also note from the order of CIT(Appeals) that while giving relief the net profit is wrongly had been calculated at 7.75% on the net turnover of the assessee, however the other sub-contract works have been ignored. The CIT(A) has

relied on the judgment of Shri Lakshmanan v. ITO which is not applicable in the present case because this is a search case and various discrepancies were noted for inflating expenses by the assessee. We noted from the grounds of appeal that the payments made to sub-contractors are bogus payments. If the contention of the revenue is accepted then the income offered by the sub-contractors on the payments received from the assessee should have also been treated as bogus income in the hands of sub-contractors. But the ld. DR could not produce any documents in this regard. Considering the entire shortcomings of assessee, it will be just and appropriate to consider the net profit rate @ 5.40% on the total turnover/gross receipts reported in the profit & loss account excluding the sub-contract amount given to Uday Shetty of Rs.22,17,17,484 ($62098213/579583321 \times 248323582$) (net of GST). Further 2% profit has to be considered on Rs.22,17,17,484 of Rs.44,34,350 as net income on the sub-contract given to Uday Shetty, since during the course of assessment proceedings vide assessee letter dated 1.3.2021 2% profit has to be given by Uday Shetty to the firm as per para 13.2 of the assessment order. The assessee is directed to provide the details for arriving net turnover net of GST for the purpose of calculation of net profit. The assessee will not get any deduction for interest on capital and salary, bonus, commission or remuneration from the above net profit calculated as provided u/s 40(b).

21. In the result, the appeal of the revenue is partly allowed.

Pronounced in the open court on this 12th day of June, 2024.

Sd/-
(SOUNДАРARAJAN K.)
JUDICIAL MEMBER

Sd/-
(LAXMI PRASAD SAHU)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 12th June, 2024.

/Desai S Murthy /

Copy to:

1. Appellant
2. Respondent
3. Pr.CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.